PUBLIC SECTOR ACCOUNTING IN INDIA: A HISTORICAL REVIEW AND AN ANALYSIS SINCE INDEPENDENCE TO THE ECONOMIC REFORMS OF THE NINETIES

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ABSTRACT. This study provides a history and an inventory and analysis of existing public sector accounting principles in India from the time of independence from the British in 1947 through the economic reforms of the nineties. It also analyses the factors that are affecting the current evolution in governmental accounting from an ineffective bureaucratic system to an informative decision making tool, utilizing Luder's Contingency Model of Public Sector Accounting.

INTRODUCTION

Literature to date in accounting has clearly shown that organized systems of accounting follow different patterns in different parts of the world. Most of these studies focused on the private sector (corporate financial reporting systems) and looked at the accounting systems in western nations with market-oriented economies. Enthoven (1988) indicated that the United Nations (UN) and the International Organization of Supreme Audit Institutions (INTOSAI) have made progress in the development of standards for social/macro accounting and governmental auditing respectively. He also stated that the great significance of the public (governmental) sector in many economies and the deficiencies that exist in public sector financial accounting will require better methodologies, practices and training in this vital sector. Even though practitioners and academicians worldwide recognize that public sector accounting is very important, very little research has actually been carried out on governmental accounting standards.

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around the world. This is because, only very recently, has there been a growing awareness that major problems exist in governmental accounting and that harmonization between countries is advisable (Freeman, Shoulders and Lynn, 1989).

In addition, the little research on governmental accounting that has been conducted to date has mainly focused on industrialized nations. Hardman (1982) conducted a comparative analysis of governmental accounting models of England, Canada, Australia, and the United States. A few years later, Luder (1989) did a comparative government accounting study of six industrialized western countries. Then in 1992, Luder proposed a Contingency Model of Public Sector Accounting Innovations that explained the transition from traditional government accounting to a more informative system. More recently, Chang and Khumawala (1994), examined the effects of cultural influences on governmental accounting systems of three developing countries. Most researchers have virtually ignored the governmental accounting systems of developing countries, which is unfortunate, because not only are developing countries the fastest growing economic segment of the world, but they also tend to have very large, dominant governmental entities. They therefore provide excellent materials for research and study. In spite of the economic growth and the growing awareness of problems in international public sector accounting, research linking the areas of developing countries and public sector has been lacking.

This article attempts to fill a niche in the literature that has been a void to date by examining the governmental accounting system of India, a third world country. India is representative of the South East Asian countries (1). It is ranked second in the world in terms of population which is approaching 890 million. Unlike that of western countries, its public sector--in which governmental entities are significant constituents--is a very large and significant part of the economy.

The objective of this article is to provide a history, an inventory and an analysis of existing governmental accounting principles in India. To accomplish this objective, at the outset, the scope of the public sector as it relates to India is defined. The public sector encompasses the Central Government (equivalent to the U.S. Federal Government), Union Territories, government agencies and departments, public sector enterprises (PSEs)(2) and not-for-profit public entities such as hospitals, schools, etc.
The progressive stages of economic development and reforms in India are discussed as they are relevant and appear to be the underlying premise for governmental accounting standards and practices not only in India but in every country of the world. Additionally, a very brief history of India is provided to give the reader a glimpse of its cultural and political heritage. Thus, the paper will (1) briefly trace the development of governmental accounting systems prior to independence; (2) provide an inventory and structure of existing governmental accounting policies; (3) provide an objective analysis of these governmental accounting policies by identifying the major domestic and international factors that have influenced the economic development of India and its reforms; and (4) provide an analysis of the four modules of Luder's Model and an overall assessment of the likelihood of change as supporting evidence of the forces which are shaping India's governmental accounting system and consequently its economy.

ANCIENT INDIA

Prior to the British rule in India, the vast Indian Empire was ruled by independent kingdoms, of which the most well known was the Mughal Empire. The economy was simple and agrarian principles were predominantly followed. Revenues for the king's government were extracted primarily from the agriculture sector in a form of land tax and assessed as a "fixed share" of the produce. Just as the Mughal Empire was declining in power and efficiency in the 1600's, traders from Europe were gaining commercial footholds on the subcontinent.

The British-owned East India Company came into existence in the 17th century as a result of this trade and slowly gained dominance in India's economy until the country finally merged into the British Crown in 1858. The East India Company was a powerful enterprise of merchants with a mission of making money, and it represented both the British power and the state's economic power. At the same time, the many fractured kingdoms in India lost most of their economic power, and remained despotic and very feudal.

The British Crown, more precisely the British Parliament, took over the country from the East India Company and set about reorganizing the entire economic system, changing the government and even reorganizing the army. Thus, the real power and initiative in India was concentrated in the hands of the English who effectively carried out British rule in India until its independence in 1947.
CURRENT GOVERNMENTAL ACCOUNTING SYSTEM

After independence in 1947, India was constituted to a Union of States, made up of 25 states and seven union territories. The accounting system of the states and territories was under the total control of the executive branch of the Central Government. The Indian Government under the Act of the Constitution proceeded on a gradual basis to develop a governmental accounting system with an accompanying body of rules. Under Article 150 of the Constitution, the form of accounts to be followed by all governmental entities is prescribed by the President on the recommendation of the Controller and Auditor-General (CAG). The system is a detailed scheme of "heads," or account categories in which classes of transactions are recorded. The major heads are further divided into sub-heads and the sub-heads divided into detailed heads much like a chart of accounts. Section 22 of the Act authorizes the Central Government to develop rules regarding the maintenance of accounts.

The conventional pattern of classification of accounts which primarily ran along organizational lines was followed. But, with the phenomenal growth and diversity in the functions of Government involving huge outlays of cash, the existing system of accounts became irrelevant and meaningless. The need for a more meaningful classification of transactions for presentation of Government operations in terms of functions, programs and activities was acutely felt. Thus in 1974-75, the CAG, with the approval of the President, prescribed a revised classification for Government transactions. Accordingly, the system was consolidated into three funds: 1) Consolidated Fund, 2) Contingency Fund, and, 3) Public Account Fund.

Besides providing a uniform classification for the budget, accounts and planning, the important objectives to be achieved under the revised classification were: (1) the presentation and compilation of Government expenditure clearly in terms of functions, programs and activities irrespective of the organization administering the activity, (2) to provide management with timely and detailed financial data to help in monitoring and analyzing the expenditures on these activities, and, (3) to facilitate the introduction of performance budgeting.

In 1976, a major overhaul or revision of departmentalization of accounts covering all of the Ministries and Departments of the Central Government was completed. The main objective was to integrate the accounting function with the administrative function of the Ministries and Departments so that
accounting and finance would form an integral part of overall management. In 1980, under the Controller General of Accounts (CGA), an organization was created in the Ministry of Finance, Department of Expenditures. This organization has been separated from the Audit Department and reports directly to the Comptroller Auditor-General. As the centralized accounting authority, the CGA has the responsibility for establishing and maintaining a technically sound accounting system in the Departmentalized Accounts Office. On behalf of the functional Departments within each Ministry, the Department of Railways, Defense, Posts and Telecommunications, and Union Territory Administrations, the CGA acts as the liaison between the Budget Division and the Comptroller Auditor-General in all accounting matters.

As a rule, subsidiary instructions for creating or modifying account categories are issued by the Central Government. However, the Rails, Posts, Communications and Defense Ministries are constitutionally allowed to have their accounts including appropriations accounts, issued by the Departmental Accounting Authorities.

Table 1 presents an overview of the administrative structure of the governmental accounting system. Having been under the British rule, India follows the parliamentary system where the overall process of control over the financial administration of the government is threefold: 1) legislative control, 2) administrative control, and, 3) audit control.

Legislative control over the finances of the government is exercised primarily in two stages. First, in policy making and second, in controlling the implementation of the policy. The Legislature controls the funds and determines not only the amount and the manner of raising the resources, but also how expenditures will be made. The initial control is exercised when the annual budget, more commonly known as the Annual Financial Statement, showing the estimated receipts and proposed expenditures for the fiscal year is presented. The second stage of control is over the implementation of policies which is exercised using a standardized set of Parliamentary procedures and a system of committees.
TABLE 1
Administrative Structure of Governmental Accounting System
Administrative control is exercised by holding the administration accountable to the Legislature for inflows and outflows of funds. Similar accountability is carried out at each level in the hierarchy of delegation.

Audit control is carried out through: (1) fiscal accountability which includes stewardship of the funds and compliance with the laws and regulations, (2) managerial accountability which is concerned with the efficiency of the resources employed, and, (3) program accountability which is concerned with determining whether government programs are achieving the objective for which they are established.

As previously noted, the accounting system is centralized with the Controller General of Accounts as the designated authority. The State Governments and Union Territories, having separate legislatures, basically follow the same form and rules of accounts as laid out by the Central Government. As can be seen from Table 1, the system is organized based on individual Ministries and functional departments within each Ministry. The cash basis of accounting is used and transactions are recorded under the single entry system. Thus, the accounts only show the actual receipts and disbursements during the accounting period and do not include assets or liabilities accrued prior to or during the current period. One of the most distinctive features of the system of Government Accounts in India is the minute elaboration with which the financial transactions of the Government are differentiated and classified for both receipts and disbursements.

All receipts, collections, payments and remittances of funds on behalf of the Central Government are carried out and transacted by the Reserve Bank of India (RBI) pursuant to the Reserve Bank of India Act of 1934. The Central Accounts section of the Reserve Bank maintains individual accounts of various Central Government Ministries, Departments and of Union Territory Administrations. The RBI also acts as the banker to the State Governments. The states are divided into a number of "districts," each with a government treasury called the "District Treasury" (with one or more sub-treasuries) at its headquarters. The Central Government, as a general rule, has an operational account in all the offices and branches of the RBI, and the branches and subsidiaries of the State Bank of India, (which are also authorized to transact government business); and all other bank/agencies throughout India that act as agents of the RBI. The system is very decentralized in that each state is allowed to make their own separate agreement with the RBI, so long as they are in accordance with the Reserve Bank of India Act of 1934, or orders from the State Government. The
operations of each state, however, are confined to the offices, branches and agencies of the RBI and the other requisite bank which falls within the State. Money transactions across state lines must first be authorized by the Accountant General of the State, since each state maintains its own separate bank accounts within its jurisdiction. The cash balance of the government therefore is the sum of the balance in the RBI and the balances at treasuries and sub-treasuries. This decentralization of the treasury work is a feature of the Indian financial system which is totally different from the financial system in England where the Public Receipts and Payments are all centralized.

Each State, Union Territory and the Central Government employ the same basic organization using the three major funds: 1) the Consolidated Fund, 2) the Contingency Fund, and, 3) the Public Account Fund.

**Consolidated Fund of Accounts**

The Consolidated Fund of Accounts has major divisions such as Revenue, Capital, Public Debt, and Loans and Advances. The Revenue division of the Consolidated Fund of Accounts is where taxes and other sources classified as revenue are recorded under the major classification section "Receipt heads (Revenue Account)." The expenditures out of this source of revenues are also recorded in this division under the classification "Expenditure heads (Revenue Account)."

The Capital Division consists of: (1) "Receipt heads (Capital Account)" which includes funds designated for the capital account and are restricted for use of only capital expenditures, (2) "Expenditure heads (Capital Account)" includes expenditures from borrowed funds which either increase fixed assets or reduce recurring liabilities.

The Division "Public Debt" and "Loans and Advances" consists of: (1) outstanding loans of the Central Government and its repayment such as internal and external debt, and, (2) loans and advances made by the Government and its collection, funds appropriated to the Contingency Fund and funds used for "Inter-State Settlement".

Within each of the Divisions of the Consolidated Fund, the transactions of the government are categorized into "General Services", "Social and Community Services", and "Economic Services", under which specific functions or services are grouped. Major heads of account correspond to these specific functions or services of the government under each category. Minor heads identify the program undertaken to achieve the objectives of the
function represented by the major head. A program may consist of a plan or set of activities and these generally correspond to the subheads below the minor heads represented by the program. Detailed heads are primarily meant for itemized control over expenditures and indicate the nature of the expenditure such as salaries and office expenses. This five-tier classification of government accounts, especially the expenditures, illustrates the minute, detailed record-keeping followed in the public sector which is more elaborate than that followed in the private sector.

**Contingency Fund**

The Contingency Fund is an imprest placed at the disposal of the President, Governor of a State or the Administrator of a Union Territory to enable him to meet urgent and unforeseen expenditures. There is only a single major head (account) in which all transactions of this fund are recorded. The high degree of centralized authority, lack of oversight controls and lack of accounting detail invite misuse of public monies in this fund.

**Public Account Fund**

The Public Account Fund (equivalent to the Fiduciary Fund of a US governmental entity) consists of provident funds (pension funds), small savings funds and other trust funds. These funds do not belong to the government and must eventually be returned to the persons and authorities who originally deposited them. In this fund, the transactions relating to debt (other than what is included in the Consolidated Fund), deposits, advances, remittances and suspense (a temporary contingent account) are recorded. The deposits are made into the units of the fiscal system called treasuries located throughout the states and union territories.

Within the Indian Parliament's committee structure, the Estimates Committee and the Public Accounts Committee are active and significant financial bodies that scrutinize matters concerning appropriations and expenditures. The Budget sets forth the estimated revenues and expenditures of the government in the Consolidated Fund for each fiscal year which runs from April 1st to March 31st. The current fiscal year's budget is presented along with the previous fiscal year's budgeted and revised (actual) figures. It is because of this unique presentation of the Budget, that it is also called the "Annual Financial Statement." It is comprised of budgeted figures for the current year and the actual figures for the prior year. The estimates of expenditures established in the Budget are divided into a number of "Demand
for Grants," (request for funds) which are allocated and controlled by individual ministries. Each of the Demands for Grants originated by a ministry separately details expenditures required to be voted upon by the Legislature. It also includes those demands which are open to discussion but not requiring votes of the Legislature. Once approved by the Legislature, the Demands for Grants are appropriated to the Consolidated Fund.

The three departments of the Central Government, Railways, Defense, Posts and Telecommunications are singled out due to their unique characteristics. They have been in existence since prior to independence, each has a separate budget, operate on the accounting policies applicable to the private sector and has a unique set of accounts to meet its specific needs.

According to the Indian Railway Board Act of 1905, the Railway Board is the central controlling authority of the entire railway system in India and functions as a department of the Government. In 1924, the Department of Railways was bestowed the status of a separate financial entity.

Revenues are classified and recorded according to the function performed. Expenditures are classified according to capital expenditure and revenue expenditure similar to the Consolidated Fund discussed earlier. The account titled "Account of net gain or loss on the working of Indian Railways" as a whole is the main account and all other accounts lead up to it. It brings together the capital invested on each railway which is financed by a combination of the Central Government funds and the net revenue receipts for the year.

In the Department of Defense, the Army Administrative and Accounts unit is the central accounting authority. Each unit is under an accounts officer called "Controller of Defense Accounts." These controllers function under the immediate control of the Controller-General of Defense Accounts (CGD), and are the heads of the respective accounts department. The unusual feature of the Defense Accounts is that Defense Service receipts are deposited into banks or treasuries through Military Receivable Orders (MROs), as compared to "challans" (invoices) used by the civil departments.

The Department of Posts and Telecommunication, like the Department of Railways is expected to meet liabilities from operating revenues. The unique features of the accounting system of this department are that it maintains:
1. a capital account that presents the value of the assets, and is reduced by,
   a) the amount of depreciation which is calculated based on the historical
      cost of the assets, and, b) an additional dollar amount to meet the
      replacement cost of the assets,
2. a Renewals Reserve Fund (built up from contributions debited to the
   revenues of the department), which was formerly an accumulated
   depreciation fund. All expenditures on accessions and replacements are
   debited to this fund and are treated as current capital outlay,
3. Suspense Accounts, where transactions relating to the purchase and
   consumption of supplies and transactions relating to manufacturing are
   recorded, and,
4. an Income Statement reflecting the true viability of each department.

Additionally, unlike most other departments, post offices do not deposit
all their collections directly into treasuries accounts, but are permitted to use
their cash receipts for departmental purposes. At the end of the fiscal period,
the remaining cash balance is transferred to the treasury.

Union Territories are administered by the President, through an
administrator appointed by him, and thus, function under the accounting
policies of the Central Government.

Public Sector Enterprises

In addition to ministries and departments, the Central Government and
State Governments have established Public Sector Enterprises or PSEs.
Central Government and State Government PSEs are grouped into one of the
three categories according to ownership and control.\( ^{15} \)

The PSEs, whether "controlled/managed" by the Central Government or
State Government, follow accounting principles based upon one of the three
categories to which they belong. The principle difference between the
departmental PSEs and other PSEs is the degree and extent of autonomy
which they enjoy. Departmentally managed PSEs are directly under a
ministry or department of government and are subject to governmental rules
and procedures (sometimes with minor modifications). Government
 corporations and companies, on the other hand, are governed by the
Companies Act of 1956, or by separate acts of Parliament and/or Legislature
which contain detailed provisions regarding their scope and functions.
The responsibility of the accounting system of departmentally managed PSEs rests with the Ministry of Finance, the Central Government or of the State Government in the jurisdiction where it is located. The Audit Officer is responsible for seeing that the system conforms to the fundamental principles of accounts and audit. Thus, like other governmental entities, PSEs also maintain accounts on a single entry system (as opposed to the double entry system used in commercial accounts) and on a cash basis. For the purpose of determining the net operating profit or loss for the year, these entities prepare a "pro forma" Trading and Profit and Loss Account (Income Statement) and a Balance Sheet annually. These pro-forma accounts are maintained by the departmental authorities themselves and do not include the general accounts of the government. These accounts are also restated under the normal double entry system and additional liabilities and assets accrued during the year are also recorded. The authority for audit of the Balance Sheet and Income Statement of all PSE's vests with the CAG. A brief summary of the financial results of these operations along with the audit reviews are included in the CAG's Reports which are presented to Parliament or State Legislature each year. The author's discussion with a state's Accountant-General highlighted the fact that the Central Government has recommended the adoption of the accrual basis of accounting for these PSE's. This new requirement of accrual basis of accounting is not being enthusiastically accepted. Implementation is slow, but by conviction or necessity, the system will change.

Parliamentary control over departmental PSEs is the same as over any government department. These entities derive their finances from the budget allocations of the administrative ministries or departments. Their revenue receipts go into the Consolidated Fund of the state or union in which they are located and their payments must be disbursed from the fund within the grant voted for the purpose by the Parliament or State Legislature.

The accounts of other PSEs (those set up under the Companies Act) follow the requirement of the Companies Act of 1956 and Generally Accepted Accounting Principles (GAAP) of the private sector. Guidelines are issued periodically by the Ministry or Department of Company Affairs so that the financial data are more informative and/or promote uniformity in practice across all other PSEs.

Government corporations generally follow the accounting rules of the private sector. The government determines, in consultation with the CAG as the need arises, the detailed forms in which the Annual Profit and Loss Accounts and Balance Sheet should be prepared by the entity.
Under the Constitution, the CAG is required to submit the accounting and financial reports of the Central Government, State Government and Union Territories having a Legislative Assembly to the President, Governor of the State and the Administrator of the Union Territories respectively. These reports are audited by the CAG and by law must include the total revenues collected and the total expenditures made by the respective governments. They are then presented to the Houses of Parliament, Legislature of the States and of Union Territories respectively, and are also made available to the public.

Additional Government Financial Reports

Every fiscal year the Economic Division, Ministry of Finance, publishes the *Economic Survey*, which is also available to the general public. This document is very detailed and provides a thorough analysis of every activity of the Government from the macro to the micro level. Unlike the Annual Financial Statement (the Budget) of the Government, which primarily presents the inflow and outflow of funds, this document also provides information on the liabilities of the government, its capital assets, its infrastructure, industrial policies and developments, social sector categories, inflation, developments in the capital market and the external sector.

Validity of Government Reports

Governmental accounting is an integral part of the public financial infrastructure and is the basis for governmental activities. In India, the equivalent to the Governmental Accounting Office in the U.S. does not exist. Also, it has to be borne in mind that presently the majority of the government accounting systems are not computerized. The Balance Sheet and the Income Statement prepared at the end of the year for the PSEs is in reality "manufactured." The audit of these PSEs is meaningless because these auditors are employees of the government (and hence not independent) and most likely were political appointments. The "I am protecting you and you will protect me" culture prevails. This validates Chan and Rubin's (1987) notion that socioeconomic status (SES) of the public has great influence both as a provider and user on the information content of public sector financial reports. In theory, the accounting system is regarded as a part of the overall management information system (MIS). However, in a country where the illiteracy rate is high and politicians from rural areas are uneducated, practice or implementation of any reliable MIS is far from reality.
ANALYSIS OF GOVERNMENTAL ACCOUNTING POLICIES

This section briefly discusses the economic development of India since independence through the reforms of the nineties. This is very relevant and appears to be the underlying premise in formation of governmental accounting standards and failure of its effective implementation. Before India became independent of the British Crown, free markets and private enterprise were well entrenched. Planned economic development was essentially based on the Directive Principles of State Policy incorporated in the Indian Constitution. In 1956, the government of India announced its objective to construct a "socialist pattern of society." This meant that government enterprises would assume the predominant and direct responsibility for carrying out key industrial activities considered essential for the State. Public Sector Enterprises, the "Temples of Modern India," came into being as a result of this deliberate policy adopted by the government.

The PSEs formed a major segment of the industrial activity of India covering important basic and strategic industries such as coal, petroleum, steel, minerals, chemicals, fertilizers, etc. It also covered public utility industries such as energy, communication, postal services and those requiring large capital investments which only the State could provide. The number of government companies increased from 74 at the end of 1956-1957 to 1,020 by the end of 1985-86 (Chakraverty and Kapoor, 1987: 287). The 244 PSEs of the Central Government alone, excluding railways and utilities, employed as many as 2.3 million workers in 1990. In manufacturing, excluding the small "unorganized" sector, public sector employment was over 40 percent of that provided by the private sector (Nayyar, 1992). By the end of fiscal year 1993, (on March 31, 1994), total capital in the public sector amounted to a staggering 1,400 trillion rupees (Kottary and Gangadharan, 1994: 10). It is not the size of the PSEs that is overwhelming but the fact that the public sector provides much of the essential economic infrastructure (electricity, rail transport, road networks, air and seaports). Furthermore, they play a major role in developing the key inputs which enter the production process (energy, metals, fertilizers, petrochemicals and certain categories of heavy machinery).

This expansion was deemed to be only short term partly due to the failure of the public sector to generate investible resources. Additionally, overspending on the part of the government, depletion of foreign exchange reserves and the socio-political turmoil caused the economy to decline until it came to a halt in 1989-1990. This period has been labeled the "dead economy" by world economists. The financial problems of the Indian
government was one of the causes of this decline in the economy. It is the basic stimulus (per Luder’s Model, 1992: 111) that is causing the change from traditional bureaucratic government accounting in India to a hopefully more reliable and informative system.

India in the late 1980s and 1990/91 went through a period of great financial stress. Its public debt including contingent liabilities reached 3,529 billion rupees up from 584 billion rupees in the early 1980s (International Trade Administration, 1994). Its liabilities in 1992, exceeded its assets by about 37%. Interest payments of 320 billion rupees in the 1992/93 Budget were absorbing over 80 percent of the government's capital budget.

In 1992 a securities scandal involving seven government ministers including Finance Minister Manmohan Singh was uncovered. They were accused of a US $1.3 billion scam. This is a clear indication that the banking system, which was nationalized in 1969, had been over-regulated and under-governed. The public sector banks held about 87 percent of the total bank deposits in the country (Wall Street Journal, 1994a). The lack of consistency and conformity in accounting practices and non-application of international standards allowed the banks to “manufacture” balance sheets which did not accurately reflect their underlying financial position (Ministry of Finance, 1994: 15). These factors highlighted the need for better controls, greater accountability on the part of public officials and the need for a more informative public sector accounting system. Thus, following the recommendations of an expert committee which examined the Indian Stock Exchange, the National Stock Exchange (NSE) of India was incorporated in 1992. The success of the NSE was dependent upon the confidence of the investors who relied upon accurate and truthful financial reports.

Independent standard setting bodies, The Indian Institute of Chartered Accountants, the Institute of Cost and Works Accountants of India and public sector financing institutions such as The Development Financial Institution, The Insurance Institution and The Nationalized Commerce Bank succeeded in promoting the NSE. The watchdog body, the Securities and Exchange Board of India (SEBI), similar to the Securities and Exchange Commission (SEC) in the United States, was also granted statutory status in 1992.

**Evolution of the Governmental Accounting System**

In 1992, Luder developed a model which predicts the evolution of a country’s accounting system. The model relates socioeconomic factors to the
stages of development of accounting policies in a country and analyzes the dependability of its financial reports. According to Luder's Model (p. 111) these socioeconomic stimuli affect the users of accounting information (social structural variables) and the producers of this information (the structural variables of the politico-administrative system). This is very true in the case of India. This author believes that these variables can be grouped into three major factors which have influenced India's development or lack thereof. These factors are, (1) the inordinately high level of poverty, (2) public sector enterprises, and, (3) the black economy.

India has 14 percent of the world's population, and it also has the misfortune of having almost twice as large a share of the world's poor. Some 30-40% of Indians (280-380 million) are still living below the poverty line and are said to be "food insecure." Per capita income in 1994 was $320 to $350, among the lowest in the world.

**Poverty**

The portion of the Indian population which is below the poverty line and struggling for its day to day survival is only concerned with the government in terms of its spending on social welfare programs. This large impoverished sector neither understands nor cares about an informative governmental accounting system. The public’s behavior and expectations are reinforced by Chan (1989:8) who indicated that demand for information is related to one's socioeconomic status (SES), and that "[Members of the public] of lower SES have greater demand for expenditure information. [Those] of higher SES have greater demand for information about revenues and liabilities." The social structural variables of Luder's Model, the socioeconomic status and political culture validate and highlight the fact that poverty is an enormous burden on the economy.

**Public Sector Enterprises**

The second major factor is related to the performance of the preeminent public sector. The main indictment against the public sector is that despite large outlays of capital, the economy is constrained by inadequate, unreliable and high-cost infrastructure services. Rather than augmenting government resources, the infrastructure has become a cost center consuming capital resources for its survival. The structural variables of the politico-administrative system in Luder's Model, the administrative culture of the government and political competition contribute to political overstaffing.
Moreover, the "goofing off" effect of soft budget constraints, inordinate delays in commissioning projects, the politicization of investment decisions and the mismanagement of public services encourage widespread corruption. "Greasing the palm" to get anything done is both legendary and real. Political corruption has infected both the establishment and operation of PSEs. Even when the system is not corrupt, the bureaucracy can be notoriously inefficient\(^{(11)}\). The lack of credible mechanisms to hold these governmental enterprises accountable to their customers and the public has resulted in a disappointing return on net profits of only 2.4 percent! The government as an investor is like a bottomless coffer, with a propensity for doling out equity or loans. The loans are eventually converted into equity and interest is converted into loans which is just as injurious to the economic health of the nation as the generation of black money. Thus, this bureaucracy and low profitability has made the notoriously inefficient public sector a wasteful swollen monster.

**Black Economy**

The third critical factor is the dual economy; the existence of "black money." Fiscal planning based on a large bloated public sector, a highly regulated private sector and direct controls on foreign exchange transactions is directly responsible for the emergence of the black economy. High tax rates have made tax evasion a national pastime through concealment of incomes and production. Only one percent of the nation paid taxes in 1993 (\textit{Wall Street Journal}, 1994b). The bureaucrats and the politicians have begun to develop a vested interest in this economy. They continue to lengthen the red tape (a term which originated in British India). As noted earlier, the system is feeding on itself. This underground economy confirms some of both the social and structural variables in the context of Luder's Model.

With its varied geographical and ethnic diversity, India provides a classic example of a developing country and an economy which in its early stages of development had adopted a socialist pattern of society. The rapid pace of Japanese development, formation of trade blocs like the EEC and NAFTA, the extraordinary growth of China, and the spectacular growth of its Asian neighbors, created major problems for India's socialist economy. However, it was the end of the Cold War, and the collapse of the Soviet Union (India's largest trading partner) and communist Eastern Europe, that left Indian leaders who believed in communism internally shaken, but still trying to maintain a public appearance of Marxist belief.
Economic Reforms and Its Impact

After being strapped to the altar of socialism since gaining independence in 1947, India marked the transition to a competitive, open economy in July 1991. It is neither the objective of this paper, nor is it possible, to cover the massive economic reforms that have swept over the country the last six years. Due to the continual and rapid pace of the reforms, only a skeletal coverage is presented here to show its impact on public sector accounting. Broadly, the package of reforms can be grouped as: 1) trade policy reforms, 2) industrial policy reforms, 3) fiscal reforms, and, 4) financial sector reforms. The Budget, as described earlier, is the main tool of fiscal and economic reform.

Reforms in the field of fiscal policy include reduction in personal taxes and rationalization and reduction of import tariffs and quotas. The government is extracting more and more revenue from the black economy which previously equaled or out-sized official GDP.

Financial sector reforms include the implementation of a four-tier banking structure, with banks and financial institutions acting as business units with full autonomy and transparency in their operations. New accounting rules related to income determination and provision of adequate capital consistent with accepted international standards have been implemented. These new rules will ensure that the balance sheet of the banks reflect their true financial position, which is a pre-requisite for effective monitoring and performance improvement.

The reforms affecting the PSEs are of critical importance because they consume a large amount of public resources and impact public sector accounting. Thirty-four major industries once under government control have been opened up for privatization. Money-losing public sector units have been alerted that they will receive no further investment from the government. The Sick Industrial Companies Act (SICA) has been amended to bring PSEs under the jurisdiction of the Board for Industrial and Financial Reconstruction (BIFR) which has the authority to restructure the bankrupt and capital-consuming PSEs or close them down. To increase the accountability of profitable public companies, some eight percent of the equity (US $1 billion) in 30 such companies has been already sold to government-owned investment trusts. The government has plans to divest itself of up to 49 percent of its interest in PSEs. Generally Accepted Accounting Principles (GAAP) applicable in commercial accounting are now
enforced on all government-owned PSEs under the new reforms although the implementation is lagging far behind.

**FORCES SHAPING INDIA’s GOVERNMENTAL ACCOUNTING SYSTEMS AND ECONOMY**

**Analysis Through Luder's Model**

On the basis of literature to date, personal observations and academic inferences, the factors that brought about the reforms in India and their impact on the governmental accounting system have been discussed so far. The major factors are additionally analyzed and grouped according to the four modules of Luder's Model.

The key stimuli that are the basic impetus of effecting the change in the governmental accounting system are: 1) Financial stress of the Indian government in 1989-1990 hence the need for accurate financial information for borrowing of capital from foreign governments, World Bank, UN, and direct foreign investment; 2) the need for accurate financial information for transition (privatizing) of PSEs to private sector; 3) the publicity of financial scandals (stock market crash), corruption and bureaucratic controls; and 4) the nation's leadership resolve to improve the economic conditions of the country.

The key factors that fall in the module of the social structural variables and the module of structural variables of the politico-administrative systems are: 1) Low SES of a large portion of the population; 2) illiteracy; 3) lack of accountability to the general public; 4) lack of true accountability of PSEs to the Central Government. With no financial information, there is no recognition of financial problems - in effect a "what you don't know, won't hurt you" attitude; 5) lack of competition due to the key industries which are largely government owned; 6) non-election of high political officials; 7) favoritism and fraternalism embedded in the system for appointments; 8) lack of professionalism, and professional training of accounting personnel for the public sector; 9) closed administrative culture - protection of one's own turf; 10) low degree of political openness; and 11) low degree of citizen participation in the public decision-making process.

The key factors that are slowing the pace of change in the governmental accounting system in the implementation barriers module are: 1) the socio-political conditions, 2) pervasive corruption, 3) cumbersome bureaucratic procedures, 4) labor laws, 5) political clout of labor unions, 6) resistance to privatization of PSEs, 7) stifling regulations at the state level, 8) state
governments’ reckless and wasteful attitude, 9) no independent standards-setting body for the public sector, and, 10) lack of an accounting standards enforcing body.

By adapting Luder’s General Classification Model as presented in Table 2, the variables in each of these modules are classified as being favorable or unfavorable in affecting the reforms and an overall assessment is performed. Since India is in a continual state of reform, the assessment is provided only for fiscal year 1996.

Research studies by Baber and Sen (1984), Evans and Patton (1987) and Ingram (1983,1984), investigated the causes and factors which influenced the decision of the states and local governments in the U.S. to follow governmental GAAP. This study has contributed to the literature by

TABLE 2
Luder's General Classification Model (Adapted)

<table>
<thead>
<tr>
<th>Module</th>
<th>Sign</th>
<th>1996 India Rating</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stimuli</td>
<td>+</td>
<td>+ One favorable stimulus present</td>
</tr>
<tr>
<td>Social Structural Variables</td>
<td>+</td>
<td>- Lack of strong political competition</td>
</tr>
<tr>
<td></td>
<td>-</td>
<td>- Low SES</td>
</tr>
<tr>
<td></td>
<td></td>
<td>- Open political culture</td>
</tr>
<tr>
<td>Structural Variables of Politico-Administrative System</td>
<td>+</td>
<td>- Little/no staff training influenced by</td>
</tr>
<tr>
<td></td>
<td>-</td>
<td>- Closed administrative culture</td>
</tr>
<tr>
<td></td>
<td></td>
<td>- Low political competition</td>
</tr>
<tr>
<td>Implementation Barriers</td>
<td>+</td>
<td>- Many barriers exist</td>
</tr>
<tr>
<td>Overall Assessment</td>
<td>+</td>
<td>- Do not expect innovations to occur</td>
</tr>
<tr>
<td></td>
<td>-</td>
<td></td>
</tr>
</tbody>
</table>

Notes: + = Increasing Trend
       - = Decreasing Trend
an analyzing the factors that are effecting the change in India, a less developed country, from a bureaucratic unreliable governmental accounting system to a more informative one and analyzing the system by applying Luder’s Public Sector Accounting Innovations Model. However, a true empirical study could not be accomplished due to the severe limitations inherent in the data set. Comparing the financial statements of the Central Government of India for 1988-1989 (prior to the reform) with the financial statements for 1993-1994 (post reform) is meaningless since these statements have no economic substance. At this early stage of transformation, the full implementation of GAAP for commercial accounting in PSEs is not yet in place and will take a few years for the system to adapt. The financial statements will then reflect the true financial position of the PSEs and hence of the governmental entity. Additionally, when these entities are fully privatized or the government has less than a controlling interest, the scope of the governmental accounting entity will also change. Comparison of the financial statements will then be meaningful, reliable and relevant and the stability of these changes can then be assessed.

General Note

Since the end of the Cold War and the collapse of the Soviet Union, India is looking east to its own Asian environment as a new diplomatic and market focus. To emphasize the importance of these nations, the U.S. Department of Commerce has labeled them the Big Emerging Markets (BEM). Of all the world trade growth in the next two decades, almost three-fourths is projected to come from the less developed countries (LDC). Economic reform is paramount to the future success of all BEMs (Business America, 1994). Other than India, neighboring countries like Pakistan, Bangladesh, Nepal and Sri-Lanka have also undergone changes in their economic and political systems. Evaluation of the governmental accounting systems of these countries in terms of Luder’s Model would be very beneficial. A comparative study similar to Luder’s 1989 study can be done of these LDCs to understand the current evolution of these systems. Another comparative study of the developed countries of East Asia, China, Indonesia, Korea, Thailand and Malaysia would also contribute significantly to the literature. This would be very beneficial to IFAC’s public sector committee, ICGFM, UN and other world organizations working towards harmonizing governmental accounting standards around the world.
CONCLUSIONS

From a bird's eye view of India's history, its development since independence and the recent sweeping economic reforms, this study has shown the pervasive influence of these factors on public sector accounting principles. The analysis of the relevant variables according to Luder's General Classification Model is provided with an assessment for the 1996 year. As reforms, however big or small are introduced everyday, they affect public sector accounting. But, the overall assessment of India per Luder's Model, due to implementation barriers, is not expected to change in the short term.

Additionally, the restructuring of the capital markets and the banking institutions and requirements to follow new accounting standards also reveal a transformation to a fairly advanced financial system. However, the reforms have yet to gain momentum and the tempo of implementation will have to be accelerated. The process has begun to bring the Indian financial system in line with the international financial system to facilitate global harmony.

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NOTES

1. Prior to independence from the British in 1947, "British India" comprised what is presently Pakistan, India and Bangladesh. In 1947, along with independence, this Indian subcontinent was divided into India and Pakistan (East and West). East Pakistan won independence from West Pakistan in 1971 and is now known as Bangladesh.

2. Public Sector Enterprises (PSEs) are grouped into one of the three categories, 1) departmentally managed PSEs which form part and parcel of government activities, 2) a government company registered and incorporated under the Companies Act of 1956, and, 3) a statutory corporation which is not a government company though all the shares in it are held and owned by the government. These are corporations as
distinguished from government companies and are incorporated under separate Acts of the Parliament.

3. The domestic factors include the Companies Act of 1956 and the social, economic and political environment. The major international factors include the Soviet influence and intervention (pseudo-Marxist ideology), the development and economic revival of Japan, formation of trade blocs like the European Economic Community (EEC), and North American Free Trade Agreement (NAFTA), collapse of the Soviet Union and Communist East Europe, extraordinary economic growth of China and other Asian neighbors and globalization of world markets.

4. Mughal is pronounced and sometimes spelled as "mogul."

5. The term "heads" is the nomenclature used in governmental accounting rules in India which represents account headings or titles of major classifications.

6. Performance budgeting is an effective management tool which seeks to improve the understanding and review of budgets; and also to clarify the purpose and use of funds that have been appropriated to the various ministries. The proposal to use performance budgeting in India, was first introduced in 1954, but currently is still being used by the government as a supplement to the main budget and not as a tool for management decisions.

7. The title of account categories on the actual budget is printed in upper and lower case letters. Only the first word is capitalized and that convention is followed here and denoted by the quotation marks.

8. See endnote 2 for a description of the categories.

9. Around 400 million, the largest number in any one country, cannot read or write. The literacy rate increased from 15.7 percent in 1961, to 36.2 percent in 1981 and 52.1 percent in 1991. The percentage of literate citizens is further broken down to 63 percent male and 37 percent female (Europa World Year Book, 1994: 1428).

10. The exchange rate on March 6, 1997 between the US dollar and Indian rupee was $1.00 = 35.86 rupees (The Wall Street Journal, 1997).

11. Singh (1992) cited that one study revealed that it took an average of 258 signatures and 118 pieces of paper to complete the formalities for a
single export shipment out of India and it took 22 hours to prepare the documentation.

REFERENCES


