

Towards Better Accounting by the Government



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There is renewed thrust on economic reforms under the new NDA government. Some of these have already been implemented like increase in the FDI limit for Insurance sector while some others like G.S.T. and Land Bill are in progress. However, the said economic reforms are primarily being discussed either in terms of the Foreign Direct Investment or with respect to rules &

processes relating to ease of doing business in India. The fundamental thrust remains on attracting foreign investment in India.

I believe that while these efforts are laudable, a major reform is needed in the system of fiscal governance by Government of India itself, which has not been given ample focus and importance by successive governments. One of the main pillars of such fiscal governance is the process of budget exercise undertaken by the government each year and the reliability of accounts prepared by government. As we are aware, every year the budget presented by the Finance Minister draws huge interest all over the country and its importance in terms of economic planning is acknowledged by one and all. It is important to note that for such an important exercise, the Government of India is still following the archival method of cash accounting based on a single entry system. Accordingly, the revenue physically received by the government in a year is taken as revenue of government and expenditure physically incurred is treated as expenditure.

Anyone who is involved with business of any scale would appreciate that a fundamental purpose of any budget exercise for any entity is to determine a direction for the coming year or years in terms of the aspirations and resources required to meet those aspirations. Each company does this – some for the immediate year and other for longer periods of three to even ten years. Whatever they may be called e.g. Annual Operating Plans (AOPs), Budgets or Business Plans, the crux is the same. It should not be any different for India if it intends to operate as India Inc. which for efficiency and better productivity is a must.

Needless to say, for a meaningful exercise of planning, it is imperative that the current financial performance of

a company or for that matter India Inc. is correct and reliable rather than based on window dressing.

For doing this, I believe that the following few steps would be imperative :

1. **Move the accounting & budgeting exercise to a double entry system & accrual based accounting:**

It is common knowledge for everyone who does business in India that come the end of the fiscal year, the pressure from the Tax department – be it income tax, service tax, customs duties or excise, mounts for not only the taxes which may be due but also the taxes which are demanded to be paid in advance so as to enhance the revenue figures and to show lower fiscal deficit. As is clear, the reason for this hyper tax collection initiative is the cash accounting system. The worst part of this practice is that to show a growth in successive years, the advance collections need to be compounded. As a result, any meaningful estimates of revenue for next year becomes impossible. It is extremely important that India moves to a double entry and accrual method of accounting as soon as possible to avoid such intentional misstatements & wrong accounting and present a more transparent picture of the state of economy on an annual basis. Needless to say, as long as this practice of 'extortion' persists, we could forget about ease of doing business in India.

Please note that most of the developed countries have already moved to the accrual accounting and it is estimated that over 40 countries have already adopted the accrual method.

It is also interesting to note that this matter has been in the purview of the government right since 2002 when GASAB (Government Accounting Standards Advisory Board) was set up. The twelfth Finance Commission recommended the transition to accrual based accounting in 2004 with the following mandate to GASAB:

- (i) To establish and improve standards of governmental accounting and financial reporting and formulate and propose standards that improve the usefulness of financial reports based on the needs of the users; and
- (ii) 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 transition to accrual accounting system and operational framework of such a system that will prevail in government.

However, even after a decade little progress has been made in fulfilling either of the mandates.

The advantages of moving to double entry based accrual accounting systems are obvious. On one hand, it would give a correct position of the government's revenues & revenue expenditure based on the amounts committed and agreed even though they may not be fully received or paid respectively. On the other, the government would be able to prepare a balance sheet showing not only the various assets & investments made by it e.g. in the public sector based on the accounting standards but would also account for the various commitments made but not paid as its payables at year end. The preparation of the balance sheet based on double entry system would clearly show the total liabilities of the government – both long term and short term.

This would enable correct reflection of revenue deficit or surplus, capital expenditure/investments for the year and overall debt. These three need to be separately seen as percentage of GDP (which would be calculated as before).

I believe that this move would provide the necessary transparency in respect of the government's accounts and would enable it to do a better planning for the coming year as well as for a longer period. All analysts including the rating agencies would be in a better position to work out the expected ratios like net debt to GDP & other productivity indicators for the economies, which in turn would enable India to invest more and attract more investments by way of debt as well as equity.

2. Audited Accounts & Variance Analysis

The government must also complete the audit of its accounts based on double entry system in timely fashion just like it expects the various corporates – big or small to do within specified period. It should

separately, as a part of its annual report on fiscal performance, present the said audited account vs the budget that had been presented along with the reasons for variances. It would be ideal if this is made as a part of the budget presentation by the Finance Minister where he could take the actual for three quarters of the previous year and the last quarter estimates. The full year audited accounts vs budget should be separately presented in the Parliament session in July of next year or immediately thereafter e.g. in the monsoon session.

3. Five Year Rolling Budgets

The government must introduce a five year rolling budget so as to provide a longer visibility of its plans and provide for the requisite resources needed to fulfil those plans. For a growing economy like India, such rolling budget would be of vital importance.

The rolling budget should be amended each year to reflect the actual performance and revised estimates along with the reconciliation of the original budget and the revisions with the reasons for such deviation.

These measures would not only bring greater transparencies but better discipline on part of the government. This would ensure that the government would be in a position to undertake significant capital expenditure that would be required from government from time to time to kick start the economy or to accelerate the growth momentum without having the fear of fiscal deficit being too high, as long as those investments are projected to produce revenue in coming years and enhance GDP.

It is high time that our government first puts its house in order and brings transparency to its own performance. Indian economy with these measures will surely be the most preferred destination of global investors.
