

Valedictory Address
by Comptroller and Auditor General of India
on the occasion of ICAI International Conference on
"Role of Accountancy Profession in Anchoring Economic
Growth"
21st January, 2006

Shri Vikamsey, President, ICAI, Smt. Komal Anand,
Secretary, Department of Company Affairs, Government of
India, Shri Suresh Pachauri, MP, Shri Ramachandraiah, MP,
Shri Manoharan, Vice President, ICAI, ladies and gentlemen.

It gives me great pleasure to be with you on the
occasion of the valedictory session of this Conference on the
"Role of Accountancy Profession in Anchoring
Economic Growth". Two compelling reasons for my
presence in Mumbai, for the valedictory session of this
conference, are firstly, the strong advocacy by the
management of ICAI and secondly, the relevance of the
subject to government accounts as to private accounts in
India to-day.

The direct relationship between good accounting
practices and better economic outcomes is widely

recognized. There are numerous instances in India and around the world of bad accounting practices leading to corporate failures. In my view there are two dimensions of this problem. The first dimension is technical and concerns the rigour of standards, guidelines, practices etc., at the national level. The other dimension is ethical. Most corporate failures have their origin in corporate greed. The ethical dimension of the accountancy profession comes into play in such situations and the accountant has to arbitrate between corporate and public interest and the final result is determined by the accountant's integrity. I am happy to note that the ICAI is paying adequate attention to both these dimensions in its efforts to promote good accounting practices in India.

A direct relationship between accountancy and growth exists in the government sector also particularly between good accounting practices and good governance. Government accounting practices are frequently characterized by lack of transparency, inconsistency and

incompleteness and these lead to poor quality accounts and result in inefficient use of public resources. In the long run poor quality accounting impacts adversely on the growth prospects and economic stability of a country. The nexus, therefore, between good accounting practices and good policy making is direct.

Government accounts and financial reporting in India have a history of several centuries. The accounting systems currently followed derive their form and substance largely from accounting procedures introduced during the British rule in India. The basic objective of the Government then was to secure full compliance to rules and a clear accountability of its operational level staff dealing with government's money. To the British the greatest virtues of the cash system were that it was simple to implement, allowed monitoring of compliance with cash based appropriations, permitted reliable and timely financial reporting and required a lower level of accounting skills than the commercial system of accounting.

However, the cash based system is not the most informative way of presenting accounts in a dynamic democracy like ours. It lacks transparency and it provides a weak basis for informed judgments on the performance of Government in terms of economy, efficiency and effectiveness of its programmes. Financial information has to be collated in parallel through the establishment of elaborate and sometimes expensive systems for centralized monitoring and evaluation of projects and programmes. These become ex-post exercises in the nature of audits because cash based accounts by themselves fail to disclose full information for financial management.

Under the cash system, as currently applied in India, there is no requirement to match expenditure with revenue. The system encourages lax fiscal discipline because it is limited in scope and not very good at showing the impact of transactions resulting in cash flows outside the current reporting period.

Capital spending under this system is brought to account wholly in the year in which a capital purchase or disposal is made. Moreover, by focusing solely on cash flows it ignores other resource flows which affect governments' ability to provide goods and services now and in the future.

The cash based system lacks an adequate framework for accounting for assets and liabilities. Once an asset is acquired it virtually disappears from the accounts. It limits accountability to the use of cash and ignores accountability for management of assets and liabilities.

Even as an instrument for managing budgetary appropriations, the cash based system has not proved very effective beyond securing compliance with law and rules. The long history of unregularised excesses and savings in the annual Budgets of the Centre and the States is evidence of this fact.

The need for a new basis of government accounts is widely recognized and there has been a demand for reforms.

In response the Twelfth Finance Commission has recommended migration of government accounts from a cash basis to an accrual basis in a phased manner. The Government of India has accepted this recommendation and the Minister for Finance has requested the Government Accounting Standards Advisory Board (GASAB) set up by the C & AG to draw a road map for such migration.

To my mind, the main advantages of a migration from cash to accrual will be:-

- (i) Better information will be available about sustainability of Government fiscal policies and the bias in favour of short term thinking will be corrected.
- (ii) A stronger basis for accountability will be established with internalized incentives for economy, efficiency and effectiveness.
- (iii) At the organizational level, it will help devise better measures for organizational efficiency. There would be better

accounting for resources that department's use.

Certainly this transition will not be easy, quick or cheap. An accrual system in Government will introduce new elements of subjective judgment into the accounting processes and practices requiring greater sophistication, professionalism and training for Government accountants and auditors. As India is a federal country a broad consensus on accounting reform between the Centre and the States would be essential. It is clear that this consensus will require a high level of political conviction and persuasion and it will have to be negotiated gradually and incrementally. A study sponsored by us shows that it will take a decade to achieve full migration to the new system. In New Zealand the process took seven years. The costs involved would also be substantial as the change will involve not only the Central Government but also the States. However, the benefits of the transition will be enormous and in my opinion they will outweigh costs. We have a large pool of excellent

accounting professionals in the government as well as in the private sector and our absorptive capacities are much greater than developing countries.

The recently created GASAB will assist in the migration to accrual accounting by advising the Ministry of Finance in the development of a new framework of rules and principles based on accrual concepts and if Government desires assist in the smooth transition.

Once the initial programme for migration from cash basis to accrual basis has been determined and put in motion the focus has to shift to the agenda for the future.

As you may be aware, currently no decision has been taken to change existing budgeting practices. The change in the basis of accounting would require a change in budget practices in due course. Any change in budgeting would require statutory changes and perhaps even constitutional changes. In a federal polity like ours, we will have to achieve a political consensus on any changes in budgetary practices. The Finance Minister has already announced Government of

India's decision to move to "outcome" budgeting. Hopefully this would be a fore-runner to the introduction of a full blown accrual accounting and budgeting system equivalent to what is known as the Resource Accounting and Budgeting (RAB) in the UK.

Another issue that would need attention would be the development of a Whole of Government Account (WGA) comprising a comprehensive account not only for the core of Government but also its Departmental and Commercial Undertakings. Only a WGA system will enable decision makers to achieve comprehensive control over public expenditure. We all know that the departments habitually exceed their budgets, unused balances are spent in the end of year shopping sprees and creative accounting is used to give the appearance of good performance by parking funds in special purpose vehicles. The WGA system will enable a true and fair view of the public sector as a whole and underpin Government efforts to improve overall efficiency of public sector expenditure. It will also enable creation of a

public sector that is more responsive to the strategic direction of Government policy. However, before that is done, new control boundaries for WGA will have to be very carefully established for meaningful financial reporting.

Further, Government will have to consider development of an integrated oversight mechanism over Government accounting systems which currently remain quite fragmented. Perhaps establishing an independent oversight Board or other suitable mechanism as it has been done in some other countries can be considered.

Finally, audit of accrual accounts would require a new “true and fair” view standard, quite different from the current standard used for audit of cash accounts in Government. Hence training programmes for public auditors particularly on application of IPSAS and International Standards of Auditing issued by the IFACs etc. would be required. We have already started action in this direction and we look forward to co-operation with ICAI in this matter.

I have briefly tried to describe the policies that have already been set in motion to change the Governments Accounting and Financial Reporting Systems and their implications for the growth and development of our country. I have also tried to indicate some of the specific directions for the future reform agenda in Government Accounting Systems. I must, however, stress that accounting reforms have relevance and can succeed only if they are set in the larger framework of complementary public sector reform and as a component of a wider budget system reform. The experience of many countries pursuing reforms from cash to accrual basis supports this conclusion.

I have no doubt that in view of the changes taking place in the world of accounting the forces of convergence will propel accounting and budget reform in India also. In the private sector itself a programme for achieving convergence of accounting practices in all OECD countries is already under way. In all the developed world there is a growing convergence between Government accounting

practices and those of the non-government sector. This means that we have to work collaboratively with ICAI and IFACs to achieve a successful transition to an appropriate accounting and budget system for India with the objective of achieving higher economic growth that we all aspire to achieve.

Thank you.

ANNEXURE

**MIGRATION FROM CASH TO ACCURAL
BASED ACCOUNTING.**

Stage 1

Get cash accounting to work well.

Stage-2

Integrate operating accounts and financial asset and liability accounts to move to modified accrual.

Stage-3

Introduce more elements of accrual reporting and move to a partial accrual presentation to ex-post reporting.

Stage-4

Recognize non-financial assets.

Stage-5

Move from accrual accounting to accrual accounting and budgeting.