CHAPTER III

GOVERNMENT ACCOUNTING SYSTEM (GAS)

“The Principles of Commercial and Government Accounting differ in certain essential points. The difference is due to the fact that, while the main function of a commercial concern is to take part in the production, manufacture or inter-change of goods or commodities between different groups or individuals and thereby to make profit, Government is to govern a country and, in connection therewith, to administer the several departments of its activities in the best way possible”. (Introduction to Indian Government Accounts and Audit” issued by the Comptroller and Auditor General of India-quoted in ARC 14th Report p. 100).
3.1 Government Accounting System (GAS)

3.2 Indian Systems

3.3 Present Condition of GAS-Primary Data

3.4 Trends in Revenues and Expenditure

3.5 Reforms in GAS

3.6 Problems in the government accounting systems

3.7 Need for Reforms

3.8 Reforms in India

3.9 Stages of introduction of accrual basis of accounting

3.10 Railway Accounts

3.11 The urgency for reforms

3.12 Global Accounting Reforms

3.13 A Critical Review of Reforms

3.14 Reforms to GAS-Primary Data-Quantitative

3.15 Reforms to GAS-Primary Data-Qualitative

3.16 Current Status of Reforms in India

3.17 Accounting Reforms and Governance

3.18 Sum-up
This chapter analyses the Government Accounting System (GAS) and the reforms that are needed therein. While its purpose and approach are broadly same as that of the other systems, Governmental Accounting differs in some significant aspects from commercial accounting. GAS has been a major instrument which determines the efficiency of the State.

3.1 Government Accounting System (GAS)

The Government is the biggest spender in any economy. Hence Public Expenditure Management (PEM) becomes a major function in all countries. Accounting is one of the principal ways of addressing transparency and accountability in public systems, and gains greater significance when the role of the state in the economy increases.

3.1.1 Objectives

IFAC PSC Study 1 (1991) ‘Financial Reporting by National Governments’ identified the following objectives of GAS:

1. *Indicating whether resources were obtained and used in accordance with the legally adopted budget;*

2. *Indicating whether resources were obtained and utilized in accordance with legal and contractual requirements, including financial limits established by appropriate legislative authorities;*

3. *Providing information about the sources, allocation, and uses of financial resources;*

4. *Providing information about how the government or unit financed its activities and met its cash requirements;*

5. *Providing information that is useful in evaluating the government’s or unit’s ability to finance its activities and to meet its liabilities and commitments;*

6. *Providing information about the financial condition of the government or unit and changes in it*

7. *Providing aggregate information useful in evaluating the government’s or unit’s performance in terms of service costs, efficiency and accomplishments.*
3.1.2 Systems

A good accounting system with appropriate mix of financial and physical reporting is basic for ensuring accountability. This was the hallmark of reforms during the post-independent era in the developed countries. However, in India the basic foundation laid by the British still holds good. There are unique features about GAS which has distinguished it from commercial accounting. In India and elsewhere the GAS follows two major features, namely:

i. It is on single entry system, unlike the near universal mercantile practice of Double Entry Accounting System

ii. It follows Cash Basis of Accounting, whereas the commercial systems support Accrual Accounting System.

3.1.3 Standards

GAS in India follows the broad provisions of the Constitution. There is however, provision for flexibility in the form of maintenance of government accounts. Article 150 of the Constitution provides the following in this context:

“For 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”

The form in which the accounts of the Union and the States are to be maintained has been delegated to the Controller General of Accounts (CGA) by a government notification. He has powers for prescribing the “General principles of accounting relating to the Union or State Governments and form of accounts, and to frame or revise rules and manuals thereto.”

**Divisions of Government Accounts:** As per GAR (Rule 23), the Indian Government Accounts are kept in three forms, as given below in table 3.1.

<table>
<thead>
<tr>
<th>Table 3.1 Divisions of Government Accounts</th>
</tr>
</thead>
<tbody>
<tr>
<td>Part I</td>
</tr>
<tr>
<td>Part II</td>
</tr>
<tr>
<td>Part III</td>
</tr>
</tbody>
</table>

Source: ARC 14th Report, P. 29
In USA, there are two bodies namely Federal Accounting Standards Board (FASB) for the Federal Government and Government Accounting Standards Board (GASB) for the rest, which are in charge of Accounting Standards. In the UK, the government is primarily responsible for setting accounting standards. It first adopted Resource Accounting and Budgeting (RAB) system which was followed by the Whole of Government Accounts (WGA) program for providing accruals-based accounting for the entire government. In Australia, standards for Government accounting are decided by the Australian Accounting Standards Board (AASB) established in the year 2000. In Canada such standards are the responsibility of Public Sector Accounting Board (PSAB). New Zealand standards are set by The Accounting Standards Review Board (ASRB), with inputs from by the Financial Reporting Standards Board (FRSB). In India the Government Accounting Standards Advisory Board (GASAB) is entrusted with this task.

3.1.4 Oversight

The Principal Adviser for the government accounting systems is the Controller General of Accounts. He is responsible for developing a sound and robust accounting system. His responsibilities are to prepare critical analysis of expenditures, revenues, borrowings and the deficit for the Finance Minister every month. He also prepares annual Appropriation Accounts and Union Finance Accounts for presentation to the Parliament.

The oversight function is given to the Comptroller & Auditor General of India. His mandate is as under:

“The Comptroller and Auditor General of India (CAG), who is the head of the Supreme Audit Institution of India (SAI) derives his duties and powers mainly from Articles 149 to 151 of the Constitution of India and the Comptroller and Auditor General’s (Duties, Powers and Conditions of Service) Act, 1971. Under the provisions of the Constitution of India and the Act, the CAG is the sole auditor of the accounts of the Central (Union) Government and the State Governments...... The CAG is also responsible for ensuring a uniform policy of accounting and audit in the Government sector as a whole. The Act authorizes the CAG to lay down for the guidance of the Government departments, the general principles of Government accounting and the broad principles in regard to audit of receipts and expenditure.”
3.1.6 Governmental reforms are no longer an option. They have become inevitable. It is essential that governments at all levels are able to discharge their duties in as efficient and cost-effective manner as is possible, (Bouvard, F; Dohrmann, T; Lovegrove, N 2009). Realizing this, governments globally are going overboard with reforms agendas to improve service delivery. Financial pressure and a lack of efficiency have caused the need for several reform processes in German municipalities, (Ridder, H; Bruns, H; Spier, F, 2005). Specific enactments are effected to improve the management of state funds. In the USA, the federal government is accountable for how its agencies and grantees spend hundreds of billions of taxpayer dollars and is responsible for safeguarding those funds against improper payments as well as for recouping those funds when improper payments occur. The Congress enacted the Improper Payments Information Act of 2002 (IPIA) and the Recovery Auditing Act to address these issues, (Williams, McCoy 2007). But the local bodies in USA are in trouble. U.S. states have spent nearly $500bn more than they have collected in taxes, and face a $1tn hole in their pension funds, (Moya E. (2010). Fiscal reforms are needed for fiscal sustainability, (Stephen Howes, Ashok. K. Lahiri, Nicholas Sern, 2003)

3.2 The Indian Systems

The first organized work on public accounting and finances is the *Arthasastra* of Kautilya, Chief Mentor of King Chandragupta Maurya in the pre-Christian era. Written around 320 B.C., during the reign of Chandragupta Maurya, the *Arthasastra* shows clear evidence of an organized accounting and control system practiced during that period. While it is often prescriptive, with a plethora of punishments for various offences of accounting and appropriation flaws, it is remarkable in terms of details. Some important ideas in the area of finance and accounting are worth mentioning, (Kangle, 1997).

**Accounting Year:** According to Kautilya, three hundred and fifty-four days and nights constitute the year of work. The king should fix the duration of the year as ending on the full moon day in the month of *Asadha*. The concept of accounting year is very much relevant in modern accounting principles which Kautilya had envisioned long ago.

**Rendering Accounts:** The account books and balances should come in on the prescribed full moon day in duly sealed containers. The work officers (accountants) should assemble in one place, and no conversation amongst them is allowed. After hearing the totals of income, expenditure and balance, the cash balance is to be taken away to the treasury. Severe penalties for any discrepancy, up to eight times of the differences are prescribed
Delays: Delays are abhorred and punishments are severe if the work officers do not come at the proper time or come without the account-books and the cash balances. Punishment lies in the form of a fine of one-tenth of the amount due. However, when the works officer presents himself, if the accounts officer is not ready for audit, the lowest fine for violence shall be imposed. If it is the other way round, the fine for the works officer is twice as much.

Provisions exist for the format of compiling accounts and treatment of outstanding income. A strong system of managerial controls is a significant feature of this work. A modified system of accrual accounting seems to have been in vogue, which is presumably refined over a period of time. The governance principles were enshrined under the overwhelming concept of dharma and accounting formed a major part of administration under this umbrella.

3.2.1 Government Accounting Structure

Accounting is an execution function and in many countries is vested in the concerned spending agencies of the government. But in India accounting has been separated from the control of the executive who actually decides the plan of action. As a control measure, it is vested in the Audit and Accounts Department, which is headed by the Comptroller and Auditor General (CAG) of India. He is outside the control of any ministry or department, and is an independent officer of the constitution which lays down his terms and conditions of service. The CAG discharges his audit and accounting functions with the help of Accountant-Generals. There is an Accountant-General in all the central Civil Departments (except for Railway Ministry which has its own set up of accounting officers) and one each in the State Government. These Accountant-Generals are responsible for keeping all governments accounts in their own sphere. The general rules and forms are provided for by the CAG of India

3.3. Perception of the Present Condition of GAS- Analysis by Quantitative Approach

That is $\mu_1=\mu_2=\mu_3$, with alternative hypothesis $\mu_1 \neq \mu_j$. A review of the perception of the GAS in its present form based on the questionnaire circulated to the respondents is worth looking into at this stage. (The Questionnaire is given in Annexure A. The detailed statistical analysis is given in Annexure B.)

3.3.1. Hypothesis 1: Null Hypothesis: The perception of present condition of GAS is significantly less than threshold expected condition of GAS with Mean Score of <3 (i.e., $H_0$: $\mu<3$) on a scale of 5. Alternative hypothesis is the Mean Score $\geq 3$ (i.e.,$H_1$: $\mu\geq3$). Table 3.2
gives the summary data of Perception of adequacy and acceptability condition of GAS at present.

<table>
<thead>
<tr>
<th>Mean</th>
<th>Std. Deviation (S&gt;D)</th>
<th>t value</th>
<th>P value</th>
</tr>
</thead>
<tbody>
<tr>
<td>3.40</td>
<td>0.52</td>
<td>12.70</td>
<td>0.00</td>
</tr>
</tbody>
</table>

Source: Primary Data

Since P value is lesser than 0.05, the null hypothesis is rejected at 5% level of significance. Hence the perception of adequacy/acceptability of present condition of GAS is significantly more than expected condition (< 3) of GAS. In other words, the perception about GAS is not that adverse and meets the threshold level.

The accounting systems are perceived to be adequate, but require enhancements. The systems have stood the test of time and are felt to be adequate. It is well understood and is linked to the Government Budgeting System. However, need is felt for accounting data on a more comprehensible fashion. The perception is clearly on the side of dissatisfaction.

### 3.3.2 Hypothesis 2: Null Hypothesis: There is no significant difference between males and females with respect to the perception of Present condition of GAS. That is $\mu_1=\mu_2$, with alternative hypothesis $\mu_1\neq\mu_2$. Relevant data are given in table 3.3.

#### Table 3.3: Perception of Present Condition of GAS - Difference between Males & Females

<table>
<thead>
<tr>
<th>Gender Groups</th>
<th>Mean</th>
<th>SD</th>
<th>t value</th>
<th>P value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Male</td>
<td>3.35</td>
<td>0.52</td>
<td>-1.55</td>
<td>0.12</td>
</tr>
<tr>
<td>Female</td>
<td>3.45</td>
<td>0.52</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Primary Data

Since P value is greater than 0.05, the null hypothesis is accepted at 5% level of significance. Hence there is no significant difference between males and females with respect to the perception of present condition of adequacy/acceptability of GAS in India. The sub-group means sport a small difference only. The issue is not mainly related to gender divisions, but the population as a whole.
3.3.3 Hypothesis 3: Null Hypothesis: There is no significant difference between Age groups with respect to the perception of Present condition of GAS. That is $\mu_1=\mu_2=\mu_3$, with alternative hypothesis $\mu_i \neq \mu_j$. The data are given in table 3.4.

Table 3.4: Perception of Present Condition of GAS - Difference among Age Groups

<table>
<thead>
<tr>
<th>Age Groups</th>
<th>Mean</th>
<th>SD</th>
<th>F value</th>
<th>P value</th>
</tr>
</thead>
<tbody>
<tr>
<td>18-25</td>
<td>3.53</td>
<td>0.31</td>
<td></td>
<td></td>
</tr>
<tr>
<td>26-50</td>
<td>3.36</td>
<td>0.59</td>
<td>6.43</td>
<td>0.00</td>
</tr>
<tr>
<td>Above 50</td>
<td>3.23</td>
<td>0.61</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Primary Data

Since P value is lesser than 0.05, the null hypothesis is rejected at 5% level of significance. Hence there is significant difference between the Age groups with respect to the perception of Present condition of GAS. There is some significant difference between the lower age group (18-25) and the group above 25. There is less variation between the other two (26-50 & above 50) groups. The perception of youth is different from the rest in terms of satisfaction with the GAS.

3.3.4. Hypothesis 4: Null Hypothesis: There is no significant difference between Government and Non-Government employees with respect to the perception of Present condition of GAS. That is $\mu_1=\mu_2$, with alternative hypothesis $\mu_1 \neq \mu_2$. The test data are presented in table 3.5, below.

Table 3.5: Perception of Present Condition of GAS - Difference between Government and Non-Government employees

<table>
<thead>
<tr>
<th>Occupation Groups</th>
<th>Mean</th>
<th>SD</th>
<th>t value</th>
<th>P value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Government Employees</td>
<td>3.43</td>
<td>0.54</td>
<td>0.55</td>
<td>0.59</td>
</tr>
<tr>
<td>Non-Government Employees</td>
<td>3.39</td>
<td>0.52</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Primary Data

Since P value is greater than 0.05, the null hypothesis is accepted at 5% level of significance. Hence there is no significant difference between Government and Non-Government employees with respect to the perception of Present condition of adequacy/acceptability of GAS in India.
The two segments are mutually not exclusive in other attributes, and hence similarities can be acceptable. But there are issues of closeness to the details where the former group is favourably positioned.

A recent report on Asian countries (by Hong Kong-based Political & Economic Risk Consultancy-PERC) has this to say

"They are a power centre in their own right at both the national and state levels, and are extremely resistant to reform that affects them or the way they go about their duties." iv

3.3.5 Present Condition of GAS -Qualitative Analysis

Focus Group and In-depth Interview approaches of research were also adopted as was pointed out in Chapter I under Research Methodology section. Focus Groups involved three sub groups (i) Government Servants, (ii) Private Sector Executives (Finance / Non Finance) and (iii) Prominent citizens. The analysis and results follow. In-depth Interview was held with one-expert well versed in government Accounting and Budgetary exercises.

3.3.5.1 Focus Group I - Government Servants.

This group expressed some positive views about the present condition of GAS, but was in general agreement for enhancement in quality and contents of GAS.

Positive Views of the Present Condition

i. It provides for consistency and comparison between different years which are important canons of accounting.

ii. Since the state does not function on a profit-basis, cash basis is adequate. (This was not a universal opinion. There were some divisions in this score)

iii. GAS has been specifically tuned on to the requirements of the governmental functions and categorically reveals the intentions, outlay and benefits of investment projects/schemes taken up.
iv. Local government staff opined that the accounting data is not too difficult to understand. Some municipalities and corporations have modernized their accounting systems (e.g. Mumbai) under pressure from institutions like World Bank.

**Negative Views of the Present Condition**

i. The group felt that GAS as a device does not have scope to cover cost, rationale and benefits of funding options

ii. There is scope for simplification of the accounting system

iii. The group agreed that the common public may not be able to comprehend the detailed accounts provided by the govt. sector

iv. Outstanding liabilities and prepaid income are not accounted for and this was a defect of the GAS.

The general view was that the accounting systems have stood the test of time and hence have credibility though they are not tuned to modern systems. Opinion was divided on the ability of GAS to easily reveal the financial status of the entity concerned for period under study. While some supported GAS, many felt it was inadequate in the modern context. However, there was overwhelming support to the fact that the current status of GAS needs to be reviewed.

**3.3.5.2 Focus Group II – Private Sector Executives (Finance / Non Finance)**

The views of the group of Private Sector Executives, both from Finance and other functional specializations, are quite critical of the status and sagacity of GAS. These are presented below in summing up statements. From their views the veracity of the need for this research stands established.

i. This group had strong reservations about the present systems of GAS. It felt that GAS has become more a ritual of merely ensuring of procedures than propriety. It is an outdated system meant for the colonial administration

ii. Many advanced countries have shifted to accrual accounting system or at least modified accrual system. India is lagging behind.
iii. The codes have not been backed up by any Accounting Standards for making GAS more effective. It has outdated system of capital and revenue accounting.

iv. GAS suffers from inadequate disclosure of information compared to the commercial accounting. One reason is that there is no focused group (like shareholders in a company) who question the adequacy of disclosure. The general public is too heterogeneous a group to take keen interest. The absence of competition and personal involvement of the stakeholders contribute to the mess.

v. In the annual budget exercise, when the accounts and budgets are presented, the focus is on the budget proposals and taxation issues. Accounts “as such are never debated, and this clearly subverts accountability” said a member.

vi. Following the above issue, the disclosure adequacy of GAS has become very questionable. Auditing is not timely and is more propriety rather than accounting in its orientation. The CAG audit has played a significant role in ensuring that the procedures are followed, but there are no accounting standards or unified systems or modernization programs.

### 3.3.5.3 Focus Group III- Prominent Citizens

i. There was support for reforms to GAS and many members insisted on simplification as a first step. “I have been going through the budgets and accounts religiously for the last twenty years, but can get nothing out of it” said a member.

ii. GAS does not help in true accountability as it is too elaborate.

iii. “Government accounting does not inform the people, but confuse and confound them” observed a member. It is too elaborate and diffused, and is very different from the normal final accounts of a company.

iv. There was pessimism about its relevance too. GAS serves no purpose because pet projects/schemes of vested interests take prominence pushing aside the well conceived, planned ones.

v. GAS cleverly hides incompetence, by being un-comprehendible. No personnel are caught or punished for improper accounting.
3.3.5.4 In-Depth Interview

In-depth interview was a great exposure to the researcher. The GAS has been the accumulated wisdom of several years under different circumstances in various aspects of public accounting. It is basically simple, but certainly is not adequate for the changing needs of a dynamic globalized world. It is true that there is staggering of activities and hence disbursals happen towards year-end. All systems need reforms and government accounting is no exception. Already reforms are underway. The local governments have undertaken major reforms already. It will soon be done at all levels.

3.4 Magnitude of Financial Transactions in Government with Respect to the Government of Tamilnadu

With reference to certain queries in the questionnaire, it is essential to know the magnitude of the governmental financial systems. This highlights the need for a robust accounting system in the various tiers of the state sector. The two constituents of the GAS are the revenue and the capital sides. It is worthwhile looking into the trends in each of them with reference to one state entity namely the government of Tamil Nadu. This gives an orientation into the magnitude of the problem and the need for reforms in the transaction – recording process i.e. the GAS.

3.4.1 Trends in Revenue Receipts

With the rise in the responsibility of the government, the size of operations has gone up substantially. Chart 3.1 shows the trend in revenue receipts in Tamil Nadu.

1. State’s Own revenue (steady increase)
2. Share of central taxes (significant increase)
3. Non-Tax revenue (has dropped in the last two years)
3.4.2 Trend in Revenue Expenditure

There are significant increases in the expenditure side, as shown by Chart 3.2.

1. General services (Significant increase)
2. Economic services (Very significant increase)
3. Social services (Very significant increase)
4. Grants in aid and contributions (Increase except in the penultimate year)
3.4.3 Trends in Capital Expenditure

Except in 2005-2006 and RE 2009-2010, the amounts show an upward trend. It has increased from Rs.1547 crores in 2000-2001 to Rs 12285 crores in 2010-2011. This is almost an 800% jump. Partly this is due to higher than usual inflation rates; but this is a period of significant growth and public spending has been higher.

Chart 3.3: Trends in Capital Expenditure


There is a remarkable increase in all heads of accounting (i.e. Revenue / Expenditure / Capital items). With quantitative growth, fineness and firmness in measurement, scheduling, classification, and control are needed, but conspicuous by their absence in the present GAS.

### 3.5 Reforms in GAS

Reforms in GAS need a careful study of the existing systems of accounting, its rationale and the shortcomings noted in the current systems. The global practices act as a guide, but reforms should be nation specific and address the issues with a long term perspective.

#### 3.5.1 Basis of Accounting

There are two principal methods of keeping accounts in an entity. They are the **accrual basis** and the **cash basis**. The two main systems of accounting are defined by the *Primer On Accrual accounting* of Government Accounting Standards Board (GASAB) established for setting up accounting standards for government entities in India, as under:

##### 3.5.1.1 Accrual Accounting

“Accrual Accounting is a system of accounting in which transactions are entered in the books of accounts, when they become due. The transactions are recognized as soon as a right to receive revenue and/or an obligation to pay a liability is created. The expenses are recognized when the resources are consumed and incomes are booked when they are earned. Therefore, 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.”

##### 3.5.1.2 Cash Accounting

“In the Cash Accounting system of accounting transactions are recorded when there is actual flow of cash. Revenue is recognized only when it is actually received. Expenditure is recognized 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.”
The principal difference between the two systems is that the cash accounting system does not consider non-cash items and ignores pre-paid and outstanding items of revenue and expenditure. The general principles of government accounting as prescribed by the Government Accounting Rules (GAR) have stipulated the cash basis of accounting for all government entities. However commercial undertakings formed under specific Acts of Legislature are not governed by this rule. *With the exception of such book adjustments as may be authorized by these rules or by any general or special orders issued by the Central Government on the advice of the Comptroller and Auditor General of India, the transactions in Government accounts shall represent the actual cash receipts and disbursements during a financial year as distinguished from amounts due to or by the Government during the same period.* \(^{vii}\)

3.5.2 The concept of cash basis is supported by the GASAB in its *Indian Government Accounting Standard 4* titled “General Purpose Financial Statements of Government” which states:

“5. Basis of Accounting

5.1 The accounting shall be on Cash Basis, i.e. the transactions in Government accounts shall represent the actual cash receipts and disbursements during a financial year as distinguished from amounts due to or by the Government during the same period. However, certain book adjustments may be specifically authorized by the Central Government on the advice of the Comptroller and Auditor General of India, as exceptions to the cash basis of accounting.

5.2 The basis of accounting being cash, the depreciation of physical assets and impairment losses are not recognized or expensed. The losses or write-offs of the physical assets at the end of their life are also not recognized or expensed.” \(^{viii}\)

3.5.3 Pre-dominance of Cash basis accounting in GAS

Government Accounting world over has followed the cash basis of accounting, though some countries are switching over to the accrual basis recently. Commercial Accounting has always followed accrual accounting, as it provides a ‘true & fair’ picture of the financial position of the entity concerned.
3.5.4 Rationale for Cash Accounting

“The principles of Commercial and Government Accounting differ in certain essential points. The difference is due to the fact that, while the main function of a commercial concern is to take part in the production, manufacture or inter-change of goods or commodities between different groups or individuals and thereby to make profit, Government is to govern a country and, in connection therewith, to administer the several departments of its activities in the best way possible”ix

3.5.5 Single Entry System in GAS

Besides the cash-basis, the government sector has traditionally followed the “single-entry system” where the dual impact of a transaction is not captured. This denies the benefit-sacrifice philosophy of double-entry system and also misses the primary check on arithmetical accuracy. This basis also does not help in the grouping of assets required for decision-making and performance measurement. In Chart 3.3 the steady growth of capital expenditure has been highlighted, but the present system does not show the break-up of the assets created.

3.6 Problems in GAS

i. Cash based Accounting System prevents analysis of financial position due to lack of structured and scientific information

ii. There is no Balance Sheet and Income & Expenditure Account (no asset / liability and receivables / payables accounting).

iii. Absence of real professionals with understanding of financial aspects is a major issue. State entities do not understand the need for structured accounting information with checks and controls. There is a total lack of training of employees.

iv. Improper approaches to budgeting, huge arrears in accounts and audit (pending for over 5 years) and lack of accounting manual or regulations to guide the accounting process made reforms difficult to achieve.

v. Near total lack of MIS and functional reviews led to lack of data support for decisions. No clear cut computerization plan was objectively designed. Absence of a single and credible database resulted in data getting compiled from various registers and records manually maintained at various offices, often not updated properly.
Table 3.6 Statement of Financial Assets and Liabilities - Government of Tamilnadu (Adapted)

APPENDIX-I

STATEMENT SHOWING FINANCIAL ASSETS AND LIABILITIES OF GOVERNMENT OF TAMILNADU

<table>
<thead>
<tr>
<th>Particulars</th>
<th>31-03-2009 Assets as on 31.03.2009 (In Lakhs of Rupees)</th>
<th>Net Increase (+)/ Decrease (-) expected during 31-03-2010 - 31-03-2011 (In Lakhs of Rupees)</th>
<th>31-03-2010 Assets as on 31.03.2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>A. Loans -</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. Due to Government of India</td>
<td>7,658,81.36</td>
<td>988,09.88</td>
<td>9,38,85.20</td>
</tr>
<tr>
<td>2. Open Market Loans</td>
<td>29,295,44.76</td>
<td>9,215,11.27</td>
<td>35,510,56.03</td>
</tr>
<tr>
<td>3. Compensation and Other Bonds</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4. Loans from Financial Institutions</td>
<td>5,179,19.11</td>
<td>221,55.15</td>
<td>5,698,12.53</td>
</tr>
<tr>
<td>5. Ways and Means Advances from the Reserve Bank of India</td>
<td>0.00</td>
<td></td>
<td></td>
</tr>
<tr>
<td>6. Special Securities issued to National Small Savings Fund</td>
<td>24,675,74.35</td>
<td>-219,02.30</td>
<td>24,596,42.25</td>
</tr>
<tr>
<td>7. Bank Deposits</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2. Other Liabilities -</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>State Provident Fund and Savings</td>
<td>8,048,60.30</td>
<td>1,501,96.00</td>
<td>9,549,56.32</td>
</tr>
<tr>
<td>C. Total - Liabilities</td>
<td>74,857,79.88</td>
<td>11,727,09.90</td>
<td>86,585,89.88</td>
</tr>
</tbody>
</table>

B. ASSETS -

<table>
<thead>
<tr>
<th>Particulars</th>
<th>31-03-2009 Assets as on 31.03.2009</th>
<th>Net Increase (+)/ Decrease (-) expected during 31-03-2010 - 31-03-2011</th>
<th>31-03-2010 Assets as on 31.03.2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Loans to Electricity Board</td>
<td>384,96.26</td>
<td>-43,27.58</td>
<td>268,65.28</td>
</tr>
<tr>
<td>2. Other Loans (Advanced by Government)</td>
<td>7,420.00.06</td>
<td>504,26.08</td>
<td>7,924,30.74</td>
</tr>
<tr>
<td>3. Capital Expenditure</td>
<td>48,947,82.10</td>
<td>12,284,68.90</td>
<td>61,232,50.00</td>
</tr>
<tr>
<td>4. Total - Assets</td>
<td>55,761,86.44</td>
<td>7,040,91.97</td>
<td>72,802,78.41</td>
</tr>
</tbody>
</table>

C. EXCESS OF LIABILITIES OVER ASSETS | 18,096,13.44 | 6,450,42.89 | -1,097,97.04 | 23,448,59.29 |

Source: http://www.tn.gov.in/tnbudget/appen_memorandum/Appendix-I-2010-11.pdf last visited on 1-3-13

Table 3.6 shows financial statement prepared on single-entry cash basis and does not show Fixed Assets category-wise, nor various accrued items. The accrual accounting system, it should be emphasized, has some significant advantages. A comparative analysis will bring out its merits. The differences between Accounting method in cash and accrual basis are highlighted in Table 3.7.
Table 3.7. Cash Basis of Accounting Vs Accrual Basis of Accounting

<table>
<thead>
<tr>
<th>S.No</th>
<th>Cash Basis of Accounting</th>
<th>Accrual Basis of Accounting</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>A statement of Receipts and Payments is prepared, based on actual cash receipts and cash payments recorded in the cash book of a year.</td>
<td>The income and expenditure account is prepared. The income and expenditure account is confined to the year of accounting only and it does not include the items of income and expenditure of past and future years optimizes performance.</td>
</tr>
<tr>
<td>2</td>
<td>There is no distinction between capital and revenue receipts or payments.</td>
<td>There is always distinction between capital and revenue of receipts and payments. The income and expenditure account includes revenue items.</td>
</tr>
<tr>
<td>3</td>
<td>The receipt and payment statement commences with the opening balance – both cash on hand and cash on bank.</td>
<td>Revenue &amp; Expenditure does not commence with any balance. It shall necessarily include all income received or accrued and expenses paid or outstanding in a year;</td>
</tr>
<tr>
<td>4</td>
<td>This statement is not necessarily accompanied by a statement of assets and liabilities.</td>
<td>It accompanied by statements of assets and liabilities.</td>
</tr>
<tr>
<td>5</td>
<td>The difference between the two sides, debit and credit, indicates the cash balance at the end of the period.</td>
<td>The difference between the two sides, debit or credit, indicates the excess income over expenditure or vice-versa or result of operational performance.</td>
</tr>
<tr>
<td>6</td>
<td>Accounting for assets-creation/acquisition, depreciation and written-down value and the like are not taken cognizance of.</td>
<td>Accounting for assets-creation/acquisition, depreciation and written-down value and the like are well recorded and used for right decisions as to repair, replacement, impairment, etc.</td>
</tr>
<tr>
<td>7</td>
<td>Governments and Government entities are not able to provide information as to the value of their assets, while even an individual is capable of the same.</td>
<td>With double entry system on accrual basis every institution is generating a fund of accounting information which helps in measuring their performance threadbare on every significant dimension and domain.</td>
</tr>
<tr>
<td>8</td>
<td>Transparency and Efficiency are difficult to achieve.</td>
<td>Transparency and Efficiency are the hallmark of accrual based double-entry system.</td>
</tr>
</tbody>
</table>

3.7 Need for Reforms
The differences between cash and accrual basis of accounting lead to a number of issues in presenting the true picture of the state of affairs of the government on a given date. This needs to be studied before stepping into the reforms agenda, if any.
3.7.1 Gaps in Cash Basis of Accounting

The cash basis of accounting provides a number of ways to present financial reality differently than it really is. Three of the most common gaps are - understating liabilities, overstating assets and unconsolidated financial statements.

**Accounting for Assets**

The government entities do not keep full records of their assets leading to failure to account for all financial resources available to meet their obligations. The government entities, do not know the position of not only the fixed assets, but even its current assets, in many cases.

**Accounting for Liabilities**

Perhaps the most serious shortcoming of the cash basis of accounting is the fact that it fails to provide the Organization, complete information on all that they owe. The cash basis accounts for transactions when the cash is received or paid. Its main advantage is simplicity. Its main disadvantage is the production and reporting of incomplete financial information. Spending controls can effectively be circumvented by simply deferring payment. But even more troubling is that, under the cash basis of accounting, huge amounts owing by the Organization go unreported and are not taken into account when assessing the entity’s financial position and results, or determining its future revenue requirements.

Entities which are on cash basis, do not have the system to provide for liabilities. Thus the resultant financial disclosure lacks

i. credibility of the accounting data (the *true* position)

ii. transparency in disclosing the correct data (the *fair* position)

As a result the financial figures do not satisfy the doctrine of “true and fair” which is the underlying principle of a sound accounting system.

**Defective Financial Statements**

In governmental basis of accounting the activities considered to be reported are not defined. So the annual statements show only the actual cash receipt and cash paid during the year, rather than the operating result of the corporation and financial status of the corporation. The accounts are largely a reflection of the cash flows. From a cash management point of view, this is adequate, but it fails to meet the requirements of other major financial management aspects. This is a fall out of the archaic governmental basis of accounting.
Lumping of Figures

The broad impact of the above defects leads to lumping of figures which do not assist in getting the right picture. Chart 3.4 shows the growth of revenue receipts and expenditure of government of Tamilnadu over years and the need for a proper accounting system.

Chart 3.4: Trends in Revenue Expenditure and Receipts

Source: http://www.tn.gov.in/tnbudget/fiscalindicators/Trends_inTREandTRR.pdf last visited on 1-3-13
3.7.2 Accrual Accounting – Benefits

The Twelfth Finance Commission (2005-10) of Government of India in its Report sums up the benefits of accrual accounting

“14.15 Compared to the cash-based system, the system of accrual accounting recognizes financial flows at the time economic value is created, transformed, exchanged, transferred or extinguished, whether or not cash is exchanged at that time. It is different from cash based system in that it records flow of resources...... in addition to cash flow, unpaid consumptions (payables) and unrealized income (receivables) is also recorded. Resources acquired but not fully consumed during an accounting period are treated as assets (inventory and fixed assets). Payments made for acquisition of inventory are included in the operating cost for the period in which it is consumed. Payments made for acquisition of physical assets, that have future service potential, are amortized over the entire useful life of the asset by charging depreciation.

14.16 The system of accrual accounting, thus, inter alia, allows better cost – price calculations, records capital use properly, distinguishes between current and capital expenditures, presents a complete picture of debt and other liabilities and focuses policy attention on financial position, as shown in the whole balance sheet not just cash flows or debts. It gives a complete measure of cost of various services, takes care of disinvestment receipts and provides adequate information of both fiscal balance and net worth and their changes over time”

3.8 Reforms in Indian GAS

The Indian GAS has been subjected to reviews and criticisms from the state-sponsored commissions, researchers, consultant firms, multilateral institutions and academics. The most comprehensive coverage is by the various Administrative Reforms Commissions constituted by the Central Government, while others are not documented though well covered by media and in entity-specific reports. It would be of great interest to have a glimpse of major areas of recommendations of the Administrative Reforms Commission on this score. The details are in table 3.8, given below.
Table 3.8: Reports of the Second Administrative Reforms Commission

<table>
<thead>
<tr>
<th>S.No.</th>
<th>Area of Coverage</th>
</tr>
</thead>
<tbody>
<tr>
<td>First Report</td>
<td>Right to Information : Master Key to Governance</td>
</tr>
<tr>
<td>Second Report</td>
<td>Unlocking Human Capital : Entitlements and Governance – Case Study</td>
</tr>
<tr>
<td>Third Report</td>
<td>Crisis Management : From Despair to Hope</td>
</tr>
<tr>
<td>Fourth Report</td>
<td>Ethics in Governance</td>
</tr>
<tr>
<td>Fifth Report</td>
<td>Public Order – Justice for each …. Peace for all</td>
</tr>
<tr>
<td>Sixth Report</td>
<td>Local Governance- An Inspiring Journey into the Future</td>
</tr>
<tr>
<td>Seventh Report</td>
<td>Capacity Building for Conflict Resolution – Friction to Fusion</td>
</tr>
<tr>
<td>Eighth Report</td>
<td>Combating Terrorism – Protecting by Righteousness</td>
</tr>
<tr>
<td>Ninth Report</td>
<td>Social Capital – A Shared Destiny</td>
</tr>
<tr>
<td>Ten Report</td>
<td>Refurbishing of Personnel Administration – Scaling New Heights</td>
</tr>
<tr>
<td>Eleventh Report</td>
<td>Promoting e- Governance – The SMART Way Forward</td>
</tr>
<tr>
<td>Twelfth Report</td>
<td>Citizen Centric Administration – The Heart of Governance</td>
</tr>
<tr>
<td>Thirteenth Report</td>
<td>Organizational Structure of Government of India</td>
</tr>
<tr>
<td>Fourteenth Report</td>
<td>Strengthening Financial Management System</td>
</tr>
<tr>
<td>Fifteenth Report</td>
<td>State and District Administration</td>
</tr>
</tbody>
</table>

The Fourteenth Report contains significant recommendations on accounting and financial areas.

3.8.1 The Second Administrative Reforms Commission (ARC)

ARC has made several recommendations for enhancing the quality of Financial Management in India in its various reports. The Finance Commissions have recommended measures to be taken at different levels to enhance governmental performance in different areas. The 12th Finance Commission recommended the setting up of a Government Accounting Standards Advisory Board (GASAB), which will function as the body in charge of setting up accounting standards for the central and state governments. On the political front, the 73rd and the 74th Constitutional Amendment Acts proved watershed legislations. They empower the Panchayati Raj Institutions (PRIs) and the Urban Local Bodies (ULBs) in respect of various functions such as education, health, rural housing and drinking water by granting wider financial resources.
“Under the Urban Reforms Incentive Fund (URIF) which was launched a few years back, 28 States/Union Territories agreed to adopt the double entry system of accounting. Further, through the National Urban Renewal Mission, the Government requires Local Self Governments to adopt modern, accrual-based double entry system of accounting.”

3.8.2 Government Accounting Standards Advisory Board (GASAB) and Indian Government Accounting Standards (IGASs)

GASAB is the statutory authority for reforms in Indian governmental accounts and was constituted by the Comptroller & Auditor General of India on August 12, 2002 for the Union and States. Its main function is to develop Indian Government Accounting Standards (IGASs)

Its scope, objectives and responsibilities are defined as under:

5. The objective of the GASAB is to formulate standards relating to accounting and financial reporting by the Union, the States and Union Territories with Legislature. The IGASs so formulated by GASAB are recommended to the Government of India for notification in accordance with the provisions of the Constitution.

6. The GASAB shall have, inter alia, the following responsibilities:-

6.1 To establish and improve standard of Government accounting and financial reporting in order to enhance accountability mechanisms;

6.2 To formulate and propose standards that improves the usefulness of financial reports based on the needs of the users;

6.3 To keep the standards current and reflect change in the Governmental environment;

6.4 To provide guidance on implementation of standards;

6.5 To consider significant areas of accounting and financial reporting that can be improved through the standard setting process; and

6.6 To improve the common understanding of the nature and purpose of information contained in the financial reports.

7. While formulating IGASs, the GASAB considers the well-established system of Government accounts in India with underlying accounting concepts and principles. The GASAB also examines relevance of international best practices and gives due consideration while formulating IGASs to inclusion of encouraged disclosures or additional information.”

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3.8.3 National Municipal Accounts Manual (NMAM)

On the technical front, the issuance of the National Municipal Accounts Manual (NMAM) by the Ministry of Urban Development, Government of India, supported by the Comptroller & Auditor General of India has become a tool for accounting reforms. Other institutions like The World Bank, National Institute of Urban Affairs, Indo- USAID FIRE-D Project and the Institute of Chartered Accountants of India have supported accounting reforms ULBs. The ULBs are also increasingly approaching capital markets for raising funds and are forced to reform their accounts. The sub-committee of the Accounting Standards Board of the ICAI has issued a Technical Guide on Accounting and Financial Reporting by Urban Local Bodies. The city corporations in many major metros have gone for some form of accrual accounting already.

3.9 Stages of Introduction of Accrual Basis Of Accounting

The ARC has provided a step-by-step introduction of accrual basis of accounting. Table 3.9 lists the items. The stages are explained in the above report of ARC and presented below.

“6.2.10 GASAB has suggested that Stage 1 depicted in the above Table should be the starting point for introduction of the accrual basis of accounting and accounting reforms should incrementally graduate to Stage V which represents full accrual accounting. It also noted that certain entities within the government like the Railways may straightaway adopt full approval on account of their preparedness and nature of activities. A description of these stages is given below:

Stage I: Accrual-based recognition is introduced in case of current expenses leading to recognition of payables which would be shown as a liability.

Stage II: Accrual-based recognition is introduced in case of non-tax revenues which would lead to recognition of receivables, to be included in assets. This will also include military assets.

Stage III: At this stage, all expenses are recognized on accrual basis and recognition of depreciation is introduced. Further, all financial and physical assets (except for infrastructure, land, heritage and intangibles) and inventories are recognized on accrual basis. Further, disclosure of all explicit contingent liability begins to be made.

Stage IV: At this stage, inclusion of provisions as expense and extension of physical assets to cover infrastructure and land would be on accrual basis.

Stage V: At this stage, all the aspects of Government accounts are based on accrual system of accounting.”
<table>
<thead>
<tr>
<th>Stages</th>
<th>Expenses Exp – current &amp; capital</th>
<th>Revenues Receipts</th>
<th>Assets</th>
<th>Liabilities</th>
<th>Contingent Liabilities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stage I</td>
<td>Current Expense on accrual basis and capital Expenditure on cash basis</td>
<td>Receipts</td>
<td>Financial assets</td>
<td>Stock of Public debt and Borrowing on Public Account + Payables</td>
<td>Guarantees</td>
</tr>
<tr>
<td>Stage II</td>
<td>current Expense on accrual basis and Capital Expenditure on cash basis [excluding Expenditure on Military Assets]</td>
<td>Non Tax Revenues on accrual basis +Tax Revenues on cash basis</td>
<td>Financial assets + Receivables +Military assets</td>
<td>Stock of Public debt and Borrowing on Public Account + Payables + All other Liabilities [except super-annuation benefits, compensated leaves, provisions and social security]</td>
<td>Guarantees</td>
</tr>
<tr>
<td>Stage III</td>
<td>All Expenses on accrual basis + Depreciation</td>
<td>Do</td>
<td>All Assets (excluding infrastructure, land, heritage, intangible assets)</td>
<td>All liabilities (except super annuation benefits, compensated leaves, provisions and security)</td>
<td>All explicit contingent liabilities</td>
</tr>
<tr>
<td>Stage IV</td>
<td>All expenses on accrual basis + Depreciation + Provisions</td>
<td>Do</td>
<td>All assets including infrastructure and land [excluding heritage and intangible]</td>
<td>Do</td>
<td>Do</td>
</tr>
<tr>
<td>Stage V</td>
<td>All Expenses</td>
<td>All Revenues on accrual basis</td>
<td>All Assets</td>
<td>All liabilities</td>
<td>All explicit contingent liabilities</td>
</tr>
</tbody>
</table>

3.10 Railway Accounts

The railways work on a more commercial basis of accounting and record the expenditure incurred or earnings accrued in a month irrespective of whether they have actually been paid or realized. On the expenditure side, the revenue liabilities are charged to a suspense head and the balance at the end of a particular month in this head represents liability incurred but not actually discharged during that month. Similar suspense account is maintained for collections as well. Thus, the Railway Accounts follow a modified accrual system in their accounts.

The *White Paper* on the performance of Indian Railways presented by the railway minister in December 2009 has underscored the need for reforms in the government accounting system for the purposes of transparency and readability from a common man’s point of view. A study by an independent consultant conducted for this purpose showed that “Though there were only two accounting changes during the last five years, these have contributed significantly in increasing the figures of "cash surplus before dividend”….These, together with other factors such as inclusion of interest on fund balances and treatment of Special Railway Safety Fund (SRSF), resulted in the cash surplus before dividend getting inflated by Rs 17,006 crore”. The adjusted figures after providing for VI Central Pay Commission arrears to appropriate years, the Cash and Investible Surplus before Dividend would appear as under in Table 3.10.

**Table 3.10 Cash and Investible Surplus before Dividend of Indian Railways**

<table>
<thead>
<tr>
<th>Surpluses</th>
<th>Earlier figure</th>
<th>After adjustment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cumulative cash surplus before Dividend</td>
<td>Rs 88,669 Crore</td>
<td>Rs 62,364 Crore</td>
</tr>
<tr>
<td>Investible surplus</td>
<td>Rs 66,804 Crore</td>
<td>Rs 43,221 Crore</td>
</tr>
</tbody>
</table>


Such *huge differences* can present a distorted picture of the true position of the Ministry. Governance is based on the principles of transparency, accountability and responsibility. The accounting system is the mirror of the performance of an entity. The stakeholders can get a true picture only if the accounting system is consistent, adopts sophisticated techniques and measures up to global standards. Particularly commercial entities like railways should have a modern focus and robust systems. Conversion to accrual accounting addresses such issues.
3.11 The Urgency for Reforms in India

The Twelfth Finance Commission (2005-10) in its Report sums up the benefits of accrual accounting

“14.16 The system of accrual accounting, thus, inter alia, allows better cost – price calculations, records capital use properly, distinguishes between current and capital expenditures, presents a complete picture of debt and other liabilities and focuses policy attention on financial position, as shown in the whole balance sheet not just cash flows or debts. It gives a complete measure of cost of various services, takes care of disinvestment receipts and provides adequate information of both fiscal balance and net worth and their changes over time.”

3.12 Global Accounting Reforms

Reforms in the GAS have been successfully attempted by several countries. A conceptual understanding of these developments puts the issue in proper perspective, as these countries have been following accounting systems similar to India.

3.12.1 Reforms in the U.K.

The UK Government has embarked upon an ambitious program of central government accounting reform. A consultative Green Paper (Treasury 1994a) in July 1994 was followed by a White Paper in July 1995 (Treasury 1995a). Resource Accounting (RA) involves moving from cash accounting to accruals accounting, aligning government accounting with United Kingdom Generally Accepted Accounting Practice (UK GAAP). (Likierman, A; Heald, D; Georgiou, G; Wright, M. 1995). However, the financial management reforms took roots in the UK in 2001-02 with the full implementation of Resource Accounting and Budgeting (RAB). RAB is an accrual based approach to Government accounting and budgeting, which also reflects Parliamentary control and a move to focus on outputs, rather than inputs. The term “resource accounting” was devised to highlight that the change proposed by the UK Government goes wider than simply the adoption of accrual accounting techniques. Other key aspects are the link between inputs and departmental aims, objectives and outputs. Resource budgeting involves the use of resource accounting information as the basis for planning and controlling public expenditure. Not all countries that have adopted accrual accounting share views on the
merits of accrual budgeting for government, but the UK is one of those which believes that it is better for budgeting and accounting to be determined on the same accrual basis. RAB translates the Government’s policy priorities into departmental strategies and budgets, and then reports to Parliament on the efficiency and effectiveness of the services provided. The overall aim is to enhance government service delivery.

3.12.2 Reforms in the USA

In 1993, the US congress enacted the General Performance Results Act (GPRA) to improve the effectiveness, efficiency and accountability of federal programs, where agencies have to focus on program results. GPRA requires agencies to plan and measure performance using the “program activities” listed in their budget submissions. So it is again performance through program/activities. It has set up the Federal Accounting Standards Board (FASAB) for the federal government, and the Government Accounting Standards Board (GASB) for the state and local governments. GASB has issued about fifty standards and these have been adopted in several Urban Local Bodies. Some local bodies in India have adopted GASB standards with suitable modifications. GASB Chairman Attmore Robert H. (2009) emphasizes the need for the development of the electronic financial reporting.

**Michigan City Policy Benchmark:** The results of reform may be seen from the following abstract from the city of Sterling Heights in the state of Michigan. This city has a double-entry accrual based accounting system and its accounts are duly audited. The *City Policy Benchmark* report in its annual reports shows the current status of various financial policy benchmarks, and is available for all the citizens.

**Urban Local Body Reforms in USA-The City of Sterling Heights:** The research scholar visited The City of Sterling Heights, a city corporation in the Michigan State of the USA. He had a detailed dialogue with the Finance Head, and the relevant details are enclosed. The milestones achieved by the ULB are shown in *Annexure H*, which depict a high degree of governance. Its achievements are comparable to the best of the corporations in the private sector, and provide considerable learning to Indian corporations as well.

3.12.3 New Zealand Reforms

Accounting reforms on a nation-wide scale was successfully pioneered by the New Zealand government by the end of the last century. Its model has been widely quoted by all
researchers in this field. Besides, the central government accounting reforms which are well known, the reforms at local government have been equally dramatic. The introduction in 1998 of a long-term financial planning regime under the Local Government Amendment (No. 3) Act 1996 has been a significant step. (Pallot, 2001)

An analysis of its financial statements bears out this truth. The accounts are certified by no less an authority than the Minister of Finance. This indicates a high level of accountability at the helm, and brings the disclosure practices of public accounts closer to the private (commercial) practices envisaged under various enactments such as The Companies Act 1956 and SEBI regulations (India) or the Sarbanes – Oxley Act (USA). The statements for the year ended 30, June 2009 were certified as under:

“I accept responsibility for the integrity of these financial statements, the information they contain and their compliance with the Public Finance Act 1989. In my opinion, these financial statements fairly reflect the financial position of the Crown as at 30 June 2009 and its operations for the year ended on that date.

-Minister of Finance, 30 September 2009”

The early adoption of accounting standards has helped NZ to be a pioneer in accounting reforms. It is now on a full double-entry, accrual based system, with proper internal controls and external audit in place. The nation-wide Balance Sheet as on 30, June 2009 is given as Annexure -F.

3.13 A Critical Review of Reforms

New types of governance have emerged in modern society. They occur in several forms and are the product of the need to tackle new problems and the wish to reform government. (Nico N. 2002). Accounting reforms are at the threshold of all formats of governance.

Government accounting reforms in industrialized countries become a recognizable component of market-oriented New Public Management reforms. A key dimension is the conversion of accounting from the traditional cash basis to accruals. (Heald; Georgiou, 2000). Several governmental entities have attempted such exercises both in the developing and the developed world. However, the most quoted reforms are from New Zealand. Few countries have undertaken such extensive reform of their public sector, or of their public sector accounting practices as an integral part of those reforms, as New Zealand. (Pallot, J 2001). Financial management best-practice technical assistance program is part of the reform
process among local governments in South Africa (Graves, N; Dollery, B 2009). In Australia, accrual accounting by local governments provides useful information as measured by the ability to predict one-year-ahead operating cash-flows. (Pinnuck, M; Potter, B N 2009)

Other Views on Reforms
There is however a flip side to accounting reforms agenda as well. All reforms are not necessarily successful. Pautz, M.C. (2009) demonstrates how some reforms may actually hinder accountability despite its explicit promises to promote it. Efforts at reform are often marked by poor change management, vague objectives, and unclear accountability (Levy, B 2009). Idiosyncratic adaptation of new standards in municipalities leads to a diversity of outcomes in the implementation process (Ridder, H; Bruns, H; Spier, F, 2005). Christiaens, Johan; Rommel, Jan (2008) feel that accrual accounting in governments will only succeed in businesslike parts of governments. In USA the role of GASB is being questioned. (Foltin, Craig) Recent movements regarding “Service Efforts and Accomplishment” (SEA) and Performance Reporting have stirred debate concerning the necessity and future of GASB. Predisposed aberrations about reforms or the Mental Models decide the approach of the policy makers. The problems faced in the transition procedures from cash towards accrual basis accounting for developing countries stated in International Public Sector Accounting Standards (IPSAS) Board established by International Federation of Accountants are also under scrutiny (Hughes, Jesse W. 2007)

The emerging picture is not too rosy. A Governmental GAAP Update (2009) outlines several financial reporting deficiencies found in the annual reports of state and local governments, as identified by the Government Finance Officers Association (GFOA) Certificate of Excellence in Financial Reporting program in the U.S. These include the failure to include losses on capital asset impairments, and the failure to properly distinguish blended component units from discretely presented component units in the financial statement presentation.

3.14 Need for Reforms in GAS-Analysis by Quantitative Approach

While reforms to GAS has been seen as a global phenomenon, and has gained momentum in several developing countries, it has its share of criticism as well. In this context, the primary data based on this study may be reviewed in the context of reforms to GAS. The detailed statistical analysis is given in Annexure C).
3.14.1 Hypothesis 5

Null Hypothesis: The perception of reforms needed in GAS is significantly less than or equal to the threshold level of need for Reforms in GAS, with Mean Score ≤ 3 (i.e., \( H_0: \mu \leq 3 \)) on a scale of 5. Alternative hypothesis is Mean Score > 3, (i.e.,\( H_1: \mu > 3 \)), depicting pressing need for reforms. The relevant test data are given in table 3.11.

Table 3.11: Perception of Reforms Needed in GAS vis-à-vis the Expected Need

<table>
<thead>
<tr>
<th>Mean</th>
<th>SD</th>
<th>t value</th>
<th>P value</th>
</tr>
</thead>
<tbody>
<tr>
<td>3.87</td>
<td>0.60</td>
<td>24.03</td>
<td>0.00</td>
</tr>
</tbody>
</table>

Source: Primary Data

Since P value is lesser than 0.05, the null hypothesis is rejected at 5% level of significance. Hence the perception of need for Reforms of GAS is significantly higher than the expected condition (≤ 3) of Reforms in GAS.

This perception is closely related to the views of the respondents on the current status of reforms, where there was dissatisfaction with the GAS in its present form. This is further to be corroborated with the qualitative analysis. But reforms have to be beneficial to all stakeholders and cannot be decorative. The reforms shall ensure to get the basics right (Malcolm Holmes 2003).

3.14.2 Hypothesis 6

Null Hypothesis: There is no significant difference between males and females with respect to the perception of Reforms needed in GAS. That is \( \mu_1 = \mu_2 \), with alternative hypothesis \( \mu_1 \neq \mu_2 \). The relevant test data are given in table 3.12.

Table 3.12: Perception of Reforms Needed in GAS-Difference between Males and Females

<table>
<thead>
<tr>
<th>Gender Groups</th>
<th>Mean</th>
<th>SD</th>
<th>t value</th>
<th>P value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Male</td>
<td>3.82</td>
<td>0.64</td>
<td>-1.62</td>
<td>0.11</td>
</tr>
<tr>
<td>Female</td>
<td>3.93</td>
<td>0.56</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Primary Data
Since P value is greater than 0.05, the null hypothesis is accepted at 5% level of significance. Hence there is no significant difference between males and females with respect to the perception of Reforms needed in GAS.

3.14.3 Hypothesis 7

**Null Hypothesis:** There is significant difference between Age groups with respect to the perception of Reforms needed in GAS. That is $\mu_1=\mu_2=\mu_3$, with alternative hypothesis $\mu_i \neq \mu_j$.

The relevant test data are provided in table 3.13.

<table>
<thead>
<tr>
<th>Age Groups (Years)</th>
<th>Mean</th>
<th>SD</th>
<th>F value</th>
<th>P value</th>
</tr>
</thead>
<tbody>
<tr>
<td>18-25</td>
<td>3.78</td>
<td>0.44</td>
<td>3.14</td>
<td>0.05</td>
</tr>
<tr>
<td>26-50</td>
<td>3.97</td>
<td>0.70</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Above 50</td>
<td>3.81</td>
<td>0.58</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Primary Data

Since P value is 0.05, the null hypothesis is rejected at 5% level of significance. Hence there is significant difference between the Age groups with respect to the perception of Reforms needed in GAS. The middle age group wants more reforms than other two groups, because they are not only informed but also concerned. The elder group is informed, but perhaps feel status-quo is fine or nothing can be done in present conditions. The younger group perhaps is yet not aware of the contexts and contours.

3.14.4 Hypothesis 8

**Null Hypothesis:** There is no significant difference between Government and Non-Government employees with respect to the perception of Reforms needed in GAS. That is $\mu_1=\mu_2$, with alternative hypothesis $\mu_1 \neq \mu_2$. The relevant test data are provided in table 3.14 below.

| Table 3.14 Perception of Reforms Needed in GAS–Difference between Government and Non-Government Employees |
|--------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------|

Since P value is 0.05, the null hypothesis is rejected at 5% level of significance. Hence there is significant difference between government and non-government employees with respect to the perception of Reforms needed in GAS. The middle group wants more reforms than other two groups, because they are not only informed but also concerned. The elder group is informed, but perhaps feel status-quo is fine or nothing can be done in present conditions. The younger group perhaps is yet not aware of the contexts and contours.
<table>
<thead>
<tr>
<th>Occupation Groups</th>
<th>Mean</th>
<th>SD</th>
<th>t value</th>
<th>P value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Government Employees</td>
<td>3.81</td>
<td>0.56</td>
<td>-1.06</td>
<td>0.29</td>
</tr>
<tr>
<td>Non-Govt. Employees</td>
<td>3.89</td>
<td>0.62</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Primary Data

Since P value is greater than 0.05, the null hypothesis is accepted at 5% level of significance. Hence there is no significant difference between Government and Non-Government employees with respect to the perception of Reforms needed in GAS. However, non-Government employees feel a marginally higher need for reforms.

In India there is a significant isolation of government accounting from commercial accounting. This denies spreading of information on global growth of accounting information. Government employees can play a significant role in making reforms. In USA the Fund Balance measures are well-established as recommended by the Government Finance Officers Association (GFOA). (Kimmersley, R. L.; Craig S.D. 2008). The system can be improved with proper inputs. The criticism is not upon bureaucrats *per se* but on the constitution of bureaucracy. (Osborne. D. and Gaebler. T. 1993). The human capability is high in India. Reforms are tough initially, but the benefits are huge. If transaction time in handling cases is brought down to 10% of the present duration, there will be a dramatic increase in the velocity of business transactions (Vittal N. 2003)

**3.15.2 Need for Reforms in GAS –Analysis by Qualitative Approach**

Focus Group and In-depth Interview approaches of research were adopted as before.

**3.15.2.1 Focus Group I - Government Servants.**

The group had agreement on the following:

i. There is a need for improving contents of GAS on the lines of accrual accounting

ii. There is need for overhauling the entire system of GAS starting with the heads of accounts, their classification and statements prepared, preferably on accrual accounting lines

iii. Asset valuation is not a priority in the current context
iv. Reforms should be preceded by adequate training

v. There was overwhelming support to the fact that there is great scope for reforms to GAS but the process has to be gradual

3.15.2.2 Focus Group II – Private Sector executives (Finance / Non Finance)

There was strong support for urgent reforms to GAS on the following aspects

i. **Reforms in clarity:** The current systems are too complicated and even professional accountants do not get a clear picture. Hence GAS must be simplified. This is the first issue to be addressed

ii. **Reforms in Audit:** There is a need for reforms in GAS (in the auditing part) for incorporating the issue of measuring the propriety aspects in a more pronounced form to ensure public money is well used

iii. **Reforms in quality:** GAS is better changed to reveal the value of assets, liabilities and capital as at any point of time, which is not the case now

Overall, there was overwhelming support for wholesome reforms on a priority basis.

3.15.2.3 Focus Group III- Prominent citizens

The opinions were somewhat similar to Focus Group II, but some cynicism was patent in this group. There were serious doubts as to whether governments are keen on reforms “which are not popular measures which get converted into votes” said an elderly journalist. However, consensus was apparent that GAS is better patterned on accrual accounting as followed by commercial undertakings, because the principles of accrual accounting emphatically fit with Government activities also

Frequency of reporting was also discussed. GAS should better be changed to provide Quarterly or at least Semi-annual accounts, instead providing accounts only annually

3.15.2.4 In -Depth Interview

Globally there are several reforms happening in the government sector. Accounting systems are undergoing qualitative changes. There is a growing awareness that GAS needs to reveal physical achievement along with financial aspect involved to ensure conformance. Accrual accounting has been adopted in some form in some advanced countries. New Zealand is a
forerunner in this field. USA, UK and Canada are other countries that have made reforms. Cash Basis is outmoded and is yielding place to moderate accrual accounting in many areas. But preparing a Balance Sheet will take some time. Reporting should be on shorter periodicity unlike the present annual basis. GAS is better changed to reveal the income, expenditure and surplus/deficit of any particular period in the accrual format.

3.16 Current Status of Reforms in India

While supporting the shift to accrual accounting, a note of caution is sounded by all the authorities.

3.16.1 ARC’s Recommendations

The ARC which has been supportive of the accrual-basis of accounting has however taken a cautious approach to it. The following excerpts from the report of ARC is worthy of consideration. “The change over to the accrual based system of accounting will place considerable demands on the accounting personnel…” It is in favour of a change over in the medium term, but in the short term is recommends of some additional information to be appended to the present cash system such as subsidies given, and details of salaries and pensions.

3.16.2 The 13th Finance Commission

Para 13.9 of the 13th Finance Commission discusses adoption of accrual accounting at length. “The Second Administrative Reforms Commission (SARC) in its Fourteenth Report appraised the issue of accrual accounting and recommended that a task force be set up to examine the costs and benefits to the system as well as its applicability in the case of appropriation accounts and finance accounts. The report also underlines the need for training and capacity building; ensuring alignment of the plan, budget and accounts; as well as putting in place a viable financial system of accounts. The Ministry of Finance, in its presentation to the Commission, urged that the changeover to accrual accounting be managed with care and circumspection, given that the process is resource and time intensive, and that its benefits have not been unambiguously proven by international experience. We are satisfied that the issue is receiving close attention from the relevant authorities, and that extant actions by the Central, State and Local Governments are facilitating a ‘bubble up’ approach to the transition.”
3.17 Accounting Reforms and Governance

There is a close relationship between reforms and good governance. The reforms involve a complicated change management process and adjustments in work culture. In U.K. there are criticisms of reforms and everything is not rosy. In the proposals for Resource Accounting and Budgeting, issues concerning consolidation are proving both important and troublesome. (Heald, ; Georgiou, 2000). However, on the whole, the reforms provide reasons for expecting benefits in terms of more efficient government and enhanced public accountability. (Likierman, A; Heald, D; Georgiou, G; Wright, M.1995). It is estimated that a 15% increase in productivity by the U.S. federal government would yield taxpayer an annual savings of $134 billion. (Bouvard, F; Dohrmann, T; Lovegrove, N 2009).

The passage of Sarbanes-Oxley Act and the creation of the Public Company Accounting Oversight Board assist reforms under the rubric of New Public Management that are intended to promote accountability. (Pautz, M.C.and Washington, C.P. 2009). However, good governance cannot be achieved merely by superficial reforms. It is often seen that while governments excel at collecting data, they often fail to make effective use of it in the decision-making process. (Levy, Alastair, 2009). There is also need for a strong action from the citizens. Public demand is a must for achieving the good governance tripod (transparency – accountability – responsibility). But, the demand factor is often subdued and hence pressure on the supply side for quality enhancements is reduced. Particularly, it is seen that there is lower level of demand for high-quality accrual-based financial reports from the government entities. (Pinnuck, Matt; Potter, Bradley N 2009).

The accounting frauds witnessed in recent years both in the public and private sectors make reforms inevitable. In a world where profit making and the accumulation of wealth is celebrated and rewarded, where it is the “bottom line” that finally matters, unless circumstances lead to the detection of fraud or a violation of the law, an increase in the wealth is normally seen as a virtue and a reflection of “entrepreneurship” and “innovation.” The practice of reacting after a scam should yield place to proactive reforms.

As the mid-term appraisal of the current plan points out, many of the tougher reforms are still pending. Accrual accounting is one such area. The real impact of even the completed reforms on the ground is sometimes unclear. There is a clear need to improve the capacity of governments to undertake these reforms. (Ramachandran, M. 2010)
3.18 Sum-up

There has been a strong support for shifting to the accrual accounting system in the government sector, from all studies and the recommendations of professional bodies / committees all over the world. The primary data – both qualitative and quantitative – reveals strong support for such reforms in India as well.

Certain other views on related issues of GAS need to be looked into. Attmore, R. H. (2009) suggests that communication between key information can be improved by using brief summary-level reports of government’s finances. The present system based on antiquated Colonial accounting concepts seemingly has outlived its utility. International Public Sector Accounting Standards (IPSAS) Board has come out with some user-friendly models which are worth emulating.

Hughes, Jesse W (2007) discusses the transition procedures from cash towards accrual basis accounting for developing countries as per International Public Sector Accounting Standards (IPSAS) Board established by International Federation of Accountants. This process obviously involves issues beyond mere book-keeping. The accounting reforms have a deeper significance. It raises questions not just about accounts, but about accountability and determines these issues through public scrutiny. (Sharma A. 2010). Apparently the enormity of the scale is not lost upon the controlling authorities in India. Hence while the transition at local body levels is easier, it is more complicated at national levels. Particularly it is likely to be slower in a country of India’s size and complexity. The phased approach recommended by ARC and the 13th Finance Commission provides a platform to scale up the conversion process.

END NOTES

1. “Article 150 in the Constitution of India 1949”  http://www.indiankanoon.org/doc/1244239/ P 1 Last Visited on 12-3-2021

2. As per Notification No. cD-896/80 dated 27th September, 1980, this function was prescribed by incorporating entry 7A (i) in the Government of India (Allocation of Business) Rules (for Department of Expenditure under the heading Ministry of Finance.

3. Para 1.1 http://www.cag.gov.in/html/auditing_standards_ch1.htm (no page number available) Last visited on 11-3-2013

5. Primer on Accrual Accounting GASAB Secretariat, O/o the Comptroller and Auditor general of India, 10, Bahadur Shah Zafar Marg, New Delhi-110002 http://gasab.gov.in/pdf/Primer151107.pdf p 1 - Last visited on 11-3-2013

6. Primer on Accrual Accounting GASAB Secretariat, O/o the Comptroller and Auditor general of India, 10, Bahadur Shah Zafar Marg, New Delhi-110002 http://gasab.gov.in/pdf/Primer151107.pdf- p 1 Last visited on 11-3-2013


