Accounting Reforms In India

A BIRD'S EYE VIEW

(With special reference to Government Accounting)

Prepared by:

Secretariat

Committee on Public Finance & Government Accounting

The Institute of Chartered Accountants of India

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FOREWORD

Any accounting reform has to be a part of larger integrated public financial management initiative. A strong political consensus on a new direction for the accounting system is essential before any overhaul of the system is undertaken. This consensus has to be achieved both at the Centre as well as the States. This is likely to take time. On the other hand, development imperatives and the rapid pace of globalisation of the Indian economy along with the increasing convergence of accounting standards the world over requires us to move rapidly.

The introduction of accrual concepts will have to supplement and not supplant the existing cash system. However change would require a holistic examination of issues related to accrual accounting and budgeting.

The Thirteenth Finance Commission has in some ways a unique terms of reference when compared to its predecessors. For the first time they have been asked to examine "the need to improve the quality of public expenditure to improve outputs and outcomes".

The overriding lesson is that implementing accruals cannot be seen as a technical accounting exercise. It needs to involve a "cultural change "in government and be linked with wider public management reforms. For accruals to be worthwhile and successful, the new information that accruals bring for needs to be used to improve decision making in government. This change would not necessarily happen automatically. It needs to be actively promoted at the level of policy makers and senior officials. I appreciate CA. Anuj Goyal and the Secretariat of the Committee for visualising and bringing out this booklet.

I sincerely hope this booklet would be useful to the elected representatives, stakeholders and would find a warm acceptance among the members and other interested readers.

New Delhi
July 21, 2010

CA. Amarjit Chopra
President

PREFACE

Government Accounting and financial reporting in India have a history of several centuries. Our current government accounting system, both in the Union and the States, derives its form and substance largely from cash based book keeping procedures, which were introduced during British era. We have ofcourse modernised the system of data collection but have continued to remain essentially on cash basis. Being primarily focussed on inputs the cash based system cannot be used effectively to fix accountability for performance. The result of these deficiencies is that it is difficult to keep an accurate track of assets and it is easy to understate liabilities.

By following accrual system of accounting, government would be better positioned to assess their financial performance and financial positions. Accrual system of accounting helps in estimating cost of services more appropriately which could form a crucial input for managerial decision making. Over the past two and a half decades many developing countries have strengthen their accounting regulations as part of broader programmes of market oriented regulatory reforms.

The purpose of this booklet is to present the salient feature and the relevance of accounting reform, the need to change from cash to accrual system, single to double entry of accounting, accounting reforms in developing countries, key issues involved in transition, technical and IT competency, social cost and benefits of government accounting reforms etc.

I also wish to place on record my thanks to CA. Amarjit Chopra, President ICAI and CA. G. Ramaswamy, Vice-President ICAI for their vision and support to the Committee on Public Finance and Government Accounting.

I sincerely appreciate the efforts put in by CA Shalini Jindal, Secretary, Committee on Public Finance and Government Accounting, Dr. Nikhil Saket, Sr. Assistant Secretary, Committee on Public Finance and Government Accounting and the entire staff of the committee in preparing the booklet.

I believe that this booklet would be immensely helpful and beneficial to the various stakeholders, members of the profession and other readers.

New Delhi
July 21, 2010

CA. Anuj Goyal
Chairman

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ABBREVIATIONS

ARF -ICAI	–	Accounting Research Foundation
ASLBs	–	Accounting Standards for Local Bodies
CGA	–	Controller General of Accounts
DoP	–	Department of Posts
ESA	–	European System of Accounts
SNA	–	System of National Accounts
COA	–	Chart of Accounts
GAAP	–	Generally Accepted Accounting Practices
IGAS	–	Indian Government Accounting Standards
IGFRS	–	Indian Government Financial Reporting Standards
GASAB	–	Government Accounting Standards Advisory Board
IAS	–	International Accounting Standards
IASB	–	International Accounting Standards Board
IFAC	–	International Federation of Accountants
IFRS	–	International Financial Reporting Standards
IPSAS	–	International Public Sector Accounting Standards
KMC	–	Kolkata Municipal Corporation
MoU	–	Memorandum of Undertaking
NACAS	–	National Advisory Committee on Accounting Standards
SRD	–	Strengthening Rural Decentralization

ACCOUNTING REFORMS IN INDIA A BIRD'S EYE VIEW

Introduction

Accounting reform is an expansion of accounting rules that goes beyond the realm of financial measures for both individual economic entities and national economies. It is advocated by those who consider the focus of the present standards and practices wholly inadequate to the task of measuring and reporting of the activity as also the success and failure of the modern enterprise, including government.

The real debate concerns issues as to whether to report transactions, such as asset recognition, liability determination, income & expenditure recognition etc. The former, traditional approach, appeals for its reliability, but can quickly lose its relevance due to inflation and other factors; the latter, increasingly common approach, is appealing for its relevance, but is less reliable due to the need to use subjective measures. Accounting standards setters like the International Accounting Standards Board (IASB) attempt to strike a balance between the relevance and reliability. Although only a few countries have, so far, successfully implemented a full accrual accounting framework, other countries, ranging from transition economies in Europe to developing countries in the Middle East, are considering such a move and are increasingly expressing an interest in receiving technical advice on various aspects of undertaking such a major reform.

Need for Accounting Reforms

Government accounting in India is predominantly on cash basis and there is hardly any correspondence with private sector accounting principles except in cases of commercial undertakings of Government departments. The operational results of commercial undertakings are expressed in normal commercial form outside the general accounts of Government under proforma accounting practices stipulated in the Government - Accounting Rules. The accounts of Government Companies and Statutory Corporations, however, are maintained on an accrual basis while the system of accounts of urban Local bodies like Municipal Bodies varies from entity to entity ranging from modified cash to full accrual basis. Government's preference for cash based accounting system is largely historical and driven primarily by considerations of budgetary control and the perceived simplicity and certainty of a cash based system.

The main criticism of the current system is that it lacks transparency and cannot be used either for meaningful cash management or rational resource allocation. The system also suffers from a lack of uniformity in measurement norms and inadequacy in disclosure standards in financial statements. It is felt that there is need for public sector accounting standards to enhance transparency and accountability of the government to the stake holders.

Any accounting reform has to be a part of a larger integrated public financial management initiative. A strong political consensus on a new direction for the accounting system is essential before any overhaul of the system is undertaken. This consensus has to be achieved both at the centre as well as the states. This is likely to take time. On the other hand, development imperatives and the rapid pace of globalization of the Indian economy along with the increasing convergence of accounting standards the world over require us to move quickly.

A Deep Introspective: Indian Scenario

Government accounting and financial reporting in India have a history of several centuries. Our current government accounting system, both in the Union and the States, derives its form and substance largely from the cash based book-keeping procedures, which were introduced during British times. We have, of course, modernized the system of data collection but have continued to remain essentially on a cash basis. While the variety and richness of the information being provided by the current system cannot be denied, the prevailing system in India is somewhat deficient on the dimensions of accountability and ease of use. Being primarily focused on inputs, the cash based system cannot be used effectively to fix accountability for performance. Transactions where no cash is paid or received are not recorded, even if value has been received or a liability contracted. Past transactions relating to assets and liabilities cannot be captured automatically but only through elaborate subsidiary information.

The result of these deficiencies is that it is difficult to keep an accurate track of assets and it is easy to understate liabilities. More significantly, Government departments that offer commercial goods and services quite often face the risk of not knowing their full cost as the current system does not automatically record and provide this information. These deficiencies result in weak stewardship, lack of transparency and an impaired ability to accurately predict the future cost of a current financial commitment.

Issues relating to accrual accounting

The introduction of the accrual concepts will have to supplement and not supplant the existing cash system. However, change would require a holistic examination of issues relating to accrual accounting and budgeting. In governments, accounting is not divorced from budgeting. Ideally, budgetary reforms should be taken up along with accounting reforms. There are significant differences in the accounting and reporting perspectives of governments. A general discussion on certain concepts and principles and other related issues involved in reporting under accrual basis of accounting ensues in the following paras:

i) Expenses

Expenses are decreases in economic benefits during the accounting period in the form of outflows or depletions of assets or incurrence of liabilities that result in decreases in equity, other than those relating to distributions to equity participants. The types of expenses/expenditures that governments generally incur include:

- Personal Expenses
- Government Transfers
- Cost of goods sold
- Capital asset use (depreciation)
- Interest
- Maintenance & Working expenses

Expenses that are unique to governments include government transfers. The general principle in such cases is to go by the degree of discretion the Government possesses in making such transfers. As a guiding principle, the discretionary grants may be recognized at the time of payment (or sanction). In the case of non-discretionary transfers fulfilment of the eligibility criteria by the recipient should be taken as the point of recognition. Distinctive recognition criteria for each class/category of transfer payments will have to be prescribed by the individual departments/organizations.

ii) Revenues

Revenues are increases in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in increases in equity, other than those relating to contributions from equity participants.

Reciprocal transfers form the majority of revenues in the for-profit sector and constitute part of the revenues of governments. Inflows to governments which have an exact counterpart in the for-profit sector include those arising from:

- Sale of goods
- Rendering of services
- Interest
- Royalties
- Dividends
- Commissions
- Long term contracts
- Lease agreements

Much governmental revenue is in the form of taxes, rates, levies, fines and non-reciprocal grants in which the existence of an exchange relationship is tenuous. In addition to tax receipts, governments may also receive grants, donations and payments on behalf of other parties. Recognition and measurement of such revenues presents a challenge. While attempting to account for taxation and other such non-exchange revenues two aspects have to be kept in mind:

- Taxation revenues do not accrue to the agency responsible for collecting it.
- Since governments are able to obtain taxation revenues through their sovereign powers to demand payment, the quantum of collection does not necessarily provide an indication of their efficiency or effectiveness.

iii) Liabilities

Liability is present obligation of the Government arising from past events, the settlement of which is expected to result in an outflow from the Government of resources embodying economic benefits or service potential.

The types of liabilities that governments may report include:

- accounts payable arising from the purchases of goods and services;
- accrued interest payable;
- accrued salaries and wages;
- accrued vested vacation pay or other accrued compensated absences;
- employee pension obligations and other accrued employee benefits, including any accrued termination benefits;
- amounts payable under guarantees and indemnities where events and amounts have become certain;
- deferred or unearned revenue (where amounts have been received but have not yet met the revenue recognition criteria, such as where there are restrictions on use of resources);
- transfer payments payable;
- currency issued;
- lease obligations related to capital leases; and
- borrowings like bank loans and other short term borrowings; long term debt; and loans and advances payable to other levels of government or government entities.

iv) Assets

An asset is a resource controlled by the entity as a result of past events which have a future service potential and from which future economic benefits are expected to flow to the entity. Assets held by Governments may be classified depending on the types of assets such as Financial Assets, Physical Assets and Intangible Assets. Assets may further be classified in terms of current and non-current nature.

An asset is recognized in the Statement of Assets and Liabilities when it is probable that the future economic benefits or service potential associated with it will flow to the Government and the asset has a cost that can be measured reliably.

The Finance Commissions have, in the past, concerned themselves with improvements in accounting procedures as a means to ensure a better assessment of the fiscal position of the Central and State governments. One significant recommendation relates to the introduction of accrual based accounting system in government.

The Twelfth Finance Commission acknowledged that the current system of cash based accounting does not provide a full picture of the government's financial position at any given point. It felt that the cash based system provides room for fiscal opportunism where taxes can be collected in advance and booked as receipts and current payments can be deferred and not booked as expenditure. The Twelfth Finance Commission, while recommending a change over to accrual accounting in government had recognized that this should be a gradual and calibrated process. In the interregnum, it had suggested that additional information be provided in the government accounts and listed eight statements, which could be usefully added to the accounts. These are: -

- Statement of explicit and implicit subsidies.
- Statement containing expenditure on salaries by various departments
- Detailed information on pensioners and expenditure on government pensions.
- Data on committed liabilities in the future.
- Statement containing information on debt and other liabilities as well as repayment schedule.
- Accretion or erosion in financial assets held by government including those arising out of changes in the manner of spending by Government.
- Implications of major policy decisions taken by government during the year or new schemes proposed in the budget for future cash flows
- Statement on maintenance expenditure with segregation of salary and non salary portions

The Thirteenth Finance Commission has in some ways a unique Terms of Reference when compared to its predecessor Commissions. For the first time, they have been asked to examine "the need to improve the quality of public expenditure to improve outputs and outcomes".

Steps for implementation of accrual based accounting

1. Using of data forms - collating and analyzing the same,
2. Identifying gaps to take actions.
   - Policy decisions based on manuals, standards, etc.
   - Comparing available data with agreed policy
3. Implementation.
   - Valuation methodologies - devising appropriate cost effective solutions keeping in mind prescribed procedures and limitations of available data and staff timeframe.
   - Evolving unique custom-built solutions like use of Tally software to minimize time and cost.
   - Reconciliation with department records and assurance of accuracy of data.
   - Depreciation Methodology and impact.
   - Issues regarding funds, grants (opening balance and adjustments thereto)

- Drafting of accounting policy disclosure and framing of accounts.
- It ensures transparency and accountability.

Initial Barriers in the way for Accounting Reforms

One barrier to accounting reform is governments themselves. They have the authority to determine what are accepted accounting principles, while using questionable accounting practices themselves.

Governments, for example, pay off operating costs with longer-term debt and thus overstate budgetary surpluses or conceal operating deficits. This is not unlike the allegedly fraudulent practices of some corporations.

There is a need to change with the times to catch up with the world. But to adapt any change there should be proper training and education so as to implement the change smoothly. Change management is portrayed in the following chart:

Change Management

A	Awareness of the need for change	• Management communication • Environment changes • Access to information
D	Desire to participate and support the change	• Fear of job loss – enhenced job seccurity • Discontent with current state • Affiliation and sense of belonging • Incentives or compenstaions
K	Knowledge on how to change	• Training and education • Information access • Exmples and role models
A	Ability to implement required skills and behaviors	• Practice applying new skills • Coaching • Mentoring • Removal of barriers
R	Reinforcement to sustain the change	• Compensation changes • Celebrations • Personal recognition

Treasury of Serbia

Source:http://www.aist-tresor.com

Evolution of Government Accounting Reforms

Significant changes in public sector accounting and financial reporting systems around the world and their increasing convergence to an accrual basis for accounting over the last two decades have underlined the need for a review of existing Government accounting practices in India as well.

IPSAS issued by IFAC:

International Federation of Accountants (IFAC) founded in 1977 issued framework to harmonize practices in public sector (i.e. the government) and businesses. IFAC issues International Public Sector Accounting Standards (IPSAS) applicable to governments across the world. IFAC has so far issued 31 IPSAS (as under) on accrual basis of accounting and one on cash basis of accounting.

List of Accrual Based IPSAS

IPSAS 1	–	Presentation of Financial Statements
IPSAS 2	–	Cash Flow Statements
IPSAS 3	–	Accounting Policies, Changes in Accounting Estimates and Errors
IPSAS 4	–	The Effects of Changes in Foreign Exchange Rates
IPSAS 5	–	Borrowing Costs
IPSAS 6	–	Consolidated and Separate Financial Statements
IPSAS 7	–	Investments in Associates
IPSAS 8	–	Interests in Joint Ventures
IPSAS 9	–	Revenue from Exchange Transactions
IPSAS 10	–	Financial Reporting in Hyperinflationary Economies
IPSAS 11	–	Construction Contracts
IPSAS 12	–	Inventories
IPSAS 13	–	Leases
IPSAS 14	–	Events after the Reporting Date
IPSAS 15	–	Financial Instruments: Disclosure and Presentation
IPSAS 16	–	Investment Property
IPSAS 17	–	Property, Plant, and Equipment
IPSAS 18	–	Segment Reporting
IPSAS 19	–	Provisions, Contingent Liabilities and Contingent Assets
IPSAS 20	–	Related Party Disclosures
IPSAS 21	–	Impairment of Non-Cash-Generating Assets
IPSAS 22	–	Disclosure of Information about the General Government Sector
IPSAS 23	–	Revenue from Non-Exchange Transactions (Taxes and Transfers)
IPSAS 24	–	Presentation of Budget Information in Financial Statements
IPSAS 25	–	Employee Benefits
IPSAS 26	–	Impairment of Cash-Generating Assets
IPSAS 27	–	Agriculture
IPSAS 28	–	Financial Instruments: Presentation
IPSAS 29	–	Financial Instruments: Recognition and Measurement
IPSAS 30	–	Financial Instruments: Disclosures
IPSAS 31	–	Intangible Assets

The World Bank has been conducting gap analysis of government accounting with cash basis IPSAS.

Formation of GASAB

Article 150 of the Constitution of India stipulates that "The accounts of the Union and of the States shall be kept in such form as the President may, on the advice of the Comptroller and Auditor General of India, prescribe." Accordingly, with the support of the Government of India, the Government Accounting Standards Advisory Board (GASAB) was constituted by the Comptroller & Auditor General of India on August 12, 2002 for the Union and States. The following is the composition of the GASAB:

- Deputy Comptroller and Auditor General as Chairperson
- Controller General of Accounts, Ministry of Finance, Government of India
- Financial Commissioner, Railways, Ministry of Railways, Government of India
- Controller General of Defence Accounts, Ministry of Defence, Government of India
- Additional Secretary (Budget), Ministry of Finance, Government of India
- Deputy Governor, Reserve Bank of India or his/ her nominee.
- Director General, National Council of Applied Economic Research (NCAER), New Delhi
- President, Institute of Chartered Accountants of India (ICAI), or his/her nominee
- Principal Secretary (Finance)/ Secretary (Finance) of four States by annual rotation and
- Director General (Accounts)/ Principal Director, Office of the Comptroller and Auditor General of India, as Member Secretary.

The Twelfth Finance Commission in its Report submitted to Government of India at Chapter 14- Institutional Changes and Reforms had recommended introduction of accrual-based system of accounting. The Government has accepted this recommendation in principle and GASAB has been asked to draw a detailed road map and operational framework for its implementation.

Government Accounting Standards Advisory Board (GASAB) at its Fifteenth meeting held on 30 July 2008 took a landmark decision to develop Accrual basis Accounting standards for Government. Twenty-one State Governments have expressed their agreement to migrate to Accrual Basis Accounting. The Standards will be issued as 'Indian Government Financial Reporting Standards (IGFRS)' and on notification by Government of India will be applicable to Government of India and State Governments in the preparation of accounts under Accrual basis accounting. These Standards are envisaged to facilitate ongoing pilot studies for migration to Accrual Basis Accounting in Government of India and State Governments. These Standards will initially be issued as recommendatory to facilitate transition to Accrual accounting.

The Board has decided to develop standards on Accrual basis on the following topics:

IGFRS 1 : Framework for financial reporting under accrual basis accounting

IGFRS 2 : Property, Plant and Equipment

IGFRS 3 : Revenue from exchange transactions

IGFRS 4 : Inventories

IGFRS 5 : Provision, contingent liabilities and contingent assets

GASAB has two fold mission improvements in the existing cash basis accounting system, and facilitating an eventual migration to accrual basis accounting. GASAB develops accounting standards under cash basis known as Indian Government Accounting Standards (IGAS) for the existing accounting system and standards for accrual basis under the nomenclature of Indian Government Financial Reporting Standards (IGFRS). The latter is essentially to facilitate pilot studies and the on-going applied research on accrual basis accounting in Government.

The Government Accounting Standards Advisory Board has so far developed five IGAS and submitted them to the Government of India for notification. GASAB has also developed a detailed road map and an operational framework for Government of India and States to migrate to accrual basis accounting. Several other products of GASAB are under various stages of development.

Role of GASAB's IGAS

Unlike accrual IPSAS, the cash basis IPSAS is a very generic standard laying down the broad requirements for preparation of General Purpose Financial Statements under cash basis. The IGAS issued by GASAB are comprehensive standards on individual line items in the financial statements. Even if India adopts cash IPSAS for its financial reporting, GASAB's IGAS would be necessary for appropriate accounting in Government. In view of the generic nature of Cash IPSAS, inconsistencies between Cash IPSAS and IGAS are expected to be very few. GASAB's IGAS where necessary can be reviewed and aligned with cash IPSAS over a transition period of five years.

Indian Government Accounting Standards (IGAS)

The Indian Generally Accepted Accounting Practices (Indian GAAP) is codified in Government Accounting Rules, List of Major and Minor heads, Civil Accounts Manual, Accounts Code for Accountants General etc. The rules embody the essential principles of accounting. No formal Accounting Standards existed for government before the constitution of GASAB. GASAB has embarked on setting up standards under the Cash basis accounting since its inception. The Cash Basis IPSAS (International Public Sector Accounting Standards) issued by the IFAC (International Federation of Accountants) Public Sector Committee - Financial Reporting under the Cash Basis of Accounting, has been examined by the Board. Based on the requirement in Indian context, the scope of the Cash Basis IPSAS has been analysed and amplified. The Board takes into account the requirements of stakeholders and decides on the topics for setting standards. GASAB Secretariat, the technical support team to the Board works on the products.

IGASs under consideration by the President of India for notification

The following Indian Government Accounting Standards (IGASs) have been proposed by the Board and approved by the Comptroller & Auditor General of India are under consideration by the President of India for notification:

IGAS 1 : Guarantees given by Governments: Disclosure Requirements
IGAS 2 : Accounting and classification of Grants-in-Aid
IGAS 3 : Cash Flow Statements
IGAS 4 : General Purpose Financial Statements of Government
IGAS 5 : Loans and Advances made by Governments

IGAS under development

In addition to the above following IGAS are under development:

IGAS 7 : Foreign Currency and Loss/ Gain by Exchange Rate Variations
IGAS 8 : Contingent Liabilities and Assets
IGAS 9 : Government Investments
IGAS10 : Public Debt and Other liabilities
IGAS11 : Accounting for revenue from exchange and non exchange transactions
IGAS 12 : Accounting for Capital transactions

IGAS planned to be taken up

- Standard on Chart of Accounts (uniform object head of classification)
- Events after reporting date
- Disclosure of information on General Government Sector
- Presentation of budget information in financial statements
- Transfer of funds from Consolidated Fund of India to Public Deposits
- Suspense and Remittance heads
- Standard on cash balance
- Incomplete capital works
- Accounting for Subsidies in government
- Off-budget borrowings

Conversion from Cash to Accrual Accounting System & Single to Double Entry Book Keeping

The terms 'Cash' and 'accrual accounting' are distinguished on the "basis of accounting" and "system of bookkeeping". "Basis of accounting" refers to the set of concepts and rules that determine when (the time) a transaction is recognised by the accounting system and recorded in the books. Accrual accounting and cash accounting are examples of basis of accounting while a "double-entry system" refers to a type of book-keeping system where for every transaction two aspects are recorded in books of accounts.

In cash-based accounting, transactions are considered when cash is received or paid, while in an accrual accounting method, the accounting system records a transaction when the right to earn income is established or when expenditure is committed.

A book-keeping system can either be single entry or double entry. In the single-entry system, income and expenses are recorded through a daily summary of cash receipts and disbursements. In the Double-entry system, daily transactions, including sales, purchases, cash receipts, accounts receivable and accounts payable, are recorded in journals. Every transaction has a debit in one account and a credit in another. While double-entry is more time-consuming, it is more accurate as it is self-balancing.

Accrual basis accounting is best implemented using double entry method of book-keeping, while single entry method of book-keeping is normally predominant where cash basis accounting is adopted.

Single entry and Double entry system of book keeping in Accounting of Government Sectors

Single entry system is a system of book-keeping in which transactions are recorded as a single entry, rather than as both a debit and a credit. When using single entry book-keeping, only cash payments and cash receipts are recorded. The receipts and payments accounts as above can also be maintained separately for capital and revenue. Single entry accounting is suitable only for small entities with limited transactions.

Double entry is an accounting technique, which records each transaction as both a credit and a debit. Credit entries represent the sources of financing, and the debit entries represent the uses of that financing. Since each credit has one or more corresponding debits (and vice versa), the system of double entry bookkeeping always leads to a set of balanced ledgers with credit and debit accounts. Selected entries from these ledger balances are then used to prepare the Income Statement and Balance Sheet.

Cash Accounting

In this system of accounting transactions are recorded when there is actual flow of cash. Revenue is recognised only when it is actually received. Expenditure is recognised only on the outflow of cash. No consideration is given to the "due" fact of the transaction. This system of accounting is simple to understand and as such needs less skill on the part of the accountant. Its whole focus is on cash management. The recognition trigger is simply the flow of cash. Budgetary and legislative compliance is easier under this system.

Limitations of cash system of accounting

The limitations of cash based accounting are:

- It does not provide a complete picture of the financial position i.e. information on assets and liabilities are not available for fixed assets (land, building, machineries, defence, heritage assets etc.)
- No information about capital work-in-progress like dams, power plants, roads and bridges etc. is available.
- It does not give the full information on current assets e.g. accrued income like outstanding royalty, fees, service charges, tax arrears etc.

- Comprehensive information is not available about government liabilities (pensionary commitments, interest due, bills payable, depreciation for replacement of assets etc.)
- Unit cost and total cost of services provided by the Government departments like health, education, water supply, transportation etc. is not ascertainable (as depreciation, interest etc. are not apportionable)
- It ignores certain transactions by not recording expenditure already incurred but payment not made e.g. supplies made, salary, telephone charges, overdue interest etc. and also revenue earned but cash not received e.g. licence fees, services delivered (electricity, water etc.)
- It gives a wrong picture of income received, as advance tax receipts are recognised as income.
- No weightage is given to the concept of 'matching' i.e. expenses of a specific period should be set off against the revenue of the same period.
- No disclosure is made about contingent assets and contingent liabilities which may turn into committed ones on account of guarantees given or letter of comforts issued by the government.
- No information is provided about existing net liabilities of public enterprises and agencies outside the government, although the latter cannot escape such liabilities.
- No disclosures are made about Accounting Policies on the basis of which Financial Statements are prepared.
- It provides room for fiscal opportunism e.g. tax revenues can be collected in excess during a particular period followed by high incidence of refunds together with interest, payments can be easily deferred and passed on to the next financial year, revenue due in the future could be compromised by providing for one time payments.

Due to the above disadvantages, it is not possible to get the real picture of the government financial performance and position.

Accrual Accounting

It is a system of accounting in which transaction are entered in the books of accounts, when they become due. The transactions are recognised as soon as a right to receive revenue and/or an obligation to pay a liability is created. Expenses are recognised when the resources are consumed and incomes are booked when they are earned. The focus is on the recording of flow of resources i.e. labour, goods, services and capital., the related cash flow may take place after some time (of event) or it may or may not take place in the same accounting period.

Advantages of the Accrual System of Accounting - Practical Approach

The system of Accrual Accounting while retaining the advantages of the Cash Accounting System overcomes its limitations by inclusion of Cash Flow Statement in the Financial Statement of the entity. The major advantages are as under:

- It helps in the assessment of financial performance by correctly reflecting surplus/deficit as all expenses whether paid or not and all incomes whether received or not are duly accounted for.
- It gives information on whether income streams are adequate to meet short and long-term liabilities so that their early payment keeping in view their payment period (short term and long term) and nature (cheap or costly loan) can be better managed.
- It provides comprehensive information on expenses that helps in knowing the cost consequences of policies and enables comparison with alternative policies.
- Also, information about calculation of subsidy can be extracted from the accounts, which helps in its rationalisation. This ensures the adoption of best policy, which in turn assures optimal use of scarce resources. It also helps in ascertaining the future sustainability of programmes.
- Liquidity position of the government can be better assessed
- It gives comprehensive information on the Financial Position i.e. assets and liabilities of government. In this system of accounting the financial decisions are not seen merely from the point of view of cash outgo or inflow but also from their impact on the asset-liability position of the government, future funding requirements of assets enabling planning of their timely maintenance and replacement.
- It makes disclosures on account of contingent assets and contingent liabilities so that risk associated with the guarantees issued and letters of comfort given can be better assessed by the user of the financial statements.
- It bridges the gap leftover by cash accounting by inclusion of accrued expenses and revenues (receivables and payables), physical assets, capital work-in-progress and depreciation, pension liabilities and provisions etc. in the accounting system.
- It discloses the Accounting Policies used in the preparation of Financial Statements for better understanding and appreciation of the Financial Statements.

Alternative Bases of Accounting including Modification to those Bases-Ability to meet Objectives

The following chart depicts the alternative basis of accounting including modifications thereto:

	Cash		Accrual	
Objective	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 ad 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.				

Impact of recognising expenses on accrual basis and income on cash basis

What is important to note is that the accounting treatment that best represents the actual situation (in other words the "true and fair" view) should be used. If revenue from tax is not measurable and is uncertain or difficult to realise, then the correct principle would be to recognise such income on cash basis. The accrual-based system that intrinsically follows the principles of conservatism and measurability requires that we "anticipate no gains, but provide for losses". In the context of government accounting, recognising expenditure on accrual basis meets the criteria of conservatism, measurability and practicability. Government should put in place procedures to recognize expenditure in accrual basis. Information on expenses is to be complied to assess the cost of mobilizing revenue and sustainability of existing programs. It is also necessary to know the likely cost of proposed activities and services or alternative proposals and to determine that whether to fund the production of services within government sub-entities or to purchase directly from non-government organizations. Generation of surplus or deficit is not as much an issue as is a transparent depiction of the underlying situation. It may be noted that banks (including public sector banks and the Reserve Bank of India) recognise all expenditure on accrual basis, and revenue from impaired assets on cash basis.

Checks and balances and risks involved in accrual accounting

Before accrual accounting is implemented, accounting policies that determine principles of recognition, measurement and disclosure need to be defined. These policies will ensure that discretion is not applied indiscriminately. Further, the role of Audit needs to be strengthened to ensure compliance. Since every transaction will have a corresponding entry, audit will assume a stronger role and responsibility and ensure checks and balances. The risks involved in accrual accounting can be similar to the risks involved in the present cash accounting system - However, accrual accounting leads to greater transparency in accounts resulting in easier detection of frauds.

Accrual accounting as a tool for sound decisions of financial in the Government Sectors

By following accrual system of accounting, governments will be better positioned to assess their financial performance and financial position. Accrual system of accounting helps in preparing the position of assets and liabilities of the government, which is not possible under the current system. This helps in better fund management and evaluation of performance of various departments. Further, accrual system of accounting helps in estimating cost of services more appropriately, which could form a crucial input for managerial decision-making.

Accounting reforms vis-à-vis concomitant budgetary reforms

Budgeting and accounting systems are closely linked to each other. In the long run it is desirable to have concomitant reforms in the budgeting and accounting systems, if government were seeking the full benefit of reform in its accounting system. However, implementing reforms simultaneously in both accounting and budgeting systems is very complex, and the task of managing the change is extremely difficult. Most countries that embarked on reforms first undertook accounting reforms, followed by budgetary reforms within a few years. Examples include New Zealand, Canada and UK. Modifying the accounting system is a good way to start the reform process, but it needs to be continued to its logical conclusion.

Accounting reforms in developing Countries:

Over the past two and a half decades, many developing countries have strengthened their accounting regulations as part of broader programs of market-oriented regulatory reform. Whilst the extent to which they have done this has varied from country to country-the capitalist economies of East Asia (South Korea, Taiwan, Singapore, Hong Kong, Indonesia, Thailand, Malaysia, and the Philippines), for instance, have gone much further than their socialist neighbours (China, Vietnam)-there has nevertheless been a broad shift towards accounting reform throughout the developing world (Nobes 1995; Ma 1997; Pacter 1998; Roberts et al 1995). In most cases, the central element of this process has been the introduction of International Accounting Standards (IASs), although in some countries-such as the Philippines-it has been the introduction of US standards.

In explaining accounting reforms in developing countries, accounting researchers have generally relied on explanations that emphasise the economic rationality of accounting policy-makers. Anglo-Saxon accounting policies, it is argued, represent a "logical guide" for developing countries because they reduce the cost of capital, lower investment risk and promote a more efficient allocation of economic resources and higher rates of economic growth (Graham and Wang 1995: 150; see also Han 1994). At the same time, traditional accounting systems in developing countries are seen as being incompatible with the changing business environment and in conflict with the goal of economic development (Chow et al 1995; Graham and Li 1997). In this view, then, accounting reform is simply a matter of accounting policy-makers making rational choices. The only precondition for reforms, it is implied, is the existence of policy-makers who are able to overcome the cultural obstacles to reform that exist in many developing countries and put considerations of efficiency above everything else.

The problem with these explanations is that, like the neo-classical and modernisation theories on which they are based, they portray accounting reforms as a purely technical process in which politics and power play no role. It is assumed that accounting policy-makers make their decisions solely on the basis of considerations of efficiency and growth. Yet, as several scholars have pointed out, it is less a technical concern to improve efficiency and growth that drives the process of economic policy reform than a desire to protect, reinforce or gain social and economic power (Chaudhry 1993; 1994; Bardhan 1989; Robison et al 1997; Rosser 1998; Sargeson and Zhang, forthcoming; Tinker, Merino and Neimark 1982; Tinker 1984). Economic policies, they have argued, not only influence the efficiency with which resources are allocated but also their distribution within society-that is, they influence "who gets what, why and how" (Chaudhry 1993: 247).

One approach that does take issues of power and interest seriously is that associated with scholars such as Briston (1978), Samuels and Oliga (1982), Johnson (1982), Hove (1986) and Annisette (1997). According to this approach, accounting reforms in developing countries should be understood not in terms of rational choices by wise policy-makers but rather as the result of a colonial heritage and continued neo-colonial domination. Foreign governments and capitalists, it is claimed, have promoted Western accounting policies in developing countries because such policies have helped to expand the frontiers of international business and thereby contributed to the wealth of shareholders back at home. At the same time, it is argued that these policies have been "inappropriate" for developing countries because they have reduced these countries' ability to deal with several important development-related issues, including environmental protection and transfer pricing (Samuels and Oliga 1982; Hove 1982).

Status of Government Accounting system of selected Countries moving towards reforms

The following table gives a glance of the status of Government accounting system of select countries:

Members of the European Union are required to prepare their budgets in accordance with the European system of Accounts (ESA 95). It is not a full-fledged accrual system but is predominantly based on accrual concepts.

Name of the Country	Accrual Accounting for Individual Agencies /Departments	Consolidated Accrual Reporting	Accrual Budgeting
Australia	Since 1995	Since 1997	Since FY 200
Austria	No[1]	No	ESA 95. Modified accrual.
Belgium	Some	No	ESA 95. Modified accural.
Canada	Some 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	ESA 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, Asisa Development Bank, Philippines, PP 12-14, (Modified)

Reference Practice of other countries:
Appropriation Accounts under the accrual system

In most countries, the government needs funds for the purposes of development from their respective consolidated funds. Accordingly their legislatures authorise appropriations through approvals to the appropriation bills. Once an appropriation is authorised, an appropriation account is established, which discloses expenditure at the same level of detail as in the estimates, to make amounts available for expenditure from the Treasury. Various countries follow different types of appropriation.

The different types of appropriation accounts in International context are:

- Open Appropriation Account: An open appropriation account is an account that has not had the balance transferred to a successor account or to surplus. The appropriation in the account may be expired or unexpired.
- Closed appropriation account: A closed appropriation account is an account that has had the balance transferred to a successor account or to surplus. The appropriation in the account is lapsed.
- Successor Account: A successor account is an account established for the payment of obligations applicable to appropriations for the same general purposes, but which have either lapsed or been discontinued. A successor account is available indefinitely for the payment of obligations chargeable to any of its predecessor accounts. Further, appropriation accounts may include not only accounts to which money is directly appropriated, but also other funds. A fund, as used in connection with appropriations, is a sum of money or other resources, usually segregated, to be expended or used for specified purposes. Funds differ from appropriations in that they are usually permanent in nature and do not expire unless they are revoked by the Parliament. Thus, in USA, appropriation accounts are prepared for General Fund, Trust Fund and Revolving Fund. Nevertheless, appropriation accounts as prepares in India, are similar to the system followed in the Commonwealth countries like UK, Canada and Australia. Thus, in UK, the Resource Accounts for each financial year are prepared and laid before Parliament under the Government Resources and Accounts Act 2000. They show the extent to which the resources granted by Parliament through Consolidated Fund Acts (following voting by the House of Commons on Estimates presented to it) have been used, and are signed by senior civil servants from the departments concerned (Accounting Officers). They are audited by the Comptroller and Auditor General. In addition to giving his certificate that the financial statements give a true and fair view of the state of affairs of the audited department concerned and that expenditure has been applied for the purposes authorised by Parliament, he may make additional comments on the accounts.

Status of Accounting System in other Countries

The following table depicts the overall status of accounting system adopted by other countries across the world:

Country	Status		
	Full Cash Basis	Combination of Cash and Accrual Accounting	Full Accrual Basis1
Australia			✓
Austria	✓		
Belgium	✓		
Carnbodia		✓	
Canada			✓
Colombia			✓
Czech Republic	✓		
Finland		✓	
France			✓
Germany	✓		
Greece	✓		
Hungary	✓		
Iceland		✓	
India	✓		
Indonesia		✓	
Ireland		✓	
Israel		✓	
Jordan		✓	
Kenya	✓		
Mexico		✓	
Morocco	✓		
Netherlands	✓		
New Zealand			✓
Norway	✓		
Slovak Republic	✓		
Slovenia	✓		
Suriname	✓		
Sweden		✓	
Turkey	✓		
United Kingdom			✓
United States			✓

(Source: Transition to Accrual Accounting- Technical Notes and Manuals by IMF, September 2009)

[1] "Full accrual basis" means financial statements are prepared on the basis of accrual-based national or international accounting standards, also sometimes referred to as generally accepted accounting principles (GAAP).

The above countries are generally following IPSAS 1 framework for presentation of financial statements. The presentation of financial statements has been modified to suit the local requirement in India.

Countries that have set in motion the process of moving over to an accrual based accounting system:

- Fiji Islands
- Indonesia
- Marshall Islands
- People's Republic of China
- Philippines
- Republic of Korea
- Sri Lanka
- Mongolia

Key Issues Involved in Transition

1. Formulating accounting policies

Cash accounting is concerned mainly with the recording of cash receipts and payments, and is relatively simple to operate. This simplicity, however, comes at a cost-cash accounting fails to provide essential information about non-cash transactions and stocks of assets and liabilities. Accrual accounting, as discussed above, is a more comprehensive accounting system requiring the recording of flows and stocks within an integrated framework. The recognition and measurement or valuation of complex transactions, and assets and liabilities (e.g., finance leases, private-public partnerships (PPP), financial instruments, and intangible assets) often require the exercise of judgment and technical skill with attendant risks of errors and misstatements. It is partly to reduce such risks that national and international accounting standards are necessary. Accounting standards provide guidance on acceptable accounting treatment of specific items and define the minimum requirements that general purpose financial statements need to satisfy. One of the most important issues that governments need to address when contemplating a move to accrual accounting is the selection and application of appropriate accounting policies consistent with relevant accounting standards. Where existing standards do not deal with a particular issue, judgment has to be exercised to select accounting policies that would help generate relevant and reliable financial information.

2. Budget classification and the chart of accounts

A budget classification sets out the manner in which the budgeted revenues, expenditures, and financing items would be categorized and presented in the budget. Under a cash budgeting system, the budget classification would not include stocks of assets or liabilities.

A chart of accounts (COA) is a logical coding framework that forms the basis of recording accounting transactions and balances (flows and stocks) in the general ledger, the principal accounting record of an entity.

In a well-designed system, the COA should incorporate the budget classification. This means that in addition to all the accounts specified in the budget classification, the COA will include other accounts required for accounting and reporting purposes. For example, a COA will have accounts for assets and liabilities that would not normally be included in a cash-based budget classification.

In addition, a COA would normally also include information about particular revenues and expenses at a more detailed level than required for the budget classification.

If a government moves to accrual accounting and accrual budgeting simultaneously, then the COA and the budget classification can be expected to be unified, at the appropriate level of aggregation.

However, if the government decides to adopt an accrual accounting regime, while continuing with cash budgets, there will be significant differences between the two classification systems.

The COA, in these circumstances, must maintain the capacity to generate both accrual-and-cash based reports. In addition, in these circumstances, the accrual system must provide necessary functionality to prevent breaches of legal expenditure limits, which may be based on cash or commitment concepts.

The design of the government's COA can have a critical impact on the efficacy of the accrual accounting framework. The COA occupies an important central place because it determines the classification of transactions and balances recorded in the government's general ledger and, therefore, determines the scope and content of financial reports that will be available from the government's central system. The COA must have the capacity to accommodate current data requirements and, to the extent practicable, anticipate future requirements. The COA must also be designed in such a way that it can support diverse reporting requirements of governments (e.g., management reports, budget reports, financial statements subject to audit, and reports in accordance with other applicable requirements (e.g., GFSM 2001, the European System of Accounts (ESA) 1995, and System of National Accounts (SNA), without the need for multiple data entry.

In order to meet the diverse requirements, COAs are often designed as a combination of segments (or dimensions) where each segment corresponds to a particular information element. Thus a COA may have separate segments for economic, functional, administrative, and regional classification.

In addition, separate segments may also be utilized to capture data about cost centers, programs, projects, outputs and outcomes. Transactions would be recorded, and reports generated, utilizing an appropriate combination of segment codes. In this way, a well-designed COA can facilitate the capture, classification, analysis, and reporting of a large quantity of data.

3. Opening balance sheet

The systematic identification and valuation of assets and liabilities as at the date from which accrual accounting is to commence is an indispensable step in the move to accrual accounting. The opening balance sheet has to be supported by adequate information and explanation necessary for audit. This can be a very challenging and time-consuming process. The concept of materiality and prudence may be used to make judgments about assets and liabilities that should receive the most attention during this exercise.

4. Valuation Issues

The traditional basis for valuation has been historic cost. There is, however, a growing movement to adopt more current approaches to valuation. Conceptually, current valuations are generally viewed as superior, but practical considerations have often led to the continuation / adoption of the historic cost approach. There are, however, problems regardless of which approach is adopted.

The historic approach is based on assets valued at their acquisition costs with subsequent depreciation. This can be viewed as a more objective approach as it is based on the amount actually paid for the asset. It is also easier to handle from a practical point of view.

Current valuations are meant to alleviate this problem. By their very nature, they are more relevant, i.e. the information is not out-of-date. As a result they are viewed as a better indicator of the level of resources tied- up in an entity and a better basis to evaluate the performance of an entity. This is especially so when calculating the true cost of services provided (i.e. the flow-through from the balance sheet to the operating statement in the form of depreciation). Current valuation is also of much greater value for economic analysis.

The use of current valuation methodologies does, however, require many professional judgements to be made. There are a number of different methodologies for applying current valuations. These include depreciated replacement cost, value-in-use and net realisable value. Each of these has its own problems. Depreciated replacement cost assumes that one would purchase exactly the same asset in future, which most likely is not the case. Value- in- use methodologies are very dependent on management intent. Furthermore, when this approach is adopted in non -competitive environments, an entity can raise its charges and thereby the cash flows from an asset. As a result the value of the asset would increase. This can therefore become a circular and rather meaningless exercise. The problem with the net realisable value approach centres on specialised assets, where markets may not exist or may not be reliable.

A further difficulty with current valuations is that they can fluctuate significantly from one year to another. This can create windfalls when values go up, but short -falls when values go down. This can have a great impact on the reported bottom line of governments. Will politicians be willing to accept that the government's bottom line can be determined by such fluctuations? Also, is there a danger that fiscal discipline may be undermined if the windfalls from such fluctuations are used to increase other expenditures. This again highlights the behavioural impact that the adoption of accruals can bring about.

5. Technical & IT Competency

International experience suggests that a lack of adequate technical resources can be a major impediment to successful implementation of accrual accounting. It is essential that a government considering a move to accrual accounting has either a core of officials with required technical (accounting, IT, etc.) skills, or the capacity to recruit such people for its key positions. Outside consultants may be used to supplement in-house resources to develop the framework and the associated systems and procedures.

Although, in theory, cash or accrual accounting can be implemented with either a manual or an electronic system, in practice, it would be inadvisable for a government to attempt to implement full accrual accounting without the aid of a modern government financial management information system (GFMIS) with proven functionality in areas such as general ledger, accounts payable, purchases, assets management, etc. Implementation of such a system would be a major project, which would normally be a part of the accrual accounting project.

However, in order to ensure that the reforms are sustainable, consultants should be used mainly for capacity-building purposes and to assist officials with specific technical implementation issues (e.g., IT systems). The following institutional and professional arrangements would greatly facilitate a move to an accrual accounting framework :-

- a well-established and regulated national professional accounting body;
- a well functioning supreme audit institution;
- effective parliamentary public accounts committees;
- a national valuation office (or private sector valuation experts) to assist with valuation of assets; and
- an actuarial institution to assist with valuation of employee and social policy liabilities.

6. Social Insurance Programs

The treatment of social insurance programs, such as general old-age pension programs, is a very contentious issue in an accrual environment. It is important to emphasize that this does not refer to the treatment of government employees' pension programs; these are contractual obligations and their treatment as a liability is clear-cut.

There are two schools of thought on this subject. Those who believe social insurance programs should be treated as a liability for the government, and those who do not. Social policy obligations at times may trigger liabilities upon government and for which accounting issues need to be considered whether to bring these obligations into the accounts or ignore on the grounds that the legislation affecting them can be changed and therefore the potential liabilities are not capable of measurement.

7. Fostering a "Cultural Change"

Perhaps the overriding lesson is that implementing accruals cannot be seen as a technical accounting exercise. It needs to involve a "cultural change" in government and be linked with wider public management reforms. For accruals to be worthwhile and successful, the new information that accruals bring forth needs to be used to improve decision-making in government. This change will not necessarily happen automatically. It needs to be actively promoted, especially at the level of policy makers and senior officials.

8. Communication

The countries that were first to move to accruals generally cite the need for more and better communication as the single overwhelming factor that was underestimated in the implementation of accruals. This includes promoting the "culture change" as noted above, but extends to all facets of the implementation cycle.

It is essential to have the specific new accounting policies available early so that line ministries and agencies can have adequate preparations. The use of task forces on specific issues composed of officials from a range of ministries and agencies serves to get buy-in from them more readily than otherwise.

Close communication with the audit office is also necessary if they are to reinforce the reform and attest to the accounts on an accrual basis. It allows the finance ministry to understand their concerns and the audit office to understand better the motives and rationale of the government for the decisions it takes as it implements accruals.

Impetus for adopting accrual concepts differently from private sector

The private sector focuses on commercial viability whereas the government plays a developmental and social role. Therefore, the need for economic and rural development might necessitate governments to adopt accrual concepts differently from private sector. The concept of 'true and fair' is different in government from that of the private sector. Further the concept of net worth in government is not as important as in the private sector. The focus of accrual accounting in government is to ensure that the output and outcome of the spending are commensurate with the inputs and the long-term fiscal sustainability of government is captured appropriately.

Social costs and benefits of government accounting reform

It is not widely recognized that a sound government accounting system is an important part of a country's institutional infrastructure. Rather, government accounting is commonly perceived as a bureaucratic function. To make matters worse, like the foundation of a house or the sewer lines under the street, the accounting system as a critical institutional infrastructure is often invisible until it fails: when public money is lost and wasted, when taxes are not collected, or when employees are not paid on time. Better accounting systems can quite readily lead to improvements in a government's financial management. However, the accounting system's contribution to the achievement of higher-order goals, such as poverty reduction, is necessarily indirect and long-term. Hence, it is difficult to see its social benefits.

Furthermore, in economically poor countries, government accounting reform poses a moral dilemma. Because of its costs, such reforms compete with food for the hungry, medicine for the sick and clean water for urban slum dwellers. In such an environment, one can't justify spending money to improve the way a government keeps its accounts and produces annual financial reports.

This moral predicament is resolved by the social benefits of government accounting. Government accounting itself does not reduce poverty. Government accounting contributes to a country's socioeconomic development through its effect on public financial management and accountability. Effective government accounting makes it possible to manage the government's finances smoothly and provides audit trails to prevent and detect financial misconduct. In the light of the pervasiveness and severity of government corruption in many developing countries (Rose-Ackerman, 1999), financial integrity assurance is a critically important function of government accounting systems. Only an ethical and competent public management can efficiently and effectively implement programs to reduce poverty reduction and achieve other socioeconomic goals. Sachs declared: "No country should receive greater funding unless the money [for poverty reduction] can be audited."

It is important for accountants to educate the public and public officials about the social value of government accounting. The accounting system is in effect the "nerves of government" -to use Karl Deutsch's phrase (Deutsch, 1966) -because it is the core of a government's financial command and control centre. A government accounting system can be rudimentary or sophisticated. As in business (Simon, 1954), a good government accounting system at the minimum keeps accurate financial scores; a better government accounting system directs the attention of policy makers and managers to problem areas; and at its best, a government accounting system provides information useful for decision making.

Thus it takes a certain amount of foresight and insight to make investments in government accounting reform: the foresight to anticipate the consequences of bad or no accounting and the insight to link accounting to government performance and eventually the achievement of societal goals. Government accounting can contribute to a country's socio-economic development by providing information to public managers and those who hold them accountable to perform the fundamental functions of the state. As a support function, accounting does not have value of its own, and does not decide the allocation of resources. However, once these decisions are made, the accounting system performs the critical function of following the money. As such, accounting and its allied functions including information system design, internal control, pre-and post-audit, revenue administration, and public expenditure management -ensure that resources are used for their intended purposes. If the purpose is socio-economic development, accounting can help meet this goal by ensuring legal and contractual compliance, facilitating financial management, and promoting transparency and accountability.

Accounting Reforms in India and the Role of the Institute of Chartered Accountants of India

In order to leverage the accounting reforms process, the Institute of Chartered Accountants of India felt the need of local bodies and brought out a publication titled 'Technical guide on Accounting and Financial Reporting by Urban Local Bodies in India' in 2000. This publication provides a broad framework for reforming the accounting systems so as to provide the guidance for switching to double entry accrual system in these bodies.

The ICAI Accounting Research Foundation (ICAI ARF) registered under section 25 of Companies Act 1956 and set up by the ICAI has contributed towards accounting reforms in following government departments:

Municipal Corporation of Delhi Project: The Project on, 'conversion of accounts to accrual basis of accounting in the municipal bodies i.e. for the Municipal Corporation of Delhi' taken up in March, 2002 had been successfully completed in May, 2006. During this period the ICAI ARF assisted in the preparation and presentation of financial statements for the year ended 31st March 2006. ICAI ARF was also actively involved in restructuring and refining of various budgeted heads, accounting process, setting up of Asset Information System and introduction of accrual system of accounting in the various zones of MCD.

Controller General of Accounts: The project was undertaken in May, 2006 for the specific purpose of bringing accrual accounting reforms in the identified pilot units i.e. Dr. Ram Manohar Lohia Hospital, New Delhi of (Ministry of Health & Family Welfare) and the C.P.W.D. Divisions of New Delhi Zone of the Ministry of Urban Development. The Controller General of Accounts (CGA) and the ICAI have decided to cooperate and collaborate with each other to improve financial recording, reporting and management system and utilize the accrual accounting information for better management in Pilot Units. The project funded by the World Bank, was completed successfully in September 2008.

Department of Posts: As a part of its continued pursuit of social responsibility, the ICAI-ARF recently signed a Memorandum of Undertaking (MoU) with the Department of Posts (DoP), Ministry of Communications & Information Technology, Government of India, for taking up a pilot project for conversion of the accounting system in two Head Post Offices to accrual accounting system (double-entry system).

Pilot Study in Madhya Pradesh: The Madhya Pradesh Government has engaged IPAI (Institute of Public Auditors of India) as consultant for conducting Pilot study in public works division (Vidisha). Under the pilot projects following transformations are being undertaken like preparation of the statement of Assets and Liabilities and Statement of Income and Expenditure, Valuation of land at the average minimum rate of non-irrigated land prevailing, Assets classification into land, buildings, assets of historic and artistic value, roads, bridges and culverts, plants and machinery and furniture and fixtures, Depreciation rates are being included and adopted, Percentage charges rent of buildings and amount recoverable from suppliers for rejected material are to be taken as sundry debtors, Assets created under BOT, BOOT and BOLT-timing of assets recognition to be decided, Pension liabilities to be disclosed on actuarial basis. Deposits works, interest bearing security etc. are to be taken as liabilities.

Pilot study in Andhra Pradesh: The pilot study consists of the district model of accrual accounting in Mahboobnagar and pilot project in Transport, Roads and Buildings and Tribal Welfare Departments.

Kolkata Municipal Corporation Project: Continuing the initiative to develop new areas of applied knowledge. The ICAI took up a project from Kolkata Municipal Corporation (KMC) in the month of June, 2004 for application of advance concept in financial monitoring reforms in KMC and successfully completed the project in September, 2007.

Financial and Accounting Reforms, Capacity building and Related Strategies in Urban Local Bodies (EU Project): This project was successfully completed in September, 2006. The project as awarded by the Delegation European Commission to the ICAI, aiming at the introduction of accounting and financial reforms in the City Governments in the light of European experience. The European Commission has appreciated the high quality of the output brought out by the ICAI.

Strengthening Rural Decentralization (SRD) at Gram Panchayat Levels in West Bengal: The ICAI had undertaken and successfully completed this DFID funded project to improve the accounting, auditing, procurement and capacity building systems at the Gram Panchayat levels in the State of West Bengal.

Project on Outcome Budget: The Union Finance Minister introduced Outcome Budget from 2005-06, as a part of the reform in public expenditure management. ICAI, as a partner in national development, undertook the project to review the Outcome Budget prepared by the various Ministries and Departments with a view to improve these. The project has been completed successfully under the Chairmanship of Shri Suresh. P. Prabhu, Member of the Parliament.

The Institute of Chartered Accountants of India constituted a Committee on Accounting Standards for Local Bodies in the year 2005 to formulate the Accounting Standards for Local Bodies. The Committee has been established with the primary responsibility to conceive and suggest areas in which Accounting Standards for Local Bodies (ASLBs) need to be developed, formulate ASLBs, integrate the ASLBs to the extent possible, with the International Public Sector Accounting Standards issued by the International Public Sector Accounting Standards Board, provide implementation guidance on ASLBs, review and revise the ASLBs, assist Local Bodies in adoption of accrual system of accounting, and propagate the ASLBs among the stakeholders in preparation and presentation of financial statements. So far, the Committee has four accounting standards ASLB 3 'Revenue from Exchange Transactions', ASLB 4, 'Borrowing Costs, ASLB 5,' Property, Plant & Equipment' and ASLB 6,' Events After the Reporting Date'. The Committee has also published a Booklet on 'Accrual Accounting for Local Bodies: Elected Representatives & Stakeholders' and organised an Awareness Workshop on 'Implementation of Accounting Reforms in Local

Bodies: Current Scenario and a Way Forward' jointly with the Ministry of Urban Development, Government of India in January 2009 at Goa for the benefits of end users.

In 2008, the ICAI constituted the Committee on Public Finance for the first time to use the professional excellence in the area of Public Finance. The principal objectives of the Committee, inter alia includes to review, analyze, recommend measures and assist the Central and State Governments as also Civic Bodies. Also in the same year, Committee on Government Accounting was constituted with the mission to review, suggest improvements and provide awareness on Government Accounting to the society at large and specifically to the stakeholders.

Committee on Public Finance and Government Accounting

In the year 2010, the Committee on Public Finance and Committee on Government Accounting have been merged. The principal objectives of the Committee on Public Finance and Government Accounting are:

- To review, analyze, recommend and suggest measures to the Local, State & Central Governments, PSUs and other organizations in Policy assessment, planning and execution in public finance, Reforms in Government accounting system and Maximizing public fund's utility to augment and vitalize economic growth for end beneficiaries.
- To provide training within the Government bodies, to evolve methods which would enable use of present day Information technology in assisting the accounting reform process, Collaboration and coordination with Comptroller & Auditor General of India (CAG) and Controller General of Accounts (CGA) to bring improvements in the framework of Government Accounting System.
- To suggest to the Central and State Governments the means and ways which would assist in widening the tax base and in better administration of the revenue collection, improve MIS, budgetary control mechanisms, and enhance accountability and transparency.
- The Committee also strives to undertake capacity building measures for the profession to enable the profession to assist the Government in the process of implementation of Government Accounting and Public Finance reforms.

Thus, the Committee on Public Finance & Government Accounting is a stepping stone in Institute's mission of partnering with the Government in Nation building.

"WE CARE FOR THE FISCAL HEALTH OF THE NATION"

About the Institute of Chartered Accountants of India

The Institute of Chartered Accountants of India (ICAI) is a statutory body established under the Chartered Accountants Act, 1949 (Act No. XXXVIII of 1949) for the regulation of the profession of Chartered Accountants in India. During its six decades of existence, ICAI has achieved recognition as a premier accounting body not only in the country but also globally, for its contribution in the fields of education, professional development, maintenance of high accounting, auditing and ethical standards. ICAI now is the second largest accounting body in the whole world.

ICAI has its Headquarters at New Delhi with five Regional Offices at Mumbai, Chennai, Kanpur, Kolkata, New Delhi and 125 branches spread all over the country. In addition, it has set up 21 Chapters outside India and an office in Dubai.

Currently over 690,000 students are pursuing the Chartered Accountancy course and the total membership of ICAI is over 1, 64,000. Among the members in government, industry, banks, financial institutions, private enterprises etc. a significant number of members occupy eminent positions in their respective organizations. Chartered Accountants are also serving as Vice-Presidents and Members of Income Tax Appellate Tribunals besides being in IAS, IPS and IRS cadres. The members of ICAI are also considered to be very competent even in foreign countries as is evident from the positions they are occupying in all major cities across the World. Presently, there are about 12,000 members working abroad.

The affairs of ICAI are managed by the Council in accordance with the provisions of the Chartered Accountants Act, 1949 and the Chartered Accountants Regulations, 1988. The Council consists of 40 members of whom 32 are elected by the members and remaining eight are nominated by the Central Government to represent the Comptroller and Auditor General of India, Ministry of Corporate Affairs, Ministry of Finance and other stakeholders. The Council functions through four Standing Committees and 32 Non-Standing Committees.

In terms of the Chartered Accountants Act, 1949, the President of the ICAI is the Chief Executive Authority of the Council. The Secretariat of ICAI is headed by the Secretary who is in-charge of the office of ICAI as its Executive Head. The activities of ICAI can be broadly divided into four parts comprising of Technical Directorate, CPE Directorate, Board of Studies and the Administration, each one headed by separate head. Other important wings of ICAI are the Examination Department, Disciplinary Cell, Legal Department, Members and Students Services, International Affairs, Research etc. ICAI has also set up the ICAI Accounting Research Foundation as a Section 25 Company under the Companies Act, 1956.

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