# EXECUTIVE SUMMARY
# OF
# PILOT PROJECT
# ON
# CONVERSION OF FINANCIAL STATEMENTS FROM CASH BASIS TO ACCRUAL BASIS AT NWR, JAIPUR



# Project Background

## Accounting System in Government of India:

Government accounting system in India, in all three tiers of Governance, i.e., the Union, States and Local bodies including Autonomous or Statutory Bodies, is pre-dominantly on Cash based accounting system. The basic principles of government accounting are enunciated in the General Financial Rules and other related legislations, manuals, etc. In recent times, there has been a paradigm shift in the priorities of public finance management from identifying resources of public finance management to fiscal prudence, efficiency and transparency in public spending. These shifts in priorities have been reflected in initiatives like the *Fiscal Responsibility & Budget Management Act* and Outcome Budget. It is felt that there is a need for Financial Reporting that is 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 rules to standards based accounting and migration from cash to accrual based system of accounting.

## Accounting System in Ministry of Railways:

Indian Railways (IR), being a Government Department, primarily maintains its Finance Accounts under Cash based Government Accounting in the form and format mandated by Controller General of Accounts and the Comptroller General of Accounts. However in line with the mandate given by the Separation Convention to IR in 1924 to become self sufficient in Financial Management, IR has revised its classification of Accounts long back. IR moved towards the hybrid system of Accounting by adopting a few aspects of commercial Book Keeping i.e. Accrual Accounting. Linkages of Accrual Accounting were provided by means of Suspense Heads viz. Traffic suspense, Stores Suspense, Demands Payable, etc. to capture the accrual impact of revenue, stores and establishment transactions. As a result, the Accounting system of IR is distinct from the Government of India.

Various Committees formed, post 2000 by Ministry of Railways, suggested that the existing Accounting System of Indian Railways should be reformed to improve the quality of financial reporting. In pursuance of this objective, Ministry of Railways (MoR) has decided to prepare accrual based financial statements as it would help in

bringing more transparency, timely availability of information, improved financial performance, advanced decision-making, etc.

## Understanding of Accrual Based Accounting System

Accrual basis is the method of recording transactions by which revenues, costs, assets and liabilities are reflected in the accounts of the period in which they accrue and arise, whether or not a receipt or payment takes place. Unlike this, Cash basis of accounting accounts for revenue only when the money is received and for expenses only when the money is paid out. Thus the main difference between accrual and cash basis of accounting is the timing of the recognition of revenue and expenses.

## Objectives and Benefits of Accrual Based Accounting System

The worldwide trend of shifting from cash based accounting to accrual based accounting is a key building block in progress towards the broader context of public sector accounting reform.

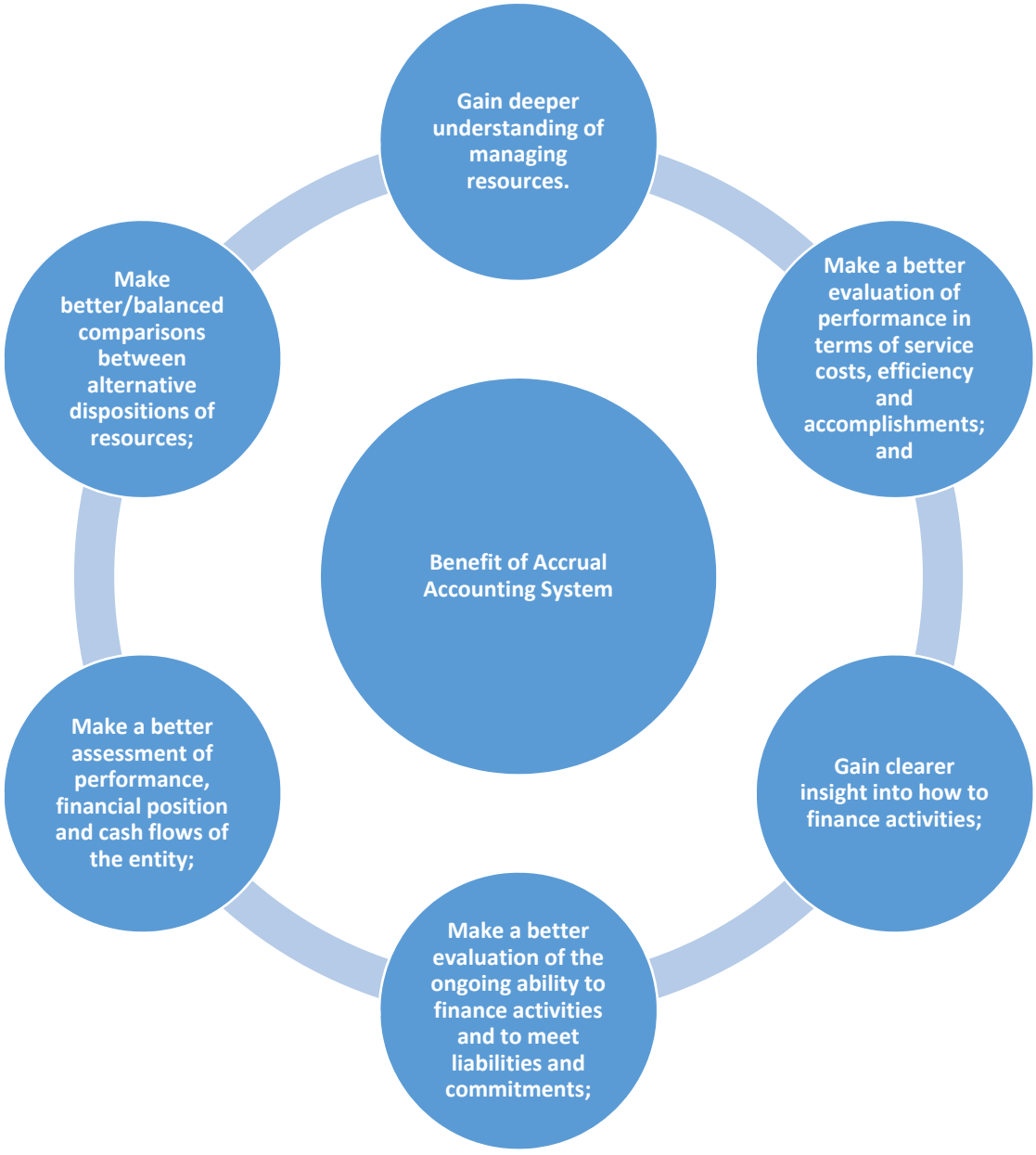
### Objectives

The primary objectives of accrual accounting are:

i. Improved decision-making to enhance efficiency and effectiveness of public spending through the creation of more accurate and accessible financial information.
ii. Improved resource allocation due to a better insight into costs of policy and transparency of results.

## Benefits of Accrual Accounting System

Accrual Accounting provides meaningful information both for accountability and decision-making. Financial information prepared on an accrual basis allows users to:



## Accounting Reforms in IR

Under the dynamic leadership of Hon'ble MR and the inspirational guidance of Financial Commissioner, Railways a number of initiatives have been taken in the Accounting Reforms Project. The budget announcement of 2015-16 gave a tremendous boost and enthusiasm to IR. Broadly, the three reforms identified are in the areas of switching over from cash based government accounting to accrual accounting, tracking of expenditure to desired outcomes and online availability of costing data. This was further reiterated in this year's budget wherein it was asserted that right accounting would determine right costing and hence right pricing and right outcomes.

## Vision of Hon'ble MR




## Initiatives on Accrual Accounting in IR:

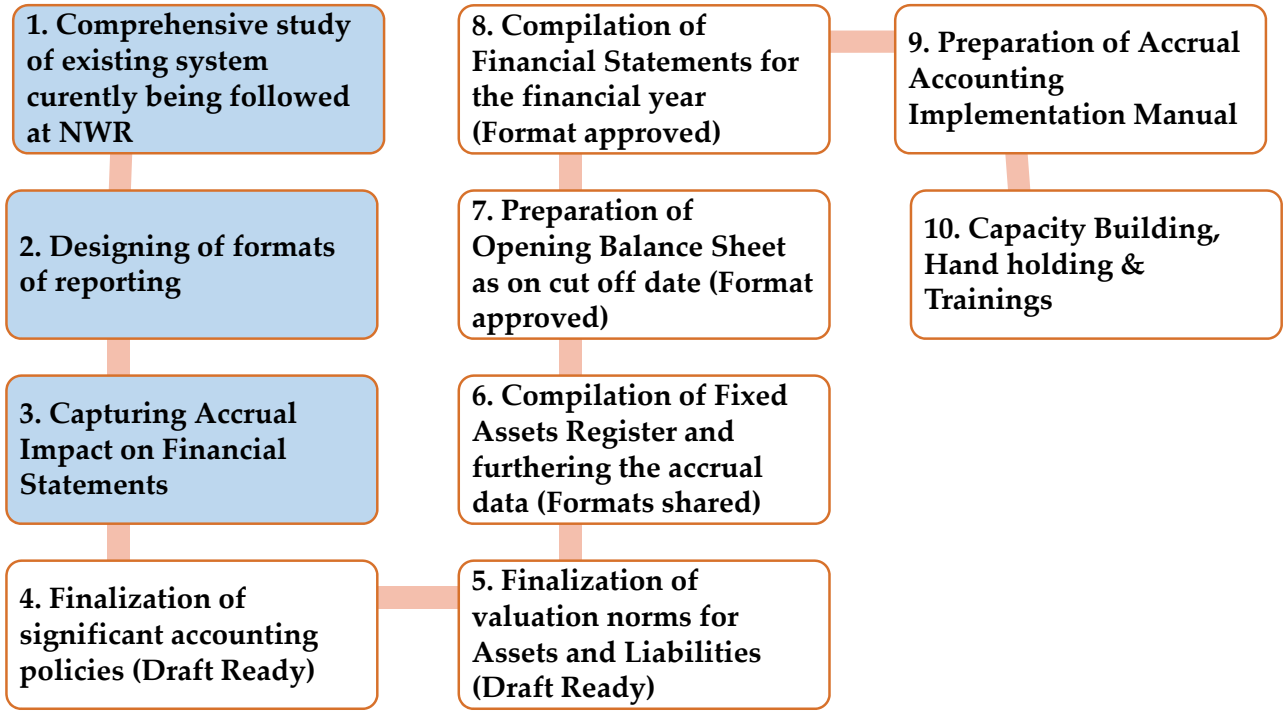
Ministry of Railways has engaged the ICAI Accounting Research Foundation (ICAI ARF), the Research arm of the Institute of Chartered Accountants of India (ICAI) to conduct a pilot study at North Western Railway for introduction of Accrual Accounting in a Zonal Railway. A similar exercise has been initiated at RCF/Kapurthala with the aim to introduce Accrual Accounting and an upgraded Costing system in a Production Unit. It is to be noted that Production units have a different phraseology of Accounting and Costing as compared to a Zonal Railway.

## Methodology adopted in the Pilot studies at NWR and RCF/Kapurthala:

ICAI ARF is preparing the financial statements of NWR and RCF/Kapurthala on grafting basis, i.e. based on existing financial statements with some additional information in respect of accrual elements. Same strategy will be adopted in preparing financial statements of other Zonal Railways and Production Units during the roll out phase. However it is proposed to prepare financial statements by capturing accrual transactions on a day to day basis with the use of IT in due course.

# Detailed roadmap designed to conduct the pilot study at North Western Railway:

## Road Map of Pilot Project in NWR




| Box Highlighted | **Work Completed** |
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# Brief overview of the Comprehensive Scope Evaluation Report (CSER)

As a part of the pilot study at North Western Railway, a Comprehensive Scope Evaluation Report (CSER) has been prepared by ICAI ARF. The CSER has been designed to address the task of bringing together, in a detailed manner, all the components of the existing accounting system. CSER presents a detailed description of the existing accounting system for recording and processing of revenue and capital receipts and revenue and capital expenditure. It also prescribes formats for capturing of data relating to fixed assets, current assets, current liabilities required for the purposes of accrual accounting. CSER also provides mapping of the existing processes and identifies the gaps that exist in the present system from the perspective of accrual based accounting, and the impact those gaps might have on the proposed double entry accounting system. CSER outlines the changes required for the implementation of accrual accounting and also lays down the way forward for implementation of Accrual Accounting.

## Objectives of CSER:

1. Bringing together in a detailed manner all the components of the existing accounting system and the prudence and propriety of the existing system;
2. To present a detailed description of the present accounting system for the purpose of recording and processing of revenue receipts, capital receipts, revenue expenditure and capital expenditure;
3. To present detailed internal organization chart of Finance and Accounts department;
4. To present flow of data/information in respect of all kind of assets and liabilities and also the validity thereof.
5. To present the methodology for converting cash based financial statements into accrual based financial statements and roadmap to achieve.

## Scope of CSER:

1. Project Background
2. Approach and Methodology
3. Observations on Existing Accounting System

4. Gap Analysis
5. Proposed Accounting System
6. Way Forward plan for Implementation of Accrual Accounting which would further enable preparation of opening Balance Sheet as on 1st April, 2014 and the Financial Statements for the year 2014-15 on accrual basis. The financial statements include the P&L Account, Balance Sheet, Cash Flow statement, Notes to Accounts and Significant Accounting Policies.

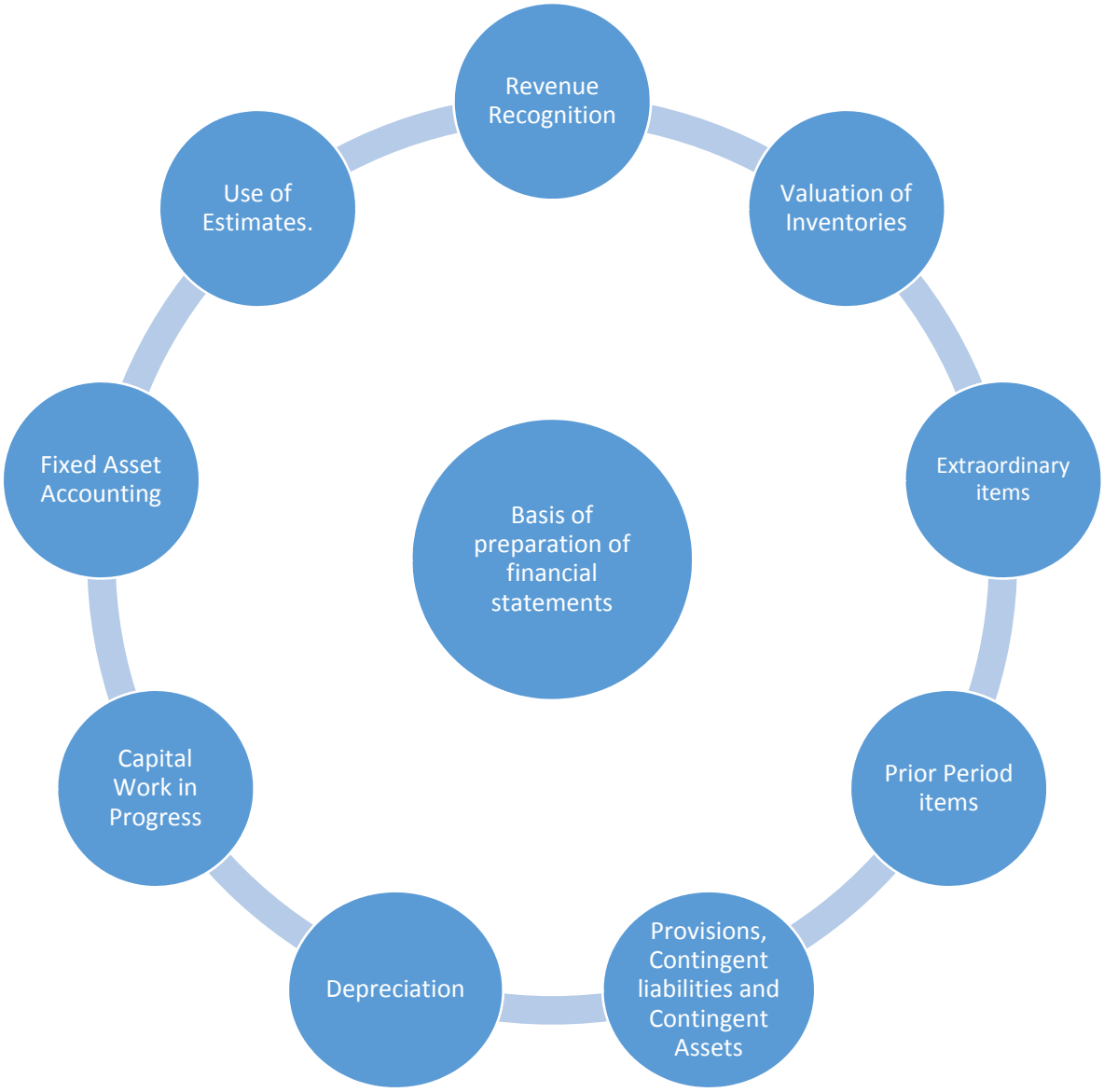
## Areas of Accrual Impact:

The CSER has also identified several areas of accrual impact which are hitherto not shown as current assets and current liabilities. Formats for capturing data about these accrual impact areas have also been devised. Once data is captured in these formats, it will form part of the current assets and current liabilities in the Balance Sheet. Some of these areas of accrual impact are as under:

1. Work/measurement done but bill not received
2. Bill received but payment not made
3. Revenue received but service not provided
4. Employees liabilities viz. Pension
5. Demands payable, Salary payable

## Significant Accounting Policies:

CSER has also highlighted the need for Significant Accounting Policies and Notes to Accounts based on the Generally Accepted Accounting Principles (GAAP) to enable conversion of the existing cash based system of accounting into accrual based system of accounting. A group, comprising of professionals from the Central Council of ICAI ARF and senior officers from IR, has been constituted to deliberate upon and finalise the Significant Accounting Policies that will form the basis of the accrual based financial statements of NWR. Some of the Significant Accounting Policies highlighted in the CSER are as under:




## Capacity Building and Handholding:

Strengthening and capacity building of human capital for the sustainability of Accrual Accounting is one of the most important steps of the implementation of Accounting Reforms. In pursuance of this objective, a number of initiatives have been undertaken both by IR and ICAI ARF. A structured course on Accrual Accounting is being regularly held since November 2015 in the Centralised Training Academy of Railway Accounts (CTARA) at Secundrabad and 750 supervisors and 147 officers of the Accounts Department from all Zonal Railways have undergone training upto the end of May

2016. Several Workshops and Seminars have jointly been organised by IR and ICAI ARF to acclimatise senior officers of the Accounts and Executive Departments to the concept of Accrual Accounting. Besides ICAI ARF is organising a core training session for Central Council Members of ICAI for sharing its experience at North Western Railway.

## Conclusion:

The Pilot study in NWR is likely to be completed by August 2016. Thereafter introduction of Accrual Accounting, as an additional set of accounts to the existing cash based government accounting, would be rolled out in other Zonal Railways. A Project Management Unit has been established in Northern Railway, headed by a Chief Project Manager (CPM) in Senior Administrative Grade, to assist in the rolling out of Accrual Accounting in Zonal Railways. A suitable set up is envisaged in the other Zonal Railways during the roll out phase. Similarly based on the outcomes of the pilot study at RCF/Kapurthala Accrual Accounting, an upgraded Costing system would be rolled out in other Production Units.

Introduction of Accrual Accounting in Zonal Railways and Production Units is just the beginning of Accounting Reforms in IR. This would be followed by introduction of Performance Costing and Outcome Budgeting in all the units. A draft Concept Paper on Performance Costing and Outcome Budgeting has been uploaded on the IR website for feedback. The terms of reference of the study are being worked out by the AR Directorate. It is envisaged to work out the detailed design framework of Performance Costing and Outcome Budgeting by engaging professional agencies shortly. The roll out of Accrual Accounting across Zonal Railways is likely to be completed by March 2018.

# NOTES

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