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PILOT STUDY FOR FUTURE MIGRATION TO ACCRUAL ACCOUNTING SYSTEM IN GOVERNMENTS IN INDIA

PILOT STUDY
ON

"RAJA RAMDEV PODDAR GOVERNMENT SENIOR SECONDARY SCHOOL" JAIPUR (RAJASTHAN)

CONDUCTED BY

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Pilot Study for introduction of accrual system of accounting in Rajasthan

Introduction

Public financial management has evolved significantly in recent years. In the last couple of decades many countries have reviewed the way their governments function, manage their resources and disclose their operations. Issues like operational efficiency, effectiveness of the delivery system, cost of service delivery, ability to support welfare programs, good governance, etc., have been actively debated and considered. The financial, budgetary, accounting and management systems have seen many changes and experimentation. Responding to these dynamics, many countries have shifted to the accrual based accounting systems, fully or partly or with some variation.

The Twelfth Finance Commission, recognizing the need for improvements in accounting and financial reporting, recommended a gradual shift to accrual accounting by the Union Government, i.e. transition from existing cash based accounting to accrual based accounting. The Central Government has accepted the recommendation in principle. In its explanatory memorandum as to the Action Taken on the recommendation of the TFC, Finance Minister had stated that the Government Accounting Standards Advisory Board (GASAB) in the Office of the Comptroller and Auditor General of India would recommend an operational framework and detailed road map for its implementation.

Apart from the Central Government, so far eighteen State Governments have accepted the idea of accrual accounting in principle. Rajasthan is one of them apart from Andhra Pradesh, Assam, Bihar, Chhattishgarh, Goa, Gujarat, Himachal Pradesh, Karnataka, Madhya Pradesh, Maharashtra, Manipur, Meghalaya, Sikkim, Tripura, Uttaranchal, Uttar Pradesh and West Bengal.

For the pilot study, a government school- Raja Ramdev Poddar Govt. Sr. Secondary School, Jaipur, was selected in consultation with State Govt. This is a very prestigious institution functioning since 1963 in a building constructed by the PWD, on a land donated by the trustees. Presently 97 officials (including teaching and departmental staff) are working at the institution and 750 (approx.) students are studying in various classes (IX to XII). As this school is one of the several Sr. Secondary Schools working under the Department of Education, Govt of Rajasthan, its working is more or less similar to others and therefore the annual financial statement prepared and prescribed for this school can be adopted in all other schools of similar nature.

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Scope and objective of pilot study

This unit was selected as a precursor to the introduction of accrual system of accounting to identify the various types of accounting information, i.e. expenses, incomes, assets, liabilities and other information capable of inclusion in the annual financial statement. The primary objective of the study was to assess the feasibility of migrating from the present system to the accrual system in the five phases as prescribed in the operational framework of Accrual Basis of Accounting in Governments in India issued by GASAB. It aimed at analyzing the present accounting system and the means to convert the present financial information maintained in single entry system on cash basis into the double entry system based on accrual accounting. The process was expected to highlight various items of financial information, where conversion from the present system would pose a number of operational and processing difficulties. The study is restricted to identifying and highlighting such issues ab initio and prescribing the process for the migration to the accrual system.

Findings of pilot study

The findings of pilot study are discussed in detail in the following paragraphs.

Unit of Financial statement

The various types of records/books/information maintained were studied in detail, along with objectives of their maintenance and extent of their utility in proposed system of accrual accounting. Our suggestions/comments to change or improve the process of compilation of information, etc. are given in the Annexure 'C' and 'D' of this pilot study.

During the study, it was noticed that various records/information maintained by the units are not adequate for the preparation of annual financial statements. The system of records maintenance is in the nature of subsidiary records in support of bills passed by the treasury for the payment of salary, other expenses in the form of routine expenses as well as scholarships to students, etc. The unit maintains cash book recording receipts from the treasury, their disbursement and balance in the form of undisbursed amount at any point of time.

The unit recovers various types of fees, i.e. tuition fees, admission fees, TC charges, library receipts and miscellaneous receipts and these are deposited in the nominated Bank in the Govt accounts and recorded on receipt as well as payment side of cash book which are ultimately reflected in the books of treasury in respective heads. The unit also recovers science fees, boy fund fees, scout receipts, etc. from the students, which are recorded in cash book as local fund account and used for the purpose for which these are recovered. Further receipts relating to development fees, computer fees, etc. are recorded in the cash book of school

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development fund and used for development activity as well as general expenses on maintenance, etc. The accounts of this fund, i.e. receipt and payment, income & expenditure and balance sheet, are separately prepared for this fund and audited by the Chartered Accountant.

Conclusion

Thus, the unit is not preparing any financial statement at present even on cash basis system in respect of activities other than development fund. The present set of system, records and information is not adequate for the preparation of annual financial statement even on cash basis and therefore does not have required system, procedures, infrastructure (adequate records and information, accounting system) and resources (trained manpower in accrual accounting) for adopting accrual accounting, which is discussed in detail in the succeeding paragraphs.

Suggestion/recommendation

The first and foremost requirement for adopting the accrual system of accounting at this level is to declare the unit as a separate accounting unit and place the responsibility of preparing and maintaining accounts independently as a branch of education department of Govt or smaller set up of education department, as in the case of Branch accounts of any company/organization in commercial accounts. These independent branch accounts can then be consolidated to prepare consolidated accounts for the education department. The fulfillment of this requirement is to be accepted in principle before any meaningful step is taken towards introduction of accrual system of accounting.

The second issue relates to aligning the working of treasury with the proposed system of accrual basis. This may require adopting the system of pay & accounts officers for each department as prevalent in the central side.

Review of income items

During the study, it was noticed that the unit had operational incomes in the form of various types of fees for imparting education to beneficiaries, i.e. students, as brought out above. This income is collected for the session, which commences from July each year to June next year, while the financial year is from April to March. This results in lack of matching for income and expenses and on accrual basis of accounting, necessary adjustment for accounting of fees for nine months in one year and three months in next year, is required to be done. Alternatively, the education session can also be changed as commencing from April each year and ending in next March so as to be coterminous with the financial year; in such case whole fees for the relating year can be accounted for without any adjustment. However, provision for income that is not received, or income that is received in advance, has to be done. Further, there are certain fees that are received for specific purpose, i.e. science fees, computer fees, etc. that needs to be spent on those issues only. To ensure this, separate accounting within the system can be devised to know how much is the specific fees received and what amount is spent on this purpose in a transparent manner.

It was noticed that the unit does not have any other income as interest on investment in the form of bank deposits for deployment of temporary surplus funds, if any, in any of the specific fund or general surplus. However, if any unit is authorized and has such interest income, the income generated from general surplus can be treated as other income and income from specific fund can be added to the specific fund as the case may be. The unit also allows its operational facilities for use by other institutions for conducting exams, while no charges are recovered presently for this. However, in future if any charges for these facilities are recovered, the same can be accounted for as other income of the unit.

Review of expenses and liabilities items

During the study, it was noticed that in respect of various expenses such as salary, various allowances, travelling expenses, library books, laboratory equipments, stationery, telephone expenses, repair & maintenance, tournament expenses, computer teaching expenses, sweeper and cleanliness charges, etc., there is no concept of capital and revenue expenditure at present. All types of expenses are accounted on cash basis, implying at the time of payment irrespective of when the services or equipments or material had been received, i.e. without matching concept as required in accrual accounting. It is necessary that provision for expenses, which had been incurred, or benefit of such expenses had been received but the payment for the same had not been made, should figure in the accounts. Similarly, if any advance had been extended for expenses, and the benefit or services against such advance is not received, it should not be shown as expenses but as advance under the assets. The unit is required to frame procedure and records to generate such information for accounts purpose. As per operational framework, the provision for liability for revenue expenditure should be made in the first phase, while the process can be carried forward to capital expenditure as well in the second phase. It was noticed that this is possible and feasible, once proper records and infrastructure are created for generating such information.

Depreciation, an expense item as diminution in value of assets, can be accounted by finalizing the format of assets register, prescribing the useful life of assets and depreciation charges, as required in the third phase of accrual accounting.

Retirement benefits in the form of gratuity, leave encashment, pension and other benefits, etc. are also recorded in the Govt accounts on cash basis without any linkage to the period that they relate to. While adopting the new system, the provision for these benefits would have to be made each year on accrual basis. These benefits would have to be assessed up to the date of shifting to the system of accrual basis by adopting actuarial valuation and every year thereafter for making

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suitable provisions. This would be one of the largest liabilities for the Govt. to account in its books. It was noticed that as per operational framework, this must be done by the fifth phase. In this connection, on review of relevant information and infrastructure, it was felt that this exercise would not be possible and feasible at the unit level and Govt would be required to conduct this exercise for the whole set up, department wise, and account for these liabilities in the consolidated accounts of the department instead of at the unit level. However, efforts had been made to work out extent of accrued liability in respect of leave encashment of the unit and include it in the accounts finalized for the unit on accrual basis. This issue would have to be addressed at the highest level considering the intricacies of working out the liability and extent of liability. The Govt would also require professional assistance from the actuary experts on this issue. Further, there would be a need to streamline the linkages as regards GPF, insurance, etc. between the accounting units and directorates maintaining these accounts at state level.

Review of assets items

During the study, various types of assets used in the unit had been identified- land & building, furniture & fixtures, laboratory equipments, library books, games equipment and also other types of equipments, etc. It was noticed that the unit does not have adequate information relating to date of acquisition, value of acquisitions, and extent of useful life, etc. However, while preparing the financial statement, the valuation given by the head of office of the unit had been taken. The level of records in this area needs to be improved before accrual accounting is adopted. The format of assets register must also be prescribed, whose status is discussed below.

Assets Register

The unit maintains a register of items, mainly of capital nature (assets mentioned in the preceding paragraph). This register is a quantity record as there is no concept of assets register and no need to provide depreciation in the present set up. There is need to establish the system of distinction between capital and revenue expenditure and also to prescribe reasonable limits for capitalizing the assets in the assets register to provide depreciation over the useful life of assets. To record assets with the reasonable value for exercising proper control, monetary limits must be prescribed for capitalization of assets based on group as is prevailing in commercial organizations.

Review of other relevant and important information

During the study, efforts were made to extract other relevant information, i.e. contingent liabilities, guarantees, court cases, capital contracts remaining to be executed, insurance and risk management policy and measures, etc. It was noticed that there were no such cases and information on these was nil. However, proper system and records for generating above information must be prescribed.

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Preparation of unit accounts on accrual basis

To achieve the objectives of the pilot study, opening balance sheet as on 1-04-2007 as well as annual financial statement for the year 2007-08 in the form of Receipt and Payment Account, Income and Expenditure Account for the year and Balance Sheet as on 31-03-2008 had been prepared along with the notes to the accounts. The write up on this exercise along with the above-mentioned accounts are given in the Annexure ‘A’.

Feasibility of migrating to Accrual system of Accounting

As discussed in the preceding paragraphs, the **migration from cash basis of accounting to Accrual basis of accounting may be feasible in stages as prescribed in the operational framework of accrual basis of accounting**. The pattern of maintenance of various records on commercial basis (double entry system) requires major changes from the present pattern. Besides, maintenance of Asset Register and Liability Register is a must for accrual basis of accounting for which instructions from the State level authority is required. The current treasury system has to be changed as well.

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ANNEXURE 'A'

WRITE-UP ON ACCRUAL ACCOUNTING

Introduction

Raja Ramdev Poddar Government Senior Secondary School, Jaipur, is a very prestigious institution, which is functioning since 1963 in a building constructed by PWD, Government of Rajasthan, on a land donated by the trustees. The trustees made a payment of Rs.1.50 lakh in February 1956 for the construction of the building. At present 97 officials (including teaching and ministerial staff) are working in the institution and around 750 students are studying in various classes (Class IX to XII).

Special features of Financial Books of Accounts

The institution is maintaining the following four cash books: -

1) **Government Cash Book:** In this cash book, the funds provided by Government of Rajasthan are accounted for. The receipts of tuition fee, admission fee, library fee, etc. received from students are recorded which are subsequently deposited in Government Accounts. Further, the pay & allowances of the staff drawn from treasury and office contingencies are also recorded here.

2) **Scholarship Cash Book:** This Cash Book also records the funds provided by Government of Rajasthan. The scholarship received from Government under various schemes, viz. Panna Dhay Jeewan Amrit Yojna, Mada Yojna scholarship for SC and ST students, etc. and its disbursement are recorded in it. A separate bank account is maintained for this and the interest earned on undisbursed scholarship is credited in the Government account. The undisbursed scholarship pending for a considerable time is refunded to the Government account.

3) **Local Fund Cash Book:** The funds under this cash book are provided from the receipt of students' fee, science fee, etc. collected from the students and scout grants and grants for training camps for military orientation received from Government. A review of the cash book revealed that the office expenses such as (i) water and electricity charges (ii) expenditure on training (iii) stationery and printing (iv) store articles (v) sport activities and (vi) expenditure on examination, are met from this fund with the permission/approval of a seven member committee inter alia representative of students, teachers, guardians, local MLA, etc. administering the fund. A separate Bank Account is maintained for the transactions made from this fund. This fund is kept out of the Government Accounts.

4) **Development Fund Cash Book:** The funds under this cash book are the receipts of computer fees and school development fees realized from students. The expenditure is incurred on (i) maintenance of buildings (ii)

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gardens (iii) cleanliness (iv) telephone expenses (v) Annual functions (vi) purchase of books, furniture, office equipments, water cooler, etc. .A separate Bank Account is maintained for the transactions made from this fund. This fund is kept out of the Government Accounts.

Financial Statement for 2007-08

Based on the data recorded in the cash books and various information collected from the records of the institution, the following financial statements have been prepared (Annexure 'B'): -

A. (1) Receipt and Payment Account of Government Cash Book (including Scholarship Cash Book) for 2007-08- Annexure B I (i)

(2) Income and Expenditure Account for 2007-08- Annexure B I (ii)

(3) Balance Sheet as on 31.3.07 (for opening balance)- Annexure B I (iii)

(4) Balance Sheet as on 31.3.08- Annexure B I (iv)

B. (1) Receipt and Payment Account of Local Fund Cash Book for 2007-08- Annexure B II (i)

(2) Income and Expenditure Account for 2007-08- Annexure B II (ii)

(3) Balance Sheet as on 31.3.07 (for opening balance)- Annexure B II (iii)

(4) Balance Sheet as on 31.3.08- Annexure B II (iv)

C. (1) Receipt and Payment Account of Development Fund Cash Book for 2007-08- Annexure B III (i)

(2) Income and Expenditure Account for the year 2007-08- Annexure B III (ii)

(3) Balance Sheet as on 31.3.07 (for opening balance)- Annexure B III (iii)

(4) Balance Sheet as on 31.3.08- Annexure B III (iv)

Since the institution maintains all the above Cash Books and expenditure is incurred by the institution from all the above funds, as such a Consolidated Balance of the institution at the close of 2006-07 (for opening balance) and at the close of 2007-08 has also been prepared. (Annexure B IV (i) & (ii))

Sources and uses of cash (Receipt and Payment Account)

The Receipt and Payment Accounts show the sources of funds and its utilization during the accounting period. The receipt side accounts for (i) opening cash balances, and (ii) revenue received on actual basis. The payment side accounts for payments actually made (cash or cheque) and the closing balance of Cash/Bank. Receipt and Payment Account for the year 2007-08 has been made accordingly.

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Statement of Financial Performance

Income & Expenditure Account

The Income and Expenditure Account of Government Account (including scholarship fund), Local Fund and Development Fund for the year 2007-08 have been prepared separately on accrual basis. The difference between income and expenditure has been shown as excess of expenditure over income or excess of income over expenditure, as the case may be.

Deductions from Salary

The bills for salary and allowances are preferred to Treasury Officers for gross amount; the net amount of the bills is paid to the institution and recoveries of GPF, LIC loans & advances, etc. are transferred directly to the concerned department, which is maintaining the said account. As such, the net amount of salaries & allowances has been accounted for in Receipt & Payment Account through cash book and the gross amount of salary & allowances has been shown in Income & Expenditure Account on accrual basis.

The recoveries of State Insurance, GPF etc. have been shown as deposits on liability side in the Balance Sheet, since Director PF & Director State Insurance maintains these Accounts and release the final payments on retirement.

Recovery of Advance in respect of Personal loans to Government servants has been shown on the asset side as deduction from outstanding amount of loan/interest. The deduction of LIC, income tax, etc. made from the salaries and allowances are shown as credits of respective Department by the Treasury Officers for their onward transmission to respective Department since these are centralized at state level. As such these deductions have been shown as liability in the Balance Sheet and on the income side of Income & Expenditure Account as these are not long-term liabilities.

Financial Position

Balance Sheet as on 31.03.2008: To ascertain the opening balance of items of Balance Sheet as on 31.3.2008, the balance sheet for the period ending 31.3.2007 has been prepared for Government transactions, Development fund and Local fund. However, a consolidated balance sheet for the institution has also been prepared as the transactions made under all the four cash books pertain to the institution itself.

Cash Flow Statement: The cash flow statement for the year 2007-08 has been prepared taking into consideration the cash transactions for the year, including various cash books maintained by the institution. Separate Cash Flow Statements for Government Fund, Local Fund and Development Fund have also been prepared. A consolidated cash flow statement for the year 2007-08 has been prepared on the basis of the three cash books. (Annexure B-V (i) (ii) (iii) & (iv))

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Contingent liabilities: No case of contingent liability for guarantees, pending court cases or capital contracts for which the institution is contingently liable has been noticed up to the year 2007-08.

Notes on Accounts

1) The financial statements have been prepared on accrual basis except in respect of liability towards retirement benefits on retirement/death of the employees as these are centralized at State level.
2) Provisions have been made for all known liabilities.
3) Provision for accumulated leave encashment benefits to the employees as accrued has been made on the assumption that employees are entitled to receive the benefit at the time of retirement.
4) Land and Building (costing Rs. 1.50 lakh) was donated by Trustees; as such token value of Rs.1 has been taken in the Balance Sheet.
5) The valuation of petty items has been taken into account as intimated by the Principal.
6) No Depreciation has been charged on the assets, as it has to be decided at State level.
7) Serviceable assets physically available have been included in the Balance Sheet.
8) Pending write off sanction of the unserviceable articles, these have been taken as assets.
9) The library books received from 1969-70 to 2007-08 and physically available have been valued at cost and taken as assets.
10) All assets acquired from Development fund and Local fund have been taken into account as assets since the ownership of these assets vests with the institution.
11) The balancing figures of assets and liabilities have been taken as Capital Fund in the Balance Sheet.
12) Accumulated excess expenditure over receipt has been taken as minus capital fund in liability side of the Balance Sheet.