

**Road Map and Transition path  
for Accrual Accounting**

## **Report of GASAB on Road Map and Transition path for Accrual Accounting**

1. The Twelfth Finance Commission (hereinafter referred to as the TFC) recommended adoption of accrual accounting for the Union and the State Governments. 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 (hereinafter 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 eight State Governments have accepted the idea of accrual accounting in principle. These States are Assam, Bihar, Kerala, Madhya Pradesh, Maharashtra, Sikkim, Uttaranchal and West Bengal.
2. Some countries such as Australia and New Zealand have approached the issue of accounting reforms as part of an integrated financial management and accounting reforms agenda. Accounting and budgeting reforms as an integrated package were spelt out in the form of Public Finance Acts. A few other countries such as Canada (Accrual Accounts with Cash Budget up to 2003) and United Kingdom (Resource Accounting and Budgeting – RAB) started with accounting reforms followed by budgetary reform after a gap of three to five years. There are certain other countries such as United States of America and Spain which combine modified accrual accounting with cash budgeting as of now. This presents a flexible approach towards accounting and budgetary reforms. However, it is generally felt by experts that benefit of accrual accounting and financial reporting are fully realized if budgetary reforms are incorporated. Pending the Government's consideration on budgetary reforms the present recommendation limits itself to accounting reforms and transitional issues related thereto.
3. The mandate given to GASAB is two-fold (i) suggesting an operational framework, and (ii) suggesting a road map for transition from the present cash system to accounting on accrual basis. The operational framework will encompass the contours of the accounting system under accrual basis including accounting and treatment of assets, liabilities, revenue and expenses and the final accounts of the Governments consistent with the provisions of the Constitution, and duly meeting budgetary reporting requirements. This means the operational framework to be suggested by GASAB would indicate the following broad accounting heads and treatment of transactions relating thereto: (i) Revenues and Expenditure

Accounting; (ii) Fixed Assets Accounting; (iii) Long term Liability Accounting (iv) Accounting for Current Assets and Current Liabilities; (v) Accounting for Period Costs (Interest and Depreciation); and (vi) Non-Financial and Contingent Liabilities.

The issue was discussed at GASAB meetings and GASAB constituted two separate Committees to look into issues involved in operational framework of accrual accounting system and roadmap of transition.

4. The Committee constituted by GASAB to examine the proposed operational framework, presented in the 9<sup>th</sup> Board meeting held on December 21, 2005, is expected to finalize its recommendations soon. The Committee dealing with roadmap of transition has brought out that the user departments namely, Civil Ministries / Departments (Controller General of Accounts), Ministry of Defence (Controller General of Defence Accounts), Ministry of Railways (Financial Commissioner, Railways), Department of Posts and the State Governments are best placed to draw up the detailed road map for their respective jurisdictions. This recommendation stems from taking note of different nature of functions in the departments and the fact that the different departments are at different stages of preparedness/ readiness in terms of their data availability, etc. For example, in the Central Government, Railways are far ahead in their readiness to switch over to accrual accounting system. Under Fiscal Reforms and Budget Management framework Central civil departments have started listing their assets. The Receipt Budget, 2006-2007 of the Central Government for example, contains a statement of Assets Register. Ministry of Defence and Department of Posts are comparatively less prepared and as per the FRBM framework the norms concerning disclosure are different for Defence. So is the case with the State Governments. Given the fact that the various stakeholders/ departments are at varying stages of preparedness it may not be feasible to have a unified road map for all departments. However, there are certain activities / items of work that cut across the departments/ ministries/ state governments and are prerequisites for all departments/ ministries/ state governments to complete for transition to accrual accounting system. Listing of these prerequisite activities/ tasks will provide ready guidance and will enable the user departments to assess their requirements and move forward with a clear direction. These need to be spelt out for taking action concurrently along with the efforts to be undertaken or being undertaken within the respective accounting jurisdiction.

The proposed transition could be envisaged in three stages, namely (i) value addition within the existing system by additional statements on salaries, subsidies, pension, etc. This can be a short term activity; (ii) value addition in the existing system with minor modifications to enable greater disclosures such as arrears in revenue, committed liabilities, etc., This can be a medium term activity; and (iii) achieving the desired accounting system in the long-term based on accrual system.

5. A period of 10-12 years may be a reasonable and feasible time frame for the transition road map, given that different user departments are at different stages of preparedness. GASAB suggests that the user departments may like to use the following activities/ items of work, which constitute prerequisites of a road map for transition. These activities/ items of work cover the administrative, technical and capacity-building aspects. Detailed time frame and task schedule will need to be finalised by the user departments:

**5.1 Setting up Task Force/ Cell:** There is need for setting up of a Task Force/ Cell or designating a nodal agency preferably at Min. of Finance, Govt. of India level for implementation and coordination. It may include representatives of CGA, C&AG, CGDA, Railways, Posts and State Governments. Setting up of such a Task Force will facilitate an integrated approach across Governments. It will provide a forum for evolving accounting policies and experience sharing and facilitating resolution of issues faced by different stakeholders. Since changes in the accounting system would necessarily involve modifications in the existing system of accounting, a Task Force needs to be set up in the concerned ministry/ department headed by the administrative Secretary being the Chief Accounting Authority and the State Governments.

**5.2 Building adequate database essential for implementation of accrual accounting:** This needs to be done by bringing in a broad spectrum of financial information, presently lying outside the reporting framework. These may include required information vis-à-vis data on physical and financial assets; liabilities including accrued liabilities and pension liabilities; information on salaries, subsidies, committed and contingent liabilities, etc. A detailed review needs to be carried out to identify whether the data required for accrual accounting exists somewhere. Means need to be devised to bring such data into the reporting framework in a systematic and reliable fashion. For the data that is not held systematically either with the executive or in the present financial reporting system, modalities of its identification, capture and maintenance thereafter need to be

worked out also. Building adequate database is a short to medium-term activity; however, some of the actions on this could be taken up straightaway.

**5.2.1 Assets identification and creating Assets Registers for physical assets:** Information of financial Assets in terms of loans, equity and investments by Governments are available. Information on physical assets and current assets need to be built up by creating an asset register. These involve (i) identification of assets, (ii) grouping them as per accepted classification like property, plant, equipment, infrastructure, block assets etc., (iii) valuation of assets for opening balance, (iv) identification of other financial assets, (v) inventory recording. This will be a short to medium-term activity.

**5.2.2 Identification of liabilities:** Information relating to long-term debt is available. This will require mapping the types of current liabilities, which persist in Government, and maintenance of Liability Register. Further, to assess pension liabilities actuarial valuation would be required. This should be a medium-term activity.

**5.3 Pilot Study:** Pilot studies would be required covering a few Ministries/ Depts. / State Governments with a view to assess the gaps and the problems in the existing system so that the transitional requirements could be worked out. This will be crucial for process mapping. Ministries which have dedicated accounts services such as Railways, Defence and Posts, may select areas within their jurisdictions for pilot study based on feasibility and their requirements. It is of crucial importance that the Pilot Studies be identified and carried out with the active involvement of the executive branch concerned. Any changes leading to introduction of accrual accounting would have very significant impact on the working of the executive and recording of financial transactions. For the Civil Ministries/ Departments and the State Governments, it may be possible to select departments with an asset base such as Public Works and Irrigation and social orientation and large expenditure such as Health or Education. It is noted that the Controller General of Accounts and the Ministry of Railways have already taken concrete action in this regard. Conducting pilot study should be a short to medium-term activity.

**5.4 Process mapping:** Detailed process study is required of various activities and accounting practices to know the type and nature of

accounting and financial information available and to assess the departure from the existing system in terms of principles and points of recognition, measurement, classification and disclosures. This will also involve listing the agencies and sources of information and mapping their inter-linkages. This should be a medium term activity.

- 5.5 Detailed framework of accounting:** While GASAB will suggest a broad operational framework for consideration of the Government, each user department or stakeholder jurisdiction will be required to devise their detailed accounting system taking into account the broad contours of operational framework as accepted by the Government on suggestion of GASAB. While switching over to accrual accounting there may be a need for integrating the requirements of information stipulated in the FRBM rules for respective users. This could be done at the time of devising detailed accounting system by each user department. This should be a medium-term activity.
- 5.6 Laying down accounting policies:** There is need to prepare a new Accounting Manual as a new policy document containing accounting policies to be followed in the new system. This could evolve over a period of time. There is also a need to clearly spell out principles and criteria of recognition, measurement and classification applicable in the accrual accounting system in the new Accounting Manual and also policy on depreciation of physical assets. These accounting policies will be based on accrual based public sector accounting standards pending formulation of GASAB's accounting standards. The draft policies should be discussed in the task forces working in the ministries/ departments headed by Chief Accounting Authority of the ministry/ departments and also in the task forces in the states. Preparation of the new Manual and laying down accounting policies could be a medium-term activity.
- 5.7 Preparing Chart of Accounts:** The existing List of Major and Minor Heads (LMMHs) needs to be recast as Chart of Accounts, which will need to include Object heads of classification to depict accrual transactions. There is need for rationalisation/ standardisation of the Object Heads across the States and the Union as also recommended by the TFC. Presently, given the flexibility in the operation of object heads at the States level, there is no standardized list across the Union and the States. In the new system based on accrual concepts, preparation of Income and Expenditure Statement and Statement of Assets and Liabilities would require information on primary allocation basis, i.e., the object heads. It may be noted that Chart of Accounts should be comprehensive as far as

possible and should be prepared after wide consultation and with a long-term perspective. It should take into account different dimensions of information vis-à-vis, functional, programme and object heads classification to take care of the desirable requirements of the stakeholders. This is important due to the fact that modifications or changes in the Chart of Accounts may not be feasible frequently. Preparation of the Chart of Accounts could be a medium-term activity.

- 5.8 Devising documentation/ subsidiary ledgers:** Necessary documents/ ledgers and other subsidiary books will be required to be in place at the appropriate transaction points such as the PAOs/Treasury/DDOs/CDOs as applicable, for capturing transactions at their point of origin. This will be a medium term activity.
- 5.9 Organizational arrangements for data / information flow:** Making / streamlining arrangements for accounting data flow and defining role and relationships amongst various officials dealing with transactions and accounting will be required. It is also suggested that rationalization of the number of DDOs/ CDOs and limiting their number is an important consideration given the fact that information about payables and receivables (and also asset acquisition and discharges) is to be captured and got reflected in the primary accounting documents which Treasuries/ PAOs forward for further consolidation. This will be medium to long-term activity.
- 5.10 Decision on IT system:** There is need to assess adequacy of the existing IT system to meet transition needs. It may be noted that the desired accounting reforms require a robust IT system to be in place. An IT system should be envisaged which enables entry of primary information from the basic accounting records at a single point and maintenance of an integrated database. A desirable IT system should ensure that after the initial entry further human intervention for data entry is not required. This will help maintenance of accurate, reliable, valid and integrated data and generation of accounting and financial information. Assessment of requirements and putting in place the IT system will be a medium-term activity.
- 5.11 Training needs:** Assessment of training needs in terms of capacity-building for managing transition, implementation and management of accrual accounting system is required. This will require designing training plans/ programmes, training for implementation of the work plan etc. There may also be requirement of dedicated trained

cadre of officials for managing issues of valuation of assets and other balance sheet items. This could be a short to medium term activity.

- 5.12 Pilot Implementation:** Pilot Implementation of a designed system for a few depts. / States is required. This is for testing the system after it has been designed in all its aspects covering accounting framework, Chart of Accounts, asset classification, necessary documentation, etc. Pilot implementation is different from pilot study. While pilot study is for process mapping and knowing the requirements of transition, pilot implementation is for testing the readiness for full implementation. After taking pilot experiences into account and making necessary modifications, as may be required, full implementation in all user departments/ states may be taken up. At this stage, there may be requirement of parallel running of the new system along with the existing system before switchover to accrual accounting completely. This should be a long-term activity.
- 5.13 Full implementation:** Switch over to accrual accounting system as per the operational framework suggested by GASAB and accepted by the Government.
6. Many of the steps that are indicated in the preceding paragraphs, 5.1 to 5.13 above, can be taken up concurrently and they are not meant to be sequential. For example, identification of assets and inventory recording can be taken up in parallel along with mapping of current liabilities. However, some of the tasks may require completion of other tasks before being taken up. For example, process mapping and detailed framework of accounting may require pilot study; assessment of IT requirements may be based on finalization of Charts of Accounts; pilot implementation will require trained personnel, etc. The Task Force that is proposed at paragraph 5.1 above can chalk out a detailed plan of action for scheduling of different activities.
7. Accounting reforms and completion of tasks/ activities will involve costs for the governments. Internationally, different countries have assessed costs involved differently based on their size of operations. In India, given different stakeholders (Civil, Defence, Posts, Railways and the State Governments) and their size of operations, it may not be feasible at this stage to assess or even estimate costs that will be involved in transition. Further, cost-benefit analysis of such a transition may not always be based on quantitative aspects, as many of the benefits of accounting reforms will be in qualitative terms, such as better financial information on assets and liabilities, costing of services and goods provided, satisfaction to users and other stakeholders, etc.

8. It is strongly felt that benefits of accrual accounting will not be reaped in the absence of an overarching financial reform package including budgetary aspects. International experience suggests that such reforms also help smooth implementation of accounting reforms.
9. Above all, unless the top management in the line Ministry / Department is committed to and assumes full ownership of the process, the entire reform process will be thwarted and the envisaged benefits will not accrue.