

GOVERNMENT ACCOUNTING: SOME FUNDAMENTAL ISSUES

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ABSTRACT

Government accounting deals with the identification, measurement and communication of information about the financial events and phenomena of governmental entities. There are three major subsystem of Government accounting: union or central Government accounting, state government accounting and local government accounting. The accounting system consists of the methods and records established to identify, assemble, analyze, classify, record, and report an entity's transactions and to maintain accountability for the related assets and liabilities. Accountability is an obligation to answer for a responsibility that has been conferred. It is often linked with the obligation of the leader, government, and corporate managers to answer for their actions to those who selected, elected or appointed them.

KEYWORDS: *Government Accounting, Governmental Entities, Identification, Measurement, Communication.*

Introduction

In government entities, accountability refers to the obligation on the part of the public officials to report on the usage of public money and resources which are controlled by the entity. It is often used synonymously with such concept as responsibility, answerability, blameworthiness, liability, and other terms associated with the expectation of account-giving. In leadership roles, accountability is the acknowledge and assumption of responsibility for actions, products, decisions, and policies including the administration, governance, and implementation within the scope of the role or employment position and encompassing the obligation to report, explain and be answerable for resulting consequences.

The bases of accountability may be varied. *Stewart* (1984, p.16), *Sinclair*(1995, p.225) have identified, apart from financial accountability, a number of forms of accountability like accountability for probity, accountability for legality, accountability for efficiency, public accountability. *Behn* (2001, pp.3-8) provides a slightly different classification, which recognizes four accountability types: accountability for finances, for fairness, for the use (or abuse) of power and performance. For Behn, the substance of financial accountability is rather straightforward and is provided in the answer to a question "*whether the organization and its officials have been wise stewards of the resources with which they were entrusted*". However, in relation to the government accounting and financial reporting, the financial accountability is the most relevant as argued by *Boyne and Law* (1991, p.179) saying "the annual report is the only comprehensive statement of stewardship available to the public.

Engine of Government Accounting

An effective Government accounting system which contributes to fulfilling an agency's control responsibilities would give appropriate consideration to establishing methods and records that will:

- identify and record all valid transactions;
- describe on a timely basis the transactions in sufficient detail to permit the proper classification of transactions for financial reporting;
- measure the value of transactions in a manner that permits recording their proper monetary value in the financial statements;

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- Determine the time period in which transactions occurred to permit recording of transactions in the proper accounting period; and
- Present properly the transactions and related disclosures in the financial statements.

Although government accounting has many features in common with other branches of accounting, there are certain distinct accounting measurement and classification issues which are unique to governmental entities. It is in view of this that government accounting has come to be recognized as a separate branch of accounting. The issues on which attention is focused include the application of the fund concept, the determination of the basis of accounting and the application of the concept of accountability. The discussion begins with the identification of the specified features of governmental entities which are responsible for creating demands for special accounting concepts and principles in government accounting.

Characteristic Features of Governmental Entities

The common characteristics of governmental entities are as follows:

- **Governmental units exist to serve the citizens:** Governmental entities exist to serve the citizens subject to their jurisdiction. The citizens as a whole establish Governmental entities through the constitutional and charter process.
- **The prime source of revenue is taxation:** A lion's share of revenue of a governmental unit comes from taxation. There may be two types of taxes: direct taxes and indirect taxes. The taxes are provided by the citizens under the jurisdiction of the governmental entity.
- **Absence of profit motive:** The government entities in general render services to the citizens without the objective of profiting from those services. However, there may be a few exceptions.
- **Impact of legislations:** The operational activities of a governmental unit are subject to legislative enactments, such as operating budgets, borrowing authorizations, tax levies etc.
- **Accountability and stewardship:** The government itself is accountable to a variety of elements of society (*Dittenhofer, 1994, p.102*). A governmental unit is accountable to:
 - Its constituents for the economic use of the resources that they have provided;
 - Other governments and organizations for the efficient and effective use of the resources that they supply; and
 - The society itself for constituting a dependable, efficient and ethical segment of the fabric of which the society is structured.

The governmental entity needs an accounting system that is capable of demonstrating how efficiently and effectively it has discharged its above-mentioned accountability.

Essential Features of Government Accounting

The essential features of the government accounting system are clearly specified in a UN document as follows (UN, 1969, pp. 17-18).

- The accounting system should comply with the constitutional, statutory and other legal requirements of the country.
- The accounting system must be related to the budgetary classification.
- The accounts must be maintained in a manner that will clearly identify the objects and purposes for which funds have been received.
- The accounting system must be maintained in a way that will facilitate the audit by external review authorities and readily furnish the information needed for an effective audit.
- The accounting system must be developed in a manner that will permit effective administrative control of funds and operations, programme management and internal audit appraisal.
- The accounts should be developed so that they effectively disclose the economic and financial results of programme operations, including the measurement of revenues, identification of costs and determinations of the operating results (the surplus or deficit positions) of the government and its programmes and organizations, provide data useful for economic analysis and reclassification of governmental transactions and assist in the development of national accounts.

Difference between Accounting Practices of Government Organization's and Profit-Seeking Organizations

The nature and significance of the works of Government Organization performs is quite different from that of profit-seeking business organizations in the private sector. Its main objective is to provide some civic amenities to its citizen at cost price or sometimes even at price lower than the cost. These

essential characteristics of Government Organization's cannot be found in the activities of a private sector profit-seeking organization, whose ultimate objective of economic operations is to earn profit, or more accurately, to maximize the volume of profit within certain legal boundaries. Because of differences in the objectives, the accounting practices of the two organizations also vary widely. Meigs et al(1979, P. 614) has pointed out that in accounting for business enterprises, economic substance of financial transactions is emphasized over their legal form in contrast and accounting for government units emphasizes legal form over economic substance.

Framework of Government Accounting and Fund Concept

The General Accounting Office (GAO) under the Comptroller General of the United States in relation to the conceptual framework of governmental accounting observes (GAO, 1985, pp.2-4) that the objective of financial management in the government organizations is to assure that to the maximum extent possible, the resources entrusted to it are acquired and used lawfully, efficiently and effectively. It has formulated seven underlying concepts that may be considered as key in making a framework of governmental accounting and financial management. These are mentioned below:

- **Use a structured planning and programming process for evaluating and choosing alternatives for achieving desired objective:** A planning and programming process assists policy makers in focusing on what government should be doing, how to best accomplish it, and how to measure performance based on expectations. The process provides an analytic framework for evaluating the benefits and costs of alternatives and facilitates choices among alternative goals, strategies and programmes.
- **Make resource allocation decisions within a unified budget:** A unified budget focuses attention on total expenditure and revenue requirements since the total requirements are known and deficits are fully disclosed, it becomes helpful for the policy makers to make right decision in the course of allocation of resources.
- **Preparation of budget and keeping of accounts would be on the same basis:** Integration of budgeting and accounting provides a common set of rules by which managers make valid comparisons between estimated and actual results, Difference between the two can also be detected and corrective measures can be taken in time.
- **Use accounting principles which match the delivery of services with the cost of services:** It is only the accrual principles of accounting that provide policy makers and management with consistent information to compare project/service costs between periods of agencies. These also help in minimizing inter-period distortions and better informed cost/benefit evaluations become possible.
- **Encourage financial accountability:** A system of detailed and summary management reports identifies costs and accomplishment by the managers and organizations assigned the responsibility for controlling costs, provides accurate, comprehensive information on spending decisions and helps in evaluating those decisions.
- **Measure outputs as well as inputs:** In government budgeting and management reporting system, it is necessary to incorporate the measurement of performance by the managers by way of comparing the project cost with output. It helps to determine if objectives are achieved at an acceptable cost. Analysis of how costs change in proportion to output assists future programme planning.
- **Prepare consolidated report:** Consolidation of annually audited financial statements provides an overall picture of the government's financial conditions. Disclosure of the cumulative financial effect of past decision aids the citizens and policy formulators in analyzing resources and commitments.

Concept of Fund Accounting

Fund accounting is an accounting system emphasizing accountability rather than profitability, used by non-profit organizations and governments. In this system, a fund is a self-balancing set of accounts, segregated for specific purposes in accordance with laws and regulations or special restrictions and limitations (Hay, 1980, p.5). Engler et al (1995, p.886) has rightly pointed out that the fundamental equation for the fund accounting theory may be described as Assets = Restrictions as Assets. In fund accounting a fund may be defined as a separate pool of monetary and other resources established for the purpose of specified activities and is operated and accounted for independently of other accounting entities. According to the GASB (1987, p.45) a fund is... a fiscal and accounting entity

with a self-balancing set of accounts recording cash and /or other resources together with all related liabilities and residual equities or balances, and charges therein, which are segregated for the purpose of carrying on specific activities of attaining certain objectives in accordance with special regulations, restrictions or limitations. In government accounting a fund is a sum of money and often other assets constituting a separate accounting entity, created and maintained for a particular purpose and having transactions subject to legal or administrative restrictions. There is a basic difference between conventional commercial accounting and fund based accounting. While in former system generates one set of accounts consisting of a number of interlocking self-balancing accounts, the latter is composed of multiple sets of accounts, called funds, and within each fund there exists a set of self-balancing accounts.

The objective of the fund system of accounting is to assure that the funds have been properly utilized and to give a report in compliance with finance related legal and contractual restrictions as stated above in basic equation of fund accounting. A fund is established when restrictions have been placed on the purpose for which particular resources may be used. Thus if the law provides that a tax is to be levied for park purposes, the establishment of a Park Fund provides a control over the proceeds from the levy. Establishment of a separate fund means that there must be a separate accounting unit with a separate bank account and the financial information of an individual unit should not be combined with other accounting units of the governmental entity. In financial management of government organizations, where internal control mechanisms play a vital role in economic, efficient and effective usage of public money, in addition to the budgetary control, fund accounting practices may be considered as a second level of control by restricting the employment of particular resources (*Rutherford, 1983, p.46*).

International Picture of Basis of Government Accounting

Basis of accounting refers to when the effects of transactions or events should be recognized for financial reporting purposes. The basis of accounting is an essential aspect of measurement focus because a particular timing of recognition is necessary to accomplish a particular measurement focus. The effects of transactions or events can be recognized on an accrual basis (that is, when the transactions or events take place) or a cash basis (that is, when cash is received or paid). In accrual basis of accounting, in addition to recording transaction resulting from the receipts and disbursement of cash, the amounts the organization owes others and those that owe to the organization are recorded. Cash basis of accounting, on the other hand, recognizes transactions only when cash receipts and payments are involved. No attempt is made to record unpaid bills owed by the organization or amounts due to the organization.

There has been a prolonged debate over the issue of whether governmental entities should prepare and present their accounts on a cash basis or on an accrual basis. During the early of seventies of last century, initiatives have been taken by some of the developed countries like USA and UK to change the cash basis of accounting generally followed in governmental entities. For example, modified accrual basis of accounting was promulgated by AICPA as the basis of government accounting. In the UK another version of the method is known as "*income and converted payments*" method. However, in 1990 the Government Accounting Standard Board (GASB) of the USA published an important guideline on *Measurement and Basis of Accounting – Governmental Fund Operating Statements* and clarifies its position stating that "*this statement requires the use of an accrual basis of accounting to recognize the effects of transactions or events that affect financial resources in the period they take place.*" Since then there have been exercises by the government of most of the countries across the world to switch over from cash or mixture of cash and accrual to the full accrual basis of accounting. For example, countries like Australia, New Zealand, the Netherlands, Sweden and Switzerland have moved over to accrual accounting and accrual budgeting. Again there are countries like Canada, Japan, Italy and Portugal that have adopted full accrual accounting but follow cash based budgeting. Others countries like France, Indonesia, Philippines, Republic of Korea and Sri Lanka have set in motion the process of moving over to an accrual based accounting system.

Basis of Government Accounting in India

In India the Government Accounting Standards Advisory Board (GASAB) was constituted by the Comptroller & Auditor General of India on August 12, 2002 with the objective of formulating standards relating to accounting and financial reporting by the Union, the States and Union Territories with Legislature. In Indian Government Accounting Standard 4 as issued by GASAB, it has been mentioned that *the accounting shall be on Cash Basis, i.e. the transactions in Government accounts shall represent the actual cash receipts and disbursements during a financial year as distinguished from amounts due to or by the Government during the same period.* But the Twelfth Finance Commission recommended adoption of

accrual accounting for the Union and the State Governments. The Central Government has accepted the recommendation in principle. The state governments like Assam, Bihar, Kerala, Madhya Pradesh, Maharashtra, Sikkim, Uttaranchal and West Bengal have also accepted the idea of accrual accounting in principle. Therefore, GASAB is now formulating principles and detailed operational framework and comprehensive road map for migrating basis of government accounting from cash to accrual. Two pilot projects have been completed in this regard. One is *Research Study on Piloting Accrual Accounting in the State of Andhra Pradesh* and report submitted to the government on April 2010. Another report prepared on *Pilot Study on Migration to Accrual Accounting Forest and Health Departments of State Government of Madhya Pradesh* and submitted on May, 2010. Based on the pilot studies, GASAB is now developing the Version 1.0 of the financial statements formats and is working on a comprehensive migration manual to facilitate entity level implementation. At present, the PRIs in West Bengal are keeping their accounts on cash based double entry system. However, it may be mentioned that since 2004-05, the urban local bodies in our state have been keeping their accounting records following the principles of accrual based double entry system which is based on the National PRI Accounting Manual (NMAM) as prepared by C & AG on recommendations of Twelfth Finance Commission.

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