INDIAN RAILWAYS - STAGES IN CHANGE OVER TO ACCRUAL ACCOUNTING

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Indian Railways is poised to switch over to Accrual Accounting from the present system of accounting which is considered translucent to outsiders. Over a period of time, the present system of accounts has served the requirements of Railways very well and they are well structured, classified and systematic but the requirements of Railways and the face of Indian Railways is changing fast. The users of accounting statements/reports are many now when compared to management at different levels of IR hitherto going through the financials of railways.

Accrual accounting can be defined which takes into account not only discharged liabilities and realized earnings or income during the year but also brings into account unrealized income and outstanding expenses as well as properly excludes prepaid expenses and incomes received in advance from the accounts of the year. To put it more precisely, accounting recognizes both income and expenditure as they occur irrespective of time of realization or payment. Similarly, accounting ensures that income or expenditure which does not pertain to the financial year stand excluded and reflected as either on liability side as income received in advance or prepaid expenses on asset side in Balance Sheet of the company. This is the fundamental principle of any commercial accounting system.

What ails IR accounts and why to change over to Accrual or commercial accounts?

The present system of Accounting in Indian Railways was designed to suit the requirements of railways and the reporting requirements and has served very well till now. As Debroy Committee described in their report, accounts of Railways are very much clear to insiders but translucent to outsiders. The stake holders in Indian Railway are increasing from mere management, audit ministry of finance, planning commission and parliament to a large number like state governments, financial institutions, private participants in investment plan like SPVs, Ports, LIC, Industry besides FDIs to whom Railways want to attract. Some of the shortcomings observed and commented by several committees appointed to study IR and its finances are highlighted as under:

- Formats of P&L Account and Balance Sheet are not conforming commercial organizations.
- Terms and items are quite different and in some cases they are not intelligible to outsiders.
- IR is not following Accounting Standards envisaged for accounting expenses and income.
- Both Incomes and expenses are recorded without following concepts of accounting period. Incomes are recognized well before the service rendered and expenses are not brought into books as outstanding liabilities or as prepaid expenses.
- Depreciation is not provided as per commercial principles but on adhoc basis based on affordability of IR

In the light of above, there is absolute need for change of accounting, adopting formats of final accounts in tune with accounting standards and ensuring more transparency and better disclosures in accounts.

Stages anticipated to switch over to Accrual Accounts are outlined below:

- **Legal Changes**

Some of the arrangements presently in vogue between Government of India and Indian Railways call for relook and resultant changes in legal framework. They are outlined below:

(i) Dual Role of IR needs relook as at present IR is functioning both as a Department under Government of India and as well as a commercial Organization.

(ii) It should also be examined afresh whether the budgetary support provided by the GOI is capital or loan and whether GOI is a lender or investor. The present arrangement is quite disadvantageous financially to railways as it has to pay dividend at the prescribed rate perennially irrespective of the fact that the assets created from this amount have been replaced with internal resources. If it is a loan , there must be repayment schedule. If it is treated as Capital, dividend is payable only when the Same is declared from divisible profits.

(iii) Similarly, the cost of social obligations should be reimbursed as the same is financial burden every year on the scarce resources of IR.

(iv) With the anticipated FDI into IR, necessary amendments to Railway Act need to be made defining the role of FDI. Relationship with IR, duties and obligations and guarantees to be provided to FDI sources..

- **Modifications to Codes and Manuals**

  In the light of decision to go in for Accrual Accounting, it is considered essential to revisit the Codes and Manuals of IR to conform to the requirements of change in accounting system envisaged. Concepts/systems already in vogue like payments to staff/outsiders through banks, e recon, MMIS, FOIS, PRS, UTS etc., are not incorporated in Codes/Manuals. Some provisions /chapters of Accounts Code on payment system and apportionment of earnings and so on need complete redrafting to afford clarity.

- **Changes in formats of Final Accounts**

  Criticism against IR by many expert committees who studied IR accounts has been that the format of final accounts prepared by IR is not understood by the prospective investors. Moreover, the format of Profit & loss account and Balance Sheet are quite different from other commercial organizations. IR is not following Accounting Standards of ICAI. Terms used are not understood by the outsiders. Of late, IR Annual Accounts contain foot notes and schedules explaining the details of components of earnings and expenses which is a good step in right direction. Much needs to be done before IR switches over to commercial accounts. Clearances from Audit and CGA are required to changes the formats

- **Building up of Asset Register**

  Most important aspect which requires a lot of effort and co-operation and involvement of Executive Departments is building up Asset Register on Indian Railways. There are different kinds of assets on IR ranging from track, buildings, rolling stock, machinery, bridges, signaling and telecom equipment, Medical equipment etc. all over. All these are to be brought in asset register by the departments concerned.

Following data are required to build the asset register.

1. Date of Acquisition of asset.
2. Original cost of the asset.
3. Life of the asset and
4. Scrap value of asset.

In many cases, the date of acquisition and cost are not available. The Institute of Chartered Accountants of India suggested a method of arriving the original cost if the present cost of the same or similar asset is known and date of acquisition are known. The methodology envisaged is something opposite to indexing of present cost to work out capital gains as in incase of Income Tax. This is the area where executive interface and participation is called for.

- **Working out Depreciation on commercial lines**

  The present policy of IR in respect of depreciation is governed by the provisions contained Indian Railway Code for Finance Vol I. More importantly, IR provides depreciation as per affordability than the requirement based on age cum condition of assets. Further depreciation is an appropriation. At present, there is no primary unit for depreciation in Railway Accounts and in case Ir decides to follow commercial accounts, the same needs to be provided. Suitable mechanism to be evolved to invest depreciation amount provided in commercially viable and profitable avenues to generate required amount at the time of replacement.

- **Working out actuarial pension liability**.

  Indian Railways provide appropriation to pension fund at the end of the year based on actual outgo of pension already debited to Demand no 13. IR does not estimate its pension liability on actuarial basis as done by Pension funds all over the World. It is essential to focus on this area and asses pension liability over next few decades.

- **Orientation and Training**

  Indian Railways need to train all the supervisory staff and Officers of Accounts Department on the various aspects of Accrual Accounting. With this end in view, CTARA at Secunderabad has been entrusted with the huge task of organizing training programmes duly drawing faculty of experts like Chartered Accountants besides engaging experienced Railway Accounts Officers as guest faculty. This is a prerequisite for switching over to Accrual Accounts.

- **Activity Based Costing**

  The costing practices of IR are not refined as prevailing in other commercial entities. Costing has not been providing desired help to management to take decisions such as introduction of new trains, new halt etc., In order to have a Regulator as suggested by Debroy Committee, costing system is to be revamped. Activity Based Unit Costing System is to be introduced. At present, cost of activities carried out by SSE/P WAY, SSE/Works, SSE/ Signals etc is not readily available which is to be captured by the system. One suggestion is to provide separate code for activity center and another code for each activity carried out by center in the financial accounting so that FMIS can accomplish the Activity Based Costing which will be useful for taking decisions.

- **Implementation of Pilot Project**

  IR before taking final decision to switch over to commercial accounts, pilot projects are to be implemented on few divisions. As such, Railway Board nominated Ajmer Division for Pilot Project. Based on the feedback, further, projects will be started.

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