FINANCIAL MANAGEMENT AN OVERVIEW WITH SPECIAL REFERENCE TO INDIAN ECONOMY

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INTRODUCTION

These are special purpose financial statements whose format is agreed upon during project appraisal. The purpose of these statements is to fulfill the fiduciary requirements of the borrower, cofinanciers/donors and the bank, and to provide financial management information including that required under PMR-based disbursements. Project implementing units are usually fully financed by the project concerned. In these instances, all the expenses of the PIU are part of the project and will normally be shown separately as project implementing unit expenditures in the sources and uses of funds statements. When the project implementing unit administers several projects. It should be noted that the financial statements of the projects cover not only bank funds but all other funds are reflected in the project appraisal document. Where significant funding is provided in kind, appropriate adjustments should be made to the accounts and reflected in the financial statements. One project financial statement is required for each project even though it may be financed by a blend of loan, credit, trust fund etc. The same also applies where the vehicle of financing may change, such as a change to single currency loan. Where a project is implemented by several PIUs, the main PIU should consolidate the various financial statements. In certain circumstances, where there are several auditors involved and a consolidation is not convenient, a tabulation of the audit reports may be made, supported by necessary individual audit reports. Where one finances a multi-state project and the bank intends to apply its covenants separately to each participating state, a project financial statement is required from each state. As the project is defined as covering all sources of funds (both bank provided and otherwise), the annual financial statements of the projects should also include all sources of funds. Similarly, the audit should relate to the whole project, not just to the bank-financed portion. In a project which supports capacity building in several institutions, the bank may require each to provide annual audited financial statements will need to be shown in the listing of compliance with covenants and considered when judging
compliance with legal convenants ,they will not narmally be reported individually via the Audit Report Compliance System (ARCSs). The PIU is required to monitor the receipt of these reports, review them and prepare a periodic report to the bank summarizing the status of compliance with the relevant convenants. In addition, the project financial statements would include the amounts disbursed to the participating institutions, summarizing the institutions use of funds to the extent that this may be required under the project. Special accounts and expenditures disbursed on the basis of PMRs should be integrated with project financial statements. The financial statements should include summary statements for special account (SA) transaction and for PMRs submitted during the year 2012. The audit opinion should also include a special reference to the SA activities and PMR-based disbursements. It is important that all details of the special account, including bank statements, be made available to the project’s auditors to reconcile project with bank records.

A separate financial statements for the entity as a whole is often required for project implemented, industrial and business entities. Entity financial statements are only required for those projects which (a) are implemented by revenue-earning entities (b) the financial viability of the implementing organisation is vital to the success of the project (c) one of the objectives of the project is to improve the institutional capability of the implementing organisation. These vital situations usually arise when the project is implemented by a commercial, industrial or business enterprise. Where a commercial type-entity wishes the project financial statements to be integrated as a part of the entity’s financial statements, the project must be identifiable (through an accompanying table or annex summarizing the sources and uses of funds of the projects, or through the notes to the financial statements). In addition to the auditor’s opinion on the financial statements of the entity, there must also be an auditor’s opinion on those of the project.

Fixed assets is the normal basis for quarterly disbursement using PMRs. As a result, accounting for fixed assets has not been given the attention which it normally receives in financial reporting. Whatever the basis of accounting used, accounting for fixed assets requires serious consideration. Even though the main financial statements may not feature fixed assets (e.g. Under cash accounting), there is a clear need to account for and report fixed assets. Without this information, an element of the accountability chain is broken because information needed for management and fiduciary purposes cannot be supplied. It is, therefore, important that projects maintain complete fixed assets registers specifying details such as the type of assets, its cost, the number of units, the date of acquisition and the beneficiary institution to which the assets have been transferred. For projects involving large engineering works, a full cost ledger is needed so that costs can be accumulate for each component of the project during the planning construction and commissioning phases of the project. To summarize, accounting for fixed assets is an important aspect of due diligence, even though it not figure prominently for the purposes of the PMR. Fixed assets should be recorded in asset registers or ledgers, and periodic management reports should report summary data on their status. Projects normally finance fixed assets for beneficiary entities including the relevant PIU. These assets are used for the production or the supply of goods and services, for rental or for the administrative purposes of the beneficiary entities. Project fixed assets as reported in the financial statements of the project are usually limited to those used in the administration of the project such as vehicles and equipment used by
project managers and staff. Even under the accrual basis of accounting, fixed assets should be shown at cost without depreciation. Amortizing their cost over the life of the project would normally serve no useful purpose due to their immateriality to total project costs and because typically there is no project income against which the depreciation could be charged.

Where the project is implemented by a non-revenue earning entity, the cash basis of accounting is normally used. The project’s annual financial statements are presented in the format agreed with the bank. No balance sheet is required on the assumption that cash balances would be reflected in the project sources and uses of funds statements. Where the project is implemented by a revenue-earning entity, the accrual accounting basis is applied and the entity’s financial statements presented in accordance with an agreed national accounting standards (International Accounting Standards are the benchmark). Where possible, non-revenue earning projects are also encouraged to use the accrual accounting basis as this leads to better accounting and provides more relevant information for comparison with output and other indicators.

Under the accrual accounting basis:

- Balance sheet is always required.
- Assets may be shown gross under project expenditures with project financing shown under funds. This reflects the idea that the project represents work in progress until it is completed.
- Project sources and uses of funds include all accruals and advances. For example, where the borrower has pre-financed 100 percent of project cost over a period, and the bank will finance 50 percent thereof, the report will show the borrower as having advanced the bank 50 percent, showing the bank as a receivable for the same amount, and
- A cash flow statement is required summarizing receipts and payments. The special account and PMR disbursement statement and notes to the financial statements are also included.

The reporting principles applicable to revenue-earning entities are fully covered by International Accounting Standards and are therefore omitted from this. However, the bank provides two options for meeting its reporting requirements for revenue–earning entities.

**OPTION 1** :- Provide separate project financial statement with a separate audit opinion on the special account and on disbursements made on the basis of PMRs. This option is usually the most suitable.

**OPTION 2** :- Attach with the project sources and uses of funds, and summary of PMR disbursements and the special account as appendices of the entity’s financial statements with (a) the note to the entity’s financial statements covering any aspects requiring disclosure and (b) the audit opinion specifically covering such appendices.
Bank policy (OP/BP 10.02) requires the borrower and the project implementing entities to have the required financial statements for each year audited. Audits are to be in accordance with standards that are acceptable to the bank. Examples of such standards are the International Standards on Auditing (ISA) published by the International Federation of Accountants (IFAC) and auditing standards issued by the International Organisational of supreme Audit Institution (INTOSAI).

Overall real Gross Domestic Product (GDP) growth for 2001-02, which was estimated at 5.4 percent by the central statistical organisation (CSO) at the time of budget formulation improved to 5.6 percent as per the quick estimates. However, industrial growth remained subdued, which severely constrained the process of fiscal consolidation in 2001-02. Net revenue receipts of the centre at Rs 2,02,881 crore fell short of the budget estimate by Rs 28,864 crore mainly on account of shortfall in tax revenue. Net tax revenue of the centre was 2.5 percent below the level in the previous year. The shortfall in revenue from income tax and corporation tax was over 19 percent, as compared with the budget estimate. Revenue from excise fell short of the budget estimate by 11 percent.

There was some decline in the total expenditure of the central government as a proportion of GDP in 2001-02. Plan expenditure witnessed in increase in the capital account mainly is a result of step up in the levels of investment in different sectors. Non-plan expenditure remained lower than budget estimate by Rs 16,298 crore. Capital expenditure recorded an increase of 26.9 percent in the year 2001-02 year over the previous year, while revenue expenditure recorded a modest increase of 7.4 percent in the same period.

The decline in revenue receipts led to higher borrowings, which grew by 14.6 percent in 2001-02 as compared with growth of 13.5 percent in 2000-01. As a result, the fiscal deficit which was budgeted to remain at 4.7 percent GDP could not be contained and went up to 5.9 percent of GDP.

**VALUE ADDED TAX (VAT)**

Almost three-fourths of India has adopted Value Added Tax regime, switching off its ageold sales tax system that had existed for more than 50 years. While this change is a welcome measure for the trading community at large, the changeover would be a success only when the same is implemented across the country. This article analyses some of the major issues and concerns arising out of this so-called fractured implementation of VAT.

The much talked-about tax reform—Value Added Tax (VAT) that replaces the existing Sales Tax structure across various states has at last come to stay in majority of the states in India, thanks to the efforts of Mr. Asim Das Gupta, the Chairman of the Empowered Committee (EC) of State Finance Ministers. After several rounds of discussions and meetings to arrive at a consensus on various issues concerning the trade and industry at large, the EC has started its first phase of implementation in various states. Though, the White Paper on the State Level Value Added Tax released on the 17th of January 2005 has talked about various decisions which the EC has agreed upon, it is not out of place to mention that not all problems of the trade are addressed to in the same. The discussions after the release of the White Paper also solved certain
issues like a definitive time frame for the removal of the Central Sales Tax (CST). However, this article critically examines the issues causing concern for trade and industry due to the so-called fractured implementation of the VAT in India, where some states follow VAT regime while some others stick to the age-old sales tax system.

FRACTURED IMPLEMENTATION AND ITS EFFECTS

The proposal to integrate the various indirect taxes across the country, by involving a uniform Goods and Service Tax (GST), as recommended by the Kelkar Committee, would be possible only when there is a uniformity in the taxation system. This is because the uniformity itself will lead to smooth transition to an integrated GST. However, due to certain political and other considerations, some of the states have not joined the bandwagon of VAT that came into force w.e.f 1st of April 2005. This will create problems, some of which are listed as under:

DIFFERENTIAL TAX TREATMENT

While the states following the VAT regime allow the credit of all the taxes paid at an earlier stage (subject, of course, to certain restrictions), against the final tax liability, the states following the sales tax still follow the single point levy, exempting subsequent stages of sale/imposing another tax by various names such as resale tax, turnover tax, etc. This may lead to a situation, where a business unit having its business spread across the country would not be able to maintain a uniform pricing system. Also, the margins of various businesses would get affected due to this indifference.

MOVEMENT OF GOODS

Where the goods move from a VAT state to a non-VAT state, the credit of Locally procured materials would be available against the Central Sales Tax that is required to be paid. On the contrary, movement of goods from a non-VAT state to a VAT state would not be able to set off its tax paid on the purchases, which would obviously result in a position that the customer would be required to bear an additional brunt of tax in this case. Though the VAT acts allow the set-off of tax paid on the inputs in excess of 4% in case of stock transfer of goods, the same would not be useful in case where the goods are transferred from a non-VAT state, where similar provisions do not exist. Hence, the stock transfers from VAT states would bear a less tax burden compared to the transfers from a non-VAT state. However, the impact would also depend on the prevailing sales tax rate because in a case of sales tax rate being less than 4%, the same would not affect the stock transfers. Phasing out of CST:

It has been agreed that the CST would be phased out completely by 2007. The Government needs to be firm on this decision as this is an area, which is presently hurting the business segment. With the CST not being allowed as a credit, all the business units need to find a local sourcing of materials for a temporary period of two years (as it stands today), which would not be possible for many traders who have been dealing on inter-state purchases for the last several years. The major decisions such as changing the sourcing person would not also be worth as the existence of CST is only for a limited period from now.
Hence, till the time the CST is phased out, the additional burden of tax has to be borne by the ultimate consumers. This also results in a competitive advantage to the businesses, which completely depend on local supplies against a business having multi fold sourcing from various parts across the country.

**INCENTIVE SCHEMES**

With the decision of the implementation of the VAT, all the State Governments have put the incentive schemes aside. All the businesses, which were granted the benefits of various incentive schemes, need to find a way out to sustain and survive, as all their financial projections need to be adjusted so as to suit the requirements of the current legislations across various states. This will also lead to another problem in cases where the unit having businesses across the country in states that are imposing VAT and states not imposing VAT, such as there could not be uniformity in the pricing system.

**EXEMPTION SCHEMES**

As the basic idea of VAT is to ensure uniformity across various sections, it is imperative that there should not be any schemes permitting exemptions for specific dealers. This would result in a situation where the VAT chain breaks in between in case there are dealer specific exemptions, as they exist today. This would also affect the supplies made to the various exempted units such as Canteen Stores Department. All the Charitable Institutions which were earlier granted exemption under the Sales Tax regime needs to gear up to comply with the new tax regime attracting for the first time and following the updated legislations, which would be a cumbersome process given the nature of the businesses being carried out by them. The so called fractured implementation would now make the VAT states as less competitive compared to non VAT states, as they would not be in a position to avail any of the exemption schemes.

**ACCOUNTING SYSTEMS**

The fractured implementation of VAT basically affects the companies following a uniform and centralized accounting system in an Information Technology environment. This is because of the fact that the accounting treatment differs in a VAT regime when compared to a non-VAT regime. When these both co-exist, the problems on account of maintenance of books of account would be innumerable as it would be difficult to keep a trail of events that would be necessary in order to avail the full benefits accruing under a VAT system.

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**NO UNIFORMITY IN THE RATES**
Even among the states that have implemented the VAT, there is no uniformity in the rates that is being followed. As one could see, the Empowered Committee covered only 550 commodities in two schedules of 4% and 12.5% VAT, leaving out many items and more products to the whims and fancies of State tax administration. Also, the current rates as proposed by the White Paper, which were now implemented differ with the rates existing in the State of Haryana, pioneer state in introducing the VAT in the year 2003 itself. There are three rates existing in Haryana i.e. 4%, 10% and 12.5%. However, the states, which have implemented the VAT, now have only two rates namely 4% and 12.5%. There are certain critical items where there is a wide disparity in the rate of taxes across neighbouring states. In order to maintain uniformity all over India, rates of VAT are required to be decided by the Empowered Committee and applied in all the states and Union Territories. Adoption of a uniform system like that of a Harmonised System of Nomenclature (as is in force today for the Central Excise and Customs purposes) would be convenient for all the states to comply with. This type of uniform system is bound to reduce considerable litigation, which could be on various matters relating to classification of goods.

CONCLUSION

The move towards the VAT regime is a welcome step for the Indian Economy, but to get the complete benefits of this VAT, it is necessary that the whole nation should understand the issues and concerns of the trade and the industry at large in evolving a common system of taxation across the country. The states, who have not yet implemented the VAT, have to understand the problems being faced by the trading community at large and should implement the VAT as quickly as possible so as to reduce the concerns of trade. This would pave the way for initiating the steps for the introduction of the GST in a near future. As already steps have been initiated in integrating the taxation on goods and services at the central level (already inter sectoral credit has been introduced), it would be necessary to initiate the steps for ensuring a uniform value added tax law across the country which would then pave the way for implementation of a common GST across the country.

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