

## **Accrual Accounting & Budgeting in Government**

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- Present system of accounting
- Accrual Accounting
- Accrual budgeting
- Advantages and relationship with ongoing reform efforts
- Results of Pilot studies in States
- Road ahead

# Present System of Accounting

## ➤ Cash basis

- Accounting on cash basis
- Transactions accounted for only when cash is received or paid within the reporting period

## ➤ Advantages

- Budget and legislative compliance
- Focus on cash management
- Relatively simple

# Present System of Accounting: Cash basis

- Limitations of cash basis
  - Non-accountal of expenditure already incurred but payment not made
  - Non-accountal of revenue earned but cash not received
  - Incomplete or partial asset accounting
  - Incomplete liability accounting as it excludes current & pension liability
  - Areas of concern – depreciation & outstanding revenue and expenses
- Not True and Fair View

# Accrual basis Accounting system

- Basis of accounting shifts from cash to accrual
- Method of book keeping shifts from single entry to double entry
- A transaction is accounted for not when cash is received or payment is made but when it is earned and when incurred

# Accrual basis Accounting system: Examples

- Tax assessed but not received will be accounted for unlike in cash system
- Licence fee / royalty due but not received
- Bills raised but not paid
- Liabilities accrued but not paid

# Accrual basis Accounting system: Examples

- Revenue and expenses are accounted for in a comprehensive manner
- Information on cash as well as non-cash transactions
- Assets and liabilities are reflected adequately
  - Short term and long term
  - Pensionary liability
  - Depreciation cost

# Form of Accounts

- Article 150 of the Constitution of India, reads

*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*

- Form of Accounts includes...

- Division & structure of accounts

- Classification of transactions

- Basis of accounting

- Format of financial reporting

- Principles of recognition, measurement, classification and disclosure

- We are at present following cash basis since GAR21 /GFR68 provides for cash basis

# Accrual Basis of Accounting: Reporting

- **Statement of Operating Performance**
  - Financial performance
- **Statement of Asset and Liabilities**
  - Financial position
- **Cash Flow Statement**
  - Operating, financing and investing activities
  - Receipts and Payments

# Twin positive features

- Help executive in assessment of
  - **financial performance,**
    - recognition of transactions comprehensively including depreciation
  - **financial position**
    - Complete record of assets and liability

# Financial performance

- Impact of transactions where cash has not been received or paid
  - Information relating to both cash flow as well non cash flow transactions
  - Full information on expenses helps in knowing
    - Cost consequences of policies and comparison with alternative policies
    - Calculation of subsidy

# Financial position

- Comprehensive information on current stock of assets and liabilities
  - Financial decisions seen not merely from the point of view of cash outgo or inflow but
    - their impact on the asset- liability position of the Government
    - Future sustainability of programmes
    - Future funding requirements of asset maintenance and replacement
    - Plan for repayment of liabilities

# Why government cannot readily adopt commercial model?

- Nature and purpose of transactions from accounting perspective
  - Not for profit motive
  - Social, regional, national commitments
  - Public goods like national defence, law and order, natural and environmental protection
  - Budgetary requirements and parliamentary sanction
  - Non-exchange transactions -sovereign right to tax

# Present system of budgeting

- Annual Financial Statements – A constitutional responsibility under Article 112 & 202
- Annual Financial Statement, a statement of estimated receipts and expenditure of the Government of India, laid before Parliament in respect of every financial year.
- Shows receipts and payments of Government
- Revenue Budget consists of the revenue receipts of Government (tax revenues and other revenues) and the expenditure (or rather payments) met from these revenues
- Capital Budget consists of capital receipts and payments

# Accrual Budgeting

- A full set of forecast financial statements, including assumptions used in preparing those statements
- Formal budget appropriations (cash) to be consistent or linked with forecast financial statements
- In accrual budgeting, estimates would reflect the complete liability based on expenditure for the year
  - Ideally, the difference should be minimal
- Similarly in case of receivables, the entire revenue relating to the year is accounted in accrual budget and not merely the amount collected /collectible

# Accrual Budgeting

- Shifts budgeting from cash flows (money received and payments made) to revenues earned and liabilities incurred
- The accrual basis would align budgeting and financial reporting: both would be on the same accounting basis

# Is accrual Accrual budgeting a pre-condition for Accrual Accounting

- No. It is feasible to report in terms of accruals and to budget on a cash basis
- Many governments report finances (ex post) in the accrual basis: few governments budget (ex ante) on the accrual basis
- Australia and New Zealand - integrated financial management and accounting reforms agenda including budgeting
- Canada – Accrual Accounting with cash budgeting
- USA and Spain – Modified Accrual accounting and cash budgeting

# Accrual Budgeting

- If budgeting were continued on the cash basis, financial reports would be analytic tools
- If budgeting were shifted to the accruals, accounting principles would become decision rules in budgeting
- Financial reports are subject to audit; budgets are not

# Accrual Budgeting

- Full benefits of accrual accounting can be gained only when it goes hand in hand with accrual accounting
- In public sector accounting cannot be divorced from budgeting
- On going initiatives with regard to Asset Registers (GFRs & Budget speech)
- Ideally when we migrate to accrual accounting, accrual budgeting should also follow

# Accrual Accounting: Some disclaimers

- **Accrual Accounting in Government:**
  - **Is not a Private Sector Accounting**
    - Uses certain commercial principles to meet its own objectives
  - **Is a means or a tool for decision making and not an end**
  - **Provides more comprehensive, accurate and reliable financial information**
  - **Is not entirely novel**
  - **Is to be adapted to the requirements of**
    - Social policy and commitments of government
    - Public goods
    - Budgetary requirements
    - Government as going concern

# Government's Decision

- Recommendation of the Twelfth Finance Commission
- Government of India has accepted in principle to migrate to accrual basis accounting
- 20 States agreed in principle
  - Pilot projects in progress

# Efforts in the direction

- **All State Government's FA include additional information recommended by Twelfth Finance Commission while migration to accrual accounting takes place - Salaries expenditure; pension; subsidies; Debt repayment schedule; Financial Assets etc**
- **A Roadmap and an operational framework developed and issued to government**
- **Seminar-cum-works conducted in 14 states**
- **Task force are constituted and pilots are initiated in the States, the important ones being in MP, AP, Haryana and Gujarat**

# Pilot Study in Madhya Pradesh

- **Pilot in Public Works Division (Vidisha) with IPAI as consultant**
- **Statement of Assets and Liabilities and Statement of Income and Expenditure prepared**
- **Value of land at the average minimum rate of non-irrigated land prevailing in Vidisha district**
  - **Only acquired land may be included in FS?**
- **Assets classified into land, buildings, assets of historic and artistic value, roads, bridges and culverts, Plant & Machinery and Furniture and Fixtures**
- **Depreciation rates decided and adopted**
- **Inventory can included from Priced Stores Ledger**
- **Percentage charges, Rent of buildings and amount recoverable from suppliers for rejected material taken as Sundry Debtors**

# Pilot Study in Madhya Pradesh

- **Miscellaneous Public Works Advance, Motor Cycle Advances, Grain Advance, advances to contractors etc taken as loans and advances**
- **Assets created under BOT, BOOT and BOLT – timing of asset recognition to be decided**
- **Pension liabilities to be disclosed on actuarial basis**
- **Deposit works, Interest bearing security etc taken as liabilities**
- **Accrued other liabilities towards outstanding electricity charges, telephone charges, salaries and allowances taken as Current liability**
- **Difficulties in ascertaining compensation payable for land acquired by government**
- **[Financial statements of Vidisha division](#)**

# Pilot Study in Andhra Pradesh

- **District model of accrual accounting in Mahboobnagar**
- **Pilots in Transport, Roads and Buildings and Tribal Welfare departments**
- **Existing GO on Assets registers – information available in some sub-units in detail**
- **Pilot worked on development of input for line item on ‘Assets’ in financial statements**
- **Covered Non-financial Assets, Financial assets, Capital work-in progress etc**
- **Inventories details available in Roads and Building department**
- **Receivable – not recorded in the absence of existing recognition principle – work continuing on the subject**

# Lessons learned from the pilot studies

- Values for assets are available in many cases from the existing records (Public works division and revenue division)
- Heritage assets can be valued at a nominal value
- Fixed assets registers are available in some departments in sufficient details
- In offices where general standards of book keeping and accounting is good, accrual based information can be easily developed
- Entity needs to be defined as Government of India, State Government or departments / DDO

# Lessons learned from the pilot studies

- Depreciation rates similar to commercial accounting
- Values of only acquired property should preferably be included in the financial statements
- Threshold needs to be defined for accruing expenses and revenues
- The unit of accrual should be the DDO
- At the entity level information moving from lower levels should be merely consolidated. For example, for accruing indirect taxes for the entire state, the principles can be laid down generally and there should be no discretion at the entity level to modify the amount

# Lessons learned from the pilot studies

- A robust IT system connecting all the DDOs, Treasuries, AsG and the departments may be necessary
- The pilot projects are best executed with the support of a consultant
- Training the officers and staff with accrual / government accounting background

# Public Sector Financial Reporting framework

- Need for changes in Indian Government GAAP (GAR, LMMH, CAM, ACAG etc)
- Possible alignment of national standards with accrual IPSAS or direct adoption of IPSAS with local requirements taken care of through implementation guides and additional specialized standards
- Policies and rules to be designed for specific departments / units and notify them
- Opening Balance Sheet of key importance

# Plans ahead

- Based on the pilot studies, GASAB is developing the Version 1.0 of the financial statements formats
- GASAB is working on a comprehensive migration manual to facilitate entity level implementation
- Comptroller and Auditor General of India plans to convene a National Workshop of all the stakeholders with the support of Ministry of Finance to brainstorm based on the pilot studies and develop principles of recognition and accounting for under accrual accounting in India
- GASAB is embarking on development of Accrual based accounting standards along with cash basis standards

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