

**Address of the CAG at the ‘Conference on
Accrual Based Financial Reporting in Government’**

Hon’ble Union Finance Minister, Shri Pranab Mukherjee, Hon’ble Finance Ministers from State Governments, Secretaries to the Government of India, Finance Secretaries from the states, Distinguished Guests, Colleagues, Ladies and Gentlemen. It is my pleasure to welcome you all to this “Conference on Accrual Based Financial Reporting in Government”.

It is an honour to have the Honourable Finance Minister, Shri Pranab Mukherjee in our midst today to share his thoughts on the issue of transition from cash to accrual accounting, which is a step forward to improve our accounting system and make financial reporting more meaningful and transparent . I am particularly grateful to you, Sir, for accepting our request to inaugurate this conference today.

2. 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. Therefore, there is a felt need for a shift

in Financial Reporting to be in sync with the shift in priorities of Public Finance. Accounting should not be perceived just as a mechanism of systematic recording of receipts and expenditure or exercising budgetary and expenditure control but more as a tool of planning and financial management. It should enable informed decision making by the managers. Accounting should reflect true and fair value of government's financial position. To achieve this, accounting systems, the world over, are being revisited with an emphasis on transition from rule to principle based standards and migration from cash to accrual based system of accounting. If we wish to be part of this transition we have to be more proactive.

3. In response to this paradigm shift the world over, 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. GASAB, which has, as its members, the Heads of all Central Government Accounting Services and also representatives of ICAI, Ministry of Finance, Director General of NCAER and RBI is committed to formulating and recommending Indian Government Accounting Standards (IGASs) to improving standards of Governmental accounting and financial reporting, which in turn, is expected to enhance the quality of decision-making and public accountability. Later, as all of you are aware, 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. In its explanatory memorandum to the Parliament on the Action Taken Report on the recommendations of the 12th Finance Commission, the Government conveyed its acceptance to move towards accrual accounting. GASAB was entrusted with the additional responsibility of creating a Roadmap and Operational Framework for transition to accrual accounting.

4. The Twelfth Finance Commission in its Report has elaborated on the issues in the present cash based system and brought out some of the possible improvements in the accounting system once a shift to accrual takes place. The cash-based system of accounting is based on inputs and outputs as against what was budgeted by the government. Complete financial information for resource management and a full picture of the government's financial position at any given point and the changes that take place over time are not provided in the cash based system. Government's liabilities such as accrued liabilities on interest payments due as also dues on account of pensions and superannuation benefits are not reflected. Current assets as well as non-financial assets are not tracked. The present system does not provide information on assets held by government, ascertain the full cost of holding and operating these assets, and on the full cost

of providing services by the government's departments or future commitments. Cash-based accounting leads to ambiguity, as tax revenues can be collected in excess during a period followed by high incidence of refunds, payments can easily be deferred and passed on to future periods, revenues due in the future could be compromised by providing for one-time receipts etc.

5. 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 to this transition. Under such an approach, local bodies (and within local bodies – large municipal bodies and Panchayati Raj institution) 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. This initiative would then slowly 'bubble up' to the State and Central Governments. Over the last few years over 48 ULBs in 17 states have switched over accrual based accounting. Four States- Gujarat, Karnataka, Kerala & W.B. have adopted double entry/accrual based accounting for PRIs. Also, 16 states have adopted the Model Accounting System developed by Ministry of Panchayati Raj. The model accounting system is amenable to conversion to accrual basis.

Given the progress made at the local bodies level, it is time the central and state governments take concrete steps to shift to accrual accounting.

6. At the international level also, in recognition of the need for having an accounting system with better disclosures and, thus, ensuring better accountability and asset management, transition to accrual accounting has been suggested. Since the principles of accrual accounting being followed in commercial entities cannot be transposed in their entirety in Government accounting because of the differences in their objectives, a transition to modified accrual accounting has been suggested as a way forward. It is for this reason that countries like USA, UK, Canada, Australia, New Zealand, Spain, Italy and Finland are in various stages of migration to accrual accounting. The United Nations and other organizations in the UN System have also decided to adopt IPSAS and have commenced the migration process from United Nations System Accounting Standards (UNSAS) to International Public Sector Accounting Standards (IPSAS). A convergence in public sector accounting is clearly emerging in the international scene.

7. To facilitate the process of transition from cash to accrual system and as per the mandate entrusted by the Government, GASAB prepared a “Roadmap for

Accrual Accounting” which has been accepted by the Government of India. The road map mentions the activities and milestones to be completed for migration to accrual accounting. GASAB has also developed a detailed “Operational Framework for Accrual Basis of Accounting in Governments in India” providing an overall architecture of the accounting model that would prevail in government while conforming to constitutional reporting needs. The transition would involve a great deal of preparation and may take nearly 5 to 6 years. The proposed transition could be envisaged in three stages, namely (i) Short term activity involving value addition within the existing system by additional statements on salaries, subsidies, interest, pension etc (ii) Medium term activity providing for value addition in the existing system with modifications to enable greater disclosures such as arrears in revenue, committed liabilities, etc, and (iii) Long term activity for achieving the desired accounting system based on accrual basis. Important steps involved in this transition process would involve building up of adequate database essential for implementation of accrual accounting, identification of assets and liabilities, creation of asset registers etc.

8. At the request of the Deputy Chairman Rajya Sabha, a seminar on accrual accounting was organized to sensitise Members of Parliament in 2007, wherein the then Speaker of Lok Sabha and Minister of State for Finance were the chief

guests. The commitment of ultimately transiting to accrual accounting was reiterated by the Union Finance Minister. GASAB had also convened a 'National Round Table Conference on Accrual Accounting' in May 2009. State Finance Secretaries participating in the Round Table Conference had shown keen interest in moving towards accrual accounting. Recently, a two day training programme on 'Leadership Development for Transition to Accrual Accounting' was imparted to all the participants from premier accounting services of the country as well representatives from Accountants General's Offices deliberating on from accrual accounting being practiced and piloted in Central government offices, corporate sector, local bodies and many countries across the world.

9. Similarly, various Central Government organizations like Railways, Department of Posts etc., are also conducting pilot studies to move towards accrual accounting. In 2001 the Supreme Court of India opined that the accounts of the local bodies should be in the accrual format. Based on that, several municipal corporations have moved over to maintenance of accounts in accrual format. In addition, so far, 21 State governments have conveyed their acceptance, in principle, to move towards accrual accounting.

10. Since state governments are the major stakeholders in the whole process of this transition, we have been holding seminars in various states. Pilot studies have also been conducted under the aegis of GASAB, in various states like Madhya Pradesh, Andhra Pradesh, Haryana, Gujarat and Rajasthan. Recently, results of a pilot study conducted in select departments of the State of Andhra Pradesh was shared with all the important stakeholders and circulated to all the Chief Ministers of States. The objective of this pilot study was to identify the key issues relating to the transition process by conceptualizing model formats for Annual Financial Statements. Apart from recognizing the need to build up adequate data on assets, liabilities, pension etc., two very important issues have been highlighted as a prerequisite to facilitate the transition. A robust IT system for maintenance of accurate, reliable, valid and integrated data and generation of accounting and financial information is essential. Enterprise Resource Planning (ERP) systems like SAP may have to be established across the country, both at the Centre and the States. In addition, assessment of training needs in terms of capacity building for managing transition, implementation and management of accrual accounting system is required. A few states have constituted Task Force on transition to accrual accounting and some states have asked for assistance from GASAB for training and providing guidelines.

11. This conference 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.

12. GASAB and my organization are also conscious of the lessons learnt from these pilot studies. As a step towards accrual accounting we have introduced several statements in the Finance Accounts of the states from last year. The recording of physical assets will also require greater effort and my officers have actively taken up this issue with the state governments.

13. The pilot studies and international experiences have also shown that the transition to accrual accounting is often difficult and expensive; one of the reasons for this is the significant investments in IT infrastructure. However, in India several states have already computerized the treasury systems and the Government of India has also undertaken the computerization of treasuries in mission mode involving 626 districts. The mission mode project of Treasury Computerization envisages a large financial investment of around Rs 600 crores. We must take advantage of it. Any computerisation project relating to accounts

and treasuries being undertaken at any level in the government involving both hardware and software must incorporate modules for accounting reform. I am given to understand that a large part of treasury computerization would become possible only after relevant codes are amended by the State/UTs. This then is the time we must incorporate changes and amendment required for transition to accrual accounting to ensure that expenditure on computerization is optimally utilized. Provisions of appropriate accrual heads of accounts would be necessary when treasury computerization is taken up, even though these heads may not be utilized in the very near future.

14. The quality of book-keeping should improve to effect a shift to accrual accounting. Any effort in this direction would only improve the efficiency of the administration and the confidence of the stakeholders on the administration. This would lead to rich data being available to enable various analysis & MIS reports. Over a period this would enable the governments to allow powers to devolve to the departmental functionaries to take management decisions coupled with a powerful requirement for them to be accountable for those decisions. This I hope would improve the speed of project implementation, transparency & efficiency of government functioning.

15. Accounting system in India is uniform across the Union & States and Union Territories having Legislature. The uniformity is envisaged in Article 150 of the Constitution of India. This should be taken care of during the transition to accrual based accounting. As of now, different stakeholders, such as the Civil Ministries and Departments, Department of Posts, Ministry of Railways and Ministry of Defense at the Union level and the States and Union Territories having Legislature are at different stages in terms of their preparedness and may take different time-period to achieve the suggested level of reforms to implement accrual accounting. Migration to accrual accounting must be within a uniform operational framework so that the final accounts of the Governments, both the Union and the respective States and the Union Territories with Legislature fall within a uniform reporting framework. This also requires uniformity in the classification system. Pilot studies could throw up specific requirements of different stakeholders. This may need moderation in the operational framework suitable to their needs. However, this does not obviate the need for maintaining an overall uniformity of financial reporting.

16. In this conference, Hon'ble Finance Minister would be releasing a brochure on "Operational Guidelines for Accrual Based Financial Reporting". I am confident that this would be useful and provide the necessary guidance required for the

transition to Accrual based accounting and financial reporting. However, since reforms are always evolved over a period of time, and it could take a preparation time of about 5 years, 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. If we want to retain our position among the global leaders, we must move with a definite time-frame to achieve this transition towards accrual based financial reporting.

Thank you very much.