



सत्यमेव जयते

Comptroller and Auditor General of India

Operational Guidelines for Accrual based Financial Reporting in Government

21 June 2011



Foreword

In recent times, there has been a paradigm shift in the priorities of Public Finance Management from identifying resources for public scheme funding to fiscal prudence, efficiency & transparency in public spending. These shifts in priorities have been reflected in initiatives like the Fiscal Responsibility & Budget Management Act and Outcome Budget. There is a need for Financial Reporting to be in sync with the shift in priorities of Public Finance. To achieve this, accounting systems the world over, are being revisited with an emphasis on transition from rule to standards based accounting and migration from cash to accrual based system of accounting. We cannot afford to be left behind in this transition process. Hence the need to be more proactive.

In response to this, the Government of India established the Government Accounting Standards Advisory Board (GASAB) in 2002 under the Comptroller and Auditor General of India to suggest reforms in the Government cash accounting system. Later, the 12th Finance Commission had recommended transition to accrual accounting for the Union and the State Governments. These recommendations were accepted by the Central Government in principle. The 13th Finance Commission also expressed its satisfaction with the attention accorded to the issue of transition to accrual accounting by the relevant authorities, and the extant actions taken by the Central, State and local governments facilitating a 'bubble up' approach. Under such an approach, local bodies (and within local bodies – large municipal bodies and Panchayati Raj institutions) would adopt accrual accounting first, given that the National Municipal Accounting Manual which incorporates the principles of accrual accounting stage has already been prepared under the aegis of the CAG.

Since the principles of accrual accounting being followed in commercial entities cannot be transposed in their entirety in Government accounting, GASAB was entrusted with preparation of a "Roadmap for Accrual Accounting" and "Operational Framework". To facilitate this transition, this one day Conference on "Accrual based Financial Reporting in Government" being inaugurated by the Union Finance Minister, Shri Pranab Mukherjee, with

participation from Finance Ministers from states and all other key stakeholders, is a step forward in building consensus on providing guidelines which will help all stakeholders in moving towards better financial reporting through accrual accounting. In fact, this conference is in response to the need expressed by some of the states for training and guidance in this migration process.

I would look forward to active participation from all the participants present here today to flag issues to be addressed to make the process of transition smooth. I am sure that the seeds which we are sowing today will bear fruit in setting up a robust modern accounting system that will promote better financial reporting in government for the use and understanding of the common man.

I congratulate GASAB Secretariat for issuing these operational guidelines which will be a good resource for the executive to facilitate this whole transition.

I wish the conference all success.

New Delhi
June 21, 2011

(Vinod Rai)
Comptroller and Auditor General of India

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Operational Guidelines for Accrual based Financial Reporting in Government

Background

Under Article 150 of the Constitution of India, accounts of the Union, States and the Union Territories are kept in the form as prescribed by the President on the advice of the Comptroller and Auditor General of India. At present, the transactions in the Government accounts represent the actual cash receipts and disbursements during the financial year as distinguished from amounts due to or from government during the same period. Government accounts are thus maintained on cash basis.

Public financial management has evolved significantly in recent years. There is a shift the world over in the manner in which Governments are approaching the important business of annual stewardship reporting through accounts. Rule based accounting systems are giving way to standard based accounting and financial reporting. In the last few years the following developments have taken place.



The Twelfth Finance Commission (TFC) recommended in 2004

- A move by the Government towards introduction of accrual basis of accounting.
- Standardization of accounting classification up to the object head level for all States to improve fiscal management.
- Additional eight statements relating to subsidies, expenditure on salaries, expenditure on pensions, committed liabilities, maintenance expenditure, segregation of salary and non-salary portions and liabilities and repayment schedule on outstanding debts.
- The definition of revenue and fiscal deficits be standardized

- The Government accepted these recommendations and entrusted the Government Accounting Standards Advisory Board (GASAB) in the Office of the Comptroller and Auditor General of India to steer the accounting reforms.

The Thirteenth Finance Commission recommended in 2009

- The transition from cash to accrual accounting.
- Advocated a cautious approach towards changeover to accrual accounting considering that it was resource and time intensive.

The 14th report of the Second Administrative Reforms Commission in 2009, recommended

- A task force should be set up to examine the costs and benefits of introducing the accrual system of accounting. The Task Force should also examine its applicability in case of the Appropriation Accounts and Finance Accounts.
- Initially, a few departments/ Organizations may be identified where tangible benefits could be shown to be derived within 2-3 years by implementing the accrual system of accounting, especially departmental 'commercial undertakings'.
- The result of this initial implementation may be studied by a committee of experts which would recommend on its further implementation in all departments/ organizations at the Union/State level along with exclusions, if any. This may proceed in a phased manner.
- Prior to its implementation, training and capacity building needs of the accounting personnel and all stake holders in the decision making process would have to be addressed and a meticulous schedule worked out in line with the road map of implementation.
- Before the new system is adopted, alignment of the Plan, budget and accounts, needs to be achieved and a viable financial information system needs to be put in place.

Government Accounting Standards Advisory Board (GASAB)

- Prepared the Operational Framework and Road Map in 2007 detailing various stages for transition from the existing cash based accounting to accrual based accounting.
- These documents provided guidance for pilot studies undertaken in select ministries and departments of Union and the State Governments.

Outcome of pilot studies

- Response of stakeholders was positive and encouraging.
- Requests from many States to organize training modules.
- Flagged limitations of cash accounting.
- The need for operational guidelines was stressed.



Lessons learnt from pilot studies

■ Strengthen the existing accounting framework prescribed in

- Fiscal Responsibility & Budget Management Act 2003 (FRBM)
- General Financial Rules (GFR) , 2005
- Government Accounting Rules (GAR), 1990

■ Maintenance and inclusion of important returns / statements and registers prescribed by government in main accounts.

- Asset Registers category wise (GFR 190 and Form D 4 as per FRBM Rules, 2004)
- Losses due to depreciation (GFR 202)
- Payables: Liability registers (GFR 53) from the month of October each year to capture payables
- Receivables : Non-tax revenue raised but not realized (Form D 1 as per FRBM Rules, 2004 and Tax revenue raised but not realized and Form D 2 as per the FRBM Rules, 2004)

■ Improving quality of maintenance of primary records at the operational level and consolidation at Drawing and Disbursing Officer (DDO) level

- Prioritizing the data collection exercise relating to existing assets
- Commissioning a physical verification and valuation of assets.

■ Identification of Chief Accounting Authority in accordance with GFR 64 who shall

- Be responsible and accountable for financial management of his Ministry or Department
- Ensure that the public funds appropriated to the Ministry or Department are used for the purpose for which they were meant.
- Be responsible for the effective, efficient, economical and transparent use of the resources of the Ministry or Department in achieving the stated project objectives of that Ministry or Department, whilst complying with performance standards.
- Appear before the Committee on Public Accounts and any other Parliamentary Committee for examination.
- Review and monitor regularly the performance of the programmes and projects assigned to his Ministry to determine whether stated objectives are achieved.

- Be responsible for preparation of expenditure and other statements relating to his Ministry or Department as required by regulations, guidelines or directives issued by Ministry of Finance.
 - Shall ensure that his Ministry or Department maintains full and proper records of financial transactions and adopts systems and procedures that will at all times afford internal controls.
 - Shall ensure that his Ministry or Department follows the Government procurement procedure for execution of works, as well as for procurement of services and supplies, and implements it in a fair, equitable, transparent, competitive and cost-effective manner;
 - Shall take effective and appropriate steps to ensure his Ministry or Department
 - i) Collects all moneys due to the Government and
 - ii) Avoids unauthorized, irregular and wasteful expenditure
- **Inclusion of Management and Discussion Analysis report** signed by the Chief Accounting Authority on the statements relating to the General Purpose Financial Reporting (GPFR)
 - **Identified the need for a robust accounting system for a**
 - An integrated financial management information system for seamless transition to accrual
 - Need for revision in Chart of Accounts including accrual heads, in keeping with information requirements for better and informed decision making by the Government, at the Centre and State, by a committee constituted for the purpose
 - **Capacity building**
 - A task force be set up to oversee the accounting reforms
 - Regular training be imparted to staff identified for the process of change
 - **Information Technology Reforms**
 - **The reformed accounting would need strong information systems with an IT backbone.**
 - An Enterprise Resource Planning (ERP) system like SAP may be required to capture each transaction instantly at the Drawing and Disbursing Officer (DDO) level.

- Mandatory inclusion of accrual heads in any major up gradation in the accounting system in near future by the Government
- The mission mode project of Treasury Computerization involving 626 districts at a cost of ₹ Rs. 626 crores must address the accounting needs for the transition.

■ Identification of the Reporting Entity

- Critical for reporting purpose to define the entities included
- Government departments/ units whose budgets are approved by the legislature
- Various parastatals which are controlled by the government
- Special Purpose Vehicles which receive funds outside the State budget and create assets and obligations for the State
- Centrally sponsored flagship schemes which are being implemented through State government machineries/NGOs but creating assets for the States.

The Guidelines

The Operational Framework provides the overall architecture of the accounting model. These guidelines aim at laying down the principles for recognition and measurement for General Purpose Financial Reporting (GPFR).

Objectives of General Purpose Financial Reporting

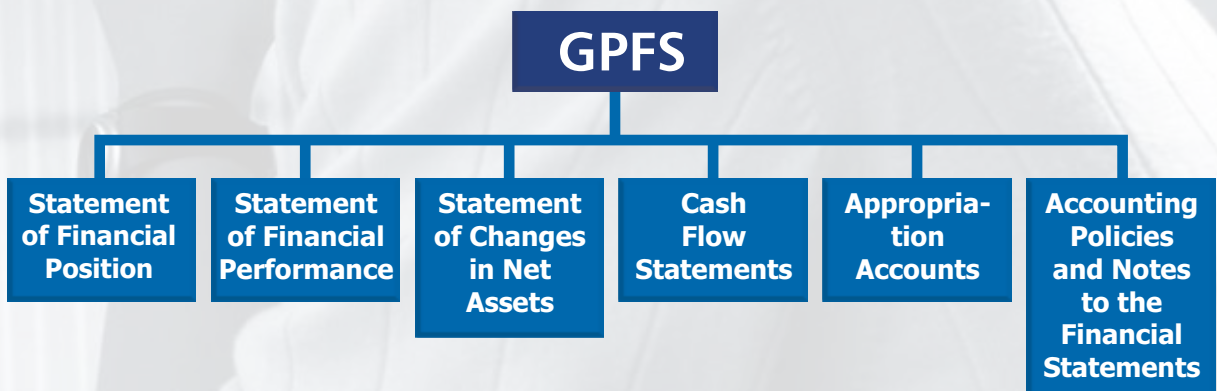
- Provide financial information about the reporting entity which would be useful in making decisions about providing resources to the entity and in assessing whether the government has made efficient and effective use of the resources.
- Make financial reporting more transparent.
- Improve understandability of financial statement by users.
- Make financial statements more relevant.
- Improve performance reporting in keeping with Results Framework Document (RFD)

Components of GPFR

$$\text{GPFS} + \text{MDA} = \text{GPFR}$$

GPFS : **General Purpose Financial Statements**

The conceptual framework of International Public Sector Accounting Standards (IPSAS) 1 on General Purpose Financial Statements (GPFS) provides guidance for the structure and minimum requirement for the contents of financial statements prepared under accrual basis of accounting. The complete set of financial statements, keeping in view the requirement as prescribed by the Government of India, may include the following statements:



MDA : **Management and Discussion Analysis**

- A management report commenting on financial statements highlighting key performance indicators
- To be signed by the Chief Accounting Authority as prescribed in GFR 64

For a complete set of General Purpose Financial Reporting (GPFR), Management Discussion and Analysis report is essential.

Statement of Financial Position

The Statement of Financial Position exhibits the balance of assets and liabilities as on a particular date. The assets and liabilities may be further classified into current and non current categories. Statement of Financial Position must include the following:

- 1) **Assets** – This should include all physical and financial assets, cash and cash equivalents, investment, inventories, receivables from exchange and non exchange transactions, capital work in progress.
- 2) **Liabilities** – This should include all debts and borrowings of the government, payables, benefits payables to employees.

The progressive total of capital expenditure available in Finance Accounts should reconcile with lump sum figure in the Statement of Financial Position after making adjustment for valuation of historical assets.

Statement of Financial Performance

The Statement of Financial Performance exhibits the revenue and expenses for an accounting period and the excess/deficit of revenue over expenses. The Statement of Financial Performance must include the following:

- 1) **Revenue from exchange transactions**
- 2) **Revenue from non exchange transactions**
- 3) **Expenditure by function and nature.**
- 4) **Surplus/Deficit**
- 5) **Appropriation to earmarked funds**
- 6) **Cost of borrowings**

Statement of Changes in Net Assets

The Statement of Changes in Net Assets represents the changes between two reporting dates reflecting the increase or decrease in its net assets during the period.

Cash Flow Statements

The Cash Flow Statement should provide cash flows during the period classifying them into operating, investing and financing activities.

1. Cash flows from operating activities are primarily derived from the principal cash-generating activities. This includes cash receipts from taxes, from non-tax revenues, cash payments to suppliers/contractors, grants in aid received or given.
2. Cash flows from investing activities are derived from acquisition and disposal of long term assets and other investments not included in cash equivalents. This includes cash payments to acquire or construct property, cash advances and loans made, etc.
3. Cash flow from financing activities represents the changes in the size and composition of the contributed capital and borrowings.

Appropriation Accounts

As part of GPFS, Appropriation Accounts would continue to reflect

1. Comparison of budget with actual
2. Original with final budget
3. Detailed reason for variations of actual with final budget

Accounting Policies and Notes to the Financial Statements

1. Accounting policies, rules and practices applied by an entity in preparing and presenting financial statements be stated
2. Use of reasonable estimates and valuation methods for assets and liabilities be stated
3. Stages and period of transition be stated

Various stages of Operational Framework highlight maintenance and recognition of Assets and Liabilities, recognition principles for Current Expenses and Receipts new head 'Payables', Revenue receipts and new head 'Receivables'.

The focus of these operational guidelines is to analyze the changes that are required in the process of reporting of Accounts and other allied statements from cash based to an accrual based accounting system.

Assets

1. The first step towards accrual based accounting system is categorization of assets into distinct group eg. Land, buildings, bridges, roads etc.
2. All assets acquired through capital outlay are to be valued.
3. Assets acquired through revenue outlay, materiality should determine whether the asset needs to be expensed or accounted for in the asset register. The threshold for materiality may be differing from one entity to the other.
4. The materiality threshold should pre determined at an apex level before implementing the new system.
5. Recognition and measurement of assets is required to be done on historical cost basis.
6. Wherever, historical cost is not available or feasible, these may be valued on replacement cost basis (where the information on the replacement value and residual value of the asset is easily ascertainable).
7. In case it is not possible to ascertain the above, these assets may be valued at a nominal value to be determined through an accepted process.
8. Heritage assets too should be valued at nominal price.
9. Assets prospectively acquired after the date of implementation of the new system should be valued on historical cost basis.

Note: However, the basis on which assets have been valued may be categorically mentioned in the Notes to Accounts.

Provision for depreciation

1. Provision of depreciation should be made by allocating the value of assets category wise.
2. Capital assets may be depreciated over their estimated useful lives unless they are either inexhaustible or infrastructure assets.

3. The provision should be estimated on a realistic basis and only revised where justified in the light of further experience.
4. The provision of depreciation should be made each year and put away in a sinking fund.
5. As is the accepted principle, land is not depreciated.

Liabilities

1. The first step towards accrual based accounting system is identification and categorization of liabilities into distinct groups eg. short term, long term and contingent liabilities.
2. Guarantees should be disclosed in accordance with Indian Government Accounting Standard (IGAS 1) on 'Guarantees given by Governments: a disclosure requirement' notified by Government of India in December 2010.
3. Accounting and classification of Grants-in-Aid should be disclosed in accordance with Indian Government Accounting Standard (IGAS 2) notified by Government in May 2011.
4. Liabilities of the Government including Stock of Public Debt and Borrowings on Public Account and Liabilities on account of superannuation benefits, compensated leave, provisions and social security are to be provided for on accrual basis.
5. Recognition of expenses relating to superannuation benefits, compensated leaves, provisions and social security may be taken after actuarial valuation.
6. Contingent liabilities other than guarantees, Claims made by third parties against the Government should also be disclosed.

Recognition of all expenses and payables

Recognition of all expenses on accrual basis would lead to recognition of payables, which will be shown as a liability.

The following table shows the accounting treatment and measurement to be followed in case of common expenses.

Item of Expenditure	Realisation Criterion	Measurement	Recommended basis of accounting (Accrual)
Salaries, Wages, Dearness Allowance, Travelling Allowance, office expenses, etc.	Obligation established in the period of utilisation of service	Agreed amount	Full cost should be charged to the accounts of the relevant period e.g.' within the period in which the employees work. Material amounts earned but unpaid at the end of the period should be accrued and placed under the head payables.
Interest	Obligation established at the time of entering into the loan agreement	Multiple of loan value, period, and rate of interest	Liability to be recognized periodically on the due date for payment. Expense recognition to be in the period for which it is charged under the head payable, regardless of when the payment is made.
Contribution to PF and defined contribution to Superannuation Funds	Obligation established when an employee enters service	Agreed amount	To be accounted on accrual basis
Gratuity and Superannuation liabilities	Obligation established when the employee enters service	To be determined on the basis of actuarial valuation	To be accounted to the extent of contribution made to recognized funds – accrual basis
Leave encashment benefit	Obligation established when the employee enters service	To be determined based on service rules	To be accounted when it is due - accrual basis (except when leave encashment is permitted within the reporting period)

Recognition of revenues and receivables

Recognition of all revenue on accrual basis would lead to recognition of receivables, to be included in assets.

The following table shows the accounting treatment and measurement to be followed in case of common expenses.

Item of Expenditure	Realisation Criterion	Measurement	Recommended basis of accounting (Accrual)
Rents	Right to charge rent established at the time of entering into agreement, realisable on the due date for payment of rent	Agreed amount	To be accounted for in the accounting period to which it is realisable – Accrual basis. If rent becomes overdue, income should be recognised and a provision should be made. For example, if more than two rental installments are not received, a provision should be made for the same and shown as receivable. This will help in internal control purposes.
Hire charges of machinery	Right established at the time of entering the contract	Agreed amount	To be accrued and accounted for in the accounting period to which it relates – accrual basis
Interest	Realisable on the due dates for the interest payment	Function of loan value, period and rate of interest	Interest income to be accounted on accrual basis on the due dates. If interest becomes overdue, income should be recognised and provided for.

Note: Revenue from Taxes, stamps and registration, at this stage, is recommended on cash basis for a conservative approach so as not to inflate revenue.

The Way Forward

■ 1st Phase: (2011-12 to 2012-13)

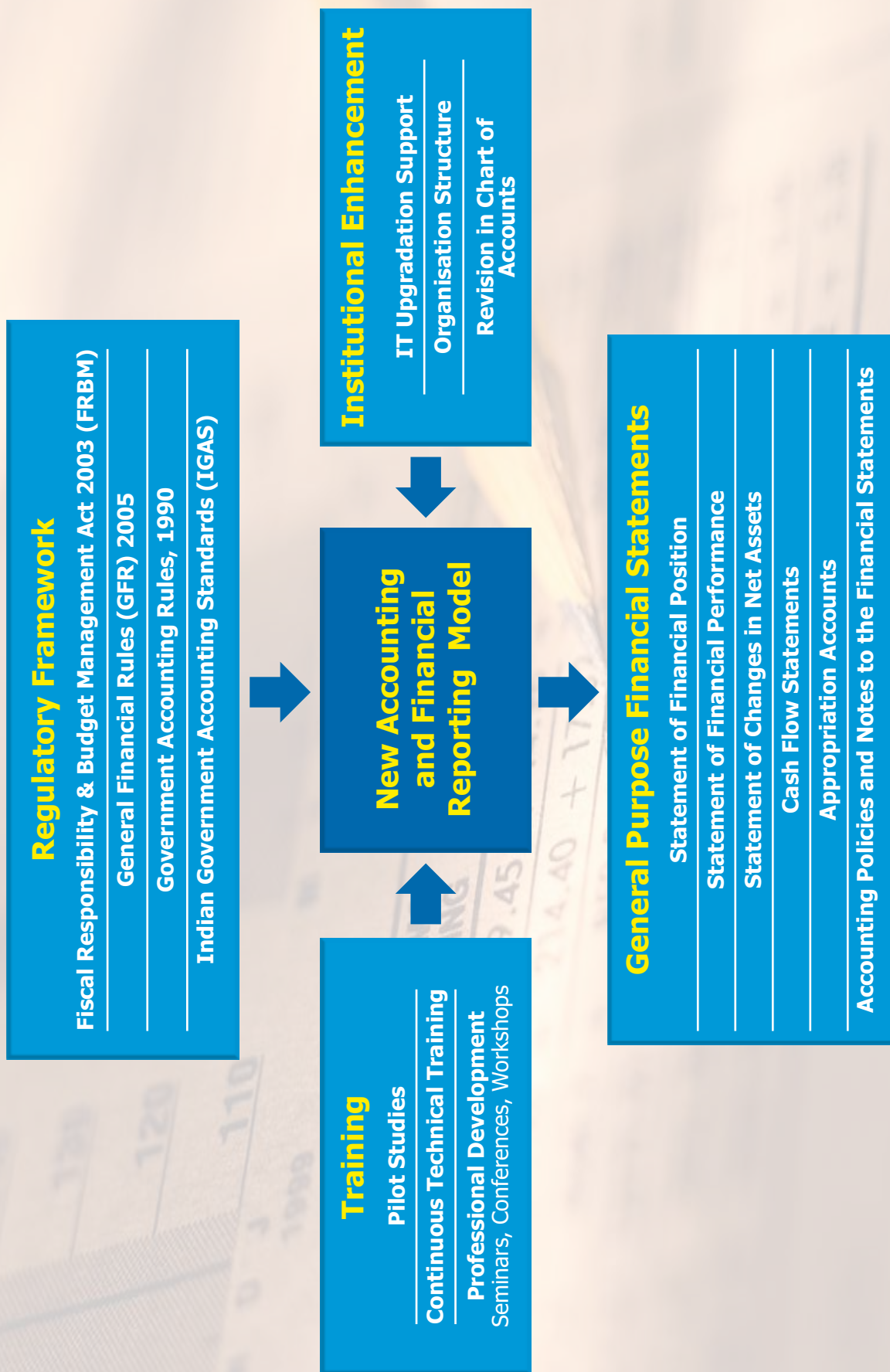
- Formation of an apex body at Ministry of Finance level with representation from key stakeholders at Union and State level for coordination, monitoring, decision making and overseeing implementation issues
- Formation of task based groups in each entity to initiate the transition process in a time bound manner
- Revision of Chart of Accounts to integrate accrual accounting needs
- Development of an IT enabled Integrated Financial Management System
- Centrally Sponsored Scheme for Treasury Modernization issued by MoF mention developing of an Accounts Module and budget module. The benefits of these modules can be greatly enhanced to include revision in account code classification/ chart of accounts, building into it features of asset management, liabilities and other key features of accrual accounting.
- Capacity building in terms of human resources
- Identification and consolidation of assets category wise at DDO level
- Valuation of all assets except historical assets
- Valuation of asset with historical cost after determination of a cut off date to ensure no backlog accumulates
- Identification of liability and their valuation

■ 2nd Phase (2013-14 to 2014-2015)

- Valuation of historical assets
- Provision of depreciation
- Recognition of all expenses and payables
- Recognition of revenues and receivables

■ 3rd Phase - Preparation of Statements of General Purpose Financial reporting (GPFS) including the following (2015 onwards):

- Statement of Financial Position
- Statement of Financial Performance
- Statement of Changes in assets/liabilities
- Cash flow Statements
- Appropriation Accounts
- Accounting policies and Notes to the Financial Statements
- Management and Discussion Analysis





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