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**India**

**A Study of Recent Literature on Public Financial Management  
and Accountability (PFMA) System of the Government of India**

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**Financial Management Unit  
South Asia Region**

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## LIST OF ABBREVIATIONS AND ACRONYMS

### *Alphabetically listed*

<b>ACA – EAP</b>	Additional Central Assistance for Externally Assisted Programs
<b>ATF</b>	Ad-hoc Task Force
<b>BIFR</b>	Bureau for Industrial and Financial Reconstruction
<b>CAG</b>	Comptroller and Auditor General of India
<b>CBDT</b>	Central Board of Direct Taxes
<b>CBEC</b>	Central Board of Excise and Customs
<b>CENVAT</b>	Central Value Added Tax
<b>CEO</b>	Chief Executive Officers
<b>CESTAT</b>	Customs, Excise and Service Tax Appellate Tribunal
<b>CETA</b>	Central Excise Tariff Act
<b>CGA</b>	Controller General of Accounts
<b>CODE</b>	Code of Good Practices on Fiscal Transparency
<b>COPU</b>	Committee on Public Undertakings
<b>CPSE</b>	Central Public Sector Enterprise
<b>CSS</b>	Centrally Sponsored Scheme
<b>DEPB</b>	Duty Exemption Pass Book
<b>DFPR</b>	Delegation of Financial Powers Rules
<b>DPE</b>	Department of Public Enterprises
<b>DRSC</b>	Departmentally Related Standing Committee
<b>EFC</b>	Expenditure Finance Committee
<b>ELFC</b>	Eleventh Finance Commission
<b>EC</b>	Estimates Committee
<b>EOU</b>	Export Oriented Units
<b>EPZ</b>	Export Promotion Zone
<b>EPCG</b>	Export Promotion Capital Goods
<b>EVO</b>	Established Voluntary Organisation
<b>FADS</b>	Financial Advisor, Defence Services
<b>FRBM</b>	Fiscal Responsibility and Budget Management
<b>FRF</b>	Fiscal Reform Facility
<b>GASAB</b>	Government Accounting Standards Advisory Board
<b>GDP</b>	Gross Domestic Product
<b>GFR</b>	General Financial Rules
<b>GoI</b>	Government of India
<b>GOUP</b>	Government of Uttar Pradesh
<b>HPC</b>	High Powered Committee
<b>HSN</b>	Harmonized System of Nomenclature
<b>IGM/EGM</b>	Import General Manifest/Export General Manifest
<b>IFAC-PSC</b>	International Federation of Accountants, Public Sector Committee
<b>IMF</b>	International Monetary Fund
<b>INTOSAI</b>	International Organization of Supreme Audit Institutions
<b>IR</b>	Indian Railways

<b>MoF</b>	Ministry of Finance
<b>MOU</b>	Memorandum of Understanding
<b>MNGO</b>	Mother Non-Government Organization
<b>MTFRP</b>	Medium Term Fiscal Restructuring Program
<b>NCA</b>	Normal Central Assistance
<b>NDC</b>	National Development Council
<b>NGO</b>	Non-Government Organisation
<b>NIPFP</b>	National Institute of Public Finance and Policy
<b>NIRD</b>	National Institute of Rural Development
<b>PAC</b>	Public Accounts Committee
<b>PAN</b>	Permanent Account Number
<b>PEM</b>	Public Expenditure Management
<b>PFM</b>	Public Financial Management
<b>PFMA</b>	Public Financial Management and Accountability
<b>PER</b>	Public Expenditure Review
<b>PERT</b>	Public Expenditure Round Table
<b>PESB</b>	Public Enterprises Selection Board
<b>PC</b>	Planning Commission
<b>PIB</b>	Public Investment Board
<b>PMP</b>	Phased Manufacturing Program
<b>PRI</b>	Panchayat Raj Institution
<b>PSE</b>	Public Sector Enterprise; also described as Public Sector Undertaking or
<b>PSU</b>	
<b>PSU</b>	Public Sector Undertaking also described as Public Sector Enterprise or
<b>PSE</b>	
<b>RCC</b>	Railway Convention Committee
<b>RBI</b>	Reserve Bank of India
<b>ROSC</b>	Report on the Observance of Standards and Codes
<b>SOSVA</b>	Society for Services to Voluntary Agencies
<b>TIN</b>	Tax Information Network
<b>TFC</b>	Twelfth Finance Commission
<b>TRU</b>	Taxation Research Unit
<b>ULB</b>	Urban Local Body
<b>VAT</b>	Value Added Tax
<b>WCO</b>	World Customs Organization
<b>WMA</b>	Ways and Means Advance
<b>ZBB</b>	Zero Base Budgeting

## **GLOSSARY**

**Annual Financial Statement :** Generally known as the Budget, it consists of Revenue Budget and Capital Budget of Consolidated Fund of India, Contingency Fund transactions and receipts and disbursements out of Public Account, receipts and expenditure of Union Territories without Legislature (five). Amounts charged on the Consolidated Fund of India are shown separately.

**Appropriation Accounts:** The Appropriation Accounts is an annual financial report that depicts the expenditure of the Government compared with the amounts authorized by the Parliament with explanations for variations between the two by way of Saving or Excess.

**Centrally Sponsored Schemes:** This is essentially a device adopted by the Central Government to promote (through the provision of financial assistance) certain activities or schemes, which it considers important, but which fall within the sphere of the State Governments.

**Committee on Estimates:** This Committee of the Parliament is entrusted with the functions of suggesting the form in which the Budget estimates may be presented as well as economies in expenditure including alternative policies.

**Committee on Public Accounts:** Popularly known as the Public Accounts Committee (PAC), this Committee of the Parliament mainly follows up the Audit Reports of the Comptroller and Auditor General of India on the accounts of the Union.. The PAC also examines cases of expenditure over Parliamentary authorization and makes recommendation before such excess expenditure is accorded ex post facto authorization by Parliament.

**Committee on Public Undertakings:** This Committee of the Parliament follows up on the Audit Reports of the Comptroller and Auditor General of India relating to the Public Sector Undertakings.

**Comptroller and Auditor General of India:** The Comptroller and Auditor General of India is the country's Supreme Audit Institution common to the Union and the State Governments.

**Consolidated Fund of India:** All revenues raised by Government, loans raised by it and also its receipts from recoveries of loans granted by it, form the Consolidated Fund of India. All expenditure of Government is incurred from the Consolidated Fund and no amount can be withdrawn from the Fund without authorization from Parliament.

**Contingency Fund of India:** The Contingency Fund is an imprest placed at the disposal of the President to meet urgent unforeseen expenditure pending authorization from

Parliament. Parliamentary approval for such expenditure and for withdrawal of an equivalent amount from the Consolidated Fund is subsequently obtained and the amount spent from the Contingency Fund is subsequently recouped to the Fund. The corpus of the Fund is authorized by the Parliament.

**Controller General of Accounts:** The Controller General of Accounts is an officer of the Ministry of Finance who prepares the financial reports of Government. Chief Controllers/Controllers of Accounts have been positioned in the Ministries for the performance of accounts functions.

**Departmentally Related Standing Committees:** Also called the Standing Committees, these Committees consider *inter alia* the Demands for Grants of the concerned Ministries/Departments and report on the same to the Houses. The reports shall not suggest anything of the nature of cut motions.

**Deposit Heads:** These are heads of accounts classification for recording transactions relating to deposits in respect of which Government has an obligation for repayment.

**Finance Accounts:** This is an annual financial report that shows the receipts and outgoings of the Government for the current year, together with the financial results disclosed by the revenue and capital accounts, the accounts relating to public debt, and liability and assets of the Government.

**Integrated Financial Advisor:** Generally referred to as Financial Advisor, he is a senior functionary in a Ministry responsible for rendering advice on financial matters. Also oversees the work of Chief Controller/Controller of Accounts.

**List of Major and Minor Heads:** The List of Major and Minor Heads provides the dictionary of the classifications used in the compilation of Government accounts.

**Parliament:** Parliament is the country's legislative body at the national level and consists of the President and two Houses known as the Council of States (Rajya Sabha) and the House of the People (Lok Sabha). In financial matters the Lok Sabha has the primacy.

**Planning Commission:** The Planning Commission was set up by a Resolution of the Government of India in March 1950 in pursuance of declared objectives of the Government to promote a rapid rise in the standard of living of the people by efficient exploitation of the resources of the country, increasing production and offering opportunities to all for employment in the service of the community. The Planning Commission was charged with the responsibility of making assessment of all resources of the country, augmenting deficient resources, formulating plans for the most effective and balanced utilization of resources and determining priorities.

**Public Account:** Besides the normal receipts and expenditure of Government which relate to the Consolidated Fund, certain other transactions enter Government accounts, in respect of which, Government acts more as a banker, for example, transactions relating to provident funds, small savings, other deposits etc. The moneys thus received are kept in the Public Account and the related disbursements are also made therefrom. Parliamentary authorization for payments from the Public Account is not required since the funds do not belong to Government and have to be paid back to the persons and authorities who deposited them.

Suspense Heads: **Generally in the Public Account these heads of accounts record transactions that cannot be accounted under the final heads of accounts**

# CHAPTER 1

## INTRODUCTION

### **Purpose and Background of the Study**

1. The primary purpose of the study is to conduct a survey of the more recent literature on the public financial management and accountability (PFMA) system of the Government of India (GoI) and to analyse its contents in a structured manner. The overall objective is to provide the basis for enhanced knowledge and understanding of the GoI PFMA System including its strengths and weaknesses as perceived by the authors of the publications surveyed.

2. GoI has a history of a structure of public financial management and financial accountability that in modern times dates back to the eighteenth century. GoI PFMA system has evolved and undergone several changes over the years to keep pace with its growing requirements as well as the emerging best practices. In the process of renewal and rejuvenation it has come up for frequent debate, discussion and review by expert committees and students and practitioners of public administration that has spawned considerable quantity of informed literature. It has been felt, and subsequently validated by experience, that many research groups have done considerable work in this area and enough material is available in the form of books, research publications, lectures, and articles in reputed journals and newspapers. The material is scattered widely, not easily accessible to a serious student of PFMA in India. In fact, not many are even aware of the existence of such a large body of literature in this area.

3. This study makes an attempt to fill this gap. The objectives of this study are: to (1) prepare an annotated bibliography of select contemporary material on the Public Financial Management and Accountability (PFMA) System of the Government of India. and; (2) to present an analytical survey relating to the various components of the System.

The study intends

- To identify recent reports, studies, current legislation and other relevant material related to the subject matters;
- To provide an analysis of the issues, opinions and recommendations emerging in available literature; and
- To finally organize and present the material in a readily accessible format.

In the process the study brings out areas where the literature identifies the opportunities that may exist for system improvement, capacity building and capacity enhancement.

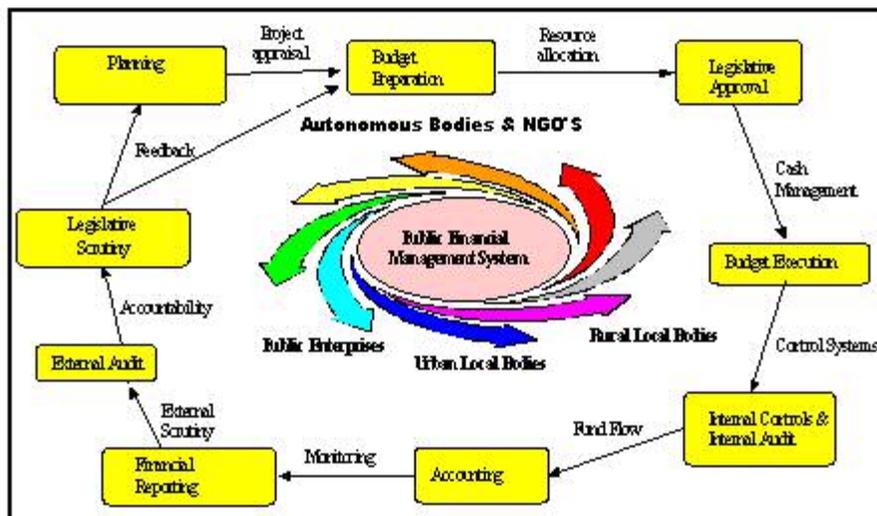
4. The survey reflects the views expressed in the literature studied as captured by the researchers undertaking this Study.

5. There is a growing appreciation that development is an outcome of efficient institutions rather than the other way around<sup>1</sup>. Public Expenditure Management (PEM) has come to be recognized to be an essential component of public governance in the last three decades. Developed countries, and to some extent many developing countries too, have adopted modern public expenditure management systems to bring in greater fiscal discipline, better accountability and enhanced transparency. Emphasis on procedures is giving place to emphasis on monitoring systems; centralized control to more devolution of authority and accountability; input to output. PEM is all about delivering value for money in the most efficient way in a transparent manner. For this purpose PFMA systems need to be strengthened. These are the nuts and bolts that define and govern the operating parameters as distinct from policy issues. The legal framework, the rules, the role definitions, planning, budgeting, the approvals, the oversight mechanisms, internal controls, and transparent accounting and financial disclosures form the various elements of PFMA.

### Public Financial Management and Accountability System

6. The following schematic traces the route of PFMA. It starts with budget planning through to budget preparation, legislative process of budgetary approval, revenue administration, budget execution, and internal controls, including cash management, internal audit, accounting and financial statements, external audit and legislative scrutiny of expenditure. Government of India's role and accountability towards the public enterprises, autonomous bodies, the States and the third tier of administration of Urban Local Bodies and Panchayati Raj Institutions also form important elements of PFMA. The entire cycle gives a constant feedback to budget planning.

### "THE SYSTEM"



<sup>1</sup> Government of India, Planning Commission, Approach Paper to the Tenth Five Year Plan (2002-2007)

**The study, additionally, includes access/ right to information as an instrument of accountability and transparency.**

7. The research on the System's capabilities was conducted more from an accountant's and an administrator's perspective rather than an economist's or planning perspective. As such the coverage of the study relates to the workings of the PFMA System in relation to the implementation process and effectiveness of the institutions of budget preparation and implementation. The research does not go into policy and planning aspects of PFMA per se, and in terms of the boundaries between public expenditure management and public financial management and accountability the lines are drawn in favour of the systems and procedures for budget formulation, approval, delivery and controls rather than resource allocation and methods for establishing priorities of government. In this regard the systems and procedures of internal control, accounting, reporting and scrutiny are given due attention including the extent to which they are (or not) oriented towards measuring and reporting of results.

## **Methodology**

8. The study has been executed mainly, though not exclusively, through desk study of the published material. In each of the areas of study the starting point was the literature relevant to the institutional framework and the published commentaries thereon. This was tracked through to the legal enactments, the subordinate legislation and the rules and regulations. This was followed up with a study of recent and competent literature in the related area by way of books, reports and articles. While the focus was on recent literature, some vintage literature of the 'mother' literature genre was also studied. The sources of information that were readily identified were:

- The Constitution of India;
- The law(s) enacted there under;
- The rules and orders issued by the Government of India;
- The relevant procedural instructions;
- Reports of the official committees/commissions;
- Planning Commission documents;
- Audit Reports of the Comptroller and Auditor General of India;
- Reports of the Public Accounts Committee;

Some of the leading libraries in the country were visited for study of the relevant literature. The websites of the Ministries were also explored for identification of literature.

9. In each case the cross references cited were followed through. Discussions were held with knowledgeable senior, serving and retired officers of Government of India, for pointing to the published literature. Discussions were also held with the officers and librarians of the professional institutes. The main points of the publication were abstracted. The material so built up has been thematically arranged within each subject; this has some times meant that a particular reference may be listed more than once. Only

the dominant theme(s) has been abstracted. Based on this an analytical survey of issues, opinions and recommendations has been prepared.

### **Some Basic Considerations**

10. There were several parameters that needed to be decided upfront. How recent is recent? How wide should the search be for literature? How should the selection be made of the material to be included? What should be the basis for identifying the essence of the material for abstracting?

**11. The study has been confined to the literature published during the last five years, extended in some cases to 10 years.** In selected cases where it was felt that documents were in the nature of a ‘mother document’, such documents have been featured, irrespective of the age of the document.

**12. The available material has been scanned for relevance and materiality.** Those documents, which are not considered to be of immediate relevance or which do not bring out any fresh perspective, have not been included. Some basic reference works have, however, been included<sup>2</sup>.

**13. The study covers only such literature, as came to notice and absolute comprehensiveness or coverage can never be claimed for work of this type.** The exclusion or omission of any document is not to be considered as a reflection on its relevance or worth. In some cases the document may not be in the public domain<sup>3</sup>.

**14. A study of this nature is inherently to be considered as perpetual work-in-progress.** This is even more so in the context of today’s fast changing scenario when major reforms are in the air<sup>4</sup>.

**15. The study abstracts only the distinctive theme(s) from a particular publication, which may or may not be even the dominant theme(s).** Effort has been made to be faithful to the original and extract what is most relevant to the task on hand, even though it may not be the most important angle that the author might have sought to present. The effort at being faithful to the original has necessarily involved compromises being made with the style of presentation on occasions. But, despite every effort to the contrary, inadvertent introduction of some element of subjectiveness is not entirely ruled out.

**16. The analysis reflects only the views of the authors of the documents studied.** The personal views of the members of the study team have not been given either in the abstract of literature or its analysis.

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<sup>2</sup> World Bank Studies of State Financial Accountability Assessments of State Governments of Karnataka, Orissa and Uttar Pradesh have generally not been referred to since these deal with State PFMA. For the same reason Andhra Pradesh State Financial Accountabilty Assessment has not been referred to.

<sup>3</sup> For example, some of the World Bank Notes, e.g., Notes on Centrally Sponsored Schemes, Policy Note on State Power Sector Entities in India could not be accessed, as these are not yet in the public domain.

<sup>4</sup> For example, General Financial Rules 2005, which have come into force from July 2005, have addressed some of the issues mentioned in the survey of literature.

17. **Differing, even contrary, views have been expressed in some cases.** These have been incorporated in the analysis as such. In some cases these are in the nature of the 'glass being half full and half empty'; in some other cases totally contrary positions might have been taken.

18. **Some good points which may have lost relevance with the passage of time or which may have been overtaken by subsequent developments have been left out.** The aim has been to focus on issues that are currently relevant. Nevertheless, some of the already settled issues have been listed if similar issues are being currently articulated. The output of the study is in a way intended to be a survey of the historical evolution of the PFMA systems of GoI.

### **Layout of the Report**

19. The report is in two parts. The first part gives the analysis of the issues, opinions and recommendations arising out of the assembled bibliography. Part two is the annotated bibliography starting with legal and official references followed by commentaries by others. A separate chapter has been dedicated to each component of the PFMA in both the Parts.

20. The Report begins with an Overview (Chapter 2) that provides an over-all perspective of the systems of public financial management and accountability in GoI as seen from the literature.

21. The analytical survey chapters in Part I follow thematically the schematic diagram given in Para 3 above.

22. Chapter 3 deals with Budget Planning, Preparation and Legislative Approval of the budget as these are interlinked and flow from one another. Chapter 4 on Budget Implementation, Internal Control and Internal Audit also deals with control systems cash management. Chapter 5 Revenue Administration is concerned with working of Income Tax, Customs and Central Excise departments. Government has invested sizeable amounts in Central Public Sector Enterprises (PSE). The issues connected with the accountability of the Government vis a vis these entities have been analyzed in Chapter 6.

23. Government has also established a large number of autonomous bodies, which heavily depend upon budgetary support; additionally Government provides large amounts to non-Government organizations that are engaged as instruments of programme delivery. Chapter 7 analyses the issues connected with the Government accountability vis-à-vis these entities.

24. Federal structure of the nation is one of the abiding features of the Constitution. Money flows from GoI to the States and to the third tier of administration, namely the Panchayati Raj Institutions and Urban Local Bodies through many channels, some mandated by the Constitution and others discretionary. The role of GoI and its

accountability regarding the financial transfers to the States and other tiers of administration are considered in Chapter 8.

25. The Accounting policies, the form of accounts and the accuracy and comprehensiveness of the accounts are important elements in ensuring accountability. Financial statement is the window through which the Government is viewed in financial matters. These areas have been covered in Chapters 9 and 10 respectively. The Accounting and the Financial Reporting, which flows from it, are inter-related and therefore, there is some overlap both in the analytical survey and in Part II, Bibliography of the literature. This has become unavoidable. But as the two subjects are very important from the accountability angle, it has been decided to treat them in independent chapters, keeping each chapter self-contained as far as possible and with minimum overlap and repetition. The intention is to ensure that, as far as possible, a reader interested only in Government Accounts does not have to refer to the Chapters on Financial Reporting and vice versa.

26. The presence of an independent auditor to give assurance is a basic accountability mechanism. Chapter 11 covers the role of the external audit arrangements. Legislative scrutiny of public expenditure acts as a strong check on the executive. Chapter 12 is devoted to this aspect. Access/Right to Financial Information helps to develop transparency in the executive and promotes accountability. This has been covered in Chapter 13.

27. In Part II Bibliography of the select literature has been set out in Chapters 14 to 24 similarly laid out from Budgeting to Right/Access to Financial Information.

### **Over-all Position**

28. In areas like budgeting including implementation, legislative oversight, revenue administration and external audit enough literature was available. However, the literature was scanty in respect of 'Cash Management' and 'Right to Financial Information'. On the former, only some official references were available. On the latter, even that was scarce and essentially the evolution of the recent law has been presented. There was not enough demand for modernization of accounting and financial statements except from multi-lateral institutions. Emphasis is on giving more autonomy to the States, the PSEs, and Autonomous Bodies than on demanding accountability from GoI for the money being given to them by it.

29. The general picture that emerges from a study of the available literature is that the legal systems are in place in all areas. So are the attendant procedures, rules and regulations. Trained manpower is available. Oversight systems are vibrant through well-established independent external audit and legislative committees. There is increasingly more transparency in the budgetary disclosures. Steps have been taken to review the existing accounting systems. Much headway has been made in fiscal consolidation efforts with the passing of Fiscal Responsibility and Budget Management Act. Recent initiatives for better cash management, internal control systems and revenue

administration are expected to go a long way in reinforcing accountability mechanisms. The Right to Information Act has just been passed by the Parliament. This measure is expected to improve awareness in the public of its rights and in the civil servants of their obligation to be more open and transparent. The systems have been subjected to adequate and searching scrutiny, even if the efforts at modernization have not always kept pace with the growing requirements and the emerging challenges.

30. The more serious issue, however, is one of compliance; the compliance gap also reflects to some extent the challenges caused by the emerging requirements and demands of modern times. There is found to be slackness in observing/enforcing the rules and regulations. Wastage and overspending persist. Emphasis continues to be inputs than on outputs and outcomes. Accounting systems and financial statements are in need of modernization. Many Public Sector Enterprises continue to be a drag on public resources. GoI's control over the efficient use of resources by the Autonomous Bodies is weak. The effectiveness of oversight institutions has been impaired by the lukewarm response of the executive. There is scope for improvement in disclosures in the budgetary documents. Despite its constant review and overhaul, tax administration is in need of further reforms, in view of the persistent perception of rampant evasion, revenue leakage and harassment of tax-payers. The implementation of the Right to Information Act envisages an entirely different culture that is prepared to brave the sunlight of constant and relentless public scrutiny. A change in the mindset both at the official level and political level is needed to make further progress in financial management and accountability.

## CHAPTER 2

### OVERVIEW

#### Introductory

This overview provides a background to the prevailing PFMA System and summerizes the main points as extracted from the literature studied.

1. *Inherited from the colonial era, the Public Financial Management and Accountability (PFMA) system of the Government of India has tried to shed much of the baggage that went with the requirements of law and order administration and evolved over the years to meet the requirements of developmental needs.* The imperatives of an interventionist State, the commanding role assigned to the public sector enterprises and the paramount need of accountability to the people in a parliamentary democracy have driven the process of change. The system has been subjected to searching examination from time to time, some times even with the assistance of foreign experts and advisors, right from the dawn of independence.<sup>5</sup>

2. *The Administrative Reforms Commission of the sixties must be recalled as a landmark systematic and holistic review of the administrative systems of the country including the PFMA system.* The seminal reports of the Commission significantly informed the governance reforms of the seventies including the introduction of revised form of accounts classification and the enhanced empowerment of the line Ministries with the introduction of the scheme of Integrated Financial Advisors. The seventies also witnessed the formal and legal definition of the duties, powers and conditions of service of the country's Supreme Audit Institution, called the Comptroller and Auditor General of India, and the divestment of the latter, within a few years thereafter, from the responsibility of compiling the Union Government accounts and the creation of a separate agency for the purpose under the Ministry of Finance.

3. *Disillusionment with the administrative systems started showing up right from the early eighties* that led to the appointment of the Economic Administration Reforms Commission on Government and Public Enterprises (L. K. Jha Commission). The problems of the public sector as it grew in size and complexity triggered the appointment of the Committee to Review Policy for Public Enterprises (Arjun Sen Gupta committee). The deliberations and recommendations of both these bodies significantly impacted the PFMA system, particularly in relation to the public sector

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<sup>5</sup> According to one estimate about six hundred commissions and committees have been set up by the Union and the State Governments from time to time to look into various aspects of administrative reform. (Jagmohan, *Soul and Structure of Governance in India*, Allied Publishers Private Limited, New Delhi 2005).

enterprises. A large number of committees have looked into simplifying tax laws and tax administration.

4. *The PFMA system has also evolved in response to the recommendations of the legislative committees.* The recommendations of the Estimates Committee of the Parliament from time to time have led to systemic changes being made in budgetary processes. External Audit has undergone metamorphosis over the years, driven at once by the changes in the pattern of expenditure, the developments in the profession and the heightened demands of public accountability for the taxpayer's money. CAG's Audit Reports and the follow up thereon by the Parliamentary Committees, namely the Committee on Public Accounts and the Committee on Public Undertakings, have also led to modifications in the PFMA system to some extent.

5. *Although the nineties saw the onset of economic reforms, there has been no systematic attempt for a thorough review of the PFMA system except in regard to revenue administration.* The Fifth Central Pay Commission did make some recommendations and suggestions relating to governance, but the impact has been little. The Expenditure Reforms Commission did not go into the system of PFMA in any depth. Although the Commission to Review the Working of the Constitution made important recommendations impacting on governance, its recommendations were not followed up. The enactment of the Fiscal Responsibility and Budget Management legislation in 2003 was a significant development.

6. *But a more significant development has been the growing demand for public access/right to information.* This has only recently seen its consummation with the passing of the Right to Information law in 2005. When it comes into force, the law has the potential of a force multiplier for public accountability.

7. *Government of India's PFMA system presents a mixed picture.* The institutions are in place, the rules and procedures are well documented but the compliance leaves a lot to be desired. The popular perception is that only a very insignificant portion of government expenditure is productive. The system has focused on processes rather than products, on inputs rather than outputs and outcomes and the accountability level is minimal. The system is increasingly proving inadequate to meet the present-day challenges.

8. *There is heightened awareness of the need for further reforms in the PFMA system.* The Fiscal Policy Strategy Statement, tabled by the Finance Minister while presenting the Budget for the year 2005-2006, envisages a major reengineering of the system of expenditure management. A Government Accounting Standards Advisory Board (GASAB) has been established to drive, guide and oversee the reforms in the system of Government accounts and financial reporting. External Audit is being constantly reoriented in line with the best practices. And above all, an Administrative Reforms Commission has been announced. The rapid integration of the country's economy with that of the rest of the world, the technological revolution sweeping across the globe and the impatience of the people with the delivery system and demand for

greater accountability are some of the imperatives that will propel the process of reforms in the coming years.

### **Budget Planning, Preparation & Approval**

9. The legal basis for the budgeting process is enshrined in the Constitution of India, which mandates the presentation of Annual Financial Statement to the Parliament every year. The Constitution also lays down the procedure for different stages of legislative processing of the budget, namely, discussions and voting on the budget, discussion and voting on the Demands for Grants and passing Appropriation Bill, Supplementary Budgets and Vote on Account. No money can be spent without authorization from Parliament. Rules of the House of the People prescribe the procedure for Parliamentary approval. Departmentally Related Standing Committees examine the Demands for Grants of every department before they are considered by the Parliament. House of the People (Lok Sabha) has been given primary role in matters relating to Money Bills.

10. Fiscal Responsibility and Budget Management Act, 2003 (FRBM) is designed to bring in fiscal discipline; GoI is required to bring down the revenue deficit to zero by 2009. The Act obligates the government to lay on the Houses of Parliament the Medium-term Fiscal Policy Statement, the Fiscal Policy Strategy Statement and the Macro-Economic Framework Statement. A statement has to be presented to Parliament on any failure to keep to the targets. This Act has been hailed as the best step taken by GoI towards fiscal consolidation.

11. General Financial Rules and the annual circulars issued by the Planning Commission and the Ministry of Finance prescribe the procedure for the construction of the budget by the line Ministries. There is predictability about the process. Time frames are certain. The budget is presented on the 28<sup>th</sup> February, preceding the financial year, which starts on the 1<sup>st</sup> April.

12. The responsibilities for different activities leading to the budget preparation are well delineated. The roles of the Ministry of Finance, the Planning Commission, the administrative departments and the legislature are clear. The line Ministries frame the budget proposals which are modified, where necessary, by the Planning Commission to suit the national Five Year Plan priorities subject to the overall resource limitation set by the Ministry of Finance. Finance Minister holds extensive consultation with different groups in pre-budget discussions. Zero base budgeting was adopted in the 1980s to review and eliminate wasteful expenditure. Performance budget is prepared and presented to the Parliament along with the Annual Report of the line Ministries. Budget documents are comprehensive and are available in the official website immediately after presentation in Parliament.

13. Procedures exist for investment approvals. Gender budgeting has been introduced.

14. There is scope for improvement in many areas that is indicated by the following: budget realism with actual expenditure and revenues being far off the mark from estimates, emphasis on input budgeting rather than output/outcome<sup>6</sup> despite the introduction of performance budgeting, budget being limited to one year perspective without giving the level of future commitments, continuance of Plan and non-Plan distinction which many believe has lost its relevance, absence of disclosure in vital areas like quazi-fiscal activities and absence of analysis of fiscal risks. Legislative scrutiny through Departmentally Related Standing Committees is neither extensive nor intensive due to lack of time and expert support staff.

### **Budget Implementation and Internal Control including Internal Audit**

15. The system has certain inherent strengths with clearly defined roles and responsibilities; well-documented systems and procedures; provision of financial advice by the Financial Advisors positioned at appropriately senior levels; independent prior check of expenditure before actual payment; arrangements for internal audit; and arrangements for monitoring and evaluation. Systemic and procedural changes have also been made from time to time ensure response of the system to the changing requirements.

16. There is a perception, however, that the role, responsibility and accountability of the Secretary to the Ministry, who is its Chief Accounting Authority, need to be more clearly and sharply defined and delineated<sup>7</sup>. The position of the Financial Advisor, who currently functions under the dual control of the Ministry of Finance and the line Ministry, has also been considered to be somewhat anomalous. The Finance and the Accounts functions have not been fully integrated except in the Ministries of Railways and Defense.

17. The conditionalities that hedge the financial powers vested in the line Ministries and the economy instructions issued from time to time have somewhat restricted the exercise of delegated powers and act as a barrier in achieving the allotted goals and targets. The conditions create an ambience in which the officers are not always willing to accept responsibilities and routinely refer the cases to the Ministry of Finance.

18. Budget implementation suffers from several deficiencies. There are instances of excess disbursements over the legislatively authorized grants; these require regularization by the Parliament. On the other hand supplementary grants are found to have been obtained in several cases though the expenditure did not come up to the level of the original grant. There are instances of persistent savings under several heads of expenditure year after year. Large- scale diversions of funds between budget heads cause serious deviations from the approved budget; some of these are carried out without the mandatory prior clearance of the competent authority. The laxity in

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<sup>6</sup> The first Outcome Budget 2005-06 has been presented in Parliament in August 2005

<sup>7</sup> Rule 64 of General Financial Rules, 2005, in force from July 2005 defines the duties and responsibilities of the Secretary/Chief Accounting Authority.

monitoring and control mechanism is evident from injudicious, excessive and unnecessary reappropriations as well as inadequate, excessive and unwarranted surrender of budget provisions.

19. There is heavy year-end rush of expenditure, particularly in the month of March, with attendant enhancement of fiduciary risk. In some cases the expenditure may be only “virtual expenditure”, representing transfer of budget provisions to deposit heads or to the public sector undertakings.

20. In the implementation of the Centrally sponsored schemes, it would appear that the controlling Ministries neither assess the absorptive capacity of the State Governments nor verify the effective utilization of the funds already provided before making fresh releases; the Ministries are unable to ensure the correctness of the performance data reported by the State Governments; large parts of Central funds are released in the last month of the financial year, which could not be expected to be spent by the State Governments during that year. Nobody could be held accountable for poor performance. Since the States execute the schemes, sensitivity associated with the Centre-State relations also precludes a searching evaluation being made. There is also the unwillingness to accept poor performance, for fear of being questioned by Parliament or adverse publicity.

21. The control system focuses essentially on inputs rather than on outputs and outcomes.<sup>8</sup> The procurement controls are not considered to be compliant with the best practices. The internal controls are also not functioning effectively and have failed to prevent cases of waste and overspending. The results of audit of individual transactions as reported in the CAG’s Audit Reports are indicative of rampant disregard of the financial rules, arbitrary exercise of authority including violation of the limits of the delegated powers, non-compliance with the orders of the superior authorities, negligent processing of procurements etc. The internal audit system is also considered weak since it is only an accounts oriented system; there is no audit or control over the objectives, tasks, outcomes and performance. The internal audit system is in need of modernization and capacity building and the programme of internal audit should be Secretary-driven.

22. The implementation of the programmes is not preceded by the specifications of cost, time and quantity schedules against which the actual services may be measured; an effective cost control system is non-existent in most Government departments; the relationship between the resources provided in the budget and the services to be delivered is at best nebulous. There is no regular mechanism for evaluating all the programmes/schemes in a time-bound manner. Credible performance indicators have not been developed.

23. GoI is conscious of the need for modernization of the expenditure control systems. The Fiscal Policy Strategy Statement, tabled by the Finance Minister while presenting the Budget for the year 2005-2006, envisages a major reengineering of the

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<sup>8</sup> The first Outcome Budget 2005-06 has been presented in Parliament in August 2005

system of expenditure management with the introduction of a system of quarterly budgeting, enhanced empowerment of the line Ministries and the Ministry of Finance retaining strategic control. The expenditure will be reoriented to extract better value for money; a mechanism will be put in place to measure the development outcomes for all major programmes.

### **Revenue Administration**

24. Taxation in India is governed by well-established tax laws, rules and procedures. Income Tax Act, 1961, Customs Act, 1962, Central Excise Act, 1944 are the main laws. Service Tax was introduced in 1994 to bring in services under tax net. It is growing in size both in terms of revenue and the number of taxes covered.

25. Central Boards of Direct Taxes and Central Board of Excise and Customs, under the Ministry of Finance, administer these Acts. There are Independent Appellate Tribunals and High Courts available for appeals against the decisions of tax authorities. The judicial pronouncements form a large body of case laws that give guidance on issues of taxation. Investors can seek advance ruling from the Authority for Advance Ruling to know the tax ramifications of investment proposals. These rulings are binding on the tax administration.

26. Revenue department has extensive powers for search and seizure in pursuit of unearthing concealed income/tax evasion.

27. Many steps have been taken to improve tax administration like reducing the number of exemptions from tax, collecting assessee-based information through tax information network, increased use of information technology for customer friendly measures, better banking arrangements for online payment of taxes and direct credit of refunds, and adoption of international standards for classification of goods in indirect taxes. GoI constantly reviews the revenue administration arrangements through expert groups; there have been many such groups for simplification of tax laws and procedure.

28. There are still many concerns. Tax administration is not perceived as user friendly. There are many weaknesses leading to loss of revenue. There is rampant corruption and widespread tax evasion. Tax arrears are huge. Many mistakes in computation of taxes have been pointed out in audit. The tax structure is still deemed to be complex. There are still many exemptions making tax administration difficult. Tax laws are subject to change every year during budget leading to apprehensions in investors and other taxpayers. Search and seizure provisions are too powerful and prone to be misused. Appellate systems function too slowly for comfort. Resort to amnesty scheme periodically has had a demoralizing effect on the honest taxpayer. There are not enough senior persons for the high volume of work.

## **Accountability of Government for Public Sector Enterprises**

29. Any company registered under the Companies Act, 1956 where the Government's share of equity is not less than 51 per cent is a Government Company. Most of them are fully owned by the Government. Some Corporations have been created by statute. Some have been taken over by the Government when they have turned sick under private ownership. There are special arrangements for audit through the CAG for these companies. The auditors of these companies are appointed on the advice of the CAG; and the CAG has the right to give directions to these auditors and also conduct a super-imposed audit of the accounts besides conducting audit of transactions as well as comprehensive appraisals.

30. The management team including the Chairman and Managing Director are appointed on the recommendations of an expert body called the Public Enterprises Selection Board (PESB). The Department of Public Enterprises (DPE) is the coordinating Department for ensuring uniformity of practices among the PSEs. DPE issues guidelines to all the PSEs on common issues. Each PSE is subject to administrative control to a Ministry of GoI on functional lines. GoI nominates its representatives to serve on the Boards of the PSEs. The PSEs come within the jurisdiction of the Central Vigilance Commission. The Administrative Ministry has powers to issue Presidential Directives to the PSEs.

31. The Administrative Ministries monitor the performance of the PSEs through a system of Memorandum of Understating. The Planning Commission reviews the performance of the PSEs especially with reference to the capital projects at the time of annual budget discussions. Projects costing more than Rs. 1000 Million are monitored by the Ministry of Programme Implementation. Flash reports are sent to the Prime Minister on these mega projects every month.

32. Parliamentary oversight over the PSEs is ensured through the administrative Ministry, which handles all the parliamentary questions, and other Parliament related work relating the PSEs under them. The Committee on Public Undertakings examines the PSEs on the basis of the findings in the Audit Reports of the CAG in addition to conducting suo moto review of the working of the PSEs. The Annual Report of the PSEs containing the annual accounts with the comments of the CAG are required to be placed in the Parliament within 9 months of close of the close of the financial year.

33. Faced with the criticism from many quarters that GoI does not allow enough autonomy to the PSEs to enable them function effectively in the liberalized environment, GoI has taken a number of initiatives to give increased autonomy to the PSEs. Earliest of them (1987) is the Memorandum of Understanding between the PSEs and the Administrative Ministries where the performance parameters for the year are agreed in advance. The Ministries are also required to commit in advance the action required to be taken by them. There is an independent evaluation of the targets and achievements.

34. GoI selected nine PSEs in 1997 and delegated large powers to them in terms of capital investments and operational freedom. These were called Nav Ratna companies. More independent part time Directors were inducted in them. This was followed by liberalizing control, including induction of independent directors, over many other companies though to a lesser extent. These were called Mini Ratna companies.

35. GoI, in yet another measure, reviewed the numerous guidelines issued by them to the PSEs and drastically reduced them retaining only a few important guidelines.

36. GoI has also reduced their stake in PSEs either partially through public issues or fully/majority holding to strategic partners. GoI has also reduced the number of areas reserved exclusively for public sector.

37. GoI's role in the handling of PSEs has come in for heavy criticism from many sources. While the initiatives of the GoI in the area of giving more autonomy to the PSEs have been welcomed, the general view is that they are not adequate. Government seems to retain substantial control through the Administrative Ministries and the Ministers, the political masters. The MOU system has been found wanting as there is no system of reward and punishment related to performance. The Nav Ratna and the Mini Ratna schemes have helped those companies to gain a measure of autonomy. But, there are other companies, which continue to reel under the oppressive weight of full Government supervision. Prevalent informal control over the PSEs has a damaging effect. Government has shown itself to be incapable of providing commercial leadership needed for performance in a competitive environment.

38. There are good systems to ensure GoI's accountability for the PSEs. Even so, the inefficiencies in PSEs are endemic and non-performing companies are large in number. Often, these institutions for accountability are seen to be inhibiting the efficiency and autonomy of the PSEs. The acceptable solution would be to follow up on the statement made by the Finance Minister in his budget speech in 1998 that all PSEs except those in strategic areas must be privatized.

### **Accountability of Government for Autonomous Bodies and Government-aided Non-Government Organizations**

39. There are nearly 500 autonomous bodies in the Government sector with a budgetary outgo of about Rs. 100 billion(1999-2000). A 2001 estimate placed the number of non-Government organizations (NGOs) at 1.20 million in the country; nearly half of them without a juristic personality. Government budgetary support (Plan) to the voluntary organizations in the social sector exceeded Rs. 380 billion during 2004-2005. The Mother NGO concept seems to be the emerging preferred option for Government- voluntary sector interface and the public private partnership approach is envisaged to be the new form of relationship in place of the traditional concept of grant-in aid.

40. Systems and procedures are in place for determining the eligibility of autonomous bodies and NGOs for Government assistance. The role and responsibilities are clearly defined; there is transparency about the process; the pattern of assistance is within the public domain and wide publicity is generally given for inviting applications for Government assistance from non-Government organizations. The rules prescribe the pre-sanction requirements for assessing the bonafides and absorptive capacity of the assisted bodies for Government funding as well as their capacity for service delivery. The rules also prescribe adequate safeguards for ensuring proper utilization of Government assistance with emphasis on outputs and outcomes. The accounts of the assisted entities are subject to public audit and legislative oversight. Government has the right to nominate its representative on any assisted body, which depends upon Government assistance for meeting more than 50 per cent of its annual expenditure<sup>9</sup>. The form of accounts of the Government autonomous bodies has been standardized with a perceptible shift in favour of accrual accounting.

41. There are several areas of concern. In the past there was no formally laid down procedure for the establishment of Government autonomous bodies; some of the bodies were set up with the approval of the Cabinet, while in some cases the decision for their establishment was taken at the level of the Minister<sup>10</sup>. The nomenclature of some of the bodies also suggests that some of these might be carrying out identical or duplicate functions.

42. The autonomous bodies are still in a stage of transition in adopting the prescribed form of accounts. The autonomous bodies do not submit their accounts for audit within the prescribed time frame. The accounts of several autonomous bodies are in arrears, in some cases from 1999-2000; and the audit reports tend to be qualified.

43. There are delays in the presentation of Audit Reports on the accounts the autonomous bodies to the Parliament; in several cases the Audit Reports have not been presented from 1999-2000 onwards. The system of internal control is not fully compliant with the best practices and violations of the prescribed rules and Government orders tend to be frequent.

44. CAG's appraisals of the working of some of the autonomous bodies have been critical of their performance besides pointing out cases of irregular and wasteful expenditure. The monitoring arrangements are weak; no structured periodic meetings are held between the nodal Ministry and the autonomous body. The Ministries neither properly maintain the prescribed records of Government assistance to the autonomous institutions nor carry out the mandated review of the performance review of the grantee institutions. No worthwhile study seems to have been conducted to ascertain

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<sup>9</sup> This enabling provision has not been included in the General Financial Rules, 2005, but the Memoranda of Association/Articles of Association of the Central Government Autonomous Bodies generally prescribe the representation of the Government of India on their governing bodies.

<sup>10</sup> According to the General Financial Rules, 2005, no new autonomous body will be established except with the approval of the Cabinet.

whether the bodies are fulfilling their stated objectives and whether there exists sufficient justification for their continuance. The perception is that the institutions function like attached offices of Government, without at the same time being subject to the rigours of close scrutiny of the other wings of the Government. In many bodies reduced accountability and non-reporting seems to have been construed as essential element of autonomy.

45. In the voluntary sector the transparency requirements of the registration laws are minimal and differ across the States due to lack of uniformity. There are variations even in the minimum basic norms prescribed for Government agencies.

46. The donor guidelines and practices on project follow-up and evaluation leave large gaps. The regulatory provisions relating to accounts and audit contained in the basic statutes of the voluntary sector are very skeletal and their enforcement perfunctory. The auditing profession has only recently become conscious of the need for the development of a separate set of Generally Accepted Accounting Practices for the voluntary sector.

47. Accountants employed by the voluntary sector are not the most professional and the auditors subscribing their signature to the accounts are not the most motivated.

48. The schemes of assistance prescribed years ago have not been rationalized and revised despite rising costs, changing requirements and even the target group. The amount of assistance bears little nexus with the minimum expected standard of service. The voluntary agencies are also handicapped because of the uncertainty regarding the continuance of Government funding.

49. There are heavy arrears in submission of the utilization certificates; according to the CAG's Audit Report on Autonomous Bodies (2005) the pendency stood at a staggering amount of more than Rs. 140 billion. Fresh Government assistance was also provided to some of the defaulting entities.

50. The concept of Mother NGOs, which appears to be the flavour of the season, is apprehended to result in dilution of public audit and accountability. Assignment of public money to recipients through intermediaries results in a situation where there is nothing to see in the authorities charged with intermediation and there is absence of public audit in the recipients and actual users of public funds.

51. Government provides large amounts to autonomous bodies and there is need for proper maintenance of accounts, strengthening of internal control as well as more rigorous monitoring of their performance. The adoption of the MOU system in the case of the autonomous bodies that receive Government assistance of Rs. 50 million or more in a year has been suggested.<sup>11</sup> There should be emphasis on internal resource generation; the budget support currently extended should be progressively

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<sup>11</sup> This requirement has been prescribed in the General Financial Rules, 2005.

reduced having regard to the scope for maximizing internal resource generation and restraining expenditure growth.

52. In the case of NGOs, it is important to focus on several key factors, including the development of procedures that are easy to use, transparent, and helpful in modernizing the delivery of Government services, and the development of quantifiable evaluation systems that can measure actual performance against agreed targets. There is need for the creation of an enabling environment to facilitate quick redressal of grievances of the voluntary organizations, transparency in funding procedures, system of monitoring and evaluation of projects, adoption of appropriate standards of accountability and transparency by the voluntary organizations, capacity building for project formulation, implementation, report writing, financial and administrative management, networking, social audit, and monitoring and evaluation.

53. Validation/accreditation of voluntary agencies has been considered useful for both private and public sector donors and international donors.

#### **Accountability of Centre for Transfer to States**

54. The federal structure of the nation is enshrined in the Constitution, which lays down extensively the financial and other arrangements between the Centre and the States. Taxes which can be levied by the Centre and the States are specifically mentioned. As the principal taxes are in the Union list, the tax collected needs to be shared between the Centre and the States. The Constitution provides for the constitution of a Finance Commission every five years to decide on the quantum of central funds to be transferred to the States. The Central Government has powers to distribute additional amounts to the States depending upon the requirement. The States, which are already indebted to the Centre, can borrow funds from the market only with the approval of the Centre subject to such conditions as the Centre may impose. The Centre can also lend money to the States.

55. The Finance Commission studies the revenue and expenditure profile of the Centre and the States and recommends the share of the States in Central Taxes and specifically allocates to the States at varying levels depending on its assessment of the requirement. GoI has recently been enlarging the terms of reference to the Finance Commissions to include suggestions for measures to be taken by the States to achieve fiscal balance. As the Centre has to mandatorily give the devolution as recommended by the Finance Commission and accepted by the Centre, it has no further role in monitoring the effectiveness of such expenditure by the States. The accountability of the Centre, in this regard, for the money transferred is non-existent.

56. Institutionally, the Planning Commission coordinates all the Plan programs approved by the National Development Council (NDC). All policy decisions regarding the Plan are approved by the NDC in which all States are represented at the Chief Ministers level. It is presided over by the Prime Minister of India. Planning Commission also approves the annual plan size of each state and decides on the

quantum of central assistance to the States towards the Plan programs, after consulting with Central Ministries, Central Public Sector Enterprises and the States. The Planning Commission deals with both formula-based and non-formula-based allocations.

57. The Central assistance to the State is given in through many schemes like assistance for externally assisted projects, centrally sponsored schemes, Grant in aid under article 275 of the Constitution, etc., apart from the devolution of Central taxes as per Finance Commission formula.

58. The above is given mostly (70 per cent) as loan and the balance as aid. In the case of Special Category States the loan component is only 10per cent. The interest charged for these loans ranged over the marginal cost of borrowing by the Centre from the market. The amounts transferred to the States through the Planning Commission route for the State Plan schemes are considerably more than the Finance Commission mandated transfers. {Twelfth Finance Commission has recommended substantial changes, in favour of the States, in the rates of interest and the loan component of the plan assistance; GoI has accepted the recommendations.} The Centre has an accountability obligation in respect of non-Finance Commission transfers. The Centre monitors the performance of the States through Planning Commission, Ministry of Finance, the Administrative Ministries who administer the Centrally Sponsored Schemes.

### **Government Accounts**

59. The basic framework of the accounting structure is delineated in the Constitution of India. The form of accounts is prescribed by the President on the advice of an independent authority viz; the CAG, and is common to the transactions of the Union and the State Governments; this ensures a measure of uniformity, which facilitates the compilation of the accounts of various jurisdictions in a common and comparable format.

60. The financial transactions of Government, both receipts and payments, are differentiated and classified in elaborate detail. The accounting system is designed to give information in terms of the Constitutional provisions relating to the Fund (Consolidated Fund, Contingency Fund and Public Account) its nature (revenue or other than revenue) function (economic, social or general services) programme etc. A further distinction between Plan and non-Plan has been introduced with the advent of economic planning since the early fifties. The multi-layered classification is intended to facilitate the appreciation of resource allocation, provide a link between budget outlays on the one hand and functions, programmes, schemes and sub-schemes on the other and ensure itemized control over expenditure as may be required.

61. The organization of the Controller General of Accounts, Ministry of Finance, is responsible for the maintenance of Government accounts. The roles and

responsibilities are clearly defined and the systems and procedures are comprehensively documented.

62. An institutional mechanism functioning under the auspices of the CAG is in place in the form of GASAB not merely to frame standards and facilitate their compliance but also to keep pace with the developments in the field of Government accounting.

63. Nevertheless some issues have been raised from time to time. Currently there are no formally laid down accounting standards. The structure of financial accounts is not adequate to serve the purpose of management accounting since the accounts classification is not designed to relate to the cost Centres that makes it difficult to allocate cost to a responsibility Centre and to evaluate the actual cost against the standard cost. Government departments that offer commercial services are not in a position to know their full costs. Decision-makers (including Government itself) are unable to look ahead and estimate whether they can continue with the services they are currently delivering or whether they can afford new services. The system is input-oriented and does not capture the outputs and outcomes.

64. The system of accounting is cash-based; it does not bring out the accrual aspects of accounting such as liabilities arising from unpaid bills, unrealized tax revenue and other receipts as well as the cost of using the existing resources (depreciation, etc.).

65. The system of classification is uni-dimensional as it flows in one direction namely from Fund to sector/sub-sector to functions/programmes to schemes etc. The relationships between functions, programmes and schemes are not always linear and cut across functions. There is a gap between the heads of development operated by the plan implementation and the Heads of accounts. The system does not permit the classification of the transfer payments so as to relate these to the specific programme or function. . There are also instances of programmes cutting across various functions; this further creates a distance between the accounting format and the Plan format.

66. The distinction between capital and revenue has been the subject matter of considerable discussion. The investments made by Government are not revalued or written off if the entity ceases to exist on liquidation. There is no system of revaluing the assets for disclosure in Government accounts, and while there is a prescribed procedure for writing off the assets, the financial implications of such write offs are not reflected in the accounts.

67. Currently, the transfer payments are classified as revenue regardless of their end-use. The issue has assumed importance in the context of the large- scale transfers to the urban and local bodies for capital related expenditure. An expert committee has suggested that it is the ownership of the asset created by such transfers that should determine the classification in the books of the transferring jurisdiction. For the sake of transparency such transfers as are intended for the creation of assets should be classified as capital grants under the revenue section in the books of the transferor.

68. Another aspect that has attracted considerable discussion is the distinction between Plan and non-Plan expenditure. According to many experts this has lost its original rationale of providing a basis for differentiating between developmental and non-developmental expenditure. It no longer serves the purpose of focusing the public expenditure agenda on inter-sectoral developmental needs since non-Plan maintenance expenditures on existing projects are much larger than before. The distinction has led to distortions in resource allocation since new schemes often take priority over maintenance expenditure.

69. Implicit in the distinction is the assumption that the Plan expenditures are productive and non-Plan expenditures are not. This is not correct, for, a number of projects classified in the budget as Plan are mere salary payments that are not productive. Similarly maintenance expenditure is productive though it is classified as non-Plan.

70. The distinction has also led to complexities in budget handling of Government expenditure and prevented a holistic view being taken.

71. The basic issues are the absence of an accounting policy and formally articulated accounting standards and the cash based system of accounts. These are being addressed through the GASAB. Recognizing the difficulties in a switch over to the accrual accounting system in the near future or even in the medium term, the introduction of additional accounting information has been suggested.

### **Financial Reporting**

72. The organization of the Controller General of Accounts, Ministry of Finance, prepares financial reports from the Government accounts. At the level of the Ministry, the Chief Controller of Accounts compiles the accounts of the Ministry as a whole classified up to the Group Minor Head level for the information of the Secretary for the purpose of expenditure control.

73. The CGA prepares the consolidated accounts of the Government of India. The monthly accounts are generally ready by the end of the succeeding month and placed on the website. The CGA also prepares an analysis based on the monthly accounts. The analysis covers trends in receipts, expenditure and deficit and provides an input for monitoring the general fiscal position. The analysis profiles comparative status of fiscal deficit, borrowings, ways and means advances and tax and non-tax revenues. It also contains a macro-level picture of the resources transferred to the sub-national levels in terms of grants, loans and the share of taxes and duties.

74. The CGA prepares two annual financial statements viz; the Appropriation Accounts and the Finance Accounts. These financial statements are signed by the Controller General of Accounts, countersigned by the Secretary, Department of Expenditure, Ministry of Finance, and carry the audit certificate of the CAG before

these are presented to the Parliament. While the Finance Accounts are compiled and presented in one volume for the Union Government as a whole, the Ministries of Railways, Defence, Post and Telecommunications prepare their own Appropriation Accounts; these are also presented to the Parliament after audit by the CAG.

75. The provisional annual unaudited accounts are generally ready within two months of the close of the financial year; duly audited and certified accounts are generally presented in the Parliament's budget session in the following year.

76. The CGA also brings out the Accounts at a Glance. This annual publication gives a broad overview of the Government finances as seen from the Finance Accounts and the Appropriation Accounts. It also provides time series data on tax and non-tax receipts, capital receipts, revenue and capital disbursements, debt position, fiscal deficit, returns from investments etc;

77. According to the Fiscal Policy Strategy Statement, tabled by the Finance Minister while presenting the budget for the year 2005-2006, in order to promote transparency and accountability, the Union Government Ministries will be expected to release a monthly summary of their receipts and expenditure to the general public (through their websites etc) and in particular disclose scheme-wise funds released to the State Governments.

78. The system has certain inherent strengths. The basic framework of the accounting structure and financial reporting is prescribed in the Constitution of India. The reports of the CAG on the accounts of the Union are submitted to the President, who causes them to be laid before both Houses of Parliament. It is thus a requirement of the Constitution that the financial reports are available in the public domain duly audited by the country's Supreme Audit Institution. A uniform form of accounts prescribed by the President on the advice of the CAG that is common to both the Central and the State Governments ensures a measure of uniformity, which facilitates the compilation of the financial reports of various jurisdictions in a common format and also inter-jurisdiction comparison and analysis.

79. The classification of transactions in the financial reports is designed to capture the data with reference to the source as well as destination (Sector, Function, Programme, Project, Scheme, etc.) and is of considerable use in performance evaluation.

80. The in- year monthly financial reports comply with the IMF requirements of Special Data Dissemination Standards both in their content and timeliness and are public document. The unaudited Annual Accounts too are available for decision-making within a couple of months of the close of the year.

81. The publication Accounts at a Glance and the CAG's Audit Report provide critical analysis and evaluation of the management of Government finances. The financial reports contain wealth of information that can be of use to decision-makers, research scholars and academicians.

82. The systems and procedures are comprehensively documented and the role and responsibilities are clearly defined. An institutional mechanism is in place in the form of GASAB not merely to frame standards and facilitate their compliance but also to keep pace with the developments in the field of Government accounting and financial reporting.

83. Nevertheless some issues have been raised from time to time. There is no law that prescribes the timing and coverage of the accounts. Although the format of the Finance Accounts is comprehensive, these are not presented in the same format as the budget.

84. The complex character of the mass of data presented in the Finance Accounts has undermined their reader friendliness.

85. The Finance Accounts report heavy outstandings under suspense year after year. There is no delineation in the balances in Suspense Accounts between the outstandings that have an expenditure impact and the items that impact the cash balance of Government. Although the Finance Accounts exhibit external liabilities at the current rate of exchange, this is not integral to the accounting system.

86. The balances in the Public Account are not held separately and are merged in the cash balance of the Government. Consequently, the balances in the Public Account are frequently drawn upon for meeting expenditure debit to the Consolidated Fund. This has frustrated the legislative control over Government expenditure since it is not possible to know at any time whether the Consolidated Fund has run dry or not.

87. As the system of accounting is cash-based, the financial reports do not bring out the accrual aspects such as liabilities arising from unpaid bills, unrealized tax revenue and other receipts as well as the cost of using the existing resources (depreciation etc.). The permanent assets created through incurrence of capital expenditure such as dams, canals, roads, bridges plants, machinery etc. are not identified and disclosed in the financial reports. There is no system of revaluing the assets for disclosure in the financial reports. While there is a prescribed procedure for writing off the assets, the financial implications of such write offs are not reflected.

88. According to a World Bank Report on State Financial Accountability Assessment, Government of Uttar Pradesh (2003) GoUP accounts, though they score well on a number of parameters, do not meet the IFAC-PSC standard, mainly because of a lack of definition of their coverage, and lack of a statement of accounting policies. The Report also observed that the CAG's Audit Certificate on the Annual Accounts to the effect that, according to the best of his information, the accounts read together with his observations, are correct statements of receipts and outgoings did not meet the INTOSAI reporting standards. These observations are as relevant for the Union Government financial reports.

89. The basic issues are the absence of an accounting policy and formally articulated accounting standards and the cash based system of accounts. These are being addressed through the GASAB. Recognizing the difficulties in introducing the accrual accounting system in the near future or even in the medium term, the provision of additional accounting information has been suggested.

### **External Audit**

90. India has a robust external audit system. The Supreme Audit Institution, called the CAG, is an officer neither of the Parliament nor a functionary of Government but an autonomous Constitutional authority. The Constitution and the law framed thereunder are designed to provide a strong legally independent framework for the functioning of external audit. The CAG has vast audit jurisdiction; he has been empowered by law to inspect executive offices, call for accounts, books, documents and information and to make necessary inquiries for the performance of his duties.

91. The CAG has the unfettered right to decide the scope and extent of audit, and to determine what should or should not be included in his Audit Reports. It is a requirement of the Constitution that his Reports must be presented to the Parliament and thereby made public. The CAG also assists in the follow up action on the Audit Reports.

92. The CAG's Auditing Standards and the internal procedures of his organization are designed to ensure high quality of audit. The system has responded to the requirements of changes in the pattern of Government expenditure and the developments in the profession. A recent innovation is the introduction of a system of internal peer review.

93. However, some issues have been raised from time to time. In the absence of a definition of the expression 'Audit' in the Constitution and the law, the CAG's authority to conduct value for money audit has been occasionally questioned. Neither the Constitution nor the law prescribes the qualifications and the procedure for appointment to the office of the CAG; there is lack of transparency in the matter and apprehensions have been expressed that the claims of the meritorious persons might be ignored.

94. There is a perception that the independence of the CAG as envisaged by the founding fathers has been hedged *inter alia* by the lack of full control over his staff, restraint of the Executive (Ministry of Finance) on his budgetary autonomy and absence of direct access to Parliament, which, in the words of a former Speaker of the Lok Sabha renders him an 'orphan'. The CAG does not enjoy legal immunity; fears have been expressed that as external audit takes on sensitive issues of high level and bureaucratic corruption and lack of accountability, his organization will be vulnerable to criticism of over-stepping his competence and even partisan attitude.

95. External audit is often hampered due to the delays and denial of records and documents. The CAG does not have the power to summon witnesses and take evidence on oath.

96. The audit jurisdiction of the CAG does not extend to the public sector banks and the public financial institutions despite huge amounts of Government investments therein. The CAG is also not authorized to audit the accounts of cooperative institutions. With progressive disinvestments even some of the public sector enterprises have already gone out of the CAG's audit jurisdiction although large amounts of Government moneys continue to remain invested therein.

97. Neither the Constitution nor the law prescribes the schedule of submission of CAG's Audit Reports and their presentation to the Parliament.

98. Questions have been raised on the accountability of external audit but the issue 'Who audits Audit' has not been satisfactorily resolved. There are also certain negative perceptions about external audit; the CAG focuses more on financial irregularities and less on outputs and outcomes; the performance appraisals fall short of management audit and do not indicate how management can be strengthened; physical inspection is rarely undertaken; the system is not fully equipped to meet with the requirements of meaningful audit of activities/programmes of public expenditure in the newly emerging areas of science like nuclear energy, biotechnology etc, because of the complexities and technicalities involved. Audit focuses on negative aspects and does not give adequate credit for positive achievements. The audit reports need to be more timely to be of use to the executive. The auditors have failed to involve the civil society, put before the public the work they do in a language easily comprehensible by the latter and have made no positive effort to tell the public about their activities.

99. The CAG has taken steps to redress some of these negative perceptions; his recent guidelines on performance auditing lay stress on greater auditee involvement in the conduct of performance appraisals. But the most serious issue is the lack of adequate response to audit and follow up action. The executive authorities to whom matters proposed for inclusion in the CAG's Audit Reports are referred do not respond in time. The somewhat indifferent attitude of Government and the legislature to the audit findings has weakened the institution of accountability. The suggested measures include vesting of adequate powers in the CAG to expeditiously and effectively book individual malefactors and delinquent agencies; and the establishment of multi-member accountability tribunals for trying cases of financial malfeasance which will have the power to award punishment by way of recovery of financial loss caused in proven cases.

### **Legislative Scrutiny**

100. Legislative oversight over Government expenditure and revenues derives its authority from the Constitution of India. The CAG's Audit Reports on the accounts of

the Union and the Audit Reports on the public sector undertakings stand automatically remitted to the Public Accounts Committee and the Committee on Public Undertakings respectively for follow up action after these are presented to the Parliament. The system has certain inherent strengths; the Committees possess adequate powers to summon witnesses at the highest level of bureaucracy and to call for documents, information and records for the performance of their functions. The Committees have the assistance of the CAG's organization in follow up of matters included in the Audit Reports. The Committees function in a non-partisan manner; and their reports are generally unanimous; carry the moral authority of the House and are in the public domain after being presented in the Parliament.

101. Systems are in place for monitoring the action taken on the recommendations of the Committees. The rate of implementation of the recommendations of the Committees has also been considered to be quite satisfactory; nearly 75 per cent, according to one estimate. Although the PAC does not, ordinarily, venture into questions of policy, its recommendations have been used as input into policy formulation/revision. Several amendments have been made to the tax laws in consequence of the recommendations of the PAC.

102. Nevertheless there are areas of concern. The time lag between occurrence of a transaction, its reporting in audit its coming up before the Committees has contributed to the erosion of the effectiveness of the legislative oversight. The Committees take up only a very limited number of cases included in the Audit Reports for detailed examination; although systems have been put in place and refined from time to time for following up other cases the general impression is that the executive tends to be casual in its response in regard to these cases. Government Departments have not been very prompt in furnishing replies to the recommendations. The proceedings of the Committees are not open to the press and the public. The reports of the committees are not discussed in the Parliament with the result that some very useful recommendations may remain unimplemented.

103. The Committees do not focus on individual officers but mainly on systems; this coupled with the rather diffused decision-making system allows the erring, negligent, inefficient and corrupt officials to escape unpunished. The recommendations of the Committees for fastening individual responsibility are generally not being implemented faithfully. It has almost become tendentious on part of the bureaucracy to defend even the blatant acts of omission and commission on one ground or the other. If the power to punish the officials under question is made external to the department, it would act as a great deterrent.

104. It has been observed that the COPU also performs some of the functions of the Estimates Committee and this has diminished its performance. It has also been observed that since the COPU also takes up PSU's that have not been the subject matter of CAG's Audit Reports, it is not able to do justice to the CAG's Audit Reports. The absence of assistance of the CAG's organization in such cases also affects its performance.

## **Access/Right to Financial Information**

105. The citizen's right to information is enshrined in the Constitution of India as a fundamental right by virtue of the explicit guarantee for the right to freedom to speech and expression as a fundamental right. India is also a signatory to the UN Declaration of Human Rights, 1948.

106. India has already achieved a high level of fiscal transparency that has been recognized as such by independent assessments. The budget documents, the financial statements, the annual reports of the Ministries, the reports of the Planning Commission and the Reserve Bank of India, the Reports of the CAG and the Reports of the Parliamentary committees contain plethora of financial information for informed debate and discussion and for holding Government accountable. Additional disclosures like the amounts of tax expenditure, debt profile and medium term perspective would be in line with the best practices. As regards the hearings of the Parliamentary committees, which are currently not open to public, a beginning could be made by publishing verbatim record of the proceedings after the Committees have presented their reports.

107. The Right to Information Act, 2005, is a landmark piece of legislation with the potential of a force-multiplier for enhancing public accountability. The Act envisages wide-ranging suo moto disclosures of information as well as several proactive measures for promoting and facilitating right/access to information. Although the Act has a list of exclusions, these are subject to two important over-riding qualifications: (1) information that cannot be denied to the Parliament cannot be denied to any person; and (2) a public authority may allow access to excluded information, if public interest in disclosures outweighs the harm to the protected interests. The Act prescribes a maximum time limit of 30 days for providing information, with penalties for willful denial of or delay in supply of information and right of appeal to high-level statutory authorities called the Information Commissions at the Union Government and the State Government levels. In any appellate proceedings the onus to prove that a denial of information is justified is on the authority that denied the information. The decision of the independent statutory appellate authorities is binding.

108. With the implementation of this law Government has no longer the discretionary power over information. And most importantly Government is constantly, and not just once in five years, answerable to the people, and not merely for its achievements and failures, but for each specific action and process.

**PART ONE**

**ANALYTICAL SURVEYS**

# CHAPTER 3

## BUDGET PLANNING, PREPARATION & APPROVAL

### Legal Framework

1. Articles 112 through 116 of the Constitution deal exclusively with financial matters to be dealt with by the Parliament. No money can be spent by the government except with the approval of the Parliament. Article 112 of the Constitution of India requires a statement of the annual receipts and expenditure of Government of India (GoI), known as Annual Financial Statement, be presented to both the houses of Parliament in respect of each financial year. The other Articles relate to different stages of legislative processing, namely, discussions and voting on the budget, passing Appropriation Bill, Supplementary Budgets and Vote on Account. Rules of Procedure of the Lok Sabha supplement the provisions of the Constitution regarding the parliamentary procedure in dealing with money bills. General Financial Rules issued by Ministry of Finance (MoF) lay down the detailed guidelines for the line departments to follow in the preparation of the budget. Fiscal Responsibility and Budget Management Act, 2003 (FRBM) and the Fiscal Responsibility and Budget Management Rules, 2004 (FRBM Rules) framed there-under now guide the fiscal direction of the budget. The purpose of FRBM and FRBM Rules is to achieve long term macro economic stability by reining in the fiscal and revenue deficits through limiting debt and to ensure greater transparency in fiscal operations. The Act obligates the government to lay on the Houses of Parliament the Medium-term Fiscal Policy Statement, the Fiscal Policy Strategy Statement and the Macro-Economic Framework Statement. A statement under Section 7 has to be presented giving the reasons, if the budget presented to the Parliament does not comply with the targets in the FRBM Act/the targets fixed in the budget slip beyond prescribed levels.

### Budget Construction

2. In terms of the General Financial Rules, Department of Economic Affairs in the Ministry of Finance issues an annual circular giving specific instruction to the administrative departments regarding the formulation of the budget. Planning Commission issues a similar circular covering the plan component of the budget. Finance Minister holds discussions with various stake holders to assess their expectations. The non-plan component of the budget is finalized by MoF in consultation with line departments, while the Planning Commission (PC) approves the plan component after due scrutiny in relation to plan priorities. Overall ceiling for the plan component is indicated by MoF. Revenue estimates are prepared by the Department of Revenue under MoF under different scenarios of taxation and appropriate model is adopted. Non tax receipts are prepared by the departments, where applicable.

3. Line departments are required to prepare a Performance Budget indicating the physical targets alongside financial outlays for better monitoring. Zero Base Budget has been

made a mandatory component of budget exercise. There is a prescribed drill for appraisal and approval of new projects which are processed through Expenditure Finance Committee (EFC)/Public Investment Board (PIB) to check the technical and financial viability before approval by the designated authorities. Project appraisal division of PC helps in assessing the viability of the projects. Only approved projects get the budget allocation, except in cases where token provisions are made pending formal clearance and sanction of the scheme.

### **Legislative Approval**

4. Budget is presented in Parliament by the Finance Minister generally on the last day of the preceding financial year, along with the following documents: Key to Budget, Annual Financial Statement, Budget at a Glance, Finance Bill, Memorandum, Receipt Budget, Expenditure Budget Vol I and II, Customs and Central Excise Notifications, Implementation of Budget Announcements, Macro Economic Framework, Medium term Fiscal Policy Statement, Fiscal Strategy Statement, Statement under Section 7 of the FRBM Act, Accounting classification and Demands for Grants.

5. Finance Minister's speech presenting the budget doubles up as a policy statement of the government about the thrust and the initiatives taken in the fiscal, financial and development areas. Opportunity is also taken to tune the taxation proposals to mobilize revenues and give thrust to priority areas. Finance Bill contains the proposals for changes/refinements in tax laws.

6. Macro economic perspective is prepared by MoF and presented to Parliament as Economic Survey before the Budget is presented. Line departments prepare the Performance Budget and the Annual Report.

7. Demands for Grants are scrutinized by the Departmentally Related Standing Committees (DRSC). These committees send out questionnaires on the basis of Demands for Grants, Annual Reports and the Performance Budgets. The departmental officials are called for oral evidence to provide clarification on budget proposals. The advice given by the committees has persuasive value. The Parliament votes on the budget after discussion taking into account the recommendations of DRSC. The grants of the departments which could not be discussed in Parliament due to expiry of time allotted are passed without discussion by applying the guillotine. DRSC meets periodically to evaluate the progress made by the departments in different areas during the year and present the reports to the Parliament. The House of the People shall have power to assent, or to refuse to assent, to any demand, or to assent to any demand subject to a reduction of the amount specified therein. If any reduction of the amount proposed in any Demand, even by a token amount, is approved by the House, then it is deemed to signify 'no confidence' in the government.

8. Appropriation Bill containing the amounts for each grant is moved by the government and approved by the House authorizing the government to spend the money. The Finance Bill authorizing the government to levy the taxes is also approved by the

Parliament. The Presidential assent is then taken for both the Bills after which they become the Acts giving the government the authority to act on them.

9. The House of the People (LOK SABHA) has been given the pre-eminent position for dealing with the Money Bills; they have the final say in the matter. The Finance Bill and the Appropriation Bill being Money Bills have to be passed by the LOK SABHA.

10. Fresh requirements for money arising during the course for the year either for already approved programs or for new services have to be got approved through Supplementary Budgets following the same procedure. Excess expenditure over the amounts approved by the Parliament has to be regularized through an Appropriation Bill, based on the recommendations of the Public Accounts Committee.

11. Estimates Committee of the Parliament takes up for an in-depth examination the budget estimates of a few departments every year. They have a mandate to report on improvements in economies, organization and efficiency in policies, suggest alternative policy for better efficiency, suggest the forms in which the estimates are presented to Parliament.

### **Characteristics of the Budget**

12. The budget consists of three parts namely, Consolidated Fund, Contingency Fund, and Public Account. All expenditure is classified as under:

Revenue (i.e., current) and capital (i.e., investment); voted (i.e., subject to Parliament vote) and charged (i.e., not subject to Parliament vote, for example, salaries of President, Speakers of the Houses of Parliament, and other specified officials and payments arising out of court decree etc.); and plan (included in the development plan) and non-plan (not so included).

13. The budget is prepared on cash basis annually. Re-appropriation within the grant is permissible. Unspent balances at the end of the year lapse, excepting in specified rare cases like grants to North Eastern States which have a non-lapsable pool.

### **Positive Features of Budget Formulation**

14. The positive features of budget formulation are as follows:

#### **i. Budget Realism**

There has been increasing realization in government that fiscal deficit and revenue deficit should be controlled. Every budget, Economic Survey and Annual Reports of Reserve Bank of India refer to the deficit position and call for efforts to control it. Discontinuing the practice of automatic monetization by issue of ad hoc treasury bills from 1997 was the first step towards introducing fiscal discipline. Fiscal Responsibility and Budget Management Act is a definitive step towards introducing more realistic and transparent budgeting as seen from the Preamble to the FRBM Act.

## **ii. Input Budgeting**

There has been continuing awareness that delivery systems have not been effective. Performance budgeting was introduced nearly 30 years ago and Zero Base Budgeting 20 years ago. There is a separate ministry to monitor large value projects. An Outcome Budget has now been introduced. (August 2005)

## **iii. Medium Term Framework**

A Long Term Fiscal Strategy was prepared and presented to Parliament in 1985. It was not followed up vigorously. The FRBM Act now obligates the government to lay on the Houses of Parliament the Medium-term Fiscal Policy Statement, the Fiscal Policy Strategy Statement and the Macro-Economic Framework Statement.

## **iv. Planning Process**

National Development Council, the highest policy making body in plan matters lays down the plan priorities in investment and approves the Five Year Plans.

Planning Commission (PC) has an important role in the budgeting process. Plan expenditure has to be approved by the PC, which it does after aligning them with plan priorities. It ensures that competing claims on resources follow the national priorities as contained in the Five Year Plans.

## **v. Project Investment Decisions**

Investment proposals in specific projects, in line with plan priorities are scrutinized according to prescribed procedure. Project Appraisal Department of the Planning Commission appraises the projects on the basis of internal rate of return and net present value. Views of all departments who have a stake in the project are obtained and considered. Authorities for approving the projects are laid down according to the level of investment.

## **vi. Transparency and Comprehensiveness**

Budget documents are in great detail and are well disseminated. It becomes available on the website soon after presentation in the Parliament. Transparency in budgetary matters more or less meets International Monetary Fund (IMF) standards in so far as giving information to the public, as per the assessment of IMF as well as of the committee set up by RBI under Dr. Montek Singh Ahluwalia.

## **vii. Estimation of Revenue and Expenditure**

Tax Research Unit is well-established machinery in the Department of Revenue for estimating the receipts under different scenarios of taxation. Expenditure estimates are vetted by MoF and Planning Commission.

## **viii. Fiscal Responsibility and Budget Management Act (FRBM)**

Fiscal Responsibility and Budget Management Act is an act of self-discipline and has been largely welcomed. A measure of this nature to contain the deficits, especially the revenue deficit has been recommended for a long time. Constitution of India had envisaged the possibility fixing of limits on government borrowing.

### **ix. Parliamentary Control over Budget**

Departmentally Related Standing Committee system has been hailed as the best development in ensuring effective parliamentary control over the government finances. These committees are able to devote time to each department and examine the estimates in depth. The interaction between civil servants and the politicians helps develop appreciation of mutual concerns. This is perceived as an important tool of accountability.

### **x. Gender Budgeting**

Steps have been taken to introduce gender budgeting in a few departments from the financial year 2005-06. A statement indicating gender-wise allocations are appended to the budget documents. Progressive introduction in all departments have been promised by the Finance Minister in due course.

### **Inherent Strengths**

15. Budget preparation and presentation are governed by well-established rules and procedure. There is predictability about the process. Time frames are certain. The budget is presented on the 28<sup>th</sup> February, preceding the financial year which starts on the 1<sup>st</sup> April. The responsibilities for different activities leading to the budget preparation are well delineated. The roles of the Ministry of Finance, the Planning Commission, the administrative departments and the legislature are clear. There have been regular efforts at improving the systems introducing more transparency. Performance budgeting and Zero base budgeting are in vogue. Procedures exist for investment approvals. Gender budgeting is being introduced gradually.

### **Issues Causing Concern**

16. Issues causing concern are listed below:

#### **i) Budget Realism**

Most analysts note with dismay that fiscal deficits and revenue deficits have generally been above the budgeted levels. Rate of growth of revenue deficits as a proportion of GDP is more than that of fiscal deficits. One of the main reasons for this is the inability to achieve the targeted revenues which are seen to be overestimated. Quality of forecasts of expenditure is also poor leading to huge variation between Budget, Revised Estimates and actual expenditure. Ballooning revenue deficits have crowded out capital expenditure over the years.

#### **ii) Input Budgeting**

The perception is that emphasis continues to be on input budgeting<sup>12</sup>, i.e., focusing more on financial than on physical/performance parameters. Emphasis is on spending and is not goal oriented. Even there, expenditure reported refers to expenditure released and not necessarily spent. Present system of incremental financial budgeting only helps to increase expenditure rather than reducing/optimizing it. There is a

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<sup>12</sup> The first Outcome Budget 2005-06 has been presented in Parliament in August 2005.

mismatch between allocation of financial resources and physical targets. Performance Budgeting has become a routine exercise. No effective use seems to be made of it. Zero Base Budgeting (ZBB) has been a non-starter. Only lip service is paid to the concept of ZBB. There are many practical difficulties in implementing ZBB, including inflexible bureaucracy.

It is important to have both the Performance Budgeting and ZBB to be implemented vigorously to enable funding of projects/schemes with focus on performance/delivery. Output budgeting based on public service agreement between departments and the Ministry of Finance needs to be introduced. This concern has been sought to be remedied with the introduction of Outcome Budgeting. Finance Minister released an Outcome Budget in respect of all Plan expenditure in August 2005. It aims to convert financial outlays into physical outcomes, with fixed quarterly measurable and monitorable targets, to improve the quality of implementation of developmental programmes.

### **iii) Medium Term Framework**

The budget continues to be on cash basis with a one year time frame. Provision of token amounts in respect of some projects conceals more than it reveals. The budget does not reveal the commitments made for future years.

Medium term roll-on budget, as has been adopted in many countries, is needed to appreciate the financial/fiscal implications of the budget proposals.

### **iv) Plan versus non-Plan**

Plan expenditure has been shown as a distinct item in the budget documents since the beginning of First Plan in 1951. This was done to capture all the expenditure on plan schemes separately. Initially, the plan had more capital component and plan expenditure came to signify investment expenditure. Increasingly the revenue component of plan expenditure has been creeping up and capital component reducing. Plan expenditure does not anymore indicate the level of investment expenditure. Plan expenditure of one plan becomes the non plan expenditure of future plans.

As plan expenditure does not necessarily reflect investment, the distinction between plan and non-plan leads to non-transparency in budget. The distinction between plan and non-plan has now become artificial and needs to be removed. It introduces distortion in allocating resources to current plan projects when projects executed under previous plans are classified under non-plan and are denied funds for essential maintenance support.

### **v) Project Investment Decisions**

Despite a plethora of rules and procedures, investment decisions do not appear to be based on proper project appraisals; in some cases, the appraisals are tailored to help fund projects already selected on other considerations. This is particularly true of social cost benefit analysis. Too much time is taken for investment decisions. Data base is also unreliable. There are too many projects to be funded, with the result no

project gets funded fully. Capital expenditure may not mean asset creation and vice versa.

Money promised must be made available and the money flow should be predictable.

#### **vi) Transparency and Comprehensiveness**

Contingent liabilities are not adequately addressed and quantified in the budget. There is also no concept of risk analysis in respect of contingent liabilities.

There are some off budget items, which should be routed through the budget.

Activities of quazi-fiscal institutions are not reported. Nor does the budget contain an analysis of fiscal risks. Tax expenditure is a neglected area. The amount given away as tax concession is, in fact, an implicit subsidy and should be quantified in the budget documents.

#### **vii) Planning Process**

The general impression is that the planning process has become a game of competing numbers and is least conducive to economy of expenditure. It encourages incremental budgeting. Though the Planning Commission (PC) decides on the level of plan expenditure for each department, it is the Ministry of Finance (MoF) that determines the over-all ceiling for the plan expenditure. This causes a constant friction between MoF and PC undermining the position of PC in determining the budget allocations.

#### **viii) Estimation of Revenue and Expenditure**

Wrong estimations of revenue and expenditure which have become regular and disquieting features have attracted great attention. Realistic estimates of both expenditure and revenue must be made. Frequent resort to Supplementary Budgets is a commentary on poor estimation at the time of preparation of budget.

#### **ix) Fiscal Responsibility and Budget Management Act (FRBM)**

It has been felt by some analysts that the FRBM does not go far enough. Lack of punitive measures if the government fails to keep the targets makes it a toothless legislation. Loss of face of the Finance Minister alone is not enough to infuse discipline.

#### **x) Parliamentary Control over Budget**

While the role of the Departmentally Related Standing Committees (DRSC) has been generally appreciated, there are some analysts who hold the contrary view that the DRSCs have not been effective, as they are not serviced by a competent secretariat. The recommendations are not mandatory and the committee has no powers to reduce the budget allocation even if they wish to. The committee tends to be fault finding rather than fact finding. The hearings of the committee are not open to the public or the press. As the life of committees is only a year, the members do not get time to develop departmentally related expertise. The budget is not discussed in the House in detail, as the DRSCs are expected to do so. DRSCs, however, handicapped as they are

without adequate time or expertise, are unable to do proper justice to the examination of budget, leading to dilution of Parliamentary control over budget. The Estimates Committee (EC) has not also been effective. Awareness about the EC is poor and its impact is little as its reports are not discussed in Parliament.

#### **xi) Other Points**

There is no comprehensive budget manual. There is a lack of cost consciousness in budgeting. Much of the budget expenditure is inflexible like interest payments and pension, leaving little scope for improvement. Institutional mechanisms are not working to their full potential.

17. Sporadic efforts have been made to regulate release of funds evenly through the year. MoF repeatedly issues instructions to all spending departments to spread expenditure through the year. But, March rush of expenditure is a regular yearly feature that leads to poor quality of expenditure. Release of bulk of money in March is partly the reason for this. As money unspent out of the year's allocation cannot be carried forward to next year, there is a tendency to spend as much money as possible without surrendering. This 'Rule of Lapse' contributes to waste. Carry forward of unspent amounts to the next year would prevent substantial wastage of public resources, according to some analysts.

18. The system of accounting is on cash basis leading to distortions. System needs to be changed to accommodate many transactions on accrual basis. While budgeting would continue on cash basis, changes may need to be made in the budget in classification, disclosure and presentation. Each line department should have separate Demands for Grant.

#### **Conclusion**

19. The literature discloses many positive features pertaining to budgetary systems and processes. They are:

- Well developed systems for budget formulation including wide ranging consultations, plan/programmes, monitoring, budget implementation procedures, and audit and evaluation techniques.
- Budget documents are comprehensive and are readily available; they are put on the web immediately after presentation in Parliament.
- FRBM and the Rules there-under are particularly commented upon as good developments. Transparency in budgetary matters more or less meets IMF standards in so far as giving information to the public, with a few areas like relations with Quazi-fiscal units like banks and financial institutions, exemptions in taxes, tax expenditure needing improvements.
- The Economic Survey is an important document conveying valuable insights. Functional and Economic classification of the budget is a useful document which helps to understand the budget.
- Examination of budget estimates by the Departmentally Related Standing Committee leads to more qualitative/intense analysis than budget debates in

Parliament. Interaction between the civil servants and legislators through this mechanism is healthy. Estimates Committees have over the years contributed to fiscal awareness in government departments.

- Guarantee Redemption Fund set up in 1999 to provide for contingent liabilities.

20. On the other hand, there are some areas where there is scope for improvement.

- Budget formulation scores poorly on budget realism: more often than not actual expenditure/receipts vary from budget estimates widely.
- Emphasis is on spending budget allocation to the exclusion of output: performance orientation is absent.
- Budget does not give a long time perspective being limited to one year time frame; commitments for the future are not available in budget documents.
- The distinction between plan and non-plan is being kept up despite universal recommendation against it.
- Investment decisions lack rigor.
- Rush of expenditure towards the end of the year is a persistent malady.
- Off budget transactions and quazi-fiscal activities and absence of analysis of fiscal risks reduce the transparency of the budget.
- Disclosures are needed in many areas to increase transparency of budgeting.
- Classification of budget regarding Plan and Non-plan expenditure, object heads, and Revenue and Capital has to be modified to be more meaningful to the users.
- Each line Department should have separate Demands for Grant to ensure accountability.
- Scrutiny by DRSCs suffers from lack of expert support staff and inadequate time.

## **CHAPTER 4**

### **BUDGET IMPLEMENTATION AND INTERNAL CONTROL INCLUDING INTERNAL AUDIT**

#### **Legal Framework**

1. In terms of Article 53(1) of the Constitution of India, the executive powers of the Union Government vest in the President and are exercised by him either directly or through officers subordinate to him. The Constitution also prescribes that all contracts made in the exercise of the executive powers of the President shall be expressed to be made in the name of the President. The Annual Appropriation Act passed by the Parliament provides the authority for the incurrence of expenditure. The Government of India (Allocation of Business) Rules, 1961, allocate the business of the Union Government among the various Ministries and Departments. The Government of India (Transaction of Business) Rules, 1961, define the authority, responsibility and obligation of each Ministry and Department in the matter of disposal of its allocated business.

#### **Financial Powers of the Ministries**

2. The financial powers of the Union Government are vested in the Ministry of Finance. The Delegation of Powers Rules, 1978, prescribe the financial powers that the Ministry of Finance has delegated to the line Ministries and Departments with the attending conditionalities as well as the extent to which the latter can share their delegated powers with their subordinate formations. The residuary powers vest in the Ministry of Finance.

#### **Chief Accounting Authority and the Financial Advisors**

3. The Secretary of the Ministry is the Chief Accounting Authority. Financial Advisors have been positioned in the Ministries at appropriately senior levels for providing competent financial advice to the Ministries in the exercise of their delegated financial powers; in other matters the Financial Advisors function on behalf of the Ministry of Finance. The Financial Advisor is to be closely associated with the formulation and implementation of all expenditure

proposals. He assists in budget formulation, scrutiny of programmes and projects for approval, and post budget vigilance control of expenditure and monitoring of the progress of schemes and projects. The performance appraisal report of the Financial Advisor is written jointly by the Secretary of the line Ministry and the Secretary, Expenditure/Finance Secretary.

4. The Chief Controller of Accounts is responsible for actual payments of expenditure and maintenance and compilation of accounts and financial reporting.

## **Rules and Procedures**

5. The Ministry of Finance has issued a compendium of instructions called the General Financial Rules, 1963,<sup>13</sup> for the guidance of the Government officers dealing with matters of a financial nature. Besides enunciating the basic canons of financial propriety, these Rules set out the general system of financial management and control in Government relating to assessment, collection and check of revenues, essential conditions governing expenditure from public funds, its monitoring and control, procurement and contract management and the maintenance of accounts. The departmental codes and manuals issued by the line Ministries and their subordinate formations supplement the provisions of the General Financial Rules.

6. The Civil Accounts Manual issued by the Ministry of Finance, Department of Expenditure, Controller General of Accounts, sets out the mandatory transaction level checks before admitting any expenditure.

## **Monitoring and Control of Expenditure**

7. The General Financial Rules prescribe the procedure for monitoring the progress of expenditure against Parliamentary authorizations. The Pay and Accounts Officers are required to check availability of authorization before admitting any payment as per the procedures prescribed in the Civil Accounts Manual.

8. The primary responsibility for monitoring the physical progress rests with the line Ministries, which may call for appropriate reports from the project authorities. The control is also exercised through the mechanism of annual budgetary allocations when the

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<sup>13</sup> General Financial Rules, 2005 from July 2005

financial and physical progress is critically reviewed for deciding subsequent year's allocations.

9. The Ministry of Program Implementation monitors the progress of all projects costing more than Rs. 200 million. In respect of mega projects, monthly flash reports are obtained from the project authorities, consolidated and analyzed and summarized for the Prime Minister's office and the Cabinet Secretariat. All reports go to the Planning Commission and the respective administrative Ministries.

10. The Program Evaluation Organization of the Planning Commission undertakes evaluation studies of selected programmes/schemes as per the requirements of the Planning Commission, Ministries and Departments. The Ministries have also commissioned independent evaluation studies as required.

## **Internal Audit**

11. Internal Audit units have been set up in the Accounts organizations in the Ministries. The main objectives of internal audit are to check the accuracy of accounts, to prevent and to detect frauds and to bring to light the irregularities committed by the executive officers, the drawing and disbursing officers, the Pay and Accounts Officers and other departmental authorities.

12. The Controller of Accounts prepares an annual report on the results of internal audit for the Controller General of Accounts.

## **Cash Management**

### *(a) Institutional framework*

13. The Ministry of Finance (MoF) has the direct responsibility of cash management as per the Transaction of Business Rules of Government of India. The two wings of MoF, Department of Expenditure and Department of Revenue have the macro picture on the expenditure and the revenue flows which determine the cash flows.

14. The administrative departments get budget allocations and have the freedom to spend the money within the budget allotment and for approved purposes in line with procedure and principles laid down in General Financial Rules and the Delegation of Financial Powers.

15. Government of India has set up a cash management group in the Ministry of Finance. The group is required *inter alia* to review the cash position each month and to suggest measures to correct any temporary mismatches between receipts and expenditure.

### *(b) Role of the Reserve Bank of India*

16. In terms of the Reserve Bank of India Act, 1934, and the agreement signed thereunder between the Government of India and the RBI, the RBI is the banker to the Union Government. It has also been entrusted with the responsibility of managing the Public Debt.

17. The Union Government is required to maintain a certain minimum cash balance with the RBI on all days. The RBI grants Ways and Means Advances (WMA) to the Union Government if the balance falls below the prescribed minimum due to a temporary mismatch between receipts and expenditure. The maximum limits for the WMA are agreed separately for each half of the year; the rate of interest on such WMA is linked with the prevailing market rate. Any requirement beyond the agreed WMA limit has to be met by market borrowing; the RBI allows overdraft for a maximum period of 10 days, the overdraft carries interest rate at two per cent above the WMA rate.

18. The RBI issues a press release at the beginning of each half-year announcing the WMA limit and the rate of interest on WMA and overdrafts.

19. The Fiscal Responsibility and Budget Management Act, 2003, prohibits the RBI from subscribing to the Union Government loans.

*(c) Introduction of cash management system*

20. In March 2003 the Union Government introduced the system of cash management in nine selected Ministries on pilot basis. Under the system the budgetary allocations are to be released quarterly in a time-sliced manner to permit convergence with available resources and to permit even flow of expenditure.

21. As per the Fiscal Policy Strategy Statement tabled by the Finance Minister while presenting the Union Government budget 2005-2006, in a gradual move towards quarterly budgeting and better exchequer control, Government has decided to prescribe quarterly ceilings and targets for expenditure and revenue collection for the line Ministries. Expenditure in excess of the ceiling will require prior concurrence of the Ministry of Finance.

**Inherent Strengths**

22. The system has certain inherent strengths with
- Clearly defined roles and responsibilities;
  - Well-documented systems and procedures;
  - Provision of financial advice at appropriately senior levels;
  - Independent prior check of expenditure before actual payment;
  - Arrangements for internal audit;
  - Arrangements for monitoring and evaluation; and
  - Systemic and procedural changes made from time to time ensure response of the system to the changing requirements.

Nevertheless some issues have been raised.

## **Budget Implementation**

23. Budget implementation suffers from several deficiencies. There are persistent savings under several heads of expenditure year after year. Also in a very large number of cases savings of Rs. one billion and more are reported. Large-scale diversions of funds between budget heads cause serious deviations from the approved budget; in several instances these are carried out without the mandatory prior clearance of the competent authority. The laxity in monitoring and control mechanism is evident from injudicious, excessive and unnecessary reappropriations as well as inadequate, excessive and unwarranted surrender of budget provisions.

24. There are instances of excess disbursements over the legislatively authorized grants; these require regularization by the Parliament. On the other hand supplementary grants are found to have been obtained in several cases though the expenditure did not come up to the level of the original grant.

25. There is heavy year-end rush of expenditure, particularly in the month of March, with attendant enhancement of fiduciary risk. Capital outlay and investments and grants-in-aid to sub-national jurisdictions are specially affected by the March-rush. In some cases the expenditure may be only “virtual expenditure”, representing transfer of budget provisions to deposit heads or to public sector undertakings.

26. The rule of lapse whereby the budget allotment must lapse at the end of the year is a ready-made rule for wastage and causes distortion of priorities. For proper control over quality as well as quantity of expenditure, not more than 15 per cent of the allotted amount should be allowed to be spent in the month of March. It has been suggested that a reserve fund may be created so that the allocation is available in the subsequent year(s).

## **Implementation of the Centrally Sponsored Schemes**

27. There has been considerable criticism of the implementation of the centrally sponsored schemes. The controlling Ministries neither assess the absorptive capacity of the State Governments nor verify the effective utilization of the funds already provided before making fresh releases; the Ministries are unable to ensure the correctness of the performance data reported by the State Governments; large parts of Central funds are released in the last month of the financial year, which could not be expected to be spent by the State Governments during that year. Nobody could be held accountable for poor performance.

28. The Union Ministries have neither the capacity nor the willingness to effectively monitor the implementation of the schemes. Since the States execute the schemes, sensitivity associated with the Centre-State relations also precludes a searching

evaluation being made. There is also the unwillingness to accept poor performance, for fear of being questioned by Parliament or adverse publicity.

29. Besides the discretionary element in these transfers, the conditionality imposed by the Centre, including those on staffing patterns, tends to affect States' own priorities and programmes. It is often pointed out that the proliferation of schemes has increased even the village level bureaucracy considerably with no visible gains to the people.

## **Role of the Ministry of Finance**

30. The role of the Ministry of Finance, which is the ultimate repository and source of financial powers, systems and procedures, has been critically commented. On the one hand it has been observed that the Ministry plays a somewhat negative role, and the control exercised by the Ministry often acts as a constraint on the performance of the line Ministries and departments. On the other hand a view has been expressed that the decentralization of financial management has weakened the technical capability of the Ministry.

- The Ministry of Finance often acts as penny pinching, even petty, control agency. The prevailing belief among line Ministries is that the Ministry often relishes standing in their way by saying "No" rather than giving them a helping hand. The Ministry needs to develop a positive attitude to inject greater initiative and enthusiasm in the line Ministries.
- The Ministry of Finance should only approve the over-all budget for different Ministries and thereafter allow them sufficient flexibility to manage their resources in the most productive manner irrespective of the various heads under which it is spent.
- There is need to move gradually from 'itemized' control to 'budgetary' control, with sophisticated expenditure control mechanisms and effective implementation delivery systems. This will require detailed and careful budgeting at the beginning of the year; significant delegation to the Ministries to operate within the approved budgets; well regulated cash flows; strong financial management systems at all levels; and organizational restructuring/process-engineering with capacity building to ensure 'value for money'.
- The decentralization of financial management has weakened the technical capability of the Ministry of Finance to undertake or participate in the fundamental review of expenditure policies and programmes. The Ministry should have a much stronger scrutiny function in the matter of budget estimates.
- Excessive compartmentalization of expenditure further complicates the situation. Non-Plan segment of expenditure is under the purview of the Ministry of Finance while the Ministry of Finance, the Planning Commission and the line Ministries jointly determine the Plan outlays.
- Classification of expenditure as Plan gives it automatic priority and immunity from cuts.

## Delegation of Financial Powers

31. The observations on the powers delegated to the line Ministries and departments have mainly centred on their adequacy and the attending conditionalities.

- The powers of reappropriation of funds vested in the line Ministries are extremely restrictive.
- The conditions imposed by the Ministry of Finance while delegating financial powers to the line Ministries and Departments and the economy instructions issued from time to time have somewhat restricted the exercise of delegated powers and act as a barrier in achieving the allotted goals and targets.
- The conditions create an ambience in which the officers are not always willing to accept responsibilities and routinely refer the cases to the Ministry of Finance.
- Another consequence of the conditions is the reluctance of the “delegates” to think in terms of further re-delegation to the subordinate formations.

## Role, Responsibility and Accountability of the Secretary to the Government

32. A Secretary to the Government of India exercises considerable power and influence in the deployment of Government resources. However, the role, responsibility and accountability of the Secretary have not been delineated<sup>14</sup>. He has no legal accountability either to Parliament or to the larger civil society and only an informal accountability to the Minister. The only occasion when his accountability for expenditure proposals is enforced and the physical performance of the Ministry is scrutinized is when he appears before the Departmental Standing Committee, which examines the budget proposals of his Ministry.

33. Although the Secretary has been designated as the Ministry’s Chief Accounting Authority, not many Secretaries take their responsibility seriously. The emphasis is mainly on financial spending; in any case the Secretary can exercise only minimal oversight in respect of funds transferred to the State Governments or paid as grants to the non-government organizations.

## Financial Advisors

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<sup>14</sup> Rule 64 of the GFRs 2005 formally defines the duties and responsibilities of the Secretary/Chief Accounting Authority.

34. The scheme of Financial Advisor has attracted comment for its perceived institutional infirmities as well as the level of support provided to this functionary. The opinion is divided on the control of the Ministry of Finance over the Financial Advisor.

- The line Ministries often see the role of the Financial Advisors as one of obtaining maximum allocations from the Ministry of Finance.
- The dual control over the Financial Advisor with their mutually differing objectives by the line Ministry (maximization of spending) and the Ministry of Finance (observance of prudent financial discipline) has not quite been helpful in achieving the aims of the scheme. It is inherently awkward to expect the Financial Advisor to act both as the proposer and scrutinizer of expenditure programmes.
- The relationship between the Secretary and the Financial Advisor is beset with tension: the Secretary perceives the Financial Advisor as the outside representative of the Ministry of Finance and the Financial Advisor very often acts as such without due sensitivity to the implementation of the Ministry's programmes. In this context need has also been expressed for an institutional mechanism to insulate the Financial Advisor from any subjective assessment of his performance.
- The Financial Advisors suffer from staff constraints and do not have competent professional support and on a number of occasions the expenditure sanctions and authorizations issued with the concurrence of the Finance Division are challenged on grounds of regularity.
- Unlike the position in the Ministries of Railways, Defense and Telecommunications, the Finance and Accounts functions have not been unified in the civil departments.

## **Procurement Controls**

35. Several weaknesses in the system of procurement have been pointed out<sup>15</sup>. These range from the institutional aspects of absence of procurement law and a central procurement agency to the implementation of the prescribed procedures and their abuse.

- Despite the huge magnitude of procurement by Government of India there is no single department or agency exclusively responsible for framing policies or regulating procurements.
- There exists no separate legislation to regulate public procurement and there is no legal authority to the public procurement procedural framework, which is essentially a set of executive framework.
- The canons of financial propriety as enunciated in the General Financial Rules have not been concretized in the procurement procedures. The Ministries and Departments tend to modify the general framework of the prescribed rules and procedures, ostensibly to meet their specific requirements, but at the cost of credibility and public confidence in the system.

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<sup>15</sup> GFRs 2005 effective from July 2005 have addressed many of these weaknesses.

- Different agencies and Ministries use a multiplicity of documents/forms for identical procurements.
- Instructions for post-tender negotiations are confusing; negotiations lead to opaqueness in the system.
- Delays in tender processing are endemic and no effective, quick and credible system exists for redressal of grievance in the award of tenders.
- For works contracts the schedule of rates, which is the benchmark of assessing the reasonableness of bids, is neither computed scientifically nor updated regularly.
- The system of registration of contractors has become a vehicle of corruption and once a contractor is registered he is automatically deemed as qualified. Bad contractors are not eliminated from the list of registered contractors.
- Contracts do not provide for price adjustment and a fair dispute resolution mechanism.
- There is not much use of institutional memory and no performance indicators have been developed.

## **Performance of Internal Controls including Internal Audit**

36. Although not so explicitly stated, the system of internal control including internal audit has been sought to be benchmarked against international best practices. The main issues that have been articulated refer to their theoretical soundness and approach besides compliance.

- The internal controls are not functioning effectively and have failed to prevent cases of waste and overspending.
- The results of audit of individual transactions as reported in the CAG's Audit Reports are indicative of disregard of the financial rules, arbitrary exercise of authority including violation of the limits of the delegated powers, non-compliance with the orders of the superior authorities, negligent processing of procurements etc.
- Internal audit does not receive adequate attention; there are arrears in conducting internal audit and compliance with the observations of internal audit is tardy.
- Internal audit checked only the transactions generated through the drawing and disbursing officers and did not comment upon budget formulation, expenditure control, unspent provisions, excess expenditure and monitoring and implementation of schemes etc.
- The internal audit system is weak since it is only an accounts oriented system; there is no audit or control over the objectives, tasks, outcomes and performance.
- Not enough use is being made of internal audit as a critical management information tool to appraise performance. Performance audit needs to be made an essential part of internal audit. While continuing with regularity audit there should be focus on performance audit of programmes/schemes, as identified in consultation with the Chief Accounting Authorities.

- There is need to enlarge the scope of internal audit and make it multi-disciplinary.
- Most of the staff and officers engaged on internal audit do not have the requisite background, training or experience, either of finance or of accounts, and the work is also accorded low priority.
- The internal audit programme should be at the behest of the Secretary of the Ministry who should endorse an annual audit programme at the beginning of each financial year. The internal audit programme should be prepared by an Audit Advisory Committee headed by the Financial Advisor and with membership drawn from the accounting staff, internal audit and the policy and the operation divisions of the Ministry.
- It is also important that the Ministry of Finance reviews the results of audit, internal as well as external, with the Ministries; this is essential if the full benefits are to be obtained by using the results from investigations of the past in setting budgets for the future.

## Quality of Expenditure

37. Some of the inherent limitations in measuring the quality of Government expenditure have been recognized. A suggestion has also been made for conducting periodical base review of all activities of a department.

- Budget is on cash basis and not on accrual basis; hence expenditure spillovers from or to the current year are not reported.
- Expenditure merely represents release of funds, which is not always the same thing as actual utilization.
- Capital expenditure may not always result in the creation of assets.
- Contingent liabilities are not fully assessed and reported.
- It is necessary to make a fresh base review of all activities of a department once in three or four years. This exercise should be conducted independently a couple of months before the budget exercise begins. Such timing will ensure effectiveness of the efforts and scarce resources employed in the administrative activity besides promoting financial discipline. The fresh base-review will prove more beneficial than the traditional concept of zero base budgeting.

## Monitoring and Evaluation

38. The weaknesses in the current system of monitoring and evaluation have been recognized. Issues have been raised regarding the absence of performance indicators as well as the need to link further expenditure with performance.

- The implementation of the programmes is not preceded by the specifications of cost, time and quantity schedules against which the actual services may be measured; an effective cost control system is non-existent in most Government

departments; the relationship between the resources provided in the budget and the services to be delivered is at best nebulous.

- There is no regular mechanism for evaluating all the programmes/schemes in a time-bound manner.
- The focus of evaluation by the Programme Evaluation Organization of the Planning Commission has been on finding constraints in implementation and general impact and most evaluation studies lack focus on the economy, efficiency and effectiveness of expenditure.
- A large number of major programmes continue to be financed despite some major weaknesses because either there has not been any evaluation or because the evaluation studies are not made available in time and there are no visible lessons learnt.
- There is no effective mechanism for the evaluation of completed projects and feeding the information back into the budgetary process.
- Each Department of the Government should develop an internal evaluation mechanism of its programmes on the basis of clearly laid down parameters.
- The Secretary of the Department should formulate annual performance targets. He should also be given full freedom ---including delegated financial powers ---so that he can be held accountable for performance as per the targets.
- Concurrent evaluation studies need to be conducted in order to understand the various aspects such as the reaction of the beneficiaries to the proposed project, the reasons for time and cost overruns, the impact of the project on the target group and whether some groups have become worse off as a result of the project. These studies may be conducted at the implementation stage. Impact studies may be conducted after the project has been completed.
- The design of performance indicators must form an integral part of the programme design with appropriate emphasis on qualitative aspects. Indicators must comprise input indicators, output indicators and impact indicators.
- The system of performance-linked release of funds needs to be put in place if monitoring is to play any significant role.
- There is need for capacity building for the purpose both in the Government and in the voluntary sector.

## Conclusion

39. The Literature reveals that the Government of India has a well- designed and well-articulated system of internal control both at the transaction-level as well as at the over-all macro level. The main emphasis is however on inputs/outlays as distinguished from outputs and outcomes<sup>16</sup>. Credible performance indicators have not been evolved and the system of monitoring and evaluation remains weak. The system has also witnessed degradation in implementation.

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<sup>16</sup> The first Outcome Budget 2005-06 has been presented in Parliament in August 2005.

40. The system of internal audit is in need of modernization and organizational re-engineering.

41. The need has also been articulated for some basic reforms in regard to the role of the Ministry of Finance as well as the position of the Financial Advisor. The role, responsibility and accountability of the Secretary of the Ministry, who is its chief accounting authority, also need to be clearly delineated<sup>17</sup>.

42. The Fiscal Policy Strategy Statement, tabled by the Finance Minister while presenting the Budget for the year 2005-2006, envisages a major reengineering of the system of expenditure management. The line Ministries will be vested with enhanced delegation of financial powers, including powers of reappropriation. The Ministry of Finance will focus on budgetary/exchequer control, formulation and modification of schemes, review of norms and tariff governing user charges, and scales of expenses, manpower ceilings, and responsiveness to internal audit and follow up on CAG's Audit Reports and clearance of high value transactions and expenditures not conforming to prescribed norms.

43. In a gradual move towards Quarterly Budgeting and better Exchequer Control quarterly ceilings and targets will be prescribed for expenditure and revenue collection. Expenditure in excess of the ceilings as well as individual cases not adhering to the prescribed norms will require clearance of the Ministry of Finance.

44. The release of fresh Central assistance will be made contingent upon the submission of utilization certificates, audit certificates and expenditure statements for the amounts already released.

45. The expenditure will be reoriented to extract better value for money; a mechanism will be put in place to measure the development outcomes for all major programmes.

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<sup>17</sup> Rule 64 of the GFRs 2005 formally defines the duties and responsibilities of the Secretary/Chief Accounting Authority.

# Chapter 5

## REVENUE ADMINISTRATION

### Legal Framework

1. The Constitution of India (Article 265) lays down that no tax can be levied except under the law. Main tax laws are Income Tax Act, 1961, Central Excise Act 1944, Customs Act, 1962. While the rates of income tax specified in the Income Tax Act are modified by Finance Acts, the rates of effective duty for customs and central excise are notified, under intimation to Parliament. Service Tax was introduced through Finance Act 1994 and has been growing in terms of new services covered. Government of India has notified, as was required, Rules under the above Acts. Articles 268 to 270 lay down the nature of taxes to be distributed between the Union and the States.

### Institutional Framework

2. The above-mentioned Acts are administered by the Central Board of Direct Taxes (Income Tax Act) and the Central Board of Excise and Customs (Customs Act, Central Excise Act, Service Tax). The Boards work under the Department of Revenue, the Ministry of Finance. The system of binding advance ruling by Advance Ruling Authorities helps to clear the air on the mysteries of tax laws.

3. There is an established system of appeal against the assessments within the revenue department. Dissatisfied tax payers can appeal to statutorily established appellate authorities whose pronouncements have judicial value. High Courts and Supreme Court remain the higher courts of appeal. The judgments of the courts and the tribunals form the large body of case law guiding the tax payers and administrators alike.

4. Income Tax Department has wide powers of search and seizure to unearth concealed income. While income tax laws have taken away the discretionary element from assessments, provision for search and seizure does provide them with discretionary powers. Similar powers have been vested with customs and central excise officials also.

5. Revenue department controls the Enforcement Directorate to apprehend and punish the violators of Foreign Exchange Regulation Act, 1973 and later Foreign Exchange Management Act. The directorate has wide powers of search, seizure, arrest and prosecution. The adjudication is done by the departmental officers of the directorate and the appeal lies with High Courts on matters of law only.

## **Positive Aspects of Revenue Administration**

6. The positive aspects of revenue administration are as follows:

### **i) Revenue Realism**

There is a well equipped Taxation Research Unit (TRU) in the Ministry of Finance, which works out tax realization under different scenarios of taxation and makes them available to the Finance Minister as a part of the budget exercise.

### **ii) Arrears of Taxes**

Revenue department employs many methods, including search and seizure, to collect the arrears of taxes. Many cases of outstanding demands do get settled every year.

### **iii) Moving away from Multifarious Exemptions**

There has been a gradual move towards reduction in the number of exemptions, which have outlived their times by rationalizing the tax structures. Exemptions were introduced to meet specific fiscal, social, sectoral and developmental needs. Prior to 1999, government used to grant ad hoc exemptions varying tax rates in customs and excise through the year resulting in “exemption raj”. Adopting a measure of self restraint, Government resolved that from 1999-2000, the ad hoc exemptions would be stopped forthwith.

### **iv) Stability of Tax Laws**

The tax laws are well publicized and mostly changes are made in the beginning of the financial year along with the budget. The system of binding advance ruling helps to plan for tax in advance.

### **v) Standardization of Customs and Central Excise Classification**

The adoption of Harmonized System of Nomenclature in 1986 developed by the World Customs Council for both Customs and Central Excise tariffs has reduced the complexity of classification of goods. This is a well known international standard.

### **vi) Tariff in Indirect Taxes**

As a measure of rationalization, the number of rates has been reduced substantially in both Customs and Central Excise. This has been a major step towards better tax administration.

### **vii) Record Management and Use of Information Technology**

The Revenue Department has been moving towards better data management through the use of information technology. Unique Permanent Account Numbers (PAN) need to be quoted by taxpayers in specified transactions exceeding certain value. This enables a data trail to be established facilitating unearthing of unreported income in the tax returns. Customs houses have inter-linkages for constant exchange

of data to ensure consistency of assessment among the different customs houses. Central excise department has similar data base for tracking modvat credits. Information technology is being used increasingly. Tax returns can be filed online for selected class of tax payers. Department makes available a software online to calculate the tax liability. Tax can be paid online through certain banks. Refunds are credited directly to tax payer's bank accounts electronically in selected cities.

**viii) Appellate Systems**

Revenue departments have very good internal systems of appeal against the assessments. Internal appellate authorities have shown independence and objectivity. The Appellate tribunals are judicial authorities and give comfort to the assesseees.

**ix) Search and Seizure**

Search and seizure provisions are useful tools in the hands of a tax administrator to pin down the tax evaders who are not deterred by the existing penal provisions.

**x) Amnesty Schemes**

Amnesty schemes have been used many times to unearth black money giving a chance to the evaders to bring the money into the mainstream by paying a concessional rate of tax. Government was able to garner money through these schemes and was also able to bring those persons who had taken advantage of the amnesty scheme to tax net for future years.

**xi) Customer Friendliness**

Revenue department has been making serious efforts to woo the tax payers through user friendly gestures. Many procedures have been simplified. E-governance initiatives have been taken to have online payment of tax, online filing of tax return, liberalization of baggage rules, liberal green channel entry, increased dependence on self assessments in excise duties, adoption of citizen's charter, etc,

**xii) Reward System**

Revenue department has a system of rewarding their employees/informants for help to unearth unaccounted money. This system has motivated many individuals to participate in revenue generation.

**xiii) Administrative Structure**

Revenue department functions as a division of the Ministry of Finance under the Department of Revenue. The Central Boards which control the departments are well organized. The volume of qualitative work that needs to be done at higher levels is very heavy and there are not enough persons to handle them. As culture of tax compliance is poor, the burden cast on the tax officials is heavy.

There is an internal audit department each in the Income Tax, Customs and Central Excise Departments.

## **Inherent Strengths**

7. Revenue administration is highly specialized with defined laws and well laid out procedures. Classification systems follow international practices. Appellate systems protect the tax payers. Laws and procedures are being progressively simplified to make tax administration more efficient and transparent.

## **Issues Causing Concern**

8. Main issues causing concern are as follows:

### **i) Revenue Realism**

It has been reported that the revenue estimates have been consistently overstated in the budget leading to short realizations.

### **ii) Arrears of Taxes**

The outstanding demands in terms of both the number of cases and value are still very large, as reported in the Audit Reports by the CAG.

### **iii) Multifarious Exemptions**

There are still a host of exemptions in the tax laws. The exemptions affect various sectors in a differential and discriminatory manner. This leads to distortions and is often a major source of evasion. The transparency is lost and the tax expenditure showing the loss of revenue due to exemptions is not made public. The exemptions lead to difficulties in tax administration. While exemptions may need to be continued in some areas, the current move towards eliminating them gradually is positive. The ad hoc exemptions in Indirect taxes, which were stopped in 1999-2000, have now been resumed from 2002-03.

### **iv) Stability of Tax Laws**

A one year perspective is too short a span of time for proper investment and tax planning. A long term perspective is needed on taxation. Possibility of change every year is disturbing. Changes also take place as a measure to counter a court judgment or to plug a loophole. Such changes tend to be ad hoc responses to contingencies instead of well thought out reform of taxation. Changes of tax law retrospectively are clearly undesirable and lead to loss of credibility. Occasionally the tax laws have been amended with retrospective effect; this is considered undesirable as it leads to loss of credibility.

### **v) Record Management and Use of Information Technology**

Automation has been on the agenda of the department for a longtime now. Progress is slow. Piecemeal automation would not serve the purpose. Potential advantages of good information system are enormous. Electronic linkages among income tax, customs and excise departments should be established to cross check information.

**vi) Appellate Systems**

Recourse to appellate systems is cumbersome and time consuming. The revenue department has a habit of filing appeals to a higher authority against the appellate judgments even in small cases. This brings down the usefulness of the existing appellate systems and leads to harassment of the tax payers.

**vii) Search and Seizure**

Search and seizure provisions are dangerous tools capable of being misused. It is too draconian a measure to give comfort to honest taxpayers who can also be subjected to search and seizure activities. Studies have shown that search and seizure measures have not yielded much revenue.

**viii) Amnesty Schemes**

The amnesty schemes have not found favour with majority of tax experts. Generally it has been felt that the tax amnesty schemes are intrinsically odious. They are seen to legitimize money-laundering. They are an admission of a government's failure to ensure compliance with the laws of the land. They are also unfair to honest taxpayers who have paid taxes at higher rates in previous years. There is evidence to suggest that tax receipts go down in the next year. Delinquent tax payers prefer to wait for the next amnesty scheme. There have been as many as eleven amnesty schemes so far.

**ix) Customer Friendliness**

Public perception of the tax administration continues to be that of a formidable bully. Refund of income tax continues to be a sore point among the tax payers. Complexity of the tax laws alienates the common man.

**x) Reward System**

The system of rewards is seen as iniquitous and is liable to be misused as there is no transparency in the amounts or the persons to whom the money was disbursed.

**xii) Administrative Structure**

The present structure is seen as being vulnerable to political and bureaucratic pressures. Political interference in tax administration has marred the professionalisation of the tax administration. Tax administration needs to be insulated from day to day pressures. It should be separated from Ministry of Finance and given an independent status and sufficient autonomy. Skeptics have ruled out such far reaching reforms.

**Conclusion**

9. The Literature reveals that Revenue administration has many positive features. They are:

- The system of levy, assessment and collection of taxes are based on well established laws and rules.
- There is a respected system of appeals giving comfort to the tax payers.
- Tax laws and procedures have been responding to the changing needs. Considerable reforms have taken place over the years in tax administration.
- There have been as many as fourteen committees/commissions/task forces set up to examine the simplification of tax laws and procedures.
- The system of advance ruling is a great blessing.

10. There are many areas which have been identified by the analysts and committees as needing improvements.

- The system is not seen to be user friendly: trust is missing.
- There are many weaknesses in tax administration leading to revenue losses, as pointed out by the CAG.
- Despite measures to detect evasion of taxes, there is rampant tax evasion and perceived widespread corruption.
- There are huge arrears to be collected, as seen from CAG's Audit Reports.
- Many serious mistakes in assessments are pointed out in CAG's audit.
- With all simplifications introduced regularly, the tax structure is still complex.
- Reforms to reduce exemptions in taxes have not fully succeeded: there are still too many exemptions making tax administration difficult.
- Search and seizure provisions are too powerful and prone to be misused.
- There are not enough senior persons for the high volume of work.

## Chapter 6

### ACCOUNTABILITY OF GOVERNMENT FOR PUBLIC SECTOR ENTERPRISES

#### Legal and Institutional Framework

1. Public Sector Enterprises (PSE) may be broadly categorized as Government companies and statutory corporations. Under The Companies Act, 1956, a company is defined as a Government company if the government equity holding is not less than 51 per cent of its total equity. These companies are registered under The Companies Act, 1956 like any other company. Many are fully owned by the Government. Government had taken over many sick industries from private ownership. These companies are also PSEs as government ownership crossed 51 per cent after take over. There are special provisions in the Act relating to the audit of Government companies.
2. Government created some statutory corporations through legislation. These are owned entirely by the government.
3. Supreme Court has held in number cases that the PSEs have the character of a 'State' within the meaning of Article 12 of the Constitution.
4. The Management team consisting of Chairman and Functional Directors of the Board is appointed by the government on the advice of the Public Sector Enterprises Selection Board (PESB). PESB follows a rigorous selection process, including a personal interview.
5. The part time/independent directors are appointed by the government. Independent directors for the Navratna and Miniratna companies are selected through a search committee under the auspices of the PESB.
6. The Public Sector Enterprises (PSE) work under the direction and supervision of the administrative Ministry to which they are attached. Department of Public Enterprises (DPE) provides over-all guidance and standardization of policies and procedures among all the PSEs. DPE has issued numerous guidelines to the PSEs on every aspect of its functioning. These have, now, been pruned substantially in an attempt to provide more autonomy to them. DPE also brings out, on directions from the Estimates Committee of Parliament, an annual survey giving the performance, at the macro and micro level, of the central public sector enterprises during the previous year.
7. As a measure of economic reforms taken up in 1991, shares of several companies have been partially or fully sold to strategic investors/financial investors/retail investors. Those companies where the divestment has been more than 49per cent, the companies have lost the character of a PSE.

### Board for Reconstruction of Public Sector Enterprises

8. The Government of India has constituted a Board for Reconstruction of Public Sector Enterprises on the 6<sup>th</sup> December 2004

- To advise the government on ways and means to strengthen public sector enterprises in general and making them more autonomous and professional.
- To consider restructuring – financial, organizational and business (including diversification, joint ventures, seeking strategic partners, merger and acquisition)-of Central Public Sector Enterprises (CPSEs) and suggest ways and means to fund such schemes.
- To examine the proposals for restructuring/revival of loss making CPSEs for their turn around.
- To advise the government on disinvestment/closure/sale, in full or part, in respect of chronically sick/loss making companies that cannot be revived.
- To monitor incipient sickness in CPSEs

### **Accountability of Government vis-à-vis Public Sector Enterprises**

9. Government is accountable to Parliament for the functioning of PSEs. The Minister is answerable to the Parliament in matters relating to the PSEs. He answers the parliamentary questions; information relating to the PSE is provided by the PSEs. The Annual Report of the PSE is to be placed by the Minister in charge on the table of the House.

10. In order to play its accountability role effectively, GoI has instituted a number of mechanisms.

#### **i) Control Over Top Personnel**

The Chairman and the functional directors hold office at the pleasure of the President; they can be removed by the Government, in the capacity of the owner, if it is satisfied that circumstances so warrant.

#### **ii) Selection of Board of Directors**

GoI selects the Chairman, the functional and independent directors. GoI uses the institution of PESB to select the persons for Board level appointments. GOI goes by the recommendations of the PESB. Senior government officials are also nominated to the Board to ensure that the government policies are implemented faithfully by the company.

#### **iii) Presidential Directives**

Government has powers to issue Presidential Directives to PSEs on any matter of importance. The Board of Directors has the right to be informed of these directives, but it cannot question them. The directives are brought to the notice of the Parliament through the Annual Report of the PSE.

#### **iv) Guidelines**

PSE is expected to function in accordance with the guidelines issued by the DPE. The official directors representing the administrative Ministry ensure that the guidelines are adhered to. The government, in its capacity as the owner, issues instructions regarding the amount of dividend that should be paid.

#### **v) Audit**

Comptroller and Auditor General of India (CAG) is authorized to conduct a superimposed audit of the accounts of the Government companies after the statutory auditors certify the accounts. In the case of Corporations the relevant statutes determine the audit arrangement. CAG also conducts an audit of the transactions as well as comprehensive appraisals of selected PSEs.

#### **vi) Legislative Oversight**

Committee on Public Undertakings (COPU) of the Parliament considers the Reports of the Comptroller and Auditor General of India on the PSEs. COPU also takes up examination of some PSEs *suo moto*. The Secretaries of the administrative ministries appear before the COPU along with the officials of the PSE.

The Annual Reports of the PSEs have to be placed on the table of the House within 9 months from the date of closure of the financial year. The reports contain the audited accounts of the previous financial year including the audit comments, if any, of the CAG. A Parliamentary Committee called the Committee on Papers monitors the submission of the Annual Reports to the Parliament.

The PSEs are also accountable to other committees of Parliament like the Estimates Committee, Official Languages Committee, etc.,. The PSEs are required to provide for reservation on jobs to Scheduled castes, Scheduled Tribes and Other Backward classes, in accordance with Government policies. There is a Parliamentary committee to oversee the implementation of the same.

#### **vii) Reviews**

Planning Commission reviews the progress of the projects taken up or to be undertaken in the next financial year by the PSEs at the time of annual plan discussions to arrive at the internal accruals (extra budgetary resources) of the PSEs which would be available for ploughing back for investment in the company. The total plan size is determined taking into account the extra budgetary resources. The budgetary support, if any, is given for the balance amount only.

Department of Program Implementation reviews all projects of over Rs.1000 million and submits a Flash report to the Prime Minister, to the Planning Commission and the Administrative Ministry every month. PSEs submit the data to them in this regard through the administrative Ministry.

### **viii) Vigilance**

The PSE employees are subject to the control of the Central Vigilance Commission. Each PSE has its own vigilance officer appointed by the government in consultation with Central Vigilance Commissioner.

### **Autonomy of the PSEs**

11. The autonomy of the PSEs is to be delicately balanced with the considerations of accountability. As the government is ultimately responsible for the proper functioning of the PSEs, some amount of control over the PSEs is thought to be inevitable. There is a fine balance between accountability and autonomy.

12. Government has been made aware by many committees and the Chief Executives of PSEs of the need to provide more autonomy to them, if the PSEs were to function effectively on commercial basis. Government has accordingly been taking many steps to provide increased autonomy to the PSEs. Notable among them are the introduction of new performance assessment system called the Memorandum of Understanding (MOU), the concept of Navratna and Miniratna companies with increased delegation, increasing the number of independent directors in the Board of Directors of the company and reducing the number of guidelines to be followed by the PSEs.

### **i) Memorandum of Understanding**

13. Government introduced the concept of Memorandum of Understanding in 1987 on the recommendations of Arjun Sengupta Committee in response to the following.

- Widely held perception that the PSEs are less efficient than their private sector counterparts.
- PSEs are unable to perform at efficient levels because there are a variety of agencies within the Government who feel that they have a mandate to run public enterprises. These agencies having their own agenda to keep, setting different objectives for the enterprises which are always conflicting.
- Because of lack of clarity of objectives and confused signals imparted to the management, the accountability of the management is vastly diluted. The management of PSEs thus ceases to be accountable for the performance of the enterprise.
- At the same time, the Management of PSEs is handicapped in their operation due to absence of functional autonomy.

14. Under this system, the PSE and the Ministry enter into a Memorandum of Understanding (MOU) where the targets of performance under different measurable criteria like the financial, personnel, physical, environmental and other parameters as relevant to the undertaking are listed. Weightages for the parameters and marking system are agreed in advance. Obligations of the Ministry to enable achieving the targets are also listed. The performances of the PSEs are evaluated at the end of the year against the

agreed parameters. An expert committee helps in the preparation of the MOU and its subsequent evaluation to bring in objectivity. The evaluation is reviewed by a high power committee under the chairmanship of Cabinet Secretary. This system of annual monitoring has freed the PSEs from the strain of frequent monitoring which was prevalent earlier.

## **ii) 'Ratna' Concept**

15. Government identified, in 1997, nine public sector companies that have comparative advantages to support them in their drive to become global giants. They were called Navratna companies. Government granted the enhanced autonomy and delegation of powers for incurring capital expenditure, entering into joint ventures/strategic alliances, purchases, organizational restructuring, personnel management, raising debt and establishing wholly owned subsidiaries.

16. Simultaneously steps were taken to strengthen the Board of Directors by induction of more independent directors selected with the help of PESB.

17. The number of independent directors should be equal to one third of the board. Government would not provide financial assistance of any kind to them, not even incur contingent liabilities by guaranteeing their loans. The companies were encouraged to go to the capital market to raise resources.

18. These guidelines have been revised from time to time conferring greater measure of autonomy on these companies. More financial powers have been given. Audit committees consisting of independent directors have been introduced.

19. Government classified other profit making companies fulfilling as Miniratna companies. The delegation given to these companies was substantially more than what they had enjoyed earlier, but much less than their Navratna counterparts. Each Miniratna company should have at least three independent board members selected with the help of PESB and an audit committee consisting of independent directors.

## **iii) Guidelines**

20. Government had issued over time a large number of guidelines to the PSEs. As these guidelines covered every aspect of the functioning of the PSEs, the initiative which is the essence of a commercial enterprise had been eroded in the PSE management. In response to the demand for increased autonomy to the PSEs, the government reviewed and withdrew most of the guidelines leaving only a few to be followed now.

## **Inherent Strengths**

21. Accountability of GoI for the performance of the PSEs is ensured through the Parliament, CAG's audit, vigilance, selection of top personnel and reviews of high value capital projects.

22. The positive feature of the autonomy arrangements of Public Sector Enterprises is that they are under constant review to devolve more powers to the PSEs to enable them to function competitively in the liberalized environment. The 'Ratna' schemes and the MOU system point to the trend of devolving more autonomy to the PSEs. Strategic sale and partial divestment also indicate a change in the mindset of the government.

### **Issues Causing Concern**

23. The issues causing concern are as follows:

#### **i) Autonomy**

The accountability and the autonomy of the PSEs and the role of the government in discharging their public accountability for the money invested in the PSEs have remained a favorite theme with many analysts.

Government had set up many committees to go into the functioning of the PSEs and all of them had commented adversely about the government stranglehold on the companies. Expressions like "autonomy cannot be secured if the public enterprises are under a government department", "public sector units have become adjunct to the ministries", "mere appendages", "a mere extension of the government and the public sector are 'under a Ministry'" have been used. All of them have suggested substantial delegation to the PSEs and change of mindset in bureaucracy and the politicians to let the companies run as commercial undertakings. Government with its inflexible bureaucracy cannot take commercial risks by its very nature.

#### **ii) 'Ratna' Concept**

A survey of how the Chief executive officers (CEO) of PSEs felt about the increased delegation under the Navratna and Miniratna scheme threw up revealing insights:

- Interference from the government and frivolous rules of Department of Public Enterprises obstruct the operational freedom.
- Powers delegated were good but more freedom was needed in financial matters.
- The working style of the companies has changed for the better, becoming more commercial and market oriented.
- There is more autonomy in the Board meetings with many independent directors. The Boards have become more strategic and dynamic.

The 'Ratna' concept has not delivered in full measure as there are still some impediments like too much time being taken in appointing in non official/part time Directors. Flexibility is still limited due to government rules, salary and perks, not comparable with industry standard.

In Miniratna companies, there are still limitations on capital expenditure.

#### **iii) Memorandum of Understanding System**

The system of MOU has been generally welcomed as an important measure of reform towards autonomy and accountability of the PSEs and a significant

improvement over the past. It is a fair measure to ascertain the performance of the PSEs. Specifically, the matter of administrative departments also undertaking some obligations towards better functioning of the companies has been noted as a plus point. MOU is not a panacea for all problems of public sector enterprises, but it helps clarity of objectives and professional evaluation of performance. Despite the changes in economic policy, it continues to be relevant and important.

There are some who feel that the MOU system has inherent weaknesses inhibiting full autonomy. As the failure to perform is not followed by any punishment, MOU ultimately is not effective. There is no incentive to perform, either. The data collection is also suspect. Even after the introduction of MOU system, there is a multiplicity of controls like audit, budgets, reports etc. The whole exercise of MOU is meaningless in the absence of reward and punishment. MOU system has not been a success as the controlling ministries have not been distanced sufficiently from the Public Enterprises.

#### **iv) Government Guidelines**

The system of issuing detailed guidelines by the government has come in sharp criticism. Government has now pruned the number of guidelines. But, it is not the written guidelines that do as much damage as the informal and telephonic directions.

### **Conclusion**

24. The Literature reveals that there are good mechanisms for ensuring GoI's accountability for the performance of the PSEs like the Parliament and its committees, audit and vigilance.

25. Government of India has taken many initiatives over the years to unshackle the PSEs and give more autonomy to enable them to work competitively in the liberalized environment. Even strategic sale and partial divestment have been made in selected PSEs. The PSEs, however, continue to work under the weight of oversight of politicians, legislators and bureaucrats. Despite much liberalization, PSEs have an inherent inability to perform efficiently under a government ownership. A World Bank report has observed that the best option would be to follow up on the statement made by the Finance Minister in his budget speech in 1998 that all PSEs except those in strategic areas must be privatized.

## **Chapter 7**

### **ACCOUNTABILITY OF GOVERNMENT FOR AUTONOMOUS BODIES AND GOVERNMENT-AIDED NON-GOVERNMENT ORGANIZATIONS**

#### **Legal and Institutional Framework**

1. There are nearly 500 autonomous bodies in the Government sector with a budgetary outgo of about Rs. 100 billion (1999-2000). A 2001 estimate places the number of non-Government organizations (NGOs) at 1.20 million in the country; nearly half of them without a juristic personality. Government budgetary support (Plan) to the voluntary organizations in the social sector exceeded Rs. 380 billion during 2004-2005. A variety of laws prescribe the legal framework for the establishment of autonomous bodies and the NGOs.

2. Some of the Autonomous Bodies have been set up under separate Acts of the Parliament e.g., the University Grants Commission, the Central Universities, the All India Institute of Medical Sciences, the Employees Provident Fund Organization, the Port Trusts etc.

3. The Societies Registration Act, 1860, regulates the legal condition of societies established for the promotion of literature, science, the fine arts, the diffusion of useful knowledge, the diffusion of political education, or for charitable purposes. State-specific amendments have been made to the Act by various State Governments.

4. Under the Companies Act, 1956, a company can be registered as a charitable company. There are also the State legislations for registration of Trusts such as the Bombay Public Trusts Act, 1950.

5. The Supreme Court has held that where an entity is wholly controlled by Government not only in its policy making but also in carrying out the functions entrusted to it by the law establishing it or by the charter of its incorporation, there can be no doubt that it would be an instrumentality or agency of Government and covered under the meaning of the 'State' as defined in Article 12 of the Constitution.

6. The nodal Ministries are appropriately represented on the Governing Bodies of the Government Autonomous Bodies.

7. The Planning Commission has been declared as the nodal agency for the Government-voluntary sector interface. Largely due to the policies of the funding agencies and the

## Government, a hierarchy has emerged in the voluntary sector as shown below:

- Managing Agency NGOs; this is a relatively new concept, as it recognizes the corporatization of NGO activities;
- National Level NGOs having regional branches like Development Alternatives, Delhi, Voluntary Health Association of India, Delhi etc.
- Mother NGOs (MNGOs) usually specialized in certain sectors; the MNGOs provide base facilities, train the field NGOs, and carry out Government programmes and activities;
- Established Voluntary Organizations (EVOs);
- Technology Research Centres;
- NGOs operating at the regional level;
- NGOs operating at the district level; and
- Grass root NGOs/Self Help Groups mostly informal and unorganized.

8. The MNGO scheme has been generally patronized by the Ministry of Health and Welfare, Department of Family Welfare, for the implementation of its Reproduction and Child Health programme. NGOs with fixed assets amounting to Rs. 2 lakhs and with at least three to five year experience in health and family welfare are eligible for MNGO status. Applications for MNGO status are invited through advertisements and the applications are initially screened and selection is made by the State Selection Committee after field visit, desk review etc. The final approval rests with the Department of Family Welfare.

9. The MNGOs are responsible for identification, appraisal, selection, monitoring and appraisal of the small NGOs. The small NGOs do not have to approach Government for assistance nor do they have to report to Government about their work. The grant-in-aid received by the MNGO is passed on to the field NGOs retaining only the institutional costs for overseeing the project implementation and for providing technical assistance to the field NGOs. The MNGOs have been permitted full latitude in the selection of NGOs, content wise, area of work, and choice of activities subject to certain norms. Each MNGO is allotted 2 to 10 districts.

10. An internal review by the Department of Family Welfare, Ministry of Health and Family Welfare, has shown the soundness of the MNGO concept as a delivery mechanism.

11. The Planning Commission has also recommended the MNGO model.

### **Financial Assistance to Autonomous Bodies and NGOs**

12. General Financial Rules, 1963<sup>18</sup>, prescribe the conditions of eligibility and the manner of regulation of Government assistance to autonomous bodies and NGOs as well as the attaching conditionalities. As a general rule financial assistance can be given only to a body having a distinct legal entity. The assisted institutions are required to submit audited statements of their accounts to the sanctioning authorities, certificates of utilization of Government assistance for the intended purpose and achievement-cum-performance reports. They must also maintain the prescribed sets of records including the record of assets built out of the amounts provided by Government.

13. The Ministries are required to submit the utilization certificates to the Controller General of Accounts.

14. The Delegation of Financial Powers Rules, 1978, define the powers of the line Ministries to sanction grants-in-aid to autonomous bodies and NGOs. The line Ministries have full powers to sanction grants-in-aid and loans provided that:

- (i) Such grants-in-aid and loans are in accordance with the rules or principles and the pattern of assistance prescribed with the previous consent of the Ministry of Finance<sup>19</sup>; and
- (ii) The rate of interest on a loan and the period of its repayment are fixed with the previous consent of the Ministry of Finance or are in conformity with any general or special order of that Ministry.

Grants-in-aid and loans in excess of the specified amounts are required to be exhibited separately in the budget documents.

### **Oversight of the Sanctioning Authorities**

15. The Ministries are empowered to nominate their representatives on assisted bodies, which depend upon the Government assistance for more than 50 per cent of their annual expenditure<sup>20</sup>. The Ministries have also the right to conduct an audit of accounts of the assisted bodies. The assisted institutions are required to submit audited statements of their accounts to the sanctioning authorities, certificates of utilization of Government assistance for the intended purpose and achievement-cum-performance reports. Any unspent amount of Government assistance must be refunded to the sanctioning authority. The achievement-cum-performance report is required to be included in the Annual Report of the grantee that is presented in the Parliament or, in cases of small amounts of grant-in-aid included in the Ministry's Annual Report.

### **Form of Accounts**

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<sup>18</sup> GFR's 2005 from July 2005

<sup>19</sup> In terms of GFR's 2005 the Internal Finance Wing has been authorized to prescribe the pattern of assistance subject to any instructions of the Ministry of Finance.

<sup>20</sup> This enabling provision has not been included in GFR's 2005 but the Memoranda of Association and /or Articles of Association of the Central Autonomous Bodies generally prescribe the representation of the Government of India on their governing bodies.

16. The financial statements of the Central autonomous bodies are required to be prepared and presented in the following formats:

- Balance Sheet;
- Income and Expenditure Account;
- Schedules to the above Financial Statements;
- Instructions and Accounting Principles;
- Notes and Instructions for the Schedule; and
- Statement of Receipts and Payments.

17. Within the common format of accounts, further additional information may be given/prescribed by Government for the Central Universities and other educational institutions and for the District Rural Development Agencies.

18. The accrual system of accounting is required to be followed and the concept of going concern is to be maintained. The provision for depreciation on fixed assets should be made.

## External Audit

19. **The Constitution of India:** In terms of Article 149 of the Constitution of India, the CAG shall perform such duties and exercise such powers in relation to the accounts of the Union and of the States and of *any other authority or body* as may be prescribed by or under any law made by Parliament.

20. **Audit by the CAG:** The Comptroller and Auditor General's (Duties, Powers and Conditions of Service) Act, 1971 defines *inter alia* the audit jurisdiction of the CAG in relation to autonomous bodies including the bodies registered under the Companies Act 1956.

21. Under Section 19 (2) of the Act, the duties and powers of the CAG in relation to the audit of the accounts of corporations (autonomous bodies) established by or under law made by Parliament shall be exercised in accordance with the provisions of the respective legislations.

22. The Act prescribes the audit jurisdiction of the CAG vis-à-vis the Government assisted bodies and authorities. Broadly speaking the CAG has the right to audit all receipts and expenditure of a substantially government funded body or authority, in other cases the CAG is authorized to have access to the books and accounts of such a body or authority for the limited objective of verification of the utilization of Government assistance for the intended purpose.

23. A body or authority is said to be substantially Government funded if the amount of Government funding is not less than Rs. 2.5 million and also not less than 75 per cent of its total expenditure in a year. With the prior approval of the President, the CAG may also

audit all receipts and expenditure of such a body or authority if the amount of Government funding is not less than Rs. 10 million in a year.

24. The Act authorizes the President to entrust the audit of accounts of any corporation, body or authority to the CAG. Likewise the CAG may also propose to the President that the audit of any authority or body may be entrusted to him because a substantial amount of Government money has been invested in or advanced to such a body or authority.

25. **Audit under the Companies Act, 1956:** The Companies Act prescribes the audit arrangement for charitable companies established under the said law. Under the Act the auditor of a Government company shall be appointed on the advice of the CAG, the CAG is authorized to issue directions to the auditor and also to conduct a supplementary or test audit. The statutory auditor is required to submit a copy of his report to the CAG, and the latter has the right to comment upon or supplement the audit report of the statutory auditor and such comments shall be placed before the Annual General Body Meeting of the company.

26. The Societies Registration Act, 1860, does not contain any specific provision for the audit of accounts of bodies registered thereunder. Any such institution seeking Government assistance must however submit its audited statement of accounts along with the other prescribed documents.

## **Audit Reports**

27. The Audit Reports on the accounts of the autonomous bodies, including the companies established under the Companies Act, 1956, are submitted to the Government and barring a few exceptions the Government is required to lay these reports before the Parliament. These reports contain mainly the audit comments of the CAG on the accounts of the autonomous bodies.

28. The CAG also submits to the President a separate volume of his Audit Reports on the Autonomous Bodies and the President causes the said Report to be laid before the Parliament. The Audit Report on the Autonomous Bodies contains the results of CAG's performance appraisals of these bodies as well as the results of transaction audit of these bodies.

## **Legislative Oversight**

29. The mechanism for legislative oversight is as follows.

(i) *Public Accounts Committee:* The CAG's Audit Report on the Autonomous Bodies automatically stands remitted to the Public Accounts Committee for follow up action. (For further details refer Chapter 12 on Legislative Oversight).

(ii) *Committee on Public Undertakings*: The CAG's Audit Report on the charitable companies stands remitted to the Committee on Public undertakings for follow up action. (For further details refer Chapter 12 on Legislative Oversight)

(iii) *Committee on Papers*: In addition, a Committee on Papers monitors the timely submission of the Annual reports and the Audited Accounts of the autonomous bodies to the Parliament. According to the time schedule prescribed by the Committee the Annual Reports and the Audited Accounts of the autonomous bodies are required to be tabled in the Parliament within a period of nine months from the close of the financial year. For this the autonomous bodies should submit their accounts to the CAG within three months of the close of the year.

## **Inherent Strengths**

30. The main strengths of the system are as follows

- Systems and procedures are in place for determining the eligibility of autonomous bodies and NGOs for Government assistance.
- The role and responsibilities are clearly defined; while the line Ministries have been vested with comprehensive set of powers to sanction assistance, the pattern of assistance requires prior approval of their Internal Finance Wings.
- There is transparency about the process; the pattern of assistance is within the public domain and wide publicity is generally given for inviting applications for Government assistance. The sanctioning of project proposals through a decentralized committee-based sanctioning procedure in which participatory appraisal, monitoring and evaluation as well as sustainability are incorporated has been suggested in the Guidelines issued.
- The rules prescribe the pre-sanction requirements for assessing the absorptive capacity of the assisted bodies for Government funding as well as their capacity for service delivery. The assisted NGOs are required to sign appropriate surety bonds for the fulfillment of the attending conditionalities.
- The rules contain adequate safeguards for the proper utilization of Government assistance with emphasis on outputs and outcomes. The accounts of the assisted entities are subject to public audit and legislative oversight. Government has the right to nominate its representative on any assisted body, which depends upon Government assistance for meeting more than 50 per cent of its annual expenditure.<sup>21</sup>
- The form of accounts of the Government autonomous bodies has been standardized with a perceptible shift in favour of accrual accounting.

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<sup>21</sup>This enabling provision has not been included in GFR's 2005 but the Memoranda of Association and /or Articles of Association of the Central Autonomous Bodies generally prescribe the representation of the Government of India on their governing bodies.

## Areas of Concern

31. The following are the main areas of concern.

- The autonomous bodies are still in a stage of transition in adopting the prescribed form of accounts. The autonomous bodies do not submit their accounts for audit within the prescribed time frame. The accounts of several autonomous bodies are in arrears, in some cases from 1999-2000; and the audit reports tend to be qualified.
- There are delays in the presentation of Audit Reports on the accounts of the autonomous bodies to the Parliament; in several cases the Audit Reports have not been presented from 1999-2000 onwards.
- The system of internal control is not fully compliant with the best practices and violations of the prescribed rules and Government orders tend to be frequent.
- There is no formally laid down procedure for the establishment of Government autonomous bodies; some of the bodies were set up with the approval of the Cabinet, while in some cases the decision for their establishment was taken at the level of the Minister<sup>22</sup>.
- The monitoring arrangements are weak; no structured periodic meetings are held between the nodal Ministry and the autonomous body. The Ministries neither properly maintain the prescribed records of Government assistance to the autonomous institutions nor carry out the mandated review of the performance review of the grantee institutions.
- No worthwhile study has been conducted to ascertain whether the autonomous bodies are fulfilling their stated objectives and whether there exists sufficient justification for their continuance.
- CAG's appraisals of the working of some of the autonomous bodies have been critical of their performance besides pointing out cases of irregular and wasteful expenditure.
- The institutions function like attached offices of Government, without at the same time being subject to the close scrutiny of the other wings of the Government. In many bodies reduced accountability and non-reporting seems to have been construed as essential element of autonomy.

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<sup>22</sup> GFR's 2005 provide the requirement that no new autonomous body shall be established except with the approval of the cabinet.

- The nomenclature of some of the bodies suggests that some of these might be carrying out identical or duplicate functions.
- In the voluntary sector the transparency requirements of the registration laws are minimal and differ across the States due to lack of uniformity. There are variations even in the minimum basic norms prescribed for Government agencies.
- The donor guidelines and practices on project follow-up and evaluation leave large gaps. The regulatory provisions relating to accounts and audit contained in the basic statutes of the voluntary sector are very skeletal and their enforcement perfunctory. The auditing profession has only recently become conscious of the need for the development of a separate set of Generally Accepted Accounting Practices for the voluntary sector.
- Accountants employed by the voluntary sector are not the most professional and the auditors subscribing their signature to the accounts are not the most motivated.
- NGOs obtain funds through a number of schemes and from different Government agencies; this dilutes accountability.
- There seems to be no coordination among the agencies implementing social development programmes and the NGOs and between NGOs.
- The schemes/pattern of assistance, prescribed years ago, have not been rationalized and revised despite the rising costs, changing requirements and even the target groups. The amount of financial assistance bears little nexus with the minimum expected standard of service; this renders the system of supervision, counseling, monitoring and internal evaluation superfluous.
- There is no single source which the NGOs can access for information on schemes projects and procedures.
- The NGOs are handicapped because of the uncertainty regarding the future continuance of Government assistance.
- There are heavy arrears in submission of the utilization certificates; according to the CAG's Audit Report on Autonomous Bodies (2005) the pendency stood at a staggering amount of over Rs. 140 billion. Fresh Government assistance was also provided to some of the defaulting entities.
- The concept of Mother NGOs, which appears to be the flavour of the season, is apprehended to result in dilution of public audit and accountability. Assignment of public money to recipients through intermediaries results in a situation where there is nothing to see in the authorities charged with intermediation and there is absence of public audit in the recipients and actual users of public funds.

## Conclusion

32. The Literature reveals that the Government provides large amounts to autonomous bodies and there is need for proper maintenance of accounts, strengthening of internal control as well as more rigorous monitoring of their performance. The adoption of the MOU system in the case of the autonomous bodies that receive Government assistance of Rs. 50 million or more in a year has been suggested.<sup>23</sup> The Ministry of Finance should maintain a centralized registry of autonomous bodies within the Government sector indicating the degree of Government financial support, the level of fees and charges or other revenues, and the service that the Government is funding. There should be emphasis on internal resource generation; the budget support currently extended should be progressively reduced having regard to the scope for maximizing internal resource generation and restraining expenditure growth.

33. In the case of NGOs, current thinking seems to favour a move away from the traditional grant-in-aid arrangement to public private partnership. It is important to focus on several key factors, including the development of procedures that are easy to use, transparent, and helpful in modernizing the delivery of Government services, and the development of quantifiable evaluation systems that can measure actual performance against agreed targets. There is need for the creation of an enabling environment to facilitate quick redressal of grievances of the voluntary organizations, transparency in funding procedures, system of monitoring and evaluation of projects, adoption of appropriate standards of accountability and transparency by the voluntary organizations, capacity building for project formulation, implementation, report writing, financial and administrative management, networking, social audit, and monitoring and evaluation.

34. Validation/accreditation of voluntary agencies has been considered useful for both private and public sector donors and international donors. The need has also been articulated for the review of the Societies Registration Act, particularly the requirement of periodical renewal of registration prescribed in some of the States.

35. Just as the Government has a responsibility to develop transparent procedures, the voluntary sector too has a responsibility to develop transparent procedures, and must accept its accountability towards Government and the larger society.

36. There is need to put in place clear performance evaluation systems, which determine the actual achievements of an organization in terms of the goal set for it while sanctioning financial assistance. The concerned Ministries and Departments should evolve systematic monitoring and evaluation practices in respect of various types of projects and should make available a concrete list of check-points to the agencies involved in the monitoring and evaluation of voluntary sector projects. There should be mid-term appraisals, the formats for reporting periodical progress should be streamlined and the committee empowered to sanction a particular project should as far as possible be associated with its monitoring and evaluation. Monitoring and evaluation should be outcome focused and it should try to elicit how much has actually reached the people. For

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<sup>23</sup> This requirement has been prescribed in GFR's 2005.

that suitable checklists of measurable social indicators should be developed. The reports of monitoring and evaluation should be published and placed on the websites of the Ministries.

# Chapter 8

## ACCOUNTABILITY OF CENTRE FOR TRANSFER TO STATES

### Legal and Institutional Framework

1. The PART XII of the Constitution of India deals with Centre State relations, including financial relations.
2. Articles 268 to 273 lay down the principle of sharing taxes between the Union and the States. The taxes that Union government can levy and retain, levy and share with States and levy to be collected by the States to be retained by them are given in these articles. A Finance Commission needs to be set up, under Article 280, every five years to review the Centre State finances and to give recommendations on the basis of sharing the net proceeds of the shareable taxes levied by the Central government. The Finance Commission is also required to recommend the principles of grant in aid to the States under Art 275 of the Constitution. Article 282 enables the GoI to transfer funds to the States on as needed basis. This provision is principally used to fund the plan schemes which are not covered by the Finance Commission. Article 292 gives the powers to GoI to borrow on the security of the Consolidated Fund of India and give guarantees within the ceiling, if any, fixed by the Parliament. Article 293 empowers the States to borrow within the territory of India on the security of the Consolidated Fund of the State and give guarantees within the ceiling, if any, fixed by the State legislature. The States have to seek prior approval of the Central government in case the State owes any money to the Centre. The Central government has also been empowered to extend loans to the States.
3. 73<sup>rd</sup> and 74<sup>th</sup> Amendments to the Constitution have given a legal basis to the third tier of government in Panchayati Raj Institutions (PRI) and Urban Local Bodies (ULB). States must constitute a State Finance Commission every five years to recommend devolution from the States to the PRIs and ULBs. In addition, Central Finance Commissions are now being tasked by GoI to make recommendations for Central assistance to the third tier from the Central funds.
4. National Development Council meetings chaired by the Prime Minister and attended by the Chief Ministers of all the States is the highest policy making body for Centre State coordination. They lay down plan priorities and approve the approach to the national plans.
5. Planning Commission plays a large role in determining the annual plan size of the States and recommending the extent of plan assistance to the States. All plan schemes need to be approved by the Planning Commission. In absolute terms the amount of assistance that flows through the Planning Commission is much larger than the amount as per the awards given by the Finance Commissions.

## Process of Central Assistance

6. The Central assistance to the State is given in the following categories, apart from the devolution of Central taxes as per Finance Commission formula,

- (i) Normal Central Assistance to various States for State plan schemes on the basis of Gadgil-Mookherjee formula (NCA).
- (ii) Additional Central Assistance for Externally Assisted Programs (ACA - EAP).
- (iii) Centrally Sponsored Schemes (CSS).
- (iv) Small Savings Loans.
- (v) Grant in aid under Art. 275 of Constitution.
- (vi) Others - largely including assistance for earmarked hybrid type of schemes where Central Ministries are entrusted with the monitoring responsibility.  
These include;

- (a) Accelerated Irrigation Benefit Programme (AIBP).
- (b) Accelerated Power Development Reform Programme (APDRP).
- (c) Border Area Development Programme (BADP).
- (d) Hill Area Development Programme/Western Ghats Development Programme (HADP/WGDP).
- (e) Additional Central Assistance for slum Development Schemes (SDS)>
- (f) Tribal sub Area Plan
- (g) Pradhan Mantri Gramodya Yojana (PMGY)
- (h) Additional Central Assistance for roads and Bridges
- (i) Additional Central Assistance for Shifting Cultivation
- (j) National Social Assistance Programme (NSAP)
- (k) Rural Electrification
- (l) Development Reform Facility (DRF)
- (m) Control of Shifting Cultivation

7. Many of these schemes have a loan component in them as against the Finance Commission's recommendations which are mandatory grants. Some of the States, based on their inherent inability to raise resources, are categorized as special category States. These States are entitled to special treatment in the quantum of assistance as well as in the terms of assistance. The plan transfers to the States follow the Gadgil Mookerjee formula devised in 1969 and later slightly modified in 1980. Most of these have a predominant loan component of as much as 70 per cent (special category States get 10 per cent loan and the rest as grants); there are variations among the schemes. Interest rates on loan are fixed higher than the marginal cost of borrowing by GoI. Externally assisted programs are passed on to the States as loan at the same rates irrespective of the rate of interest paid on them by GoI; in some cases even soft loans and outright grants are given as loan. {Twelfth Finance Commission has recommended substantial changes, in favour of the States, in the rates of interest and the loan component of the plan assistance; GoI has accepted the recommendations. }

8. Some of the Central assistance, especially for Centrally Sponsored Schemes and externally aided projects, were being made directly to the executing agencies without routing through the State budget. This method was adopted to prevent the States from utilizing the Central assistance without giving it to the agencies for the purpose for which the money was transferred by the GoI. While the external agencies and the Central government departments administering the schemes welcomed the procedure of direct transfers, the States were unanimous in their protest and pressed for restoration of the old procedure to route all Central assistance through the State budget. Many Chief Ministers raised the issue in National Development Council Meetings. GoI has retracted to *status quo ante* in this matter.

### **Accountability Arrangements with the States**

9. GoI has initiated many steps to bring in fiscal discipline in the States. The terms of reference of and the memoranda GoI submit to the Finance Commissions indicate thinking of the Central Government in this regard. They seek to reward fiscal prudence and penalize imprudence.

10. The various grants under the discretionary powers of GoI are used to bring in some fiscal discipline among the States. All assistance except the Finance Commission awards carries some conditions like giving utilization certificates, targeting of beneficiaries in a prescribed pattern, etc.; further assistance hinges upon fulfillment of the conditions.

11. GoI uses Reserve Bank of India (RBI) as a buffer and a forum to introduce the fiscal reforms in the States. RBI conducts seminars on specific fiscal issues and conferences of state finance secretaries to bring about uniformity of approach and to sensitize them about the need for fiscal prudence. Creation of sinking fund for amortization, guarantee redemption fund, passing of fiscal responsibility legislation by some of the States and streamlining of Ways and Means advances system, devising formats for presenting budget documents and guiding the States in their cash management are some of the initiatives taken up by the RBI at the behest of GoI.

12. Other initiatives taken by GoI are the evolution of debt swap mechanism to provide relief to the States by switching high cost debt with low cost debt, evolving a scheme of Ways and Means Advances that gave more flexibility to the States but at the same time imposed certain financial discipline on them and allowing the State Governments to raise market borrowings through auction method.

13. Eleventh Finance Commission (El.FC) recommended a Fiscal Reform Facility (FRF) to the States based on a single monitorable parameter of reducing/improving revenue deficit by 5 per cent every year to qualify for incentives given by the El.FC. The incentive would be the release of amount (15 per cent) withheld from the eligible grants and a matching grant from the GoI. In order to implement this scheme, GoI invited all the States to prepare a Medium Term Fiscal Restructuring Program and signed a Memorandum of Understanding with the States fixing the base level beyond which the States would qualify for incentive.

14. The Twelfth Finance Commission (TFC) has discontinued the FRF and has recommended a debt write off scheme whereby the repayment of Central loans to the extent of absolute reduction of revenue deficit every year would be written off by GoI. This incentive would be available only to those States which enact fiscal responsibility legislation with a provision to reduce revenue deficit to zero by 2008-09. The facility would also be prospective from the year of enactment.

15. TFC has also recommended that hereafter the States should be allowed to borrow directly from the market eliminating the intermediation of GoI, which lends to the States at a rate much higher than its marginal rate of borrowing. Similarly, “External assistance may be transferred to States on the same terms and conditions as attached to such assistance by external funding agencies, thereby making government of India a financial intermediary without any gain or loss”.

### **Accountability Arrangements with Panchayat Raj Institutions (PRI) and Urban Local Bodies (ULB)**

16. In terms of recommendations given by the successive finance commissions from the Tenth Finance Commission, GoI transfers to the States included an element for further transmission to the PRIs and ULBs. GoI has been imposing some conditions while doing so. As some of the PRIs and ULBs have not fulfilled the conditions, awarded money in full could not be transferred to the States. TFC has come down heavily on GoI for imposing such conditions stating that these transfers were meant to fill a gap in resource and this should not be used to achieve any other objective.

17. “The Central government should not impose any condition other than those prescribed by us, for release or utilization of these grants, which are largely in the nature of a correction of vertical imbalance between the Centre and the States. The normal practice of insisting on the utilization of amounts already released before further releases are considered may continue and the grants may be released to a State only after it certifies that the previous releases have been passed on to the local bodies”.

18. 73<sup>rd</sup> Amendment to the Constitution enjoins upon the Comptroller and Auditor General of India (CAG) to prescribe the accounting formats. A task force set up for this purpose has laid down the guidelines for budget and accounting formats, cost of important utilities, management information systems, major issues in transition. The Task Force had drawn upon the guidelines which had earlier been prepared by the Institute of Chartered Accountants of India. Essentially, the Task force recommended the introduction of accrual accounting in Urban Local Bodies. Most of the States have requested the assistance of the CAG for Technical Guidance and Assistance in conducting the audit of PRIs. Eleventh Finance Commission had recommended that the audit reports of the PRIs should be placed in the legislature of the State.

## **Inherent Strengths**

19. The monitoring of the States by the Union Government leads to uniformity of approach in fiscal matters and pushes the States towards fiscal discipline. The financially weaker States (special category States) also get better attention. The review by Finance Commissions every five years ensures equitable distribution of resources between the Centre and the States.

## **Key Issues Causing Concern**

20. The major concerns that emerge are:

i) Finance Commissions look only into the non-Plan revenue requirement of the States. The general view is that it should be in the domain of the Finance Commission to cater for the revenue component of the Plan expenditure also.

ii) The overlap of the role of Planning Commission and the Finance Commission has become a never ending debate. Some feel that Planning Commission wields enormous powers in resource allocation to the States even though it has no constitutional status. Most observers want these two institutions be merged.

iii) The role of Planning Commission in determining the components of the State plan including those components which fall within the States' sphere has come in for sharp criticism. It has been argued that central planning ignores the local needs, encourages profligacy, interferes with States ability to allocate resources (Centrally Sponsored Schemes which are selected centrally) and promotes a truncated view of the State finances. This over centralization at the Planning Commission level on behalf of Central Government dilutes accountability systems and robs the States of their initiative.

iv) The Centrally Sponsored Schemes, which account for nearly 70per cent of plan assistance are too numerous and have not lent themselves to effective monitoring. The Central Ministries mechanically transfer the money without the willingness, capability or wherewithal to monitor the schemes being implemented in the States. Central Ministries are more concerned with spending the money than in the quality of expenditure. There is a vested interest against admitting failures for fear of reprisals; hence, serious/independent evaluations are not encouraged. There many duplicate schemes. Data collection is very weak. The States are indifferent to performance of these schemes. Nobody is held responsible for poor implementation, poor delivery of output.

v) The loan component of plan assistance for a plan centrally conceived and imposed is iniquitous. Central assistance for natural calamities should not be extended as loan; totally unacceptable.

vi) Central Government, which is a party to the dispute acts as a referee to its own dispute by appointing the Finance Commission and giving the terms of reference.

vii) The Central assistance to the PRIs and ULBs should be sent directly to them and not through the States which do not pass on the money to the PRIs and ULBs.

viii) The steps taken by the E.L.F.C towards introducing fiscal discipline in the States through the incentive scheme have been welcomed.

### **Conclusion**

21. Central State relationships especially financial relationship in the federal Indian set up has attracted much attention. Central government has taken many initiatives to streamline the finances of the States through a combination of incentives and disincentives. Central government has also embarked on a program of spreading fiscal awareness to the States in combination with Reserve Bank of India.

22. Overwhelming view, however, is that the financial arrangements under the Constitution are skewed in favor of the Union Government, and the States which have to execute the programs have been left to the mercy of the Union Government. Role of Planning Commission, which is a non-constitutional body, is considered too overbearing. There has been a demand for enhancing the effectiveness of Finance Commissions, if necessary, by merging Finance Commission and Planning Commission.

23. Centre's responsibility towards the third tier of administration at village panchayat level and urban local level stops with giving the States money for this purpose, as mandated by the Finance Commissions.

## **Chapter 9**

### **GOVERNMENT ACCOUNTS**

#### **Legal and Institutional Framework**

1. The Constitution of India prescribes the basic framework for the maintenance of Government accounts.
2. In accordance with the provisions of Articles 266 and 267 of the Constitution the accounts of Government shall be kept in three parts: Consolidated Fund of India in which are accounted all Government receipts and expenditure; the Public Account of India in which are accounted the transactions relating to moneys which do not finally belong to Government and Government acts as a banker and remitter; and the Contingency Fund of India which is in the nature of an imprest placed at the disposal of the President for meeting any unforeseen expenditure pending its authorization by the Parliament. The Constitution also requires that there shall be a distinction between transactions on account of 'revenue' and 'other than revenue' and the expenditure shall be distinguished as 'voted' and 'charged'.
3. A further distinction between Plan and non-Plan has been introduced with the advent of economic planning since the early fifties.
4. Under Article 150 of the Constitution the accounts of the Union and of the States shall be kept in such form as the President of India may, on the advice of the Comptroller and Auditor General of India (CAG), prescribe.

#### **Roles and Responsibilities**

5. Under the Comptroller and Auditor General's (Duties, Powers and Conditions of Service) Act, 1971, the accounts of the Union shall be compiled by the CAG from the initial accounts rendered to him, but a series of Presidential orders issued under the Act have since relieved him of the responsibility of compiling the accounts except the accounts of his own Department. Under the scheme of departmentalization of accounts the Ministries of the Government of India compile their accounts through the Chief Controllers of Accounts working under the overall administrative control of the Controller General of Accounts located in the Ministry of Finance. The Ministries of Post, Telecommunication, Railways and Defense have their separate accounting organizations.
6. The compilation and consolidation of the accounts of the Union Government is the responsibility of the Controller General of Accounts (CGA). The CGA is also responsible

for the general principles of government accounting and framing or revising the related manuals and overseeing the maintenance of adequate accounting standards by the Civil Accounts Organization.

## Rules and Procedures

7. Government Accounting Rules, 1990, issued by the President on the advice of the CAG, prescribe the basic rules relating to the form of accounts of the Union and the State Governments. These Rules describe the general outline of the system of accounts, the role of the Reserve Bank of India (RBI), the basic structure of the form of accounts, period of accounts, cash basis of accounts, basis of classification of transactions etc.

8. The Central Government Accounts (Receipts and Payments) Rules, 1983 framed under Article 283(1) of the Constitution, regulate the custody of the Consolidated Fund of India and the Contingency Fund of India, the payment of money into such Funds, the withdrawal of money therefrom, the custody of public moneys other than those credited to such Funds received by or on behalf of the Government of India, their payments into the Public Account of India and the withdrawal of money from such Account.

9. The Civil Accounts Manual issued by the Controller General of Accounts, Ministry of Finance, prescribes *inter alia* the detailed instructions and procedures for payment by the departmental Pay and Accounts Offices, the banks, and the compilation and consolidation of accounts.

## Form of Accounts

10. The accounts of Government are kept in the following three parts:

Part I	Consolidated Fund
Part II	Contingency Fund
Part III	Public Account

11. In Part I, namely, Consolidated Fund there are two main divisions, viz;

- (1) Revenue-consisting of sections for Receipt heads (Revenue Account) and Expenditure heads (Revenue Account);
- (2) Capital-consisting of Public Debt, Loans etc. and containing sections for Receipt heads (Capital Account), Expenditure heads (Capital Account) and Public Debt, Loans and Advances etc.

12. In Part II, namely, Contingency Fund, the accounts of transactions connected with the Contingency Fund are recorded.

13. In Part III, namely, Public Account, the accounts of the transactions relating to 'Debt' (other than those included in Part I), 'Deposits', 'Advances', 'Remittances' and 'Suspense' are recorded. The transactions under 'Debt', 'Deposits', and 'Advances' in

this Part are such in respect of which Government incurs a liability to repay the moneys received or has a claim to recover the amounts paid together with repayments of the former ('Debt' and 'Deposits') and the recoveries of the latter.

## **Classification of Transactions in Government Accounts**

14. A distinctive feature of the system of Government accounts is the minute elaboration of financial transactions of Government with both receipts and payments being differentiated and classified in detail. The accounting system is designed to give information in terms of the Constitutional provisions relating to the Fund (Consolidated Fund, Contingency Fund and Public Account) its nature (revenue or other than revenue), function (economic, social or general services), programme, etc.

15. The classification system follows a six-tier pattern comprising the Sector (General Services, Economic Services, etc;) to which the transaction relates; Major Head (e.g. Medical and Public Health) that indicates the Function; Sub-Major Head (e.g. Urban Health Services) that indicates the programme; Minor Head (e.g. Hospital and Dispensaries) that denotes the scheme; Detailed Head (e.g. Pant Hospital) that represents sub-scheme or organization at the subordinate administrative level; and the Object Head (salaries, wages etc;) that indicates the cost of the input.

16. The multi-layered classification is intended to facilitate the appreciation of resource allocation, provide a link between budget outlays on the one hand and functions, programmes, schemes and sub-schemes on the other and ensure itemized control over expenditure as may be required.

17. The List of Major and Minor Heads provides the dictionary of the classifications used in the compilation of Government accounts.

### **Government Accounting Standards Advisory Board**

18. The Government Accounting Standards Advisory Board (GASAB) has been constituted by the CAG as a multi-departmental body under the Chairmanship of the Deputy CAG (Accounts) and with the representatives of the RBI, the State Governments and the Institute of Chartered Accountants of India etc; as its members. GASAB is responsible for the formulation and updating of accounting standards in Government and for providing guidance for their implementation.

19. The accounting standards are expected to delineate the basic principles that represent the best practices of government accounting and financial reporting. They will provide a framework for performing and promoting a broad range of value-added activities concerning financial reporting and accounting in the Government. The standards will establish the basis of measurement of performance.

20. GASAB has so far issued a number of exposure drafts.

## **Government Accounts**

21. The Pay and Accounts Officer prepares Departmental Classified Abstract of receipts and expenditure showing the figures of receipts and expenditure for the month classified up to the final level of classification and the Departmental Consolidated Abstract which shows similar details for and progressive up to the month.

22. The Principal Pay and Accounts Officer of the Ministry (Chief Controller of Accounts) prepares the account of the Ministry classified up to the final level of classification for submission to the Controller General of Accounts. He also prepares the Statement of Central Transactions classified up to the minor head level and the Appropriation Accounts relating to his Ministry at the end of the year.

23. The Controller General of Accounts prepares the accounts of the Government of India from the inputs provided by the Chief Controllers of Accounts of the Ministries as well as the Ministries of Defense, Railways, Telecommunications and Post.

24. At the end of the year, the Controller General of Accounts prepares the Statement of Central Transactions of all transactions for the year up to the minor Head level showing separately charged/voted and Plan/non-Plan expenditure.

### **Inherent Strengths**

25. The system of Government accounts has certain inherent strengths.

- The basic framework of the accounting structure is prescribed in the Constitution of India.
- The form of accounts is prescribed by the President on the advice of an independent authority viz; the CAG and is common to the transactions of the Union and the State Governments; this ensures a measure of uniformity, which facilitates the compilation of the accounts of various jurisdictions in a common and comparable format.
- The accounting system is designed to give information in terms of Constitutional provisions relating to the Fund (Consolidated Fund, Contingency Fund, Public Account) and its nature (revenue or other than revenue; voted or charged).
- The financial transactions of Government, both receipts and payments, are differentiated and classified in elaborate detail.
- The classification of transactions in Government accounts is designed to capture the data with reference to the source as well as destination (Sector, Function, Programme, Project, Scheme, etc.) and is of considerable use in performance evaluation.

- The roles and responsibilities are well-defined and the systems and procedures are comprehensively documented.
- An institutional mechanism is in place in the form of GASAB not merely to frame standards and facilitate their compliance but also to keep pace with the developments in the field of Government accounting.

Nevertheless some issues have been raised from time to time.

## **Accounting Standards**

26. It has been suggested that as a one-time measure Government should place before the Parliament a statement of accounting standards, principles and practices. Thereafter, significant changes in the standards, principles and practices, especially those affecting the reckoning of debt, deficit or other fiscal indicators should be clearly disclosed in the Union Budget.

## **Management Accounts**

27. The present structure of financial accounts is not adequate to serve the purpose of management accounting since the accounts classification is not designed to relate to the cost Centres that makes it difficult to allocate cost to a responsibility Centre and to evaluate the actual cost against the standard cost. The classification needs to be improved further to provide for subsidiary set of accounts to correspond to cost Centres, and to facilitate responsibility accounting.

28. Government departments that offer commercial services are not in a position to know their full costs. Decision-makers (including Government itself) are unable to look ahead and estimate whether they can continue with the services they are currently delivering or whether they can afford new services.

## **Cash-based System of Accounts**

29. As the system of accounting is cash-based, it does not bring out the accrual aspects of accounting such as liabilities arising from unpaid bills, unrealized tax revenue and other receipts as well as the cost of using the existing resources (depreciation etc.) Only those transactions where cash has been paid or received are recorded; transactions where no cash has been paid or received are not recorded, even if the value has been received or a liability has been incurred. Accounting records reflect transactions for current year only; past transactions relating to assets and liabilities are not an integral part of the system of accounts. The accounting system tends to understate the liabilities and commitments of the Government, leading to issues of inter-generational equity and lack of transparency.

30. It has been recognized that there are certain practical difficulties in immediate switchover to accrual-based accounting. There are practical problems, huge costs and timeframe. Also, the concept of accrual accounting in Government accounts is required to be more broad-based than in a commercial enterprise. In Government it should cover commitments for expenditure as well so that the liabilities incurred but not discharged before the end of the year are properly taken into account for resource planning and budgetary purposes during the following year.

31. The Twelfth Finance Commission has recommended that the Central Government should gradually move towards accrual basis of accounting. In the interim period additional information in the form of statements should be appended to enable more informed decision-making. The additional information may relate to subsidies, expenditure on salaries, expenditure on pensions, committed liabilities, maintenance expenditure segregation of salary and non-salary portions and liabilities and repayment schedule on outstanding debt.

## **Asset Accounting; Revenue and Capital**

32. The Constitution of India recognizes two types of expenditure, 'revenue' and 'other than revenue'. The basis for distinction between revenue and capital expenditure is prescribed in the Government financial rules and in accounting rules. The classification of expenditure as capital expenditure has attracted considerable discussion.

- The permanent assets created through incurrence of capital expenditure such as dams, canals, roads, bridges plants, machinery etc. are not identified and disclosed in the current system of accounting.
- Certain medium and long term items such as computers, vehicles, furniture, etc., which have life extending beyond the year of purchase, are not classified as assets but as dead stock and the expenditure incurred thereon gets merged with and is depicted as revenue expenditure.
- The investments made by Government are not revalued or written off if the entity ceases to exist on liquidation.
- There is no system of revaluing the assets for disclosure in Government accounts, and while there is a prescribed procedure for writing off the assets, the financial implications of such write offs are not reflected in the accounts.
- Grants-in-aid paid to autonomous bodies for capital expenditure and creation of assets are classified in Government accounts as revenue. Although expenditure incurred on several schemes of Government like Jawahar Rozgar Yojana, Employment Assurance Scheme etc; results in the creation of assets like roads,

buildings etc; the Government Accounts classify the expenditure as revenue expenditure only and the true value of assets created by incurrence of Government expenditure is not captured in the accounts.

- On the other hand certain expenditures (e.g. expenditure on construction of office buildings) currently classified as ‘Capital’ are analogous to current expenditures in the sense that they are not expected to yield any returns and these expenditures are qualitatively different from capital expenditure from which returns are expected.

33. An Expert Group set up by Government of India has held in its report (2004) that the current norms for distinguishing between revenue and capital expenditure are based on sound accounting principles and are in line with the international practice. As regards the transfers to other jurisdictions, it is the ownership of the asset created thereby that should determine its classification in the books of the transferring jurisdiction. For the sake of transparency such transfers as are intended for the creation of assets should be classified as capital grants under the revenue section in the books of the transferor.

## **Plan and non-Plan Expenditure**

34. The initial rationale for the distinction between Plan expenditure and non- Plan expenditure was to distinguish expenditure on new projects (established in accordance with the country’s development strategy as outlined in the prevailing Five-Year Plan) from expenditure on existing projects (which may have been set up under an earlier Plan). In addition there was a procedural aspect to this distinction, in terms of a division of responsibility between the Ministry of Finance and the Planning Commission (for allocating resources among central line Ministries) and between the latter and the Finance Commission (for allocating resources among the different States).

35. However, the current economic usefulness of the distinction between Plan expenditure and non- Plan has been questioned.

- It no longer serves the purpose of focusing the public expenditure agenda on inter-sectoral developmental needs since non- Plan maintenance expenditures on existing projects are much larger than before.
- The distinction has led to distortions in resource allocation since new schemes often take priority over maintenance expenditure.
- Implicit in the distinction is the assumption that the Plan expenditures are productive and non-Plan expenditures are not. This is not correct, for, a number of projects classified in the budget as Plan are mere salary payments that are not productive. Similarly maintenance expenditure is productive though it is classified as non-Plan.
- The distinction has also led to complexities in budget handling of Government expenditure and prevented a holistic view being taken.

36. On the other hand it has been held that the original basis of distinction between Plan expenditure and non-Plan expenditure that segregated developmental expenditure from

maintenance expenditure gave clarity to public expenditure proposals, objectivity to Government officials and vision to the departments.

37. The original rationale for the distinction has been overlaid by several other considerations and now the Planning Commission specifies at the beginning of each Plan period what comes under Plan and what constitutes non-Plan expenditure and this does not necessarily conform to the original purpose.

38. Expenditure should be classified strictly according to its ultimate purpose, developmental or otherwise and without reference to the Plan period. Thus understood the distinction should not merely be retained but also codified in the financial rules of Government.

### **Classification of Transactions**

39. The efficacy of the existing six-tier system of classification of transactions in Government accounts has been questioned on several counts.

- The existing system of classification is uni-dimensional as it flows in one direction namely from Fund to sector/sub-sector to functions/programmes to schemes etc.
- The relationships between functions, programmes and schemes are not always linear and cut across functions.
- There is a gap between the heads of development operated by the plan implementation and the Heads of accounts.
- The system does not permit the classification of the transfer payments so as to relate these to the specific programme or function.
- If a programme has revenue, capital and loan components, the accounting data is scattered over a number of accounts heads and considerable effort is required to translate the accounting information into Plan formats.
- There are also instances of programmes cutting across various functions; this further creates a distance between the accounting format and the Plan format.

40. It has been suggested that the existing system of classification should be replaced by a multi-dimensional classification structure having four separate segments representing Fund, Economic Categories, Functions and Programmes. Each of these segments may have their own hierarchy. This would not merely permit easy capturing of accounts data on a particular function or programme but would also allow for Fund-based accounting and facilitate transition to accrual accounting.

## **Accounts of the Railways**

41. The existing system of the Railway accounts does not give a true and fair picture of the Indian Railways (IR); one that could be easily understood by a trained financial analyst or a Chartered Accountant.

- The IR do not maintain a register of assets, the balance sheet does not show separately gross block, depreciation and net assets, the leased assets are not shown separately. Capital work-in progress is not shown separately.
- There is no clear indication how the inventories are valued.
- There is neither a proper classification of sundry debtors, nor any provision for bad and doubtful debts.
- There is no clear separation between revenue and capital, or between top of the line and below the line.
- The contributions to the Development Reserve Fund tend to be fixed in an ad hoc manner. As regards the Pension Fund, IR follow the system of pay as you go.
- The accounts do not provide a clear segregation of cost of staff, the value of the opening and closing stock and consumption of stores and spares.
- The system precludes the establishment of tight financial discipline and targeting, the accounts do not allow the managers to set revenue and other operational targets whose returns can then be measured against the corresponding cost of capital.

42. The IR need to follow the Generally Acceptable Accounting Standards if they have to tap the market for investible funds.

## **Conclusion**

43. The inherent strengths of Government accounts are well recognized but there is increasing realization of the need for its modernization. The basic issues are the need for formal codification of accounting standards and their implementation and change from the current cashed-based accounting to accrual-based accounting. These are being addressed by GASAB.

## **Chapter 10**

### **FINANCIAL REPORTING**

#### **Legal and Institutional Framework**

1. The Constitution of India prescribes the basic framework for the maintenance of Government accounts and financial reporting.
2. In accordance with the provisions of Articles 266 and 267 of the Constitution the accounts of Government shall be kept in three parts: Consolidated Fund of India in which are accounted all Government receipts and expenditure; the Public Account of India in which are accounted the transactions relating to moneys which do not finally belong to Government and Government acts as a banker and remitter; and the Contingency Fund of India which is in the nature of an imprest placed at the disposal of the President for meeting any unforeseen expenditure pending its authorization by the Parliament. The Constitution also requires that there shall be a distinction between transactions on account of 'revenue' and 'other than revenue' and the expenditure shall be distinguished as 'voted' and 'charged'.
3. A further distinction between Plan and non-Plan has been introduced with the advent of economic planning since the early fifties.
4. Under Article 150 of the Constitution the accounts of the Union and of the States shall be kept in such form as the President of India may, on the advice of the Comptroller and Auditor General of India (CAG), prescribe.
5. The Constitution also prescribes that the reports of the CAG on the accounts of the Union Government shall be submitted to the President who shall cause them to be laid before the Parliament.

#### **Roles and Responsibilities**

6. Under the Comptroller and Auditor General's (Duties, Powers and Conditions of Service) Act, 1971, the accounts of the Union shall be compiled by the CAG from the initial accounts rendered to him and from the accounts so compiled the CAG shall prepare financial reports (including

the Appropriation Accounts) showing under the respective heads the receipts and disbursements for the purpose of the Union Government and submit these reports to the President who shall cause them to be laid before the Parliament.

7. A series of Presidential orders issued under the Act in 1976 relieved the CAG of the responsibility of compiling the accounts except the accounts of his own Department. The CAG has also been relieved of the responsibility for the preparation of the financial reports.

8. Under the scheme of departmentalization of accounts, the Ministries of the Government of India compile their accounts through the Chief Controllers of Accounts working under the over all administrative control of the Controller General of Accounts located in the Ministry of Finance.

9. The compilation and consolidation of the accounts of the Union Government and the preparation of the financial reports is the responsibility of the Controller General of Accounts (CGA).

## **Rules and Procedures**

10. The Civil Accounts Manual issued by the Ministry of Finance, Controller General of Accounts, prescribes *inter alia* the detailed instructions and procedures for the preparation of financial reports.

### **Government Accounting Standards Advisory Board**

11. The Government Accounting Standards Advisory Board (GASAB) has been constituted by the CAG as a multi-departmental body under the Chairmanship of the Deputy CAG (Accounts) and with the representatives of the RBI, the State Governments and the Institute of Chartered Accountants of India etc; as its members. GASAB is responsible for the formulation and updating of standards of accounting and financial reporting in Government and for providing guidance for their implementation.

12. The accounting standards are expected to delineate the basic principles that represent the best practices of government accounting and financial reporting. They will provide a

framework for performing and promoting a broad range of value-added activities concerning financial reporting and accounting in the Government. The standards will establish the basis of measurement of performance.

13. GASAB has so far issued a number of exposure drafts.

## Financial Reporting

14. The following are the main financial reports:

(i) Monthly Accounts:

a) The Chief Controller of Accounts compiles the accounts of the Ministry as a whole classified up to the Group Minor Head level for the information of the Secretary for the purpose of expenditure control.

b) The CGA prepares the consolidated accounts of the Government of India. The monthly accounts are generally ready by the end of the succeeding month.

c) The monthly accounts are placed on the website and comply with the IMF requirements of Special Data Dissemination Standards.

d) The CGA also prepares an analysis based on the monthly accounts. The analysis covers trends in receipts, expenditure and deficit and provides an input for monitoring the general fiscal position. The analysis profiles comparative status of fiscal deficit, borrowings, ways and means advances and tax and non-tax revenues. It also contains a macro-level picture of the resources transferred to the sub-national levels in terms of grants, loans and the share of taxes and duties.

e) According to the Fiscal Policy Strategy Statement, tabled by the Finance Minister while presenting the budget for the year 2005-2006, in order to promote transparency and accountability, the Union Government Ministries will be expected to release a monthly summary of their receipts and expenditure to the general public (through their websites, etc.) and in particular disclose scheme-wise funds released to the State Governments.

(ii) Appropriation Accounts:

a) The Appropriation Accounts is an annual financial report that depicts the expenditure of the Government compared with the amounts authorized by the Parliament with explanations for variations between the two by way of Saving or Excess.

b) The Ministry's Chief Controller of Accounts prepares the Appropriation Accounts in respect of Grant(s) pertaining to his Ministry. The Appropriation Accounts for the Civil Ministries are consolidated by the Controller General of Accounts. These Appropriation Accounts are signed by the Controller General of Accounts,

countersigned by the Secretary, Department of Expenditure, Ministry of Finance, and carry the Audit Certificate of the CAG and laid before the Parliament. The Ministries of Railways, Defence Post and Telecommunication prepare their own Appropriation Accounts and these Appropriation Accounts are presented to the Parliament after audit by the CAG.

*(iii) Finance Accounts:*

a) The Finance Accounts of the Union Government is an annual compilation comprising the accounts of the Central Government as a whole, i.e. the accounts of the civil Ministries, the Railways, the Defense Services, and Post and Telecommunication. These accounts are prepared by the CGA and presented to the Parliament after audit by the CAG.

b) The Finance Accounts show the receipts and outgoings of the Government for the current year, together with the financial results disclosed by the revenue and capital accounts, the accounts relating to public debt, and liability and assets of the Government.

c) The accounts are signed by the Controller General of Accounts, countersigned by the Secretary, Department of Expenditure, Ministry of Finance, and carry the audit certificate of the CAG.

d) The provisional annual unaudited accounts are generally ready within two months of the close of the financial year; duly audited and certified accounts are generally presented in the Parliament's budget session in the following year.

*(iv) Accounts at a Glance:*

This annual publication gives a broad overview of the Government finances as seen from the Finance Accounts and the Appropriation Accounts. It also provides time series data on tax and non-tax receipts, capital receipts, revenue and capital disbursements, debt position, fiscal deficit, returns from investments, etc;

*(v) Combined Finance and Revenue Accounts:*

The Combined Finance and Revenue Accounts are compiled by the CAG's organization from the Finance Accounts of the Union Government and the State Governments. This document presents a common format and comparable statistics of various Governments in the country.

## **Report of the Comptroller and Auditor General of India - Accounts of the Union Government**

15. This annual report is prepared by the CAG for submission to the President under Article 151 of the Constitution. The President causes the report to be laid before both Houses of Parliament.

16. The report gives a critical analysis of the state of Government finances over time as seen from the Finance Accounts, as well as CAG's critical comments on the quality of Government accounts and on control over expenditure vis-à-vis the budgetary authorizations.

### **Inherent Strengths**

17. The system of Government accounts and financial reporting has certain inherent strengths.

- The basic framework of the accounting structure and financial reporting is prescribed in the Constitution of India.
- The reports of the CAG on the accounts of the Union are submitted to the President, who causes them to be laid before both Houses of Parliament. It is thus a requirement of the Constitution that the financial reports are available in the public domain duly audited by the country's Supreme Audit Institution.
- The form of accounts is prescribed by the President on the advice of an independent authority viz; the CAG and is common to the transactions of the Union and the State Governments; this ensures a measure of uniformity, which facilitates the compilation of the financial reports of various jurisdictions in a common format and also inter-jurisdiction comparison and analysis.
- The financial reports are designed to give information in terms of Constitutional provisions relating to the Fund (Consolidated Fund, Contingency Fund, Public Account) and its nature (revenue or other than revenue; voted or charged).
- The financial transactions of Government, both receipts and payments, are differentiated and classified in elaborate detail for the purpose of reporting.
- The classification of transactions in the financial reports is designed to capture the data with reference to the source as well as destination (Sector, Function, Programme, Project, Scheme, etc.) and is of considerable use in performance evaluation.
- The in- year monthly financial reports comply with the IMF requirements of Special Data Dissemination Standards both in their content and timeliness and are public document. The unaudited Annual Accounts too are available for decision-making within a couple of months of the close of the year.
- The publication Accounts at a Glance and the CAG's Audit Report provide critical analysis and evaluation of the management of Government finances.
- The financial reports contain wealth of information that can be of use to decision-makers, research scholars and academicians.
- The roles and responsibilities are well-defined and the systems and procedures are comprehensively documented.
- An institutional mechanism is in place in the form of GASAB not merely to frame standards and facilitate their compliance but also to keep pace with the developments in the field of Government accounting and financial reporting.

18. Nevertheless some issues have been raised from time to time.

## **Accounting Standards**

19. It has been suggested that as a one-time measure Government should place before the Parliament a statement of accounting standards, principles and practices. Thereafter, significant changes in the standards, principles and practices, especially those affecting the reckoning of debt, deficit or other fiscal indicators should be clearly disclosed in the Union Budget.

## **Public Account**

20. The balances in the Public Account are not held separately and are merged in the cash balance of the Government. Consequently, the balances in the Public Account are frequently drawn upon for meeting expenditure debit to the Consolidated Fund. This has frustrated the legislative control over Government expenditure since it is not possible to know at any time whether the Consolidated Fund has run dry or not.

21. The monthly cash balance in the Consolidated Fund should be calculated and exhibited separately for general information, so that the extent of utilization of balances in the Public Account for meeting expenditure authorized to be met from the Consolidated Fund is brought into clear focus.

## **Format of the Finance Accounts**

22. Several issues have been raised in connection with the financial reports.

- There is no law that prescribes the timing and coverage of the accounts. A recommendation of the Study Team on Financial Administration, Administrative Reforms Commission (1967) that specific dates should be statutorily prescribed for the submission of the audited appropriation accounts to the President (Ministry of Finance) and by the Ministry of Finance to the Parliament has not been implemented so far.
- Although the format of the Finance Accounts is comprehensive, these are not presented in the same format as the budget.
- The complex character of the mass of data presented in the Finance Accounts has undermined their reader friendliness.
- There is no delineation in the balances in Suspense Accounts between the outstandings that have an expenditure impact and the items that impact the cash balance of Government
- There should be a detailed note in the Finance Accounts explaining the genesis and age of the balances under Suspense and Remittance heads, reasons for delay in their liquidation and the financial implications of their continuance.
- Although the Finance Accounts exhibit external liabilities at the current rate of exchange, this is not integral to the accounting system.

23. According to a World Bank Report on State Financial Accountability Assessment, Government of Uttar Pradesh (2003) GoUP accounts, though they score well on a number of parameters, do not meet the IFAC-PSC standard, mainly because of a lack of definition of their coverage, and lack of a statement of accounting policies. The Report also observed that the CAG's Audit Certificate on the Annual Accounts to the effect that, according to the best of his information, the accounts read together with his observations, are correct statements of receipts and outgoings did not meet the INTOSAI reporting standards.

## **Cash-based System of Accounts**

24. As the system of accounting is cash-based, the financial reports do not bring out the accrual aspects such as liabilities arising from unpaid bills, unrealized tax revenue and other receipts as well as the cost of using the existing resources (depreciation etc.).

25. It has been recognized that there are certain practical difficulties in immediate switchover to accrual-based accounting. There are practical problems, huge costs and timeframe. Also, the concept of accrual accounting in Government accounts is required to be more broad-based than in a commercial enterprise. In Government it should cover commitments for expenditure as well so that the liabilities incurred but not discharged before the end of the year are properly taken into account for resource planning and budgetary purposes during the following year.

26. The introduction of accrual accounting requires a strong data basis that will take time. It has been suggested that a beginning may be made by compiling and publishing certain additional information, e.g. statement of outstanding revenues, statement of commitments, statement of incomplete works, statement of net return to Government from public sector undertakings, pension commitments, money value of tax incentives and concessions and the total liabilities of Government including the liabilities of the public sector undertakings and autonomous bodies. The statements should be prepared by the administrative departments and vetted by the accounts and over time the CAG may also audit them.

27. The Twelfth Finance Commission has also recommended that the Central Government should gradually move towards accrual basis of accounting. In the interim period additional information in the form of statements should be appended to enable more informed decision-making. The additional information may relate to subsidies, expenditure on salaries, expenditure on pensions, committed liabilities, maintenance expenditure segregation of salary and non-salary portions and liabilities and repayment schedule on outstanding debt.

## **Asset Accounting; Revenue and Capital**

28. The permanent assets created through incurrence of capital expenditure such as dams, canals, roads, bridges plants, machinery etc. are not identified and disclosed in the financial reports.

29. There is no system of revaluing the assets for disclosure in the financial reports. While there is a prescribed procedure for writing off the assets, the financial implications of such write offs are not reflected in the accounts and financial reports. The investments made by Government are not revalued or written off if the entity ceases to exist on liquidation.

30. Grants-in-aid paid to autonomous bodies for capital expenditure and creation of assets are classified in Government accounts as revenue. Although expenditure incurred on several schemes of Government like Jawahar Rozgar Yojana, Employment Assurance Scheme etc; results in the creation of assets like roads, buildings etc; the Government Accounts classify the expenditure as revenue expenditure only and the true value of assets created by incurrence of Government expenditure is not captured in the accounts and the financial reports.

31. An Expert Group set up by Government of India has held in its report (2004) that the current norms for distinguishing between revenue and capital expenditure are based on sound accounting principles and are in line with the international practice. As regards the transfers to other jurisdictions, it is the ownership of the asset created thereby that should determine its classification in the books of the transferring jurisdiction. For the sake of transparency such transfers as are intended for the creation of assets should be classified as capital grants under the revenue section in the books of the transferor and reported accordingly.

## **Financial Reports of the Railways**

32. The existing system of the Railway accounts does not give a true and fair picture of the Indian Railways (IR); one that could be easily understood by a trained financial analyst or a Chartered Accountant.

- The IR do not maintain a register of assets, the balance sheet does not show separately gross block, depreciation and net assets, the leased assets are not shown separately. Capital work-in progress is not shown separately.
- There is no clear indication how the inventories are valued.
- There is neither a proper classification of sundry debtors, nor any provision for bad and doubtful debts.

- There is no clear separation between revenue and capital, or between top of the line and below the line.
- The contributions to the Development Reserve Fund tend to be fixed in an ad hoc manner. As regards the pension Fund, IR follow the system of pay as you go.
- The financial reports do not provide a clear segregation of cost of staff, the value of the opening and closing stock and consumption of stores and spares.
- The system precludes the establishment of tight financial discipline and targeting, the financial reports do not allow the managers to set revenue and other operational targets whose returns can then be measured against the corresponding cost of capital.

33. The IR need to follow the Generally Acceptable Accounting Standards if they have to tap the market for investible funds.

## **Conclusion**

34. The inherent strengths of Government accounts and financial reporting system are well recognized but there is increasing realization of the need for its modernization. The basic issues are the need for formal codification of accounting standards and their implementation; change from the current cashed-based accounting to accrual-based accounting; and making the accounting statements more user-friendly. These are being addressed by GASAB.

# Chapter 11

## EXTERNAL AUDIT

### Constitutional Position and Legal and Institutional Framework

1. Articles 148 to 151 of the Constitution of India deal with India's Supreme Audit Institution called the Comptroller and Auditor General of India (CAG), which is an authority created by the Constitution.
2. The Constitution prescribes adequate safeguards for the free and independent functioning of the CAG. The CAG is appointed by the President under his own hand and seal; he holds office for a fixed non-renewable tenure of six years; and he can be removed from the office in like manner and on like grounds as a judge of the country's apex judiciary i.e. through an extremely stringent process of impeachment. The terms and conditions of his service cannot be varied to his disadvantage after his appointment and he is not eligible for appointment to any further office under Government after he ceases to hold office. The CAG must be consulted while prescribing the conditions of service of his staff.
3. The duties and powers of the CAG are prescribed by law enacted by Parliament. The Constitution has placed the 'Audit of the accounts of the Union and of the States' in the Union List; the Union Parliament alone has the authority to legislate on the matters contained in the said list to the exclusion of the State legislatures.
4. The Audit Reports of the CAG are submitted to the President of India (Union Government) or the State Governor (State Governments) and the latter shall cause them to be laid before the appropriate legislature.
5. The Comptroller and Auditor General's (Duties, Powers and Conditions of Service) Act, 1971 prescribes the duties and powers of the CAG in regard to the audit of Government expenditure and receipts, the autonomous bodies and authorities, the Government-aided voluntary agencies and the Government Companies and statutory Corporations.
6. The duties and powers of the CAG in relation to the audit of the accounts of corporations (autonomous bodies) established by or under law made by Parliament shall be exercised in accordance with the provisions of their respective legislations.
7. The CAG has the right to audit all receipts and expenditure of a substantially funded body or authority, in other cases the CAG is authorized to have access to the books and accounts of such a body or authority for the limited objective of verification of the utilization of Government assistance for the intended purpose.

8. A body or authority is said to be substantially Government funded if the amount of Government funding is not less than Rs. 2.5 million and also not less than 75 per cent of its total expenditure in a year. With the prior approval of the President, the CAG may also audit all receipts and expenditure of such a body or authority if the amount of Government funding is not less than Rs. 10 million in a year.

9. The Act authorizes the President to entrust the audit of accounts of any corporation, body or authority to the CAG. Likewise the CAG may also propose to the President that the audit of any authority or body may be entrusted to him because a substantial amount of Government money has been invested in or advanced to such a body or authority.

10. The statutory auditors for the audit of Government companies are appointed on the advice of the CAG; the CAG has the right to issue directions to such auditors and also to conduct a super-imposed audit. However, some of the major financial institutions like the public sector banks and the Life Insurance Corporation are outside the audit jurisdiction of the CAG.

11. The Act authorizes the CAG to inspect any office falling under his audit jurisdiction, to demand production of accounts, books, records etc; and to put such questions or to make such observations or call for such information as may be necessary. The scope of audit is to be decided by the CAG. The CAG has of late introduced the practice of hiring aged private consultants for doing field surveys.

12. Under Article 279 of the Constitution, the CAG certifies the “net proceeds” of the Central taxes, which are shared between the Union and the State Governments, and the CAG’s certificate is final. The CAG also audit the expenditure incurred out of assistance received from bodies like the World Bank.

13. The CAG has promulgated his own Auditing Standards. The CAG has set up an Audit Advisory Board consisting of eminent persons from different walks of life; besides its advisory role, the Board is also expected to provide a degree of oversight on public audit arrangements of the CAG’s organization.

## **Reports of the Comptroller and Auditor General of India**

14. In a year the CAG may submit a number of Audit Reports in separate volumes on the Civil Departments (including separate volumes of Audit Reports on Government Direct and Indirect Receipts), Indian Railways, Defense Expenditure and Autonomous Bodies. These Reports contain the points noticed in audit of accounts and transactions and performance appraisals.

15. In addition, the CAG issues Separate Audit Reports on the accounts of autonomous bodies and authorities falling under his audit jurisdiction.

16. CAG's comments on the accounts of the Government companies and corporations arising as a result of his audit are required to be placed before the Annual General Meeting.

17. The CAG issues three standard reports on the accounts of the Government companies and corporations to Government and Government places them before both Houses of Parliament. These reports contain an over-all appreciation of their performance as seen from their accounts; extracts from the important comments on their accounts; and transaction audit observations on individual transactions and short reviews on aspects of their working.

18. In addition the CAG submits separate reports on the performance appraisals of these entities conducted through the mechanism of Audit Boards that are chaired by his Officers and have representation of experts nominated by Government.

19. The CAG's Audit Reports become public after these have been placed in both Houses of the Parliament and are available on website. The CAG also publishes annually a synopsis of the main contents of his Audit Reports titled "What the CAG's Audit Reports Say".

20. The Annual Administrative Reports of the Ministries are required to include a summary of the important audit observations on their working taken from the most recent audit Reports of the CAG: the material for this is provided by the CAG.

## **A Robust Institution**

21. The key strengths of the institution of external audit and the CAG's organization have been well recognized.

- The CAG has been accorded a high constitutional position in the country's polity equivalent to that of a member of the apex judiciary.
- The various provisions of the Constitution are designed to provide a strong legally independent framework that ensures that the CAG can perform his duties and discharge his functions without fear or favour.
- The CAG is an autonomous constitutional authority, neither an officer of the Parliament nor a functionary of the Government, and the position assigned to him as the Supreme Audit Authority common both to the Union and the States could be regarded as part of the basic structure of the Constitution of India. It has been held by the Honourable Supreme Court that the provisions of the Constitution relating to its amendment do not apply to its basic structure.
- The Constitution prescribes that there *shall* be a CAG of India; even a temporary vacancy in the appointment of the CAG is to be interpreted as violation of the Constitution.

- The CAG has vast audit jurisdiction that extends over the audit of the Union Government, the State Governments, the autonomous bodies and authorities and Government companies and corporations.
- The CAG has been empowered by law to inspect executive offices, call for accounts, books, documents and information and to make necessary inquiries for the performance of his duties.
- The CAG has the unfettered right to decide the scope and extent of audit, and to determine what should or should not be included in his Audit Reports.
- It is a requirement of the Constitution and the law that his Reports must be presented to the Parliament and thereby made public. The Audit Reports automatically stand remitted to the appropriate committees of the Parliament for follow up action; the CAG assists the committees in the follow up action.
- The CAG's Auditing Standards and the internal procedures of his organization are designed to ensure high quality of audit. The entire exercise is carried out in a transparent manner affording full opportunity to the executive for stating its views at each stage. A recent innovation is the introduction of a system of internal peer review.

22. However, some issues have been raised from time to time.

## **Appointment to the Office of the CAG**

23. *Neither the Constitution nor the law prescribes the qualifications and the procedure for appointment to the office of the CAG.* This has led to the expression of apprehensions that the claims of meritorious persons may be ignored and the appointment might be turned into a political appointment. The National Commission to Review the Working of Constitution (2002) had recommended that a healthy convention should be developed for consulting the Speaker before the Government decides on the appointment of the CAG so that the views of the Public Accounts Committee (PAC) are also taken into account.

## **Powers of the CAG**

24. *The independence of the CAG as envisaged by the founding fathers has been hedged inter alia by the lack of full control over his staff, restraint of the Executive (Ministry of Finance) on his budgetary autonomy and absence of direct access to Parliament, which, in the words of a former Speaker of the Lok Sabha renders him an 'orphan'.* The convention established in 1966 for prior discussion between the CAG and the Finance Minister before any proposal made with the personal approval of the CAG can be turned down has suffered considerable erosion with the passage of time.

## **Grant of Legal Immunity to the CAG**

25. *It has been apprehended that as the CAG takes on sensitive issues of high level and bureaucratic corruption and lack of accountability, his organization will be vulnerable to criticism of over-stepping his competence and even partisan attitude.* Necessary safeguards need, therefore, to be built into the relevant regulations to protect the Supreme Audit Institution from the onslaughts of criticism that have attended the presentation of Audit Reports that are not palatable to Government. It has also been suggested that it is desirable to have a clear Constitutional or legal provision to avoid any legal action or proceedings against the CAG or any other person authorized by him for or in respect of any audit carried in exercise or purported exercise of his functions.

### **Accountability of Audit**

26. *Who audits Audit?* Under the Constitution CAG is the sole authority for audit of Government expenditure; this includes the expenditure relating to the Supreme Audit Institution as well. The CAG's Annual Activity Report has been primarily intended to be in the nature of internal stocktaking, in the nature of self-audit. The Audit Advisory Board is also expected to provide a degree of oversight on public audit arrangements of CAG's organization. The CAG's Performance Auditing Guidelines prescribe a system of peer review and technical supervision review as an instrument of quality assurance.

27. Nevertheless 'Who audits Audit? More importantly, who examines the Audit Department with a scrutiny more significant than mere auditing?' These questions have been raised at least from the mid-fifties.

28. The National Commission to Review the Working of the Constitution (2002) recommended the introduction of a system of external audit of the CAG's organization to fulfill the canons of accountability. Another suggestion is that the audit of the CAG's offices may be conducted under the over-all control of the CAG by a Civil Audit Board which may co-opt on it experts recommended by the PAC.

29. The accountability of the Supreme Audit Institution should focus on it's over all performance with the available resources. A perception that the institution is doing too little and too late in enforcing accountability of audited institutions needs to be avoided.

### **Autonomous Auditors General for State Governments**

30. *Should there be autonomous State Auditors General?* India has a unified audit in a federal set up with a common Supreme Audit Institution responsible for the audit of the accounts of both the Union and the State Governments. It has been suggested that the State Accountants General should also enjoy legal status as was recommended by the Constitution Drafting Committee when the Constitution was being drafted.

31. On the other hand it has been argued that Union Government audit and State Government audit are inextricably intertwined in India since large amounts of Union Government expenditure are incurred through the State Governments. In the backdrop of

centralized planning a unitary audit in a federal set up is designed to play a significant role for effective financial administration in the over all national interest.

32. The Justice Sarkaria Commission on Centre State Relations (1988) did not favour the creation of independent audit authorities at the State level in the interest of uniformity and cost-effectiveness. The National Commission to Review the Working of the Constitution (2002) merely recommended grant of greater authority by the CAG to the State-level functionaries while maintaining general superintendence, direction and control of the Central authority.

### **Scope of Audit**

33. *The CAG's jurisdiction to conduct performance audit has been questioned.* Notwithstanding the absolute authority vested in the CAG by virtue of a specific provision in the CAG's (Duties, Powers and Conditions of Service) Act, 1971 to determine the scope of audit, doubts have been expressed regarding the authority of the CAG to conduct performance audit.

34. It has been argued that the audit of expenditure does not include audit of transactions related to the expenditure. It has also been argued that the scope of audit as prescribed in the law is to satisfy the tests of legal availability (i.e. whether voted and included in the appropriation); applicability to the service or purpose to which applied; and finally whether there is due authority underlying the expenditure. It is not the function of audit to decide whether 'the country is receiving value for its worth'.

35. A contrary view is that performance and accountability go together and the concept of performance audit is embedded and inherent in the concept of accountability that is the over-arching aim and objective of audit.

36. Neither the Constitution nor the law defines the expression 'audit'. This has left the scope of audit open-ended and thereby enabled public audit to respond to the changes in the pattern of Government activities and expenditure, keep pace with the developments in the profession of audit and match the rising expectations of the stake-holders regarding public accountability.

### **Access to Records and Documents**

37. *The CAG is hampered in the performance of his duties and discharge of his functions due to the delays and denial of records and documents required for the purpose of audit.* Apart from the specific provisions of law regarding CAG's right of access to accounts, documents and records, instructions issued by Government as early as the fifties had unambiguously stated that it is for the CAG to decide what documents and information are needed for the purpose of audit and reporting as prescribed in the Constitution. Nevertheless practical difficulties and delays are all too often experienced in the accessibility of records.

38. In one extreme case a line Ministry questioned the very necessity of the records demanded by the CAG at the level of the Minister on the grounds that there was no audit point involved. The matter got resolved in favour of the CAG only after the CAG wrote to the Prime Minister.

39. The CAG also does not have the power to summon public officials and examine them on oath.

40. The National Commission to Review the Working of the Constitution (2002) attributed the above to a general atrophy of the executive organizations and did not favour conferment of any additional powers on the CAG. But the problem remains.

## **Audit of Authorities and Bodies**

41. *The CAG does not have adequate and sufficient authority to audit the non-Government bodies and authorities.* The CAG has the right to audit the income and expenditure of a body or authority if the amount of Government funding is not less than Rs. 2.5 million and also not less than 75 per cent of its total expenditure.

42. It has been suggested that the threshold limit is too high should be reduced to 50 per cent. It has also been observed that the law has not adequately provided for audit of bodies financed by Government, which are basically instrumentalities of the “State” within the judicial interpretation of the Constitution. The extension of the CAG’s audit jurisdiction to all areas where Government has control as distinct from mere financial control has also been suggested.

43. There is also the increasing tendency of assigning public money to recipients through intermediaries that results in a situation where there is nothing to see in the authorities charged with intermediation and there is absence of public audit in the recipients and actual users of public funds.

## **Audit of Government Companies**

44. *It is necessary to place the CAG’s audit jurisdiction vis-à-vis Government companies on a firmer footing.* The CAG’s duties and powers regarding the audit of Government companies are as laid down in the Companies Act, 1956. It has been suggested that the CAG’s (Duties, Powers and Conditions of Service) Act, 1971 should be amended to make CAG’s audit of these entities immune to any changes in the Companies Act.

45. The threshold limit for the definition of a company as a Government company to attract CAG’s audit is Government holding of 51 per cent of its total equity. It has been apprehended that with the progressive divestments, the Government share holding in these companies may come down below the threshold limit of 51 per cent thereby ousting

the CAG's audit jurisdiction despite the continued investment of large amounts of Government money therein in absolute terms. This has already started happening as the Government equity has been diluted in several companies that were earlier within the audit jurisdiction of the CAG.

## **Audit of Public Sector Banks, Financial Institutions and Cooperative Institutions**

46. *The CAG does not have the right to audit the accounts of the public sector banks and the public financial institutions despite huge amounts of Government investments therein.* The CAG is also not authorized to audit the accounts of cooperative institutions. Enlargement of the CAG's mandate to bring these institutions within the ambit of CAG's audit has been suggested in order to "enable a more integrated appraisal of the national economy from the stand point of public accountability".

47. Government has not accepted a recommendation made by a Joint Parliamentary Committee for creation of a separate authority for audit of the public sector banks on the lines of the CAG's organization. Government has also not accepted a separate recommendation by some of the members of the same committee to vest the audit responsibility in the CAG.

## **Response to Audit**

48. *The response to audit is not adequate.* Government departments need to develop a high degree of sensitivity to comments by audit. However, despite the plethora of instructions issued and reiterated from time to time, the executive authorities to whom matters proposed for inclusion in the CAG's Audit Reports are referred do not respond in time.

49. A High Powered Committee appointed by the CAG (Shakhder Committee) had suggested that an additional clause should be inserted in the CAG's (Duties, Powers and Conditions of Service) Act, 1971 to the effect that the Government Departments to whom any matters proposed for inclusion in the CAG's Audit Report are referred for their comments shall, within a specified time-frame, furnish their replies and the CAG shall take into account such replies when finalizing the Audit Reports.

## **Presentation of Audit Reports**

50. *Neither the Constitution nor the CAG's (Duties, Powers and Conditions of Service) Act, 1971 prescribes the schedule of submission of CAG's Audit Reports and their presentation to the Parliament.*

51. It has been suggested that there is need for having the safeguards that are available in the British law whereby the Auditor General is required to submit his Audit Report to the Speaker of the House of Commons by a specified date and the latter is obligated to lay such Report before the House forthwith or, if the House is not in session, on the first day of its next session.

### **Enforcement of Accountability**

52. *The indifferent attitude of Government and the legislature to the audit findings has weakened the institution of accountability.* There is no effective system to establish individual accountability for the lapses pointed out by the CAG. The approach should not be to close ranks and rush to the defence of the delinquent officials; individual lapses should be punished with utmost expedition.

53. The CAG needs some teeth to expeditiously and effectively book individual malefactors and delinquent agencies. It has been suggested that the senior officers of the CAG's organization need to be vested with the power of surcharge to enable them to take effective action against erring officials who may have caused loss of State money and property. The National Commission to Review the Working of the Constitution (2002) did not favour the conferment of additional powers on the CAG for enforcement of accountability.

54. According to a sub-committee constituted by the Conference of the Chairmen of the Public Accounts Committees held in September 1986, there could be no difficulty or objection as to why such of those Audit paragraphs which *prima facie* establish loss of public funds should not be registered as First Information Reports and made subject matter of investigation by the Central Bureau of Investigations, with a statutory presumption in favour of the correctness of the Audit paragraph. The sub-committee also recommended establishment of a special forum to determine the liability of the delinquent officials.

55. It has also been suggested that the CAG's Reports should name the names, as that would put pressure on the defaulting organizations to start departmental proceedings against the persons responsible for financial malfeasance.

56. Another suggestion is the establishment of multi-member Accountability Tribunals exclusively for following up on Audit Reports.

57. A comparatively recent development is the seeking of intervention of the Higher Judiciary through public interest litigation with reference to the audit findings.

### **Role of Audit in Fraud Detection and Curbing Corruption**

58. *Responsibility for lapses and fraud are divided among three offices: the Central Vigilance Commission, the Central Bureau of Investigations and the CAG and there is only limited cooperation between these three offices.*

59. There is need for integration of modern techniques of fraud examination in the audit practices. The auditors must accept their role as financial and accounting detectives. They must be prepared to accept the need to look beyond the records of the departmental authorities and should be willing to network with other organizations like the Central Vigilance Commission and the Central Bureau of Investigations that have been set up to track cases of corruption. A further suggestion is that the Central Vigilance Commission and the Central Bureau of Investigations should be directed to state in their respective annual reports to the Parliament the action taken by them on the audit points that have a vigilance angle.

### **Supplementary Audit of Government Companies**

60. *CAG's audit of Government companies has attracted considerable discussion.*

61. CAG's performance appraisals serve a very useful purpose and should continue. It has however been suggested that the CAG should be guided by the golden rule prescribed by the Parliament for the Committee on Public Undertakings, namely, to review the working of these entities in the context of their autonomy and efficiency and evaluate whether they are operating on prudent business principles and prudent commercial practices.

62. As regards propriety and transaction audit, both the positive and negative aspects need to be covered and there should be appreciation that all decisions cannot be perfect and due consideration should be given to all decisions that are judgmental.

63. The opinion is divided on the CAG's supplementary or test audit of their accounts. On the one hand it has been argued that the private statutory auditors are incapable of doing justice to the public accountability of these entities because of their approach, orientation and position. The comments of the CAG do bring out serious omissions, violation of the accounting standards, under/overstatement of profit etc. and these are featured, taken note of and discussed in the Journal of the Institute of the Chartered Accountants of India. On the other hand it has been observed that the CAG's supplementary audit places these entities in a disadvantageous position vis-à-vis their private sector counterparts. The need for revisiting the present arrangement has also been suggested in the context of the changes in the business environment with several Government companies being listed on the bourses, the SEBI listing requirements, mandatory internal audit, constitution of audit committees etc.

64. According to a suggested compromise formulation, if there is willingness on the part of the Government to give meaningful autonomy to even a few selected companies, it

might be possible to get the CAG's support for a flexible support for super-imposed audit.

## **Perceptions about Audit**

*65. There are varying perceptions about the CAG's audit.*

- The CAG focuses more on financial irregularities and less on outputs and outcomes.
- The accountability aspect remains relatively weak despite an elaborate system of finding faults and irregularities.
- The performance appraisals fall short of management audit and do not indicate how management can be strengthened.
- Physical inspection is rarely undertaken.
- The system is not fully equipped to meet with the requirements of meaningful audit of activities/programmes of public expenditure in the newly emerging areas of science like nuclear energy, biotechnology etc, because of the complexities and technicalities involved.
- Audit focuses on negative aspects and does not give adequate credit for positive achievements.
- The audit reports need to be more timely to be of use to the executive.
- The excessive secrecy observed in audit procedures has made the working of the institution a black box and to that extent repugnant to the executive departments.
- The CAG's comments on the accounts of Government companies could damage their over-all image.
- The system of stringent and repetitive audit of Government companies has created an unhealthy degree of defensiveness on the part of the managers that discourages swift decision-making.
- The 'audit paragraph' approach in the audit of Government companies and corporations that consists of micro audit of isolated transactions tends to undermine the confidence and initiative of the executive and promotes evasion of responsibility. The public sector would be greatly benefited if the CAG evaluates their performance in over all terms through inter-firm, intra-firm and inter-time comparisons.
- The auditors have failed to put before the public the work they do in a language easily comprehensible by the latter nor have they made any positive effort to tell the public about their activities.
- There is need for a more positive public relations approach on the part of audit that will help establish identity of purpose between the Supreme Audit Institution and the people at large in securing effective utilization of resources.
- While the lack of adequate follow up action is a cause for concern, there is need for creation of a comprehensive mechanism within the CAG's organization for the purpose. The remedy for the indifferent approach of the executive towards

audit does not lie in the accumulation of legal powers in the hands of the authorities that have not used their existing powers as well as they should have.

66. A survey of the auditees' perception at the highest level of the bureaucracy done in 2000 brought out that the executive officers are not indifferent to audit, the impact of audit is positive, the appraisals are very useful, audit objections are seldom frivolous, though sometimes these are uninformed, audit is necessary and the consequences of its abolition would be very serious. The respondents also expressed the view that in system appraisals audit does not give due credit for good performance and wanted audit reports to be timelier to be of use.

## **Conclusion**

67. India has a robust constitutionally guaranteed independent public audit set up backed by strong systems that have responded to the changing requirements and rising stakeholder expectations.

68. A 2003 report prepared by the National Audit Office of the United Kingdom had observed that there was no question that the organization had made serious contribution to better governance in the country through its audit work. The system is not having adequate impact mainly because of insufficient follow up action.

69. An Advisory Group on Fiscal Transparency of the Reserve Bank of India benchmarked the public financial management and accountability system in India against the IMF Code on Good Practices and Fiscal Transparency. In its report (May 2001) the Advisory Group observed that the requirement that a national audit organization, which is independent of the executive, should provide timely reports on the financial integrity of the Government for the legislators is fully met in India.

70. A World Bank assessment awarded a rating of 7 on a scale of 10 to the external audit system in India in 2000.

## **Chapter 12**

### **LEGISLATIVE SCRUTINY**

#### **Legal and Institutional Framework**

1. The system of ex post legislative oversight of public financial management is prescribed in the Constitution of India and the Rules framed thereunder.
2. Under Article 151 of the Constitution the Audit Reports of the CAG on the accounts of the Union shall be submitted to the President who shall cause them to be laid before each House of the Parliament. Any amount spent on any service during a financial year in excess of the amount of the original grant requires regularization by Parliament as per the requirement of Article 115 of the Constitution.
3. Under the Comptroller and Auditor General's (Duties, Powers and Conditions of Service) Act, 1971, the Audit Reports of the CAG in relation to the accounts of Government Companies and Corporations shall be submitted to the Central Government; and the Central Government shall cause every such report to be laid before each House of the Parliament.
4. In terms of Article 118 of the Constitution, each House of the Parliament may make rules for regulating its procedure and conduct of business subject to the provisions of the Constitution.
5. The Lok Sabha has framed Rules of Procedure and Conduct of Business in Lok Sabha. These Rules provide for the establishment of the Public Accounts Committees (PAC) and the Committee on Public Undertakings (COPU) to which the Audit Reports of the CAG stand automatically remitted for follow up action. The Directives of the Lok Sabha Speaker issued from time to time supplement these Rules. A separate committee monitors the timely presentation of reports and papers to the Parliament.

#### **The PAC and the COPU**

6. The PAC and the COPU consist of 22 members each: 15 from the Lok Sabha and 7 from the Rajya Sabha representing broadly the composition of each House and have a term of one year. A Minister cannot be a member of either of the Committees. The Chairman of the PAC is from the Opposition. Both the Committees are assisted by the CAG in the examination of his Audit Reports.
7. The PAC examines the Audit Reports of the CAG on the accounts of the Union Government. It also examines cases of excess expenditure beyond the legislatively

authorized amount of grant and makes suitable recommendations before the excess amount can be regularized by the Parliament.

8. The COPU examines the accounts and the reports of the public sector undertakings, and the reports of the CAG, if any, on these undertakings. It also examines, in the context of economy and efficiency of these undertakings, whether the affairs of these undertakings are being managed in accordance with sound business principles and prudent commercial practices.

9. A Committee may appoint one or more sub-Committees, each having the powers of the undivided Committee, to examine any matters that may be referred to them, and the reports of the sub-Committee(s) shall be deemed to be the reports of the whole Committee, if they are approved at the sitting of the whole Committee.

## **Systems and procedures**

10. Systems and procedures are in place regarding access to records, taking of evidence, presentation of reports, follow up action on the Committees' Reports and the follow up action on such of the paragraphs of the CAG's Audit Reports as the Committees do not take up for detailed examination.

11. *Self Explanatory Notes:* The Ministries and Departments are required to send suo moto self-explanatory notes to the Committees within a period of four months of presentation of the CAG's Audit Reports duly vetted by the CAG's organization.

12. *Access to records:* The Committees are empowered to issue questionnaires and to call for records, documents and information as may be considered necessary for the performance of their functions. A document may not be supplied to a committee on the ground that its disclosure would be prejudicial to the safety or interest of the State; a plea to this effect has to be entered only by the Minister himself. In other cases secret documents are made available confidentially to the Committee Chairman in the first instance and the latter gives due consideration to the wishes of the Ministry before making any such document available to the members of the Committee. Any difference of opinion in this regard is settled by reference to the Speaker of the Lok Sabha.

13. *Oral Evidence:* The Committees are authorized to summon officials for their oral evidence. Normally the Secretary of the Ministry is required to appear before the Committee; if for any reason such an officer is not able to appear before the Committee, the Chairman may on request permit any other officer to appear before the Committee on that particular occasion.

14. If an officer of a State Government is required to be examined by the Committee or if a paper, document or record of a State Government is required to be produced before the Committee, the orders of the Speaker are necessary.

15. The failure of a witness to appear before the Committee to appear before the Committee amounts to contempt of the House and the Committee may report accordingly to the House.

16. A verbatim record of the proceedings is kept, including the oral evidence of the witnesses.

17. *Evidence of the Minister:* A Minister is not called to appear before the Committee. When a Minister specifically makes a request to appear before the Committee, he may be permitted only if the Chairman considers it desirable after the Chairman has had a talk with the Minister.

18. *Evidence of the representatives of private companies:* When the Committee takes up examination of an agreement entered into by Government or the public sector undertaking with a private company or any other non-Government body, the Committee may summon or give an opportunity to the representatives of the latter to appear before the Committee for evidence.

19. *Proceedings of the Committees:* The proceedings of the Committees are not open to the press and the public. The verbatim record of the Committees' sittings is ordinarily treated as confidential. The Committees may, however, issue press notes of their sittings.

20. *Reports of the Committees:* The Committee's Chairman presents its report to the Parliament, whereafter it becomes a public document. The reports are ordinarily unanimous, representing the non-partisan approach of the Committees.

21. The reports are generally not discussed in the House.

22. *Follow up Action on the Committees' Reports:* The Ministries and Departments are required to furnish Action Taken Notes on the reports of the Committees within a period of six months duly vetted by the CAG's organization. The Committees may also present Action Taken Reports in the light of the replies received from the Ministries and the Departments.

23. *Paragraphs not selected for detailed examination:* The Ministries and Departments are required to furnish *suo moto* Explanatory Notes on the paragraphs not selected for detailed examination within a period of four months from the presentation of the Audit Reports. These Notes are sent to the CAG's organization for categorization as (a) Accepted; (b) Partially Accepted; and (c) Not Accepted and thereafter circulated to the members of the Committee for deciding further course of action.

### **Inherent Strengths**

24. The position stated in the preceding paragraph captures the inherent strengths of legislature's ex post oversight over public financial management.

- Legislative oversight of public financial management derives its authority from the Constitution.
- The Committees represent the Parliament in miniature.
- The Committees function by and large in a non-partisan manner.
- The Committees have the benefit of the assistance provided by the CAG's organization in the examination of the Audit Reports.
- The Committees possess adequate powers to summon witnesses at the highest level of bureaucracy.
- The Committees have the right to call for documents, information and records for the performance of their functions.
- The reports of the Committees are generally unanimous and carry the moral authority of the House.
- The reports of the Committees are in the public domain after presentation in the Parliament. A press release is issued after the Committee presents its report.
- The reports are available for sale as priced documents and are also placed on the website.
- Systems are in place for monitoring the action taken on the recommendations of the Committees.
- The rate of implementation of the recommendations of the Committees has been quite satisfactory. Nearly 61 per cent of 6112 recommendations made by the PAC during 1980-1999 were implemented. Many more recommendations are implemented by Government following the presentation of the Action Taken Report if reiterated by the PAC.
- Although the PAC does not, ordinarily, venture into questions of policy, its recommendations have been used as input into policy formulation/revision. Several amendments have been made to the tax laws in consequence of the recommendations of the PAC.

25. Nevertheless some issues have been raised.

## **Delays in examination of Audit Reports**

26. The time lag between occurrence of a transaction, its reporting in audit its coming up before the PAC has contributed to the erosion of the effectiveness of the PAC. The Eleventh Finance Commission has recommended that Government should lay down a maximum time limit within which the PAC scrutinizes the reports of the CAG.

27. The National Commission to Review the Working of the Constitution (2002) has suggested a time frame of 12-18 months for the examination of the Audit Reports.

### **Large number of paragraphs not selected for detailed examination**

28. According to the information given in the CAG's Annual Activity Report for the year 2003-2004 the PAC and the COPU listed only 105 out of 1413 paragraphs of the CAG's

Audit Reports for discussion and actually discussed 11 paragraphs. Since the Committees do not consider a very large number of paragraphs, the executive also tends to be casual in its response. The procedure of submission of *suo moto* Action Notes has not been found to be very effective since the PAC seldom discusses these notes.

### **Inadequate response to the Committees' recommendations**

29. According to the Activity report *ibid*, Government departments had not furnished Action Taken Notes on 1321 paragraphs.

30. It has been suggested that the Finance Minister should be called upon to place monthly statements on the Table of the House regarding the status of implementation of the Committees' recommendations and explain the reasons for delay.

### **Reports not discussed in the House**

31. Since the Reports of the Committees are not usually discussed on the floor of the House, some very useful recommendations may remain unimplemented. It has been suggested that once every year the Parliament should go into a Committee of the whole House and discuss in camera or in public such of the points as are placed on the agenda by the Speaker in consultation with the PAC/COPU Chairman.

## **Enforcement and implementation of the Committees' recommendations**

32. The recommendations of the Committees for fastening individual responsibility are generally not being implemented faithfully. It has almost become tendentious on part of the bureaucracy to defend even the blatant acts of omission and commission on one ground or the other. If the power to punish the officials under question were made external to the department, it would act as a great deterrent.

33. The Committees do not focus on individual officers but mainly on systems; this coupled with the rather diffused decision-making system allows the erring, negligent, inefficient and corrupt officials to escape unpunished.

34. The Committees do not have the executive powers to compel compliance with their recommendations. The regular recurrence and never-changing pattern of official default brought to light year after year does suggest that the value of the Committees' recommendations is limited.

35. It has been suggested that if there is any difficulty in implementing a recommendation made by the Committee and reiterated, the matter should be placed before the Cabinet and its decision communicated to the Committee. Another suggestion is that if the executive does not accept the Committees' recommendations, the matter should be discussed in the whole House, but without the matter being put to vote.

## **Evidence of the Minister**

36. In view of the increasing interest being taken by the Ministers in executive matters, as distinguished from policy matters, there should be no objection to the appearance of the Minister before the PAC, when the PAC examines any matter in which the decision was taken at the level of the Minister. There should also be no bar on the PAC making appropriate comments on the role of the Minister in such cases.

## **Proceedings not open to the press and the public**

37. The main arguments in favour of opening the proceedings of the PAC to the press and the public are that this will ensure greater transparency and that would put indirect pressure on Audit, Government and the PAC to do a better job.

38. The flip side is that this might introduce political overtones into the working of the PAC undermining the non-partisan and apolitical approach that has characterized the working of the PAC. This might inhibit the departmental officers from expressing their views freely and frankly. Finally, it has been argued that subjective reporting and pre-publicity to the conclusions of findings of the PAC might cause damage to the objectivity of the PAC.

39. It has also been suggested that evidence recorded by the PAC should be made public.

## **Lack of continuity**

40. The members of the Committees have a limited tenure of one year and the lack of continuity stands in the way of development of expertise.

41. It has been suggested that the various political parties should return their members to the Committees at least for two consecutive terms.

## **Performance of the COPU**

42. It has been observed that the COPU also performs some of the functions of the Estimates Committee and this has diminished its performance. It has also been observed that since the COPU also takes up PSU's that have not been the subject matter of CAG's Audit Reports, it is not able to do justice to the CAG's Audit Reports. The absence of assistance of the CAG's organization in such cases also affects its performance.

43. A contrary view is that the COPU should reduce its dependence on the CAG's Reports so long as these continue with a fault-finding and weakness- targeting approach.

## Conclusion

44. Legislative oversight of public financial management derives its authority from the Constitution and is backed by sound systems and procedures in place. The PAC and the COPU are faced with the ever-increasing volume of work. It has been suggested that the sub\_Committees, preferably organized Ministry-wise, could be empowered to conclusively deal with the subjects referred to them and allowed to record the evidence of the executive. Another suggestion is to have a separate Committee to follow up on the Receipt Audit Reports of the CAG. A suggestion has also been made for the integration of the functions of the PAC with those of the Departmentally-Related Standing Committees, or at least sharing some of the work of the PAC with some of the other Committees of the legislature.

45. The main disability is however the lack of adequate response the Committees' recommendations. In the words of the former Prime Minister Rajiv Gandhi "the PAC has been a failure; not that they have not done their job well ---- they cannot be accused of this---but they have not been able to take the result of their labour to its logical conclusion. Unless Parliament asserts itself and tells the Government to mend its ways in the light of the suggestions and proposals from the expert panels, the Estimates Committees and the PAC will be reduced to the status of powerless bodies comprising back-benchers in the quest of minor perks of office."

# Chapter 13

## ACCESS/RIGHT TO FINANCIAL INFORMATION

### Legal and Institutional Framework

1. Article 19(1) of the Constitution of India guarantees to all citizens the right to freedom to speech and expression as a fundamental right subject to the restrictions specified in sub-Articles (2) to (6) thereof. According to the Honourable Supreme Court of India, this includes the right to acquire information and to disseminate it. If the people are to perform their role as sovereign and instruct their Government, they must have access to all information, ideas and points of view.

2. India is a signatory to the UN Declaration of Human Rights, 1948. Article 19 of the Declaration proclaims that every one has the right to freedom of opinion; this includes freedom to hold opinions without interference and to seek, receive, and impart information and ideas through any media regardless of frontiers.

3. The Official Secrets Act, 1923, makes it a penal offence for any person holding office under the Government willfully to communicate any official information to any person other than a person to whom he is authorized to communicate it. It is equally an offence for any person to receive such information. The retention of any official document after a person has ceased to have a right to retain it, or when it is contrary to his duty to retain it, is also a penal offence.

4. In terms of Rule 11 of the Central Civil Services (Conduct) Rules, 1965, no Government servant shall, except in accordance with any general or special order of the Government or in the performance in good faith of the duties assigned to him, communicate, directly or indirectly, any official document or any part thereof, or information to any Government servant or to any other person to whom he is not authorized to communicate such document or information.

5. An analogous Rule exists in the All India Services (Conduct) Rules, 1968 that are applicable to the members of the All-India Services, namely the Indian Administrative Service, the Indian Police Service and the Indian Forest Service.

### Right to Information

6. The Right to Information Act, 2005, seeks to provide for setting out the practical regime of right of information for

people to secure access to information under the control of public authorities, in order to promote transparency and accountability in the working of every public authority. The scope of the Act also extends to any body, owned, controlled, or substantially financed and any non-Government organization substantially financed directly or indirectly by funds provided by Government.

7. The Act envisages wide-ranging suo moto disclosures of information like the procedure followed in decision-making process including the channels of supervision and accountability, the manner of execution of subsidy programmes, including the amounts allocated and the details of beneficiaries of such programmes, particulars of recipients of concessions, permits or authorizations etc. The Act also makes it obligatory to publish all relevant facts while formulating important policies or announcing the decisions that affect the public.

8. The Act envisages several pro-active measures for facilitating and promoting access to information and prescribes a maximum time limit of 30 days for providing information, with penalties for willful denial of or delay in supply of information and creation of independent high-powered appellate bodies (called Information Commissions) for appeal if the information is delayed or denied. In any appellate proceedings the onus to prove that a denial of information was justified shall be on the authority that denied the information. The decision of the Information Commissions is binding.

9. The Leader of Opposition in the Lok Sabha or the State Assembly is one of the members of the selection committee for making recommendations for appointment to the Information Commission. The members of the Commissions enjoy security of tenure and the Act prescribes stringent procedures for their removal. The Commissions have been vested with the powers of a civil court.

10. The Act also specifies the categories of information that may not be disclosed; but any information that cannot be denied to the Parliament or a State legislature shall not be denied to any person. Also, a public authority may allow access to information, if public interest in disclosure outweighs the harm to the protected interests. The principle of severance has also been incorporated in the Act. The Act provides safeguards for protection of information relating to the third parties. The provisions of the Act shall have effect notwithstanding anything inconsistent therewith contained in laws like the Official Secrets Act, 1923.

11. The Act applies to all States in India.

## **Budgetary Transparency**

12. Under the Constitution, the Annual Budget must be presented to both Houses of Parliament. The Budget is thus a public document. The Fiscal Responsibility and Budget Management Act, 2003 and the Rules framed thereunder have prescribed certain mandatory disclosures that promote transparency. According to the Act, Government shall take suitable measures to ensure greater transparency in the fiscal operations in the public interest and minimize as far as practicable secrecy in the preparation of annual financial statement (budget) and the demands for grants. Government is mandated under the Act to present the medium term fiscal statement, the fiscal policy strategy statement and the macro-economic policy framework with the budget.

13. The Fiscal Responsibility and Budget Management Rules, 2004, prescribe the forms and the contents of the medium term fiscal policy statement, the fiscal policy strategy statement and macro-economic policy framework mandated under the Act. The Rules also stipulate that, not later than the budget for 2006-2007, the Central Government shall make disclosure of the following with the annual budget:

- (a) Any significant changes in the accounting standards, policies and practices affecting or likely to affect the computation of the prescribed fiscal indicators;
- (b) Statements of receivables and guarantees; and
- (c) A statement of assets both physical and financial.

## **Government Financial Reports**

14. Government of India places the in- year monthly financial reports on website that comply with the IMF requirements of Special Data Dissemination Standards both in their content and timeliness. Government's annual financial reports (Government Accounts) are laid before both Houses of Parliament and are public documents.

## **Audit Reports**

15. Under the Constitution the President causes the Reports of the Comptroller and Auditor General of India to be laid before both Houses of Parliament. The Reports are therefore public documents.

16. The Reports of the Public Accounts Committee and the Committee on Public Undertakings that follow up on the CAG's Audit Reports are also required to be presented to the Parliament, whereafter these are available in the public domain.

### **Inherent Strengths**

17. The system has several strong points:

- The Right to Information is guaranteed as a fundamental right in the Constitution of India.
- The Right to Information Act, 2005, is a landmark piece of legislation that seeks to provide for setting out the practical regime of right of information for people to secure access to information under the control of public authorities, in order to promote transparency and accountability in the working of every public authority.
- The Act envisages wide-ranging suo moto disclosures of information as well as proactive measures for promoting and facilitating right/access to information.
- Although the Right to Information Act lists certain categories of information that may not be disclosed, any information that cannot be denied to the Parliament or a State legislature shall not be denied to any person. Also, a public authority may allow access to information, if public interest in disclosure outweighs the harm to the protected interests.
- The principle of severance has been incorporated in the Act.
- The Act prescribes a maximum time limit of 30 days for providing information, with penalties for willful denial of or delay in supply of information and right of appeal to high-level statutory authorities called the Information Commissioners.
- The Leader of Opposition in the Lok Sabha or the State Assembly is one of the members of the selection committee for making recommendations for appointment to the Information Commissions. The members of the Commissions enjoy security of tenure and the Act prescribes stringent procedures for their removal. The Commissions have been vested with the powers of a civil court.
- Government of India's budget, Government Accounts, CAG's Audit Reports and the Parliamentary Committees' follow up reports thereon are public documents.
- According to a 2001 assessment report of the International Monetary Fund, India has achieved a reasonably high level of fiscal transparency, especially as regards the amount of fiscal information that is made available to the public. Particularly noteworthy is the detailed information that is made available in connection with the budget. A large amount of fiscal information is also made available through the annual reports of the Ministries, the reports of the Reserve Bank of India and the reports of the Comptroller and Auditor General of India.

### **Opportunities for improvement**

18. Opportunities for improvement exist in the following:

- The hearings of the Parliamentary committees that examine the Budgetary Demands for Grants and follow up on the CAG's Audit Reports are not open to public.
- The budget or the budget-related documents should include a detailed commentary on each revenue and expenditure programme; non-financial performance data, including performance targets should be incorporated;
- The budget should include medium term perspective; the current year budget proposals should reconcile with the forecasts contained in the earlier fiscal statements and significant deviations should be explained;
- Earmarked revenue and user charges should be clearly accounted for separately even where a particular incentive system provides for retention of some or part of the receipts by the collecting agencies;
- The estimated cost of key tax expenditures should be disclosed;
- Borrowings should be classified by maturity profile of the debts as also whether the debt carries fixed or variable rate of interest and whether it is callable;
- Loans advanced to other entities should be listed by major categories, reflecting the nature and historical information of defaults should be disclosed;
- Accounting policies and any significant changes therein should be disclosed.
- Apprehensions have been expressed that Section 8(i)(a) of the Right to Information Act, 2005, which exempts information whose disclosure may prejudicially affect the sovereignty and integrity of India, the security, strategic scientific or economic interests etc; might be misused to block the supply of information.
- The Right to Information Act, 2005, does not provide any remedy for the failure to discharge the obligations relating to suo moto disclosures; the obligation cast under the Act on the Central Government for propagating the provisions of the Act has been hedged with considerations like the availability of resources.
- The exclusion of the Chief Justice of India from the selection committee for appointment of Information Commissioners, as originally provided in the draft bill, has made the selection process somewhat more partisan.
- The Right to Information Act, 2005, provides third parties the right to appeal against the requests for information. By allowing Government agencies to be categorized as the third parties, the law provides scope for collusion between an erring official and the Government bodies to block supply of information.

## **Conclusion**

19. The high level of fiscal transparency already achieved by Government and recognized as such by independent assessments has been considerably enhanced with the enactment of the Fiscal Responsibility and Budget Management Act, 2003, and the implementation of the Rules framed thereunder. Additional disclosures like the amounts of tax expenditure, debt profile and medium term perspective would be in line with the best practices. As regards the hearings of the Parliamentary committees, a beginning could be made by publishing verbatim record of the proceedings after the Committees have presented their reports.

20. The Right to Information Act, 2005, is a landmark piece of legislation that has the potential of a force multiplier for enhancing accountability. As governments and people begin to operate in this new era of transparency, it is inevitable that the culture within and outside the government will change. Within the government, the realization will sink in that in a true participatory democracy the government is constantly, and not just once in five years, answerable to the people, and not merely for its achievements and failures, but for each specific action and process. Among the public, it would create a new sense of empowerment and also a sense of responsibility that, along with the right to participate in governance, they also now have an obligation to do so.

21. The Government will have to ensure that its own information systems are in order so that the officials can comply with the requirements of the law. Also, there will have to be a change in the mindset of Government officials; they will have to learn with the new reality that Government has no longer the discretionary power over information. And most importantly they will have to operate on the assumption that they will be held accountable.

**PART TWO**

**ANNOTATED BIBLIOGRAPHY**

# Chapter 14

## BUDGET PLANNING, PREPARATION & APPROVAL

### The Constitution of India

1. The Constitution of India is the basic document that lays down the procedure for the presentation of the budget to the Parliament and its approval. Articles 112 thru 116 deal exclusively with financial matters to be dealt with by the Parliament.

2. The President shall cause to be laid before both the houses of Parliament a statement of receipts and expenditure of the Government of India in respect of every financial year. This is referred to as Annual Financial Statement. This statement along with other supplementary documents is called the Union Budget which is generally presented on the last day of February, *i.e.*, one month before the beginning of financial year, which runs from 1<sup>st</sup> April to 31st March. It also stipulates that the Annual Financial Statement shall show the expenditure charged on the Consolidated Fund of India separately from other expenditure. Revenue expenditure has to be shown separately. The specific items of expenditure that shall be charged on the Consolidated Fund of India are clearly spelt out in the Constitution. The annual financial statement shows the major head-wise details of the actual expenditure or receipts for the previous year, the budget estimates and revised estimates for the ongoing year and the budget estimates for the budgeted year so as to facilitate comparison.

3. The expenditure that is charged upon the Consolidated Fund of India is not subject to the vote of the Parliament though the debate on the estimates relating to such expenditure is not precluded. Other expenditure estimates have to be submitted in the form of demands for grants, with the approval of the President, to the House of the People, who have the power to assent, or refuse to assent, to any demand, or assent to any demand subject to a reduction of the amount specified therein.

4. As soon as the Parliament passes the demands for grants, an Appropriation Bill is introduced to provide for the appropriation out of the Consolidated Fund of India of all moneys required to meet the grants made by the House of the People and expenditure charged on the Consolidated Fund of India. The amounts mentioned in the bills cannot be varied by the Parliament at this stage. No money can be withdrawn from the Consolidated Fund except as authorized in the Appropriation bill.

5. Regarding Supplementary, additional or excess grants the Constitution prescribes that The President shall—

(a) if the amount authorized by any law made in accordance with the provisions of article 114 to be expended for a particular service for the current financial year is found to be insufficient for the purposes of that year or when a need has arisen during the

current financial year for supplementary or additional expenditure upon some new service not contemplated in the annual financial statement for that year, or

(b) if any money has been spent on any service during a financial year in excess of the amount granted for that service and for that year,

cause to be laid before both the Houses of Parliament another statement showing the estimated amount of that expenditure or cause to be presented to the House of the People a demand for such excess, as the case may be.

6. There is an enabling provision for the House of People to make any grant in respect of estimated expenditure for a part of the financial year pending the completion of approval procedure. This is called the Vote on Account. Grants can also be made in advance without detailed demand for grants in cases where, on account of the magnitude or the indefinite character of the service the details cannot be stated at that time, as required. Exceptional grants can also be made if circumstances so warrant.

7. The Constitution provides for establishment of the Consolidated Fund of India, Contingency Fund of India and the Public Account.

### **Consolidated Fund of India**

8. Revenues received by Government, loans raised by it, and also its receipts from recoveries of loans granted by it, form the Consolidated Fund. No amount can be withdrawn from the Fund without authorization from Parliament.

### **Contingency Fund of India**

9. Contingency Fund of India Act, 1950 (49 of 1950) in pursuance of clause (1) of article 267 of the Constitution and the Rules framed thereunder prescribe the size and modalities of operation of the Contingency Fund of India.

10. Contingency Fund of India is in the nature of an imprest placed at the disposal of the President to enable him to make advances to meet urgent unforeseen expenditure, pending authorization by the Parliament. Approval of the legislature for such expenditure and for withdrawal of an equivalent amount from the Consolidated Fund is subsequently obtained, whereupon the advances from the Contingency Fund are recouped to the Fund

### **Public Account**

11. Certain other transactions enter Government accounts, in respect of which, Government acts more as a banker, for example, transactions relating to provident funds, small savings collections, other deposits, etc. The moneys thus received are kept in the Public Account and the connected disbursements are also made therefrom. Parliamentary authorization for payments from the Public Account is, therefore, not required.

### **Money Bills**

12. Constitution defines Money Bill as the one dealing with the imposition, abolition, remission, alteration or regulation of any tax or matters relating to borrowing, giving guarantees, the custody of Consolidated Fund or the Contingency Fund or the payment of any money or withdrawal from such funds, appropriation of money from Consolidated Fund, receipt of money into the Consolidated Fund of India and related matters.

13. Money shall not be introduced in the Council of States. Constitution gives a preeminent position to the House of the People in dealing with Money Bills. In case of differences between the two Houses, the decision of the House of the People will prevail.

### **Fiscal Responsibility and Budget Management Act 2003**

14. Fiscal Responsibility and Budget Management Act 2003 provides an institutional framework binding the government to follow a prudent fiscal policy. The Act casts responsibility on the Central Government to ensure inter-generational equity in fiscal management and long-term macroeconomic stability by achieving sufficient revenue surplus, removing fiscal impediments in the effective conduct of monetary policy and prudential debt management through limits on borrowings and deficits. The Act also introduces an element of transparency in budgetary matters by providing for mandatory submission of documents to the Parliament. Rules made under the Act have laid down specific targets to be achieved with time frames.

15. The salient features of the Act are:

- Central government to take appropriate measures to reduce fiscal and revenue deficit so as to eliminate revenue deficit by March 31 2008 (amended to March 2009) and build revenue surplus thereafter.
- Rules to be made under the Act to specify the annual targets of reduction of fiscal deficit and revenue deficit, contingent liabilities and total liabilities.
- The revenue deficit and fiscal deficit may exceed the targets specified in the rules only on grounds of national security or national calamity or such other exceptional grounds as the Centre may specify.
- The Central Government shall not borrow from the Reserve Bank of India except by way of advances to meet temporary excess of cash disbursements over cash receipts.
- Reserve Bank of India not to subscribe to the primary issues of the Central Government securities from the year 2006-07.
- Central Government to take suitable measures to ensure greater transparency in its fiscal operations.
- Central Government to lay in each financial year before both Houses of Parliament three statements viz., Medium Term Fiscal Policy Statement, Fiscal policy strategy Statement and Macroeconomic Framework Statement along with the Annual Financial Statement and Demands for Grants.
- Finance Minister to make a quarterly review of trends in receipts and expenditure in relation to the Budget and place the review before both Houses of Parliament.

- A statement under Section 7 to be presented giving the reasons, if the budget presented to the Parliament does not comply with the targets in the FRBM Act.

### **Fiscal Responsibility and Budget Management Rules, 2004**

16. Government of India notified these Rules in terms of Fiscal Responsibility and Management Act, 2003. The Rules lay down annual targets of revenue deficits, fiscal deficits, limit on guarantees, ceiling of 9 per cent on additional liabilities, including external debt (at current exchange rate) with the stipulation that the ceiling should come down by one percentage point each year. Fiscal indicators that need to be indicated in the Medium Term Policy Statement have also been given in the Rules. The Rules also lay down the disclosures relating to and the assumptions behind the budget figures. Periodicity of midterm reporting to the Parliament has been prescribed. The formats in which the statements have to be made have been laid out in the Rules. Specifically,

- Reduction of revenue deficit by an amount equivalent of 0.5 per cent or more of the GDP at the end of each financial year, beginning with 2004-05.
- Reduction of fiscal deficit by an amount equivalent of 0.3 per cent or more of the GDP at the end of each financial year, beginning with 2004-05.
- No assumption of additional liabilities (including external debt at current exchange rate) in excess of 9 per cent of GDP for the financial year 2004-05 and progressive reduction of this limit by at least one percentage point of GDP in each subsequent year.
- No guarantees in excess of 0.5 per cent of GDP in any financial year, beginning with 2004-05.
- Specifies four fiscal indicators to be projected in the medium term fiscal policy statement. These are revenue deficit as a percentage of GDP, fiscal deficit as a percentage of GDP, tax revenue as percentage of GDP and total outstanding liabilities as percentage of GDP.
- For greater transparency in the budgetary process, rules mandate the Central Government to disclose changes, if any, in accounting standards, policies and practices that have a bearing on the fiscal indicators. The Government is also mandated to submit statements of receivables and guarantees and a statement of assets, at the time of presenting the annual financial statement, latest by Budget 2006-07.
- The rules prescribe the form for the quarterly review of the trends of receipts and expenditures.

17. The rules mandate the Central Government to take appropriate corrective action in case of revenue and fiscal deficits exceeding 45 per cent of the budget estimates, or total non-debt receipts falling short of 40 per cent of the budget estimates at the end of first half of the financial year.

### **Government of India, Ministry of Finance, General Financial Rules 1963**

18. Ministry of Finance by virtue of authority vested with it by the Transaction of Business Rules has prescribed General Financial Rules (GFR) which govern all financial transactions of the government. Among other financial rules and regulations, GFR has laid down the procedures and process of preparing the budget and its implementation.

#### **Annual Circular from Department of Economic Affairs, Ministry of Finance**

19. Ministry of Finance issues an annual circular to all the administrative Ministries and departments of Government of India detailing the instructions for the preparation of their budgets of the respective departments. It contains instructions for receipts as well as expenditure. Principles to be followed for preparing the budget estimates are indicated. Departments are asked to prioritize the expenditure cutting out waste and merge programs where called for by adopting Zero Base Budgeting techniques. Precise timeframes have been indicated for sending the various documents to the Ministry of Finance (for the year 2005-06 budget to be presented in February 2005, the initial set of estimates were to be sent to Ministry of Finance by the 25<sup>th</sup> October 2004).

20. The documents submitted by the departments form the basis for discussion between the administrative Ministries and departments and the Ministry of Finance to arrive at the final figures.

#### **Annual circular from Planning Commission**

21. Planning commission issues an annual circular to all the central Ministries/ Departments inviting proposals of expenditure on the plan account during the ensuing financial year. Guidelines are given indicating the priorities for the year and the likely ceiling. The proposals would be considered in Planning Commission in consultation with the concerned departments to arrive at the plan expenditure for the year.

#### **Government of India, Ministry of Finance - Circular on Zero Base Budget, 1986**

22. This was the initial circular on Zero Base Budgeting (ZBB) introducing the concept of ZBB in the departments of Government of India. It gives the rationale behind ZBB and details the procedure to be adopted while preparing the budget for the year 1987-88 onwards.

#### **The Budget Documents**

23. The following documents are tabled in Parliament along with the Budget speech of the Finance Minister.

24. **Budget speech** of the Finance Minister gives the policy thrust of the budget. It also indicates the major fiscal initiatives/tax reforms to be undertaken in the next financial year. It is as much a political statement as a financial one.

25. **Key to Budget** gives brief sketches of the documents submitted along with the Annual Financial Statement. Collectively these documents are called the budget documents.

26. **Annual Financial Statement** consists of Revenue Budget and Capital Budget of Consolidated Fund of India, Contingency Fund transactions and receipts and disbursements out of Public Account, receipts and expenditure of Union Territories without Legislature (five). Amounts charged on the Consolidated Fund of India are shown separately.

27. In budget terminology, **Revenue** and **Capital** are the two most important concepts. **Revenue** refers to the revenue receipts of Government (tax and other revenues) and the expenditure met from these revenues. Tax revenues comprise proceeds of taxes and other duties levied by the Union. Other receipts of Government mainly consist of interest and dividend on investments made by Government, fees, and other receipts for services rendered by Government.

28. Revenue expenditure is for the normal running of Government departments and various services, interest charges on debt incurred by Government, subsidies, etc. Broadly speaking, expenditure which does not result in creation of assets is treated as revenue expenditure.

29. **Capital** refers to capital receipts and payments. The main items of capital receipts are loans raised by Government from public which are called Market Loans, borrowings by Government from Reserve Bank and other parties through sale of Treasury Bills, loans received from foreign governments and bodies, and recoveries of loans granted by Central Government to States and Union territory Governments and other parties.

30. Capital payments consist of capital expenditure on acquisition of assets like land, buildings, machinery, equipment, as also investments in shares, etc., and loans and advances granted by Central Government to State and Union territory Governments, Government companies, Corporations and other parties.

### **Budget at a Glance**

31. The document Budget at a Glance shows in brief receipts and disbursements along with broad details of tax revenues and other receipts. This document also exhibits broad break-up of expenditure-Plan and Non-Plan allocation of Plan outlays by sectors as well as by Ministries/Departments and details of resources transferred by the Central Government to State and Union Territory Governments.

32. This document also shows the revenue deficit, the gross primary deficit and the gross fiscal deficit of the Central Government.

### **Finance Bill**

33. A Finance Bill is also presented in fulfillment of the requirement of Article 110(1) (a) of the Constitution, detailing the imposition, abolition, remission, alteration or regulation of taxes proposed in the Budget. A Finance Bill is a Money Bill as defined in Article 110 of the Constitution. It is accompanied by a Memorandum explaining the provisions included in it.

### **Memorandum explaining the provisions in the Finance Bill**

34. To facilitate understanding of the taxation proposals contained in the Finance Bill, the provisions and their implications are explained in the document titled Memorandum explaining the provisions of the Finance Bill.

### **Other documents**

35. The Budget documents presented in terms of the Constitution have to fulfill certain legal and procedural requirements and hence may not by themselves give a clear indication of the major features of the Budget. To facilitate an easy comprehension of the Budget, certain explanatory documents are presented along with the Budget.

### **Receipts Budget**

36. Estimates of receipts included in the “Annual Financial Statement” are further analyzed in the document “Receipts Budget”. The document gives details of revenue receipts and capital receipts and explains the estimates. Trend of receipts over the years and details of External Assistance received are also included. This also gives lot of other useful details, like statement of outstanding liabilities, capital investments and loans and trends in expenditure.

### **Expenditure Budget Vol. 1**

37. Expenditure Budget Vol. 1 deals with revenue and capital disbursements of various Ministries/Departments and gives the estimates in respect of each under ‘Plan’ and ‘Non-Plan’. This also gives analysis of various types of expenditure and broad reasons for the variations in estimates.

38. Guarantees given by Central Government and outstandings as at the end of March, and contributions to International Bodies are shown, in a separate annexure.

### **Expenditure Budget Vol. 2**

39. The provisions made for a scheme or a program may spread over a number of major heads in the Revenue and Capital sections in a Demand for Grants. In the Expenditure Budget Vol. 2, the estimates made for a scheme/program are brought together and shown on a net basis at one place, by major heads.

40. **Customs and Excise** - This gives the Notifications in respect of the new levies imposed/levies reduced/dropped in respect of customs and excise duties.

41. **Implementation of Budget Announcements** - This is a statement tabled by Finance Minister indicating the action taken on the promises made in the previous budget.

42. **The Macro Economic Framework Statement** - The Macro-economic Framework Statement, mandated by the FRBM Act, contains an assessment of the growth prospects of the economy with specific underlying assumptions. It contains assessment regarding the GDP growth rate, fiscal balance of the Central Government and the external sector balance of the economy.

### **The Medium Term Fiscal Policy Statement**

43. The Medium-term Fiscal Policy Statement, as enjoined by the FRBM Act sets forth a three-year rolling target for specific fiscal indicators along with underlying assumptions. The statement includes an assessment of sustainability relating to balance between revenue receipts and revenue expenditure and the use of capital receipts including market borrowings for generation of productive assets.

### **The Fiscal Policy Strategy Statement**

44. The Fiscal Policy Strategy Statement, as per the FRBM Act, contains the policies of the Central Government for the ensuing financial year relating to taxation, expenditure, lending and investments, administered pricing, borrowings and guarantees. It outlines the strategic priorities of the Government in the fiscal area, how the current policies are in conformity with sound fiscal management principles and rationale for any major deviation in key fiscal measures.

### **Accounting Classification**

45. The estimates of receipts and disbursements in the Annual Financial Statement and of expenditure in the Demands for Grants are shown according to the accounting classification prescribed under Article 150 of the Constitution. This classification is intended to allow the Parliament and the public to make a meaningful appreciation of allocation of resources and purposes of Government expenditure.

### **Demands for Grants**

46. The estimates of expenditure from the Consolidated Fund included in the Annual Financial Statement and required to be voted by the Lok Sabha are submitted in the form of Demands for Grants in pursuance of Article 113 of the Constitution. 'Voted' and 'charged' provisions are shown separately in that Demand. The break up of the expenditure under each major head between 'Plan' and 'Non-Plan' is also given. Generally, one Demand for Grants is presented for each Ministry/Department, but more than one Demand may be presented for certain large Ministries or Departments. If the

House of the People reduces, even by a token amount, in any of the Demands, then it is deemed to be the defeat of the government on the floor of the House.

### **Detailed Demands for Grants**

47. The Demands for Grants are followed by the Detailed Demands for Grants laid on the table of the Lok Sabha some time after the presentation of the Budget, but before the discussion on Demands for Grants commences. These Detailed Demands for Grants show further details of the provisions included in the Demands for Grants as also of actual expenditure during the previous year. A break up of the estimates relating to each program/organization, wherever the amount involved is not less than Rs.10 lakhs, is given under a number of object heads which indicate the categories and nature of expenditure incurred on that program, like salaries, wages, travel expenses, material and equipment, grants in-aid, etc. At the end of these Detailed Demands are shown the details of recoveries taken in reduction of expenditure in the accounts.

### **Performance Budget**

48. Performance Budgets are prepared and presented to Parliament by all Ministries/ Departments dealing with developmental activities. The Performance Budget presents the budget of the Ministry/Department in terms of functions, programs and activities and gives appraisal reports separately in respect of major central sector projects/programs estimated to cost Rs.1000 million or more. It also includes a statement on the programs and performance of the various public sector undertakings under the Ministry/ Department indicating, among other things, the capacity installed and utilized, physical targets and achievements, results of operation, return on capital etc.

### **Commercial Departments**

49. Railways is the principal departmentally-run commercial undertaking of the Government. The Budget of the Railways and the Demands for Grants relating to Railway expenditure are presented to Parliament separately. The total receipts and expenditure of the Railways are incorporated in the Annual Financial Statement of the Government of India.

50. The receipts and expenditure of the Defense services shown in the Annual Financial Statement are explained in greater detail in the document Defense Services Estimates presented along with the Detailed Demands for Grants of the Ministry of Defense. Secretarial expenditure pertaining to Ministry of Defense and defense pensions are included in a separate demand called civil estimates of Ministry of Defense.

### **Annual Reports of the Ministries**

51. A descriptive account of the activities of each Ministry/Department during the year is given in the document Annual Report which is brought out separately by each Ministry/

Department and presented along with Detailed Demand for Grants to the Parliament before discussion on the Demands for Grants.

### **Appropriation Bills**

52. After the Demands for Grants are voted by the Lok Sabha, Parliament's approval to the withdrawal from the Consolidated Fund of the amounts so voted and of the amount required to meet the expenditure charged on the Consolidated Fund is sought through the Appropriation Bill.

### **Economic Survey**

53. The Economic Survey, which is presented to the Parliament a few days before the budget, brings out the economic trends in the country, which facilitates a better appreciation of the mobilization of resources and their allocation in the Budget. The Survey analyses the trends in agricultural and industrial production, money supply, prices, imports and exports and other relevant economic factors which have a bearing on the Budget.

54. These surveys give the time series data, among other things, on fiscal and revenue deficits and have sounded alarm bells.

55. The Economic Survey is a sort of report card on the country's economy.

### **Economic cum Functional Classification**

56. Economic and Functional Classification of the Central Government Budget is brought out by the Ministry of Finance separately. This contains of the impact of governmental receipts and expenditure on the other sectors of the economy.

### **Ministry of Finance, Government of India - Indian Public Finance Statistics**

57. This is an annual publication of Ministry of Finance giving comprehensive overview of budgetary transactions of Central and State government. It also contains debt position, pattern of financing of plans, trends in capital formation and savings, share of taxes as percentage of GDP etc. The data is given in a time series for 10 years.

### **Parliamentary Committees**

58. There are two committees of Parliament – Committee on Estimates and Departmentally Related Standing Committees--- which have a role in examining the budget estimates of the departments. The Committees have members from both houses. Committee on Estimates takes a few departments in a year and makes in depth analysis and recommendations, whereas the Departmentally Related Standing Committees examine the estimates of all the departments after the budget is tabled in Parliament, but

before it is debated and voted upon in the House. *Rules of Procedures and Conduct of business in Lok Sabha* gives the constitution, the role and functions of the committees. The functions of the Committees are:

#### **59. Committee on Estimates**

- (a) to report what economies, improvements in organization, efficiency or administrative reform, consistent with the policy underlying the estimates, may be effected;
- (b) to suggest alternative policies in order to bring about efficiency and economy in administration;
- (c) to examine whether the money is well laid out within the limits of the policy implied in the estimates; and
- (d) to suggest the form in which the estimates shall be presented to Parliament.

#### **60. Departmentally Related Standing Committees**

- (a) to consider the Demands for Grants of the concerned Ministries/Departments and make a report on the same to the Houses. The report shall not suggest anything of the nature of cut motions;
- (b) to examine such Bills pertaining to the concerned Ministries/Departments as are referred to the Committee by the Chairman, Rajya Sabha or the Speaker, as the case may be, and make report thereon;
- (c) to consider annual reports of Ministries/Departments and make reports thereon;
- (d) to consider national basic long term policy documents presented to the Houses, if referred to the Committee by the Chairman, Rajya Sabha or the Speaker, as the case may be, and make reports thereon.

61. The Standing Committees shall not consider the matters of day to day administration of the concerned Ministries/Departments. The meetings of the Committees are not open to public.

62. The report of the Standing Committees shall have persuasive value and shall be treated as considered advice given by the Committees.

#### **Comptroller and Auditor General of India, “Conceptual Framework of Government Accounting System in India”. Ghosh, D.N., Committee Report, 2005**

63. The committee has suggested adoption of an ‘Appropriate Accounting’, which is a system of accounting based on accrual concepts with suitable departures from the accrual concept in some cases. Such departures are to be made on the basis of certain well laid down accounting conventions, principles, and (what will eventually be needed), accounting standards.

64. Regarding budgeting, the committee recommended that it should continue on cash basis supported by appropriation accounts also on cash basis. The recommendations broadly relate the following issues:

- 1) classification of expenditure,
- 2) disclosure, and
- 3) presentation

65. Some changes have been suggested in the classification to be harmonious with the changes proposed in the accounting system. Changes have been proposed in the treatment of object heads, revenue and capital and Plan and Non-plan expenditure.

66. As for disclosure, Twelfth Finance Commission had recommended some statements to be appended to budget. Statements recommended by Twelfth Finance Commission:

- (i) A statement of subsidies given by Government, both explicit and implicit;
- (ii) A statement containing expenditure on salaries by various departments/units;
- (iii) Detailed information on pensioners and expenditure on Government pensions;
- (iv) Data on committed liabilities in the future;
- (v) Statement containing information on debt and other liabilities as well as repayment schedule;
- (vi) Accretion to or erosion in financial assets held by the Government including those arising out of changes in the manner of spending by the Government; and
- (vii) Statement on maintenance expenditure with segregation of salary and non-salary portion.

67. This committee added some more statements. They are:

- (i) Statement of net return to Government from Public Sector Undertakings;
- (ii) Value of tax and non-tax concessions;
- (iii) Statement on pension commitments;
- (iv) Statement of incomplete works;
- (v) Statement of uncollected revenues
- (vi) Borrowings from trust moneys held by the government;

68. In addition, the expenses of each department should be grouped in the following manner.

<b>Particulars</b>	<b>Amount</b>
1. Wages and Salaries	
- of which pensions	
2. Goods and services (all program related expenses)	
3. Interest payments	
4. Subsidy and transfer payments	
5. Non-cash expenses	
<b>Total expenses</b>	
<b>Total income</b>	

69. On presentation aspect of the budget, the committee said that each department should have separate Demands for Grant to ensure accountability. The assumptions about the

key economic factors like growth rate of the economy, rate of inflation, and growth rate in major taxes, and other factors such as level of monsoon need more disclosure.

70. Appendix 6 on budgetary processes describes in detail all the steps involved in the making of and legislative approval of the budget in GoI. The legal framework of the budgetary process, the role of the different agencies, the timeframes, the level of pre-budget scrutiny, stages and depth of legislative scrutiny, and other related matters have been described.

71. “Parliamentary scrutiny of the Budget does not end with the passing of the Finance and Appropriation Bill. The provisions of the Constitution enable the legislators to monitor even the implementation of the Budget. The Members of Parliament can seek information, raise questions, call attention to special matters relating to implementation of budget and move motions to hold special discussions to draw attention of Parliament to any shortcomings in execution of the budget. The quarterly statements of receipts and expenditure which are now required to be placed before the Parliament under the Fiscal Responsibility and Budget Management Act, 2003 and Rules will strengthen Parliamentary Control over execution of the budget.”

#### **Ministry of Finance, Government of India - Delegation of Financial Powers Rules, 1978 (DFPR)**

72. The Rules contain the financial delegation given to the administrative departments of the Government of India. Among other things, it deals with powers of the departments to incur expenditure on capital schemes. Different slabs have been prescribed for various committees to clear the schemes. Authorities competent to approve the schemes have been prescribed.

#### **Annual Reports Reserve Bank of India**

73. Reserve Bank of India publishes an Annual Report which is as much a report on different aspects of economy as a report of the activities of Reserve Bank of India. Chapter IV on Government Finances gives an analysis of the state of finances. Level of expenditure, deficits, debt position, contingent liabilities and tax policies are some of the aspects covered. These reports have consistently pointed out every year the high levels of deficits and urged for policies for lowering them.

#### **Ganguly, S.P.: Fundamentals of Government Budgeting in India – Reprint, Concept Publishers, Delhi, 2000**

74. This book describes the structure of government budget and fundamentals of government budgeting, the procedure for preparation of government budgets in India, constitutional provisions relating to government budgeting and the roles of Finance Commission and Planning Commission. Government accounting structure has also been dealt with in this book describing briefly its linkage with government budget. The role of Parliament/State Legislature in approving budget and allowing withdrawals from the

relevant Consolidated Fund for incurring expenditure against approved budget has also been discussed in the book.

75. This is intended to be a basic reference material on budgeting process.

**SURY, M.M.: Government Budgeting In India - Indian Tax Institute, Delhi, 1997**

76. The constitutional provisions governing the budgetary exercise in Government of India have been described in detail. The principles and practices are described. Various aspects of the budget like capital budget, revenue budget, and measures of budgetary deficits, phases of budgetary cycle, including the legislative control over the budget, functional and economic classification of the budget and fiscal federalism are dealt with extensively. Some thoughts on the significance of government budgeting, canons of government budgeting, Zero Base Budgeting have also been given. The author has not hesitated to give his critical comments about some of the issues.

77. The uses and limitations of the functional and economic classification has been discussed; while functional classification helps to ensure accountability of those spending public money to those authorizing it, it does not throw much light on economic magnitudes as consumption expenditure, saving, investment, and income generation on the part of government. The economic classification only pertains to central government and excludes non-departmental public undertakings, state governments and local bodies.

**Ganguly, S.P.: Central Government Budgets in India; An Analysis, Gyan Publishing House, New Delhi, 1993**

78. The growth in all categories of expenditure like revenue, capital, savings, and in terms of economic and functional classification has been analyzed. In some cases historical data has been analyzed from 1950-51. Variance analysis has also been done from the budgets of 1976-77 to 1988-89 to assess the accuracy of estimates. A brief description of the structure of the budget is also given. This book helps to understand the maze of figures in the budget.

**Sudersanan. Dr. C.N.: Government Budgeting: Principles and Practices, Sree Sudarsan Publications, Chennai, 2001**

79. This book aims to explain the ramifications of budgeting and the processes surrounding it to the layman. It describes the theory of budgeting, procedure of government budgeting, parliamentary control, performance budgeting, zero base budgeting, railway and defense budgets, role of audit. Salient features of Fiscal Responsibility and Budget Management Bill and suggestions for budgetary reform have also been given.

80. A detailed Bibliography on government budgeting is also appended.

**Pant, U.S.: Budgeting and Public Financial Management in India - Impact Books, New Delhi, 1998**

81. Some of the major concerns/suggestions of the author that are:

- a) Performance Budgets, not being a document presented along with the budget loses its significance and seriousness.
- b) Standing Committees of Parliament examining the budget are too unwieldy and serve only a cosmetic purpose. The committee should be smaller with only four or five members who will visit the ministries to examine the proposals intensively with reference to the source documents. This will enhance the accountability of the executive.
- c) Introduction of an integrated public finance management system.
- d) Forward budgeting, including provision of carry over of unspent provisions in respect of specified projects.
- e) Introduction of accrual accounting.
- f) Departmental cash balance and cash management system.
- g) Implementation of Zero Base Budgeting.

**The Comptroller and Auditor General of India: Union Audit Reports - Accounts of Union Government**

82. These reports which are presented annually in terms of Article 151 of the Constitution bring out the state of finances of the Union Government from the accounts perspective. The reports indicate that fiscal deficit and revenue deficit have been consistently more than budget estimates. Further, the rate of growth of revenue deficit has been more than that of fiscal deficit. The reports have consistently flagged these ominous signs. The reports also analyze the extent of variation of actual expenditure from the grant approved by the Parliament.

**National Institute of Financial Management: Proceedings of Workshop on Fiscal Responsibility of Government, February 2000**

**Tiwari, A.C.: "Budgetary process"**

83. Budgeting process has been distorted due to faulty planning process which has resulted in,

- Degeneration of planning process into intense competitive game of size and numbers.
- Advance preparation of techno economic feasibility studies neglected. Money spread thinly over many projects.
- Project appraisals were mostly monetary and not output centered.
- Performance budgeting has not helped as the data supplied were doctored.
- Maintenance of assets neglected.
- Planning is more politics than development economics.
- Artificial distinction between plan and non-plan expenditure.

84. The following suggestions were offered:

- Long term fiscal policy to be prepared.
- Greater stress on expenditure management.
- More intensive pre-investment scrutiny and evaluation needed.
- Resource assessment to be realistic.
- Maintenance of assets to be given importance.

85. **Mathur, B.P.** listed the following as problem areas.

- Centralized budgeting; incremental budgeting.
- Maintenance of assets not given due importance.
- As investment decisions take a long time, budget provisions lapse. It is necessary to roll over unspent provisions for capital projects to the next financial year.
- Emphasis on input budgeting; performance budgeting has remained a formality.
- Artificial Plan/non-Plan distinction.

86. Emphasis seems to be more on controlling expenditure than optimizing expenditure.

**National Institute of Financial Management: Seminar of senior financial managers of Government of India on issues relating to operationalization of the FRBM Act., October 2004**

87. Inaugurating the seminar, P. Chidambaram, the Finance Minister made the following observations:

- Governments had borrowed indiscriminately in the past. A heavy price was paid for that. Investment was crowded out, interest rates soured and the bulk of government's expenditure became inelastic and, there was little room for development expenditure.
- The distinction between investment and expenditure was lost sight of. Fiscal sustainability became impossible. The only way is to observe fiscal prudence and fiscal discipline.
- Sanctity must be brought to the budgetary process. Estimation of expenditure and revenue must be more scientific and accurate.
- There should be a medium term budget framework; annual budgets are meaningless.
- Tax rates should be stable over the years and the annual budgets should not be a mystery.
- The mass of Information that is being collected by many government organizations should be analyzed properly for effective use of information.
- Expenditure led strategy has its limitations due to large amount of committed expenditure. FRBM objectives can be achieved only through a revenue led strategy.

88. Other major suggestions that emerged during the seminar are:

- Cash management techniques to be refined.
- Introduction of exchequer control mooted.
- Quality of expenditure to be improved; delivery systems and accountability mechanisms to be strengthened.
- Emphasis to be laid on Performance Budgeting and Zero based budgeting.
- Tax expenditure aspect to be given greater attention; it is better to give the incentives upfront directly after getting Parliamentary sanction than given as concessions/ exemptions, which are not quantified and not transparent.

**Karnik, Ajit: “Fiscal Responsibility and Budget Management Bill Offering some Credible Commitments” in Economic and Political Weekly, 19 Jan, 2002**

89. The government had shown courage in tying its hands and it has sent a signal that it was serious about fiscal consolidation. However, the dilution being brought about in the Bill would defeat the entire purpose. He has also pointed out that the implicit subsidies need to be contained to contain the deficits meaningfully.

**National Institute of Financial Management - Budgetary Reforms and Expenditure Management in Government - Edited by B.P. Mathur, Mudrit, Hauz Khaz, New Delhi, 1999**

90. This book is an edited version of the proceedings of a two day workshop for the financial advisers of the all the ministries of Government of India held on the 12<sup>th</sup> and the 13<sup>th</sup> September 1997. Major issues like budgetary control and reforms, expenditure management in government, disinvestment and restructuring of Public Enterprises and the role of Financial Advisers.

91. Major concerns were expressed by the experts and the participants regarding the budgetary issues and some of the recommendations are:

- a) Emphasis should shift from input budgeting to output budgeting; from budget deficits to performance deficits.
- b) Estimation of revenue and expenditure has become a routine incremental exercise.
- c) Budgets have failed to weed out outdated projects; zero base budgeting is largely ineffective.
- d) Performance budgets have remained lifeless; they do not help to enforce accountability. Hardly any attempt is made to correlate activities and targets with achievement and implementation.
- e) Serious distortion has crept in the budgetary systems as bulk of the money for the schemes are released at the end of the year.
- f) March rush of expenditure can be avoided if there is a system of biennial or triennial budgeting and some arrangement of roll over of funds, as is the practice in some of the countries.

- g) Distinction between plan and non plan expenditure is artificial and should be done away with.
- h) Too much time is spent for getting approval of the plan schemes through the Expenditure Finance Committee and the Public Investment Board, often delaying implementation of the scheme. On the contrary, non plan schemes do not receive adequate scrutiny.
- i) There is often an under provision of funds for maintenance of assets.

**Basu, Anuradha: Public Expenditure Decision Making – the Indian Experience, Sage Publications India Pvt. Ltd., New Delhi 1995**

92. This is a book on procedural rationalities of investment decision making in India. Currents and cross currents that influence expenditure decisions are analyzed. In a comprehensive coverage of institutional framework of different organs that influence public expenditure decision making, the relative roles played by key decision makers are explored. The tug of war between Planning Commission and Ministry of Finance is described with the gradual loss of importance of Planning Commission. The rise of the Prime Ministers office has eclipsed all other key decision makers. This book is an output of research where the methodology used is in depth interviews with bureaucrats and ministers, supplemented by time series data, and government documents and memoranda.

**Bagchi, Amaresh on “Fiscal Reform” in The Hindu - 18<sup>th</sup> July 2001**

93. The heavy revenue deficits have crowded out capital investment by GoI. From an average of 6.8 per cent of GDP in the latter half of the 1980s, the Centre’s capital expenditure has come down to 2.8 per cent.

94. System of budgeting is not conducive to fiscal discipline. Zero base budgeting remains only intent; are budgets routinely prepared in an incremental manner. Supplementary budgets have become routine. There is no effective control on commitments in the absence of multi year budgeting. Plan versus non-plan is another source of fiscal imbalance: revenue component of the plan has been increasing at the cost of the capital component, resulting in high revenue deficit.

**Indian Institute of Public Administration, Financial Administration, Edited by K.L. Handa, 1986**

95. This is a collection of articles written by experts on Financial Administration. The subjects covered include budget management techniques, performance budgeting, control over expenditure, Indian tax structure, role of audit, etc. The articles throw light on existing systems with suggestions for improvement.

**Fiscal Policy and Sustainable Growth in India, Edited by Edgardo M. Favaro and Ashok K. Lahiri, Oxford University Press, 2004**

96. The essays in this book address key issues including: sustainability of high fiscal deficits in the medium term; the role of tax revenue enhancing measures and government spending cuts in a deficit reduction strategy; soaring government spending over the past two decades; the impact of the quality of government spending on economic growth; and the agenda for policy-makers in the future.

**Sarma, E A S, in the chapter on “Quality of Government Expenditure: A Review”**

97. The budget suffers from the following limitations,

- a) Budget is based on cash accounting
- b) Expenditure as reported mainly indicates the release of funds and not necessarily expenditure.
- c) One year time frame.
- d) ‘Capital’ expenditure may not mean asset creation and vice versa.
- e) Contingent liabilities not adequately addressed and quantified in the budget.

98. The Fiscal Responsibility and Management Act would address many of these issues. The following recommendations have been made:

- Introduce Zero base Budgeting seriously.
- Target subsidies.
- Replace subsidies with other instruments like loan.
- Introduce medium term budgeting.
- Introduce rigorous cost benefit analysis.
- Have regular performance reviews through independent agencies.

99. In the same book, Premchand, A and Chattopadhyay, Suman say that the following reforms in budgeting are needed:

- Budget estimates should be realistic with proper risk management strategies.
- Medium term roll-on budget should be introduced.
- Money provided in the budget should be assured to the line departments.
- Money flow should be continuous and predictable.
- Output budgeting based on public service agreement between departments and the Ministry of Finance needs to be introduced.

**Premchand, A, Barry Potter, Mike Woolley: India: Public Expenditure Management**

100. This was a study by a technical assistance team from IMF in 1995-96 to find out how India addressed the changing requirements of expenditure management and how GoI coped with problems of expenditure growth and fiscal deficits. The team studied the following areas of PFM, viz., formulation including planning, techniques of budget review, analysis of budget impact data, expenditure reporting, cash management, cost measurement and containment, and evaluation.

101. The study identifies the specific problems of the management of central government expenditure as the inflexibility of many items of expenditure, procedures designed to increase expenditure than to reduce or contain it, large deviations from budget estimates, etc. The report gives wide ranging recommendations in the following key areas.

- Budget planning and analysis.
- Budget formulation.
- Budget implementation.
- Cash management.
- Accounting and expenditure reporting.

**United Nations: Development Papers no. 13, The Control of and Management of Governance of Government expenditure in Asian Countries**

**Rao, M. Govind: “India: Role of the State and Public Expenditure Policy”**

102. The institutional mechanisms set up for policy, process and efficiency controls have not been functioning to their full potential. He has elaborately described all the control systems starting from budget formulation to parliamentary oversight.

**Mittal, J.P. and Kumar Pramod: Zero Base Budgeting, Radha Publications, 1991**

103. The book contains a collection of articles on Zero Base Budgeting (ZBB) and covers different aspects of the subject. Feasibility of ZBB in the Indian context has also been discussed in some articles. Views of the academicians as well as professionals have been given. Absence of professional management, inflexible bureaucracy, lack of spirit of cooperation and feedback have been indicated as reasons for ZBB not taking off in India. However, it is very important for ZBB to succeed in India, considering the waste of public money.

**N. Vinayakam, Dr. N and Mathur, Dr. B. L.: Zero Base Budgeting, National Publishing House, Jaipur 1994**

104. This book is a compilation of 22 research papers on Zero Base Budgeting covering various aspects of theory and practice of ZBB. Advantages of having ZBB have been well documented. Practical difficulties in implementation in India have been brought out. Some modifications in approach have been suggested.

**Nand Dhameja, Nand: “Zero Base Budgeting (ZBB)” in the Indian Journal Public Administration, Jan—Mar 2002**

105. ZBB, as a concept, is still at an experimental stage in the various departments of Government of India. It has borne some encouraging results in resource rich countries, but its efficacy in developing countries needs a careful study. The features and

managerial processes behind ZBB have been highlighted. Case studies pertaining to two of the apex research organizations in India.

**Aggarwal, M.D., Jain, Suman C., Gaggar, R.L.: Studies in Zero Base Budgeting, Motherland Printing Press, Jaipur, 1987**

106. This is a Collection of articles written on the theory and practice of Zero Base Budgeting (ZBB) indicating likely problem areas in implementing the concept in India. This book was designed to provide guidance in the nuances of ZBB to Indian officials at a time when the ZBB was first introduced.

**Dr. Goel, S L: Public Financial Administration, Deep and Deep Publications, New Delhi, 2002**

107. There is no separate budget manual and the preparation of a comprehensive budget manual is an immediate need. There is a lack of cost consciousness in government. The estimates are inflated for fear of cuts by Ministry of Finance. He finds the attitude of Ministry of Finance arrogant; MoF cannot be repository of all knowledge.

**National Institute of Financial Management: Ghosh, Amiya Kumar - lecture on Effective Budgetary control for Expenditure Management and its Ramification for Public Policy and Governance in the workshop for the Financial Advisers of Government of India, September 1997**

108. The areas covered include prevailing budgetary control system, wider concept of accountability, new concept of budgetary management, necessity for reviewing budgetary control system, imperative need for review of obligational expenditure, need for multiyear fiscal planning, need for collective decision making on issues affecting expenditure policies and need for viewing expenditure in a holistic manner. Object classification of budget aligning with accounts classification improves the accountability at field level. However, it is a narrow view of accountability which does not provide a basis for measuring performance of a government unit or progress of a particular program. Rule of lapse is a ready made rule for waste. Carry forward of unspent budget allocation will prevent much waste. Value for money needs to be ensured. The emphasis on input budgeting without output orientation and preparation of cash budget without any control of commitment aspects is misplaced. There should not be any need for supplementary budgets and a rigorous analysis of Appropriation Accounts and March rush of expenditure must be made.

**IMF working paper on India's budget deficits: Ricardo Hausmann and Catriona Purfield [http://www.dailytimes.com.pk/default.asp?page=story\\_17-9-2004\\_pg5\\_15](http://www.dailytimes.com.pk/default.asp?page=story_17-9-2004_pg5_15)**

109. FRBM does not go far enough. Of particular concern is lack of punitive measures, if the budget deficits are not reduced to agreed levels, apart from loss of face to the finance minister.

110. A shortcoming of the FRBM is that there are no explicit penalties - just a dent to the finance minister's reputation - if the deficit-cutting goals are missed.

111. Creation of an independent budget office on the lines of congressional budget office to ensure impartial assumptions of growth, revenue and spending would be a step in the direct direction.

**Mathur, Dr. K.B.L.: Public Expenditure Management, Japan Bank for International Cooperation, Japan, 2001**

112. This report covers wide range of issues on fiscal reform. It also seeks to measure the Public Expenditure Management efforts in India in the framework of PEM cycle developed by the Japan bank for International Cooperation. Each cycle has been assessed for its system, strengths weaknesses to identify the tasks ahead. An alternative assessment made in a World Bank study has also been given alongside.

113. The study identifies the strengths and weaknesses and defines the tasks ahead.

114. Strengths: There are well developed systems for

- Budget formulation including wide ranging consultations;
- Plans/programs;
- Monitoring;
- Budget implementation procedures;
- Audit; and
- Evaluation techniques.

115. Weaknesses are:

- lack of feedback to budget makers;
- rigidities in the budget not permitting sharp changes in policies;
- lack of correspondence with plan allocations;
- absence of cost consciousness;
- ineffective zero base budgeting;
- lack of information on macro policy thrust at the level where budget estimates are prepared;
- poor monitoring mechanisms;
- mismatch between physical targets and financial allocations; and
- no visible lessons learnt in improving economy and efficiency in implementation of most of the programs.

115. The report quotes extensively from the Plan as well as the Finance Commission documents regarding the areas of weaknesses of the PEM systems in India.

116. A full chapter on the decentralization of administrative process in India devolving power has been devoted to the second and third tier of administration.

117. Annex 1.1: Perspectives of Indian Economy: Highlights of select Reports/Studies gives a synoptic view of overall assessment and perspectives on the Indian economy as present in the various reports of Government of India, Reserve Bank of India, international institutions (IMF, World Bank, ADB, UNDP, and JBIC) and academic studies published by a few individuals.

118. Annex 2.2 Gives the main features of budgetary process in India.

### **Report of the Administrative Reforms Commission on Finance, Accounts and Audit, 1968**

119. This report contains many seminal recommendations which have greatly influenced the course of financial reform in India. Recommendations range over budgetary reform, legislative control, government accounts and audit.

120. The commission recommended introduction of Performance Budgeting in departments in direct charge of development programs as a step towards output budgeting. The Finance Ministry was to take the lead in this matter. The commission suggested that it should be extended to the states as well. Recasting of heads of accounts to correspond with budget heads was another major recommendation.

121. It suggested better methods of collection of data using computers to get more accurate revenue projections. On the expenditure side, a forward looking budget was suggested for each service and activity wherein requirements of manpower and materials for a few years should be ascertained in advance.

122. The recommendations were based on the report of the study team on Financial Administration set up by the Administrative Reforms Commission. The recommendations were far reaching at that time in 1968. Many were accepted for implementation.

### **Parthasarathi, Shome, Sen, Tapas K. and Gopalakrishnan, S.: Public Expenditure Policy and Management in India: a consideration of issues, Paper presented at a seminar on “Expenditure Management”, Ministry of Finance, Government of India, on March 18, 1996**

123. This paper critically analyses the prevailing expenditure policy and control issues in India. Major points that have been made on the control issues are:

- Tax expenditure is a neglected area and needs attention to improve transparency.
- Distinction between plan and non plan expenditure needs a review as it has created much distortion.

- Though there are well defined control systems, they seem to be working in a legal or mechanical way; the expenditure has been climbing in an uncontrolled way and leakages continue.
- Budget is incremental and top driven.
- Emphasis is on spending, despite performance budgeting. The system is target oriented than goal oriented.

**Tewari, A.C.: Problems of Fiscal Management in the Government, Shipra Publications, Delhi, 1995**

124. This book attempts a critical analysis of financial management practices in India, while at the same time benchmarking selectively with practices in some other countries. The areas covered include the roles of Ministry of Finance, Reserve Bank of India, Parliament, Audit, Public Enterprises and Tax Administration.

125. The Standing Committee system of budget scrutiny has great potential to introduce real fiscal discipline. The committee's efficacy has been reduced without proper secretarial support to do research. The association of the Comptroller and Auditor General with the committee for assistance would have benefited the committees in their deliberations. The time allotted to the committee is too short to have any meaningful analysis and examination of budget estimates.

**Government Accounting Standards Board (GASAB): Exposure draft on government guarantees, May 2003**

126. The draft brings out that the guarantees by the governments have grown very steeply in the last few years raising concerns about the contingent liabilities becoming real liabilities.

**Morris, Sebastian, in the article 'Expenditure Accountability in India: the Linkages' in the book India Infrastructure Report 2003 - Public Expenditure Allocation and Accountability, 3iNetwork, Oxford, 2003**

127. The following issues have been raised.

1. Budgets are still not transparent; there are many off budget items like contingent liabilities. Underlying assumptions regarding key variables such as interest rates, exchange rates need to be explicitly revealed.
2. Budgets continue to be incremental; they need to be based on the requirement of approved projects.
3. There are too many projects to be funded, with the result no project gets funded fully.
4. Distinction between Plan and Non plan is archaic and often misleading as maintenance expenditure is treated as non essential, being non plan. Plan expenditure is not necessarily developmental and converse is equally untrue.

5. Investment decisions are not necessarily based on proper project appraisals; in practice the appraisals are tailored to help fund projects already selected on other considerations. This is particularly true of Social Cost benefit analysis.
6. Performance monitoring of government projects is at a low level. Huge cost and time over runs of public projects bear ample testimony to this.

**India: Reducing Poverty, Accelerating Development: A World Bank Country Study, Oxford University Press, 2000**

128. Chapter 4 on Good Governance: Following issues have been raised

- poor budgetary practices like; e.g. keeping revenue forecasting as a separate exercise from expenditure budgeting;
- lack of total transparency in the budgets;
- too many exemptions in taxes leading to unquantified implicit subsidies;
- absence of accountability for failure of delivery systems ;
- excess importance given to input budgeting;
- absence of customer satisfaction surveys resulting in poor feedback;
- deficiencies in expenditure management; and
- poor tax administration, etc.

129. The article gives examples to prove the points and offers a host of suggestions to improve overall governance in India. The following suggestions have been offered in the area of budgeting:

1. A multi-year expenditure framework;
2. A budget procedure with revenue budgeting and revenue policy before expenditure budgeting;
3. Removal of plan/non-plan categorization;
4. Creation of a contingency fund under Ministry of Finance to meet unforeseen expenditure (different from Contingency Fund of India);
5. A budget circular incorporating budget ceilings to the administrative departments;
6. Serious zero base budgeting;
7. Improved cash management.

**Report on the Observance of Standards and Codes (ROSC): Fiscal Transparency India, Prepared by the Fiscal Affairs Department of the International Monetary Fund (IMF) 2001**

130. This report provides an assessment of fiscal transparency in India in relation to the requirements of the IMF *Code of Good Practices on Fiscal Transparency—Declaration on Principles* based on authoritative response to the IMF fiscal transparency questionnaire and other documents provided by the authorities.

131. According to this document India has reached high level of fiscal transparency especially as regards information on budget made available to the public. There is room

for improvement in some areas like reporting on general finances, providing information on contingent liabilities and quazi-fiscal activities and analysis of fiscal risks.

### **Report of the Eleventh Finance Commission**

132. The Eleventh Finance Commission noted many deficiencies in budget preparation some of which are:

- a) Budgets are not known for their quality of forecasts; frequent resort to supplementary budgets is evidence of this.
- b) Huge variations between budget and actual.
- c) Budgets are not transparent; some items are kept “off budget”.
- d) “March rush” leads to poor quality of decision making.
- e) Non-plan versus plan adds to non transparency of government expenditure. This distinction has led to neglecting essential maintenance, if they do not come under plan.
- f) Spreading resources too thinly over many projects.
- g) Token provision followed by large expenditure in the following years.
- h) Lack of discipline in introducing new projects.

133. The Commission gave the following suggestions.

1. Introduction of multiyear budgeting.
2. Introduction of objective methods of preparing budget estimates.
3. Review of all expenditure classification other than revenue and capital.
4. Abolish plan non-plan distinction.
5. Commitment to complete all projects in time and provision of funds for the same.
6. Evaluation needs to be objective oriented and not expenditure oriented.

134. Jain, N.C, one of the members, in a separate note, suggested that the Planning Commission should be given a constitutional status and be merged with Finance Commission. This will solve the problem of overlap between the two organizations and would lead to more cohesive and dynamic attention given to the issues of fiscal transfers to the States.

### **Viswanathan, S.S.: Performance Budgeting in Government. (Illustrative Guide), Indian Institute of Public Administration, 1972**

135. This was the first authentic guide giving the basis of Performance Budgeting as a guideline for the ministries of Government of India. It covers the structural aspects, accounting aspects, physical measurement and analytical aspects, the formats of performance budget for capital projects, control aspects, program and performance in Indian context and installation of performance budgeting. Basic issues relating to performance budgeting have been elaborately covered.

### **Chaudhary, Harnita: Performance Budgeting in India Facets and Prospects, Har-Anand Publications Private Limited, 2001**

136. While reviewing the budgetary processes in India, the following deficiencies have been listed.

1. Inadequate stimulus and information base for planning and budgeting.
2. Short term perspective.
3. Emphasis on expenditure to the neglect of output.
4. Inadequate basis for economic classification.
5. Lack of coordination between structural parameters of the executive and the current needs.
6. Absence of identification of the future expenditure requirements of current programs and projects.
7. Fragmentary as some taxes are earmarked for certain expenditure.
8. Excessive emphasis on line structure.
9. Lack of integration of financial and physical aspects.
10. Inadequate alignment with development plans.
11. Incremental expenditure.
12. No review of previous commitments defeating the basic objective of optimum resource mobilization.

**Sury, M. M.: Fiscal Policy Development in India 1950–2000, Indian Tax Institute, 2000**

137. This book gives a historical perspective on developments on budgetary and taxation areas. Theory on Public Expenditure Policy is explained. New dimensions on fiscal federalism including state local level institutions are also covered.

**Tarapore, S.S.: India's Financial Policy: Adapting to New Realities, UBS Publishers and Distributors Limited, 1999**

138. This book is a collection of articles written by the author, a former Deputy Governor of Reserve Bank of India in "Business Standard". The articles relate to monetary and credit policy in 1997. While dealing with contemporary problems, the author has commented on the credit policy, money markets, regulation, non banking financial sector, exchange rate management, fiscal issues and capital account convertibility.

139. In the article on "Who surveys the Survey?" he gives a spirited defense of Economic Survey saying it is an important document containing valuable insights.

**Public Expenditure a Rising Challenge: Edited by Dr. K Venkataraman, Public Expenditure Round Table (PERT), Chennai, 2002**

140. The book starts with a premise that Public Expenditure Management (PEM) is too serious to be left to the Government of India alone.

**Rangachari, A. 'Expenditure Management– a Different Approach'**

141. The following suggestions have been offered.

1. Examination of the necessity, efficiency and effectiveness of each activity.
2. Redefinition of objectives and mission of each organization in the present context.
3. Adoption of performance indicators and outputs and better delivery of services.
4. Submission of a three or five year expenditure forecast along with each year's budget.
5. Public expenditure reviews outside the budget formulation process.
6. Monitoring.

142. There is a need for operationalizing the concept of Public Expenditure Review (PER) which should include, "a re-examination of what the government should do and pay for, what it should pay for but not do and what it should neither do nor pay for".

**Venkataraman, K in 'Dimensions of Public Expenditure Management'**

143. A number of procedural improvements have been suggested. A measure that is badly needed is the synchronization of the period of Finance Commission and the Plan. Lack of quality in government service and lack of productivity of government expenditure are areas of concern along with inefficiency of project management.

**Administrative Accountability: Edited by T.N. Chaturvedi, Indian Institute of Public Administration, New Delhi, 1984**

144. The book contains a collection of articles written on all aspects of administrative accountability by scholars in India and abroad.

145. Professor M. K. Thavaraj in his article on Financial Accountability in Government gives the theoretical framework of financial accountability systems and concludes that the systems are weak on the ground.

**Report of the Advisory Group on Fiscal Transparency: Submitted to the Standing Committee on International Financial Standards and Codes established by the Reserve Bank of India. Dr. Montek Singh Ahluwalia was the Chairman of the Advisory Group.**

146. The report used the "Code of Good Practices on Fiscal Transparency" (CODE) of the International Monetary Fund (adopted in 2001) as the benchmark to evaluate the degree of fiscal transparency in India. The report is the outcome of a study based on several meetings with senior officials in Central and State Governments, including the Comptroller and Auditor General of India. The study reported compliance with the CODE in most of the areas. More work is needed to bring in transparency in the following areas, according to the study:

- Extra budgetary fund maintained by the Oil Coordination Committee arising out of Administered Pricing Mechanism for the oil industry.

- Relations of the Government with quasi Financial Institutions like the commercial banks, Reserve Bank of India, public financial institutions.
- Discretionary elements introduced in tax administration due to plethora of exemptions.
- Disclosure on tax expenditure.
- Forecasts for at least two more years along with the budget.
- Statement of fiscal objectives (likely to be met with the passage of Fiscal Responsibility and Budget Management Act (FRBM)).
- Main assumptions underlying the budget to be given.
- Identification and quantification of fiscal risk.
- Mid year reporting to Parliament on progress of budget (would be met after FRBM becomes an Act).
- Independent analysis of fiscal forecasts and assumptions.

147. The report is available on the Website of Reserve Bank of India.

**Ghosh, Amiya Kumar: India's Defense Budget and Expenditure Classification, Lancers publishers, 1996.**

148. The contours of defense budget and expenditure control in the context developments on these fronts in civil departments have been analyzed. The following shortcomings of the defense budgeting systems are:

- The classification of expenditure in defense has remained archaic based on object heads rather than on functional classification.
- It is impossible to get any meaningful information on the level of expenditure on programs.
- The old style of classification does not lend itself to performance budgeting.
- Ministry of Defense has declined to follow Zero base Budgeting.
- Budgeting continues to be incremental in nature and is the result of bargaining between Ministry of Defense and Ministry of Finance.
- Lack of modernization of defense budgeting has led to much obfuscation.
- Monitoring and effective expenditure control is not possible under these conditions.

**Indian Railway Financial Code Volume I, Published by Railway Board, 1982**

149. This book is an updated and revised version of existing codes and manuals of Railways. It deals with various important aspects of financial management like Project Appraisal, Budget Formulation, Reporting and Control, Parliamentary Financial Control, Award of Contracts, Allocation of Expenditure, etc.

150. This is a basic reference document detailing the instructions to be followed by the finance and accounts branches in the Indian Railways.

**Railway Budget**

151. The Railway Budget is presented to the Parliament a few days before the General Budget of the Government of India, in terms of the Rules of Procedure of Parliament which permits the budget of the government to be presented in parts. The figures of receipts and expenditure given in the Railway Budget are reflected in the General Budget, since the receipts and expenditure form part of the total receipts and expenditure of the Government of India.

152. The following documents are presented along with the budget.

1. Annual statement of receipts and expenditure. Budget Statement shows the total receipts, revenue and works expenditure, distribution of excess over expenditure, and position of various Funds viz., Depreciation Reserve Fund, Development Fund, Pension Fund, Capital Fund, Railway Safety Fund and Special Railway Safety Fund.
2. Demands for Grants. Each Demand has a two way classification by activity and by primary units of expenditure. The budget classifications have been completely aligned with accounting classification. The authorities responsible for control over expenditure against budget provision in each Demand are given in the annexure 1 to the Demand.
3. Explanatory Memorandum.
4. Works, Machinery and Rolling Stock program. This is prepared in three parts. Part –I shows the overall distribution of plan outlay by Plan Heads. Part-II contains details of Railway-wise expenditure on New Works, Works-in-Progress and an analysis of inventories in stores and manufacturing accounts. These projects are financed from borrowings from the General Revenues and from internal resources; viz., Capital Fund, Depreciation Reserve Fund, Railway Safety Fund, Special Railway Safety Fund. Part-III contains details of such works which are to be replaced/renewed through the newly created Special Railway Safety Fund. A part of the investment is made through market borrowings by the Railway Finance Corporation.
5. Performance Budget. This document gives both the physical and financial performance of projects costing over Rs. 50 million.
6. Indian Railways Safety Performance.
7. ‘Indian Railways–Year Book’ and ‘Indian Railways–Annual Report and Accounts’.
8. Performance Units. The financial inputs and the corresponding physical outputs under major activities are furnished under the respective Demands.
9. Appropriation Bill. This is placed in Parliament for approval after the House approves the Demands for Grants.

153. The various Funds have a special place in the Railway Finances.

- Depreciation Fund is appropriated annually on the basis of the recommendations of the Railway Convention Committee (RCC), a committee of the Parliament. This Fund is intended to finance the costs of new assets replacing old assets.

- Appropriation to Pension fund is to finance the Pension and Death cum Retirement gratuity payments to the railway staff and is to be calculated on actuarial basis.
- Dividend is payable on the dividend paying capital (some amount is exempted from the calculation for dividend purposes on grounds of being socially relevant, but not commercially viable) to the general revenues. Railway Convention Committee recommends the amount of dividend to be paid to general revenues after estimating the surplus available for distribution as dividend.
- A special Railway Safety Fund has been set up (1998) to wipe out the arrears of replacement and renewal of over-aged assets on a fixed time schedule. This Fund is financed through levy of safety surcharge on passenger fare and assistance to be given by the Ministry of Finance.

154. The investment proposals go through rigorous finance appraisal on the basis of Accounting Rate of Return, Pay Back period, and Discounted Cash Flow for calculating Internal Rate of Return and Net Present Value.

155. The new projects after appraisal are sent to the Railway Board by the Zonal Railways. These projects are evaluated by the Railway Board in terms of the national priorities and available funds and selected projects are included in the annual works program. Funds for ongoing projects are also included in the works program.

156. Gross receipts include Coaching Earnings (passenger traffic), Goods Earnings (freight) and sundry other earnings. Gross receipts are arrived at after deducting the refunds. Detailed instructions exist for computing the receipts from different sources.

**Nanda, R.R.: Railway Accounts and Administration, Published by Bahri Brothers, New Delhi. Revised every year**

157. This is a comprehensive source book on all aspects of railway financial administration. Of particular interest are the chapters on traffic costing, traffic accounts, DP systems and management accountancy including preparation of budget.

**Shakdher S L: The Budget and The Parliament, National Publishing House. First published in 1979**

158. The book is a comprehensive study of the procedure of parliamentary approval of the budgets in many countries including India. It explores the form and preparation, presentation and discussion, execution of the budget and the control thereon by Parliament. In the last chapter, the author offers valuable suggestions for increasing the control of the parliamentary scrutiny of the budget.

159. Cross country comparisons give useful information. Indian Parliament had accepted the suggestion of having Departmental Standing Committees to examine the budget in detail, department wise, before they are passed. Separate parliamentary committees to supervise the working of the Public Undertakings almost on the pattern of Departmental

Standing Committee was also suggested. More supervision on the revenue collection has also been suggested.

**Subash C. Kashyap: “Renewing Parliamentary Polity” in Renewing Governing Issues and Options, Edited by Ajit M Bannerjee and K A Chandrasekaran, Tata McGraw, New Delhi, 1996**

160. The constitution of 17 Departmentally Related Standing Committees (DRSC) of the Parliament is the most important historical development in recent years in the area of parliamentary reforms. Series of measures/actions to be taken by the standing committees have been given, if they have to fulfill the role expected of them. They are:

- (i) close pre-budget scrutiny of the estimates and complex expenditure plans (demands for grants) before they are voted on the floor of the House;
- (ii) concurrent and contemporaneous examinations of the activities of government departments and matters of national concern in cool, non-partisan atmosphere;
- (iii) monitoring and evaluation of performance, relating finance output to the policy objectives and actual results to measure effectiveness, and, detailed examination of supplementary estimates;
- (iv) feedback of valuable insight and information to Parliament and to the government to reappraise economic proposals;
- (v) closer and more competent scrutiny of all legislative proposals-all Bills introduced in the House may automatically stand referred to the appropriate subject committee, for detailed consideration and discussion;
- (vi) review of the implementation of laws passed by Parliament in respective subject areas;
- (vii) leadership recruitment and training ground for higher responsibilities in government, participation by back-benchers and building a second line of leadership; and
- (viii) development of specialization and expertise among members.

161. He also suggested merging of all financial committees into the Standing Committees.

**P Upendran: “Role of Parliamentary Committees in India” in Parliamentary Institutions in India, Edited by Dr. D Sunderarajan, National Publishing House, Jaipur, 1998**

162. The book gives a bird’s eye view of the functioning of the Parliamentary committees. The article highlights the role of Departmentally Related Standing Committees of Parliament. It is a very vital system, but as the recommendations are not

mandatory, they do not improve accountability. Positive aspect is that the officials and parliamentarians get a chance to interact and learn from each other.

**Gadhok, D. N.: Parliamentary Control of Expenditure, Sterling Publishers (P) Ltd., 1976**

163. A comprehensive account of legislative control over expenditure is given along with a full historical background starting from pre-independence days.

164. The chapter on 'Budget in Parliament' describes the procedure of discussions on budget in Parliament like the general discussion, discussion on Demands for Grants and the cut motions. The time allotted for discussions and reply of the minister is very short, with the result no worthwhile discussion takes place. Members tend to talk tangentially. "Parliament is a very imperfect instrument for the control of expenditure, it is ill equipped for enquiry and it is hardly an instrument for achieving a close and exhaustive examination of the immense and complex estimates" (These comments were given before the introduction of Departmentally Related Standing Committees for detailed examination of the budget estimates).

165. The chapter on Estimates Committee gives the origin, the composition, the methodology adopted by the Estimates Committee. The major recommendations of the Estimates Committee over a period of 20 years have been listed. The work of the Estimates Committee is laudable and that review done by them is both extensive and intensive. Many policy directions and suggestions have been given, to improve accountability to Parliament, including those on budgetary reforms.

**Sharma, Urmila and Sharma S. K.: Public Administration, Atlantic Publishers and Distributors, New Delhi, 1997**

166. This is a text book on public administration with a chapter on financial administration. This chapter covers the entire gamut of budgetary exercise in Government of India. It also gives theoretical inputs on the significance of budget, including Performance Budgets.

167. In chapter 38 on Parliamentary control over finance, the role of legislature through the Public Accounts Committee and the Estimates Committee have been explained. An interesting criticism of the role of the Estimates Committee by Ashok Chanda, former Comptroller and Auditor General is quoted. He had said that the Estimates Committee has moved away from fact finding to fault finding.

168. There is a chapter on planning process in India giving the background and the functioning of the Planning Commission.

**Mukhopadhyay, P.K.: "Parliamentary Control Over Public Purse" presented at the National Conference on Legislative Control over Public Purse, July 2000, Lucknow.**

**Reproduced in Journal of Management and Training Apr-Dec 2002, Comptroller and Auditor General of India**

169. The Parliamentary control over expenditure has not been very effective. Much of the expenditure is non-flexible leaving little scope for control. Departmentally Related Standing Committees neither have the time nor competent secretarial support to examine the budget estimates. Overlap between Estimates Committee and Departmentally Related Standing Committee needs to be avoided to conserve resources. The tenure of the members of the Standing Committee should be more than one year to enable members to develop expertise related to specific departments. The recommendations of the committees should be taken more seriously.

170. Specific suggestions given are:

- Parliamentary financial control system in India has a firm legal base and meets the norm of good governance. But there is significant gap between theory and practice. Unless this is attended to Parliament's ability to watch over nation's financial affairs can no longer be taken for granted.
- To strengthen Parliamentary control, budget proposals need be supported by expenditure plan and periodical reports on performance. This will contribute to greater depth in control and ensure effective accountability of government to Parliament.
- There is scope for Parliamentary financial control to be proactive in monitoring the budgetary performance of government. A Parliamentary budget office could be a suitable institutional mechanism for this. Effective use of information technology would facilitate Parliamentary financial control.
- Departmental Standing Committees need research and institutional support for effective scrutiny of budget proposals. Acceptance and implementation of the Committees' reports by government should be comprehensive.

**Lahiri, Ashok. K, Chakraborty, Lekha. S, and Bhattacharyya, P.N.: Gender Budgeting in India, National Institute of Public Finance and Policy, 2002**

171. Gender related budgeting needs to be introduced. Gender disaggregated data from relevant departments to obtain the gender-wise relevant statistical database, targets and indicators.

**Budget Speech of the Finance Minister 2000-01**

172. There is an urgent need of improving the access of women to national resources and for ensuring their rightful place in the mainstream of economic development. The government would set up a Task Force to review all legislation and government schemes pertaining to the role of women in India. This is the beginning of an effort towards gender budgeting India.

**Bannerjee, Nirmala and Raj, Maithreyi Krishna: “Sieving Budgets for Gender” in the Economic and Political Weekly, Oct 30 – Nov 5, 2004**

173. The article surveys the attempts made so far for analyzing the budgets from the gender point of view and points out that lack of adequate data foil any meaningful analysis.

**Classification of Government Transactions: Report of the Expert Group Constituted to Review the Classification System for Government Transactions, National Institute of Public Finance and Policy**

174. One of the terms of reference for the Group was to examine the feasibility of introducing gender budgeting. The Group favored a gender-sensitive budget aimed at examining budgetary allocations through a gender lens. The group recommended a dissection of the budget to translate gender commitments into budgetary commitments with a view to ensure effective targeting of public spending.

**Budget 2005-2006**

175. A statement indicating the gender sensitivities in 10 departments of GoI was given in the 2005-06 budget. Finance Minister said that this was only the beginning and soon all departments will indicate the gender sensitive information.

176. Finance Minister also said that emphasis would now be on outcomes.

**177. Outcome Budget**

The Finance Minister released an Outcome Budget in August 2005. In his foreword, he said

“i) On February 28, 2005, in the Budget Speech, I said: *“I must caution that outlays do not necessarily mean outcomes. The people of the country are concerned with the outcomes.”* I promised to put in place, together with the Planning Commission, a mechanism to measure the development outcomes of all major programmes. Subsequently, the Prime Minister, by his letter dated March 17, 2005 to all Union Ministers, stressed upon the importance of converting financial outlays into physical outcomes, with fixed quarterly measurable and monitorable targets, to improve the quality of implementation of developmental programmes. All the Ministries/ Departments were accordingly requested to carry out this exercise, in respect of their respective developmental programmes/schemes.

Responding to the Prime Minister’s directive, Ministries/Departments have attempted this exercise, and worked out the targets of intermediate outputs/outcomes, in respect of the Plan programmes/schemes being implemented by them. These data have been analysed by the Planning Commission and the Ministry of Finance, Department of Expenditure, and compiled in this document. Converting outlays into outcomes is a complex process,

which differs from Ministry to Ministry and programme to programme. Some of the important steps in this conversion process are as follows:-

- Outcomes to be specifically defined in measurable and monitorable terms; intermediate outputs should also be defined wherever required.
- Standardising unit cost of delivery.
- Benchmarking the standards/quality of outcomes and services.
- Capacity building for requisite efficiency at all levels, in terms of equipment, technology, knowledge and skills.
- Ensuring flow of right amount of money at the right time to the right level, with neither delay nor “parking” of funds.
- Effective monitoring and evaluation systems.
- Involvement of the community/target groups/recipients of the service , with easy access and feedback systems.

Efficient conversion of outlays into outcomes would, therefore, require making the delivery systems effective with appropriate structures and processes, strengthening financial management systems, increasing use of information technology, and meaningful involvement of all the Ministries, Para -statal, State Governments, Local Bodies, Panchayat Raj Institutions, Self Help Groups etc., in critical decision making and implementation processes.

Administrative Ministries have to play a crucial role in defining and delivering their intended outcomes, with a strong sense of ownership. This sense of ownership, in turn, would need to be shared down the line upto the cutting edge levels, through effective communication. It is in this spirit that the outcomes identified and targets set by the Ministries/Departments for themselves have been compiled in this volume by the Planning Commission and the Ministry of Finance, Department of Expenditure. While the degree of detailing has varied across the Ministries, during the exercise on the subsequent occasions, an element of broad uniformity would be sought to be introduced by the Planning Commission and the Ministry of Finance. This is an important milestone towards preparation of the kind of ‘outcome budget’ the Budget Speech and the Prime Minister had envisaged. Appropriate monitoring and evaluation mechanisms would be put in place in due course. Initially, the focus of evaluation would be the flagship programmes and schemes of this Government, namely, ‘Sarva Shiksha Abhiyan’, Food for Work (that will be converted into the National Rural Employment Guarantee Programme), Mid -Day Meal, Integrated Child Development, National Highways and the components of ‘Bharat Nirman’.

This exercise has been taken up only for the Plan Expenditure at this stage. From the next year, ‘outcome budget’ will be prepared for the Non-Plan expenditure too. Over a period of time, the ‘outcome budget’ is expected to reflect the ‘annual budget’ in terms of intended outcomes, with the above -mentioned steps becoming integral to the budgetary process. It is important to put the ‘outcome budget’ in the public domain at each stage of its evolution, in order to enable all stake holders, including the peoples’ representatives,

civil society and the intended beneficiaries of the schemes/projects, to offer their suggestions to improve and strengthen the approach suggested through this document.

In brief, the 'outcome budget' would be a pre-expenditure instrument to help realize the Ministries' vision through clearly defined outputs/outcomes, as a supplement to the current system built around post-expenditure scrutiny. It will also further strengthen the citizens' Right to Information, by putting crucial data and information on expected outcomes in the public domain, public scrutiny of which will help ensure value for money. It needs to be recognized that development and implementation of the 'outcome budget' would be an on-going process, regularly revisited for reality check, and the structure now being put in place would be further honed and refined.

We have greatly benefited from the valuable advice and suggestions given on the subject by the Hon'ble Members of the Consultative Committee of Parliament attached to the Ministry of Finance in the Fourth meeting of the Committee held on August 17, 2005. The journey to reorient our budgetary objectives, and to evolve a robust 'outcome budget' amenable to easy analysis of achievements, is a long one. However, first steps are needed to commence any journey. This is the first step to move towards an outcome oriented budget, and to shift the focus from mere financial utilization to ensuring intended outcomes."

## **Chapter 15**

### **BUDGET IMPLEMENTATION AND INTERNAL CONTROL INCLUDING INTERNAL AUDIT**

#### **The Constitution of India**

1. In terms of Article 53(1) of the Constitution of India, the executive powers of the Union Government vest in the President and are exercised by him either directly or through officers subordinate to him in accordance with the provisions of the Constitution.
2. Under Article 77 (3) Of the Constitution, the President shall make rules for the more convenient transaction of the business of the Government of India, and for the allocation among the Ministers of the said business.
3. As prescribed in Article 299 of the Constitution, all contracts made in the exercise of the executive powers of the President are to be expressed to be made in the name of the President and shall be executed on his behalf by persons so authorized.

#### **The Appropriation Act**

4. The Act passed by the Union Parliament provides the authority to appropriate specified sums from the Consolidated Fund of India for the incurrence of expenditure as provided in the Demands for Grants for specified services.

#### **The Government of India (Allocation of Business) Rules, 1961**

5. These Rules allocate the business of Government among the various Ministries and Departments of Government of India.

#### **The Government of India (Transaction of Business) Rules, 1961**

6. These Rules define the authority, responsibility and obligations of each Ministry and Department of the Government of India in the matter of disposal of business allocated to it under the Government of India (Allocation of Business) Rules, 1961.

#### **The General Financial Rules, 1963<sup>24</sup>**

7. In accordance with the Government of India (Allocation of Business) Rules, 1961 the financial powers of the Government of India are vested in the Ministry of Finance. The Department of Expenditure in the Ministry of Finance has the authority to prescribe

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<sup>24</sup> General Financial Rules 2005 have come into force from July 2005.

financial rules and regulations necessary to run the affairs of the Government. The Department has issued a compendium of instructions called the General Financial Rules, 1963, (GFR's) with common standard forms for the guidance of Government officers dealing with matters of a financial nature.

8. GFR's set out the general system of financial management and control in Government relating to assessment, collection and check of revenues, essential conditions governing expenditure from public funds and the maintenance of accounts.

9. GFR's enunciate the canons of financial propriety and enjoin upon every officer to enforce financial order and strict economy at every step and ensure that all relevant financial rules and regulations are observed by his own office and by the officers subordinate to him. The responsibility and accountability of every authority delegated with financial powers to procure any item or service is total and indivisible. A Controlling Officer shall see not only that the total expenditure is kept within the limits of authorized grants, but also that the funds allotted to the spending units are expended in the public interest and upon objects for which the money was provided.

10. In the discharge of his ultimate responsibility, the Controlling Officer must satisfy himself not only that adequate provisions exist within the departmental organization for systemic internal checks calculated to prevent and detect errors and irregularities in the financial proceedings of his subordinate officers and to guard against waste and loss of public money and stores, but also that the prescribed checks are effectively applied.

11. GFR's also lay down the general principles that need to be observed while entering into contracts and agreements. These include the use of standard or legally vetted forms, proper verification of the antecedents of the contractors, avoidance of any ambiguity that can trigger extra-contractual claims/payments, precise statement of the basis of any price variation clause and strict adherence to the terms and condition of contract once signed<sup>25</sup>.

12. GFR's also set out the broad principles for construction of budget and the incurrence, control, reporting and monitoring of expenditure against sanctioned allotments and authorizations by the Parliament. In order to maintain proper control, the Controlling Officer should arrange to be kept informed, not only of what has actually been spent, but also what commitments and liabilities have been and will be incurred against the allotment. These Rules also prescribe the circumstances in which the allotments may be surrendered as well as the procedure for obtaining supplementary allotment and advance from the Contingency Fund of India.

13. Separate sections/chapters of GFR's deal with different types of expenditure, e.g. establishment (staff) expenditure, expenditure on works, contingent expenditure, procurement, custody and accounting of stores, grants-in-aid and loans to non-Government organizations, advances to staff and the basic principles relating to the structure and the maintenance of Government accounts.

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<sup>25</sup> GFRs 2005 effective from 2005 have thoroughly revised the procedures.

**Ramanathan R., Contract Management, Konarak Publishers Pvt. Ltd. Delhi (2002)**

14. The book lists the basic principles of contracting as prescribed in the Government Financial Rules and illustrates, with the help of selected case studies culled from the CAG's Audit Reports, the consequences of infraction of these principles. The audit process is also explained in a separate Appendix.

**The Delegation of Financial Powers Rules, 1978**

15. The Delegation of Financial Powers Rules, 1978, prescribe the financial powers that the Ministry of Finance has delegated to the line Ministries and other specified authorities and the conditionalities subject to which the delegated powers can be exercised by the latter. The residuary powers reside in the Ministry of Finance.

16. These Rules define the powers of the line Ministries and the specified authorities in the matters of creation of posts, reappropriation of funds within the legislatively approved grant and the incurrence of expenditure on works, stores, projects and schemes and contingent expenditure. The authorities for appraisal and approval of Plan schemes and projects as well as non-Plan schemes and projects are also prescribed in these Rules. The Rules also prescribe the extent to which the line Ministries can further share their delegated powers with their subordinate authorities/formations.

17. The line Ministries must obtain the prior approval of the Ministry of Finance for any re-appropriation which has the effect of increasing the original budget provision by Rs ten million or more; such re-appropriation should also be reported to the Parliament if, additionally, it also results in augmenting the original provision by more than 25 per cent. Unspent provisions of more than Rs. 1000 million also need to be explained to the Public Accounts Committee.

## **Cash Management**

*(i) Reserve Bank of India Act, 1934*

18. Under the Act, the Reserve Bank of India (RBI) is authorized to enter into an agreement with the Government of India to function as the banker to the Union Government. The RBI shall undertake to accept monies for account of the Government of India and to make payments up to the amount standing to the credit of its account, and to carry out its exchange, remittance and other banking operations, including the management of the public debt of the Union. The Government of India shall entrust the RBI with all its money, remittance, and exchange and banking transactions in India, and, in particular, shall deposit free of interest all its cash balances with the Bank. The

Government of India shall also entrust the management of the public debt and the issue of any new loans to the RBI.

*(ii) Agreement dated 5<sup>th</sup> April 1935 between the Reserve Bank of India and the Secretary of State for India in Council*

19. The Agreement dated 5<sup>th</sup> April 1935 between the Government of India and the RBI authorised the RBI (i) to act on behalf of Government of India, (ii) to be the sole banker of Government of India, and to (iii) manage Public Debt. The Agreement set out modalities of dealing with Government money. Government of India was required to maintain a minimum stipulated balance with the RBI on each day and the RBI would provide Ways and Means Advances (WMA) against Treasury Bills and *ad hoc* Treasury Bills in the event of any shortfall in the minimum cash balance.

*(iii) Agreement dated 9<sup>th</sup> September 1994, between the Government of India and the RBI*

20. The Agreement was intended to phase out the automatic monetisation of the Government budget deficit in a phased manner by 1996-97. As per the Agreement the net issue of ad hoc treasury bills for the year 1994-95 would not exceed Rs. 60,000 million; and similar ceilings would be stipulated for the subsequent years 1995-96 and 1996-97. From 1997-98 the system of issue of ad hoc treasury bills would be discontinued. (Source: Government of India, Economic Survey 1994-95).

*(iv) Budget Speech of Finance Minister in 1997-98*

21. The Finance Minister announced the termination of the system of ad hoc treasury bills for financing budget deficits and the introduction of the scheme of ways and means advances (WMA) at market rates for financing temporary mismatches between receipts and expenditure. He also signalled the end of monetization of the fiscal deficit and introduced a new concept of Gross Fiscal Deficit (GFD) in the budget as an indicator of Government fiscal deficit.

*(v) Supplemental Agreement dated 26<sup>th</sup> September 1997 to the Agreement of September 1994 on the issue of Ad Hoc Treasury Bills*

22. This Supplemental Agreement between the Government of India and the Reserve Bank of India (RBI) details the modalities of cash management through the scheme of Ways and Means Advances (WMA)/Overdrafts. As per the Supplemental Agreement the issue of *ad hoc* Treasury Bills has been discontinued with effect from 1<sup>st</sup> April 1997. Separate limits for the WMA are to be prescribed for the first half and the second half of the financial year. Interest rates for the advances under the new scheme are linked with market rates. WMA are purely meant to meet the immediate requirement of cash mismatches and would have to be repaid within the stipulated time. Any requirement in excess of the WMA would have to be met by regular market borrowings. RBI would extend the facility of overdrafts for a period not beyond ten consecutive working days, at

an interest of 2 per cent above the rate for WMA. (Source: Government of India, Economic Survey, 1997-98).

*(vi) Government of India, Ministry of Finance, No. 2(14)-W&M/96 dated 28<sup>th</sup> April 1997. Establishment of Monitoring Group on “Cash and Debt Management” of the Central Government*

23. Government of India set up in April 1997 a cash-monitoring group for a sophisticated cash management system by the Government and improvements in the debt management system of Reserve Bank of India. The chairman of the group is Additional Secretary Budget with members from other wings of the Ministry of Finance and Reserve Bank of India. Briefly, the terms of reference of the group are:

- To estimate the monthly deficit and the associated borrowing requirement. Keep the figures updated monthly.
- To recommend the proper timing, amount, instrument of borrowing.
- To review cash position each month and to suggest measures to correct mismatches in receipts and expenditure.
- To work out a basis for monitoring projections of receipts and payments both on monthly and quarterly basis.
- To suggest measures for building up a data base for advance estimation of monthly revenues.
- To review investments of surplus cash balance of the Central Government.
- To monitor and streamline the flow of information to RBI from banks and other agencies conducting Government business.
- To monitor and streamline the flow of information from RBI to Government.

*(vii) Press release issued by RBI on Ways and Means Advances for the year 2004-05*

24. Reserve Bank of India issued a press release at the beginning of FY 2004-05 indicating the limits of WMA and the rate of interest to be charged on WMA and overdraft. Similar press releases are made every year.

*(viii) Press releases by Government of India giving the indicative calendar of issuing the dated securities during the year*

25. The calendar is given separately for the first half and second half of the year. The objective of issuing the calendar in advance is stated to be to enable institutional and retail investors to plan their investment in a better manner and also to provide transparency and stability in the Government securities market.

*(ix) Indian Railway Financial Code 1982*

26. Chapter –V on Budgetary and Financial Control gives in detail the procedure of cash management followed by the Indian Railways. The railways have an elaborate system of

Exchequer Control. Money is released quarterly by the Railway Board to the Zonal Railways who in turn distribute the cash to the lower formations. The cash requirements for each quarter are estimated bottom up and sent to the higher level. The ground level officer who actually spends the money monitors the cash outgo against allotment on a daily basis. The expenditure is also to be monitored at the zonal level once a month to ensure that the expenditure remains within the budget allotment.

*(x) Government of India Ministry of Finance letter No. 1(2)-W&M/2002 dated 15<sup>th</sup> March 2003*

27. In March 2003 the Union Government introduced the system of cash management in nine selected Ministries on pilot basis. Under the system the budgetary allocations are to be released quarterly in a time-sliced manner to permit convergence with available resources and to permit even flow of expenditure.

*(xi) Fiscal Policy Strategy Statement 2005*

28. As per the Fiscal Policy Strategy Statement tabled by the Finance Minister while presenting the Union Government budget 2005-2006, in a gradual move towards quarterly budgeting and better exchequer control, Government has decided to prescribe quarterly ceilings and targets for expenditure and revenue collection for the line Ministries. Expenditure in excess of the ceiling will require prior concurrence of the Ministry of Finance.

**Mohd. Rusli Bin Haji Hussein, Zheng Li and Dharam Vir: Audit of Public Works and Projects, a Research Project Publication for the Asian Organization of Supreme Audit Institutions, 1995**

29. The India Chapter of this ASOSAI publication describes the processes and procedures, including the feasibility studies and criteria, relating to incurrence of expenditure on public works and projects. Apart from establishing the need for the project, this involves quantification of costs and anticipated benefits, preparing cash flow tables and computation of internal rate of return. In the case of irrigation projects, the economic benefit criteria is adopted so as to reflect the indirect benefits on account of multiple cropping, diversification and better quality crops, higher yields etc.

30. The India Chapter also explains the procedure of monitoring and control of public works and projects. The primary responsibility rests with the line Ministries, which may call for appropriate reports from the project authorities. The control is also exercised through the mechanism of annual budgetary allocations when the financial and physically progress are critically reviewed and the allocations for the subsequent year are decided. The Ministry of Programme Implementation monitors the implementation of all projects costing more than Rs. 200 million. In respect of mega projects, monthly flash reports are obtained from the project authorities, consolidated and analyzed and summarized for the Prime Minister's Office, the Cabinet Secretariat and the line department.

### **Scheme of Integrated Financial Advisor**

31. The scheme of Integrated Financial Advisor (now referred to simply as Financial Advisor) was introduced by Government of India in October 1975. Under the scheme the Financial Advisor is responsible both to the line Ministry and to the Ministry of Finance and both the Ministries jointly select him. He is required to be consulted in the exercise of the financial powers delegated to the line Ministry and, outside the scope of the delegations he functions under the general guidance of the Ministry of Finance. He is to be closely associated with the formulation and implementation of all expenditure proposals. He assists in budget formulation, scrutiny of programmes and projects for approval by the Ministry of Finance and post budget vigilance for ensuring proximity between the budgetary provisions and the amount of expenditure. He is also responsible for the preparation of the line ministry's performance budget and the monitoring of the progress of schemes against the budget.

32. It is open to the Secretary of the line Ministry to over-rule the advice of the Financial Advisor by an order in writing in relation to the matters falling within the scope of the powers delegated to the line Ministry. In matters beyond the powers delegated to the line ministry, the Financial Advisor is responsible to and has the right of access to the Ministry of Finance and to the Finance Minister through the Secretary, Expenditure, or the Finance Secretary. The performance appraisal report of the Financial Advisor is to be written jointly by the Secretary of the line Ministry and the Secretary, Expenditure/ Finance Secretary.

33. The officers and the staff of the Finance Division are required to have a background and training in finance and accounts and are to be appointed in consultation with the Financial Advisor.

### **Government of India, Administrative Reforms Commission, Report of the Study Team, Financial Administration, May 1967**

34. According to the Study Team, the reporting is done in terms of expenditure, and not also in terms of physical performance. The Ministries and Departments sometimes enter into commitments in comparative ignorance of the progressive figures of expenditure or the availability of appropriations or allotments.

### **Pant, U. S.: Budgeting and Financial Management in India, Impact Books, New Delhi, 1998**

35. The scheme of Financial Advisors has not been fully effective; the lack of appreciation of financial procedures, excessive centralization of financial powers and near absence of accountability at the individual level are some of the factors responsible.

The Financial Advisors do not have the support of trained staff. The Financial Advisors have not played any significant role in improving financial controls in the system.

36. On a number of occasions the Pay and Accounts Officers have rejected the financial sanctions and authorizations duly approved by the Financial Advisor or his organization on grounds of regularity.

37. The dual control of the line Ministry and the Ministry of Finance is another factor. Unlike the Ministries of Defense, Railways and Telecommunications, the Finance and the Accounts functions have not been unified for the civil departments.

38. The author throws up a suggestion for the consideration of Government of India whether it would be relevant and productive to follow the example of the USA, where the financial compliance and controls have been regulated through legislations like Government Performance and Results Act, the Chief Financial Officers Act and the Budget Enforcement Act etc.

**Premchand A.: Control of Public Money: The Fiscal Machinery in Developing Countries, Oxford, 2000**

39. The dual control over the Financial Advisor with their mutually differing emphasis and objectives by the line Ministry (maximization of spending) and the Ministry of Finance (observance of prudent financial discipline) has not been quite helpful in achieving the aims of the scheme of Integrated Financial Advisor.

**Chaudhary Harnita: Performance Budgeting in India Facets and Prospects, Har-Anand DSB Management Series, 2001**

40. The control exercised by the Finance Department is excessive, paralyses the administration and contributes to delays. The absence of proper cash management leads to under and over-spending, cost escalation, schedule slippages and non-utilization of capacity, etc. The over-emphasis on financial targets, as against the physical achievements, with a lack of developmental yardstick to measure the performance also serves as major hurdles in the execution of budget proposals.

**Government of India, Ministry of Finance, Department of Expenditure Controller General of Accounts Civil Accounts Manual Volumes I and II**

41. This departmental Manual issued by the Controller General Of Accounts comprehensively sets out the transaction level checks that are applied by the Pay and Accounts Officers on different types of claims for payment. It also lists the post-payment checks applied on payments made by the Drawing and Disbursing Officers authorized to make payments by cheques.

42. The Manual also describes the agency responsible for the internal audit function in the civil Ministries and Departments of Government of India. Internal audit functions under the Chief Controller/ Controller of the Ministry with the over-all responsibility remaining with its Financial Advisor. The jurisdiction of internal audit extends over the accounts offices of the Ministry as well as its Drawing and Disbursing Officers. Additionally, internal audit is also responsible for the audit of autonomous bodies that do not attract the audit jurisdiction of the CAG under the relevant law.

43. The main duties of internal audit are to examine the departmental accounting procedures prescribed for their correctness and adequacy and provide assurance for their proper implementation. Internal audit also checks the payment and accounting work of the accounting units and investigates into cases of significant arrears in accounting and other records.

44. The Chief Controller/Controller of Accounts is required to prepare an annual review of the performance of the internal audit function of the Ministry for transmission to the Controller General of Accounts.

**Pant U.S. and Srivastava R.S.: Payment and Accounting System in Government of India, Good Publishing Company, New Delhi, 1996**

45. Besides explaining the departmentalized system of Government Accounts, the book gives a detailed description of the role and responsibilities of internal audit functioning under the overall administrative control of the CGA. The main objectives of internal audit are to check the adequacy and correctness of accounts, to prevent and detect frauds and to bring to light irregularities committed by the executive authorities, the drawing and disbursing officers, the Pay and Accounts officers and other departmental authorities. The book lists the duties of internal audit, describes the procedures of internal audit, the nature of checks to be exercised in the audit of different types of offices, and the issue and follow up of reports of internal audit.

**Government of India, Ministry of Finance, Controller General of Accounts, Proceedings of the Silver Jubilee Conference on Financial Reforms: Issues and Challenges, April 2002**

46. According to the proceedings of the Seminar, there is need to enlarge the scope of internal audit and to make it multi-disciplinary. While continuing with regularity audit there should be focus on performance audit of programmes/schemes as identified in consultation with the Chief Accounting Authority.

**The Central Government Accounts (Receipts and Payments) Rules, 1983**

47. Framed under Article 283(1) of the Constitution, these Rules regulate the custody of the Consolidated Fund of India and the Contingency Fund of India, the payment of money into such Funds, the withdrawal of money therefrom, the custody of public

moneys other than those credited to such Funds received by or on behalf of the Government of India, their payments into the Public Account of India and the withdrawal of money from such Account.

## **Government of India, Institute of Secretariat Training and Management, Notes on Office Procedure (Aids to Office Management)**

48. These notes set out inter alia the procedure for issue of financial sanctions, drafting of sanctions, authentication, date of effect of sanctions and the circumstances in which sanctions may lapse.

### **Government of India, Planning Commission, Approach Paper to the Tenth Five Year Plan (2002-2007), September 2001**

49. The document quotes the following limitations on the monitoring and control of expenditure on the Centrally Sponsored Schemes (CSS), as observed and reported by the CAG.

- The controlling Ministries neither assessed the absorptive capacity of the State Governments nor verified the effective utilization of the funds already provided before making fresh releases;
- The Ministries were unable to ensure the correctness of the performance data reported by the State Governments;
- Large parts of Central funds were released in the last month of the financial year, which could not be expected to be spent by the State Governments during that year;
- Nobody could be held accountable for poor performance.

50. According to the document the Union Ministries have neither the capacity nor the willingness to effectively monitor the implementation of the schemes. There is also the unwillingness to accept poor performance, for fear of being questioned by Parliament or adverse publicity.

### **International Monetary Fund, Report on the Observance of Standards and Codes (ROSC) India Fiscal Transparency, February 2001**

51. Performance audit should be made an essential part of internal audit. Clear targets should be set for all major programmes; performance indicators should be developed that reflect the final objectives of the programmes (rather than intermediate outputs); assessments of performance against targets should be made every year and reported in the budget documents; and the results of performance audits should be taken into account in determining budget allocations.

## **Reserve Bank of India, Report of the Advisory Group on Fiscal Transparency, 2001**

52. The Advisory Group set up by the Reserve Bank of India benchmarked the public financial management and accountability system in India against the IMF Code on Good Practices on Fiscal Transparency (May 2001). According to the Advisory Group the system of internal audit and controls is well defined in India. However, the Advisory Group also mentioned that a committee which went into the working of the Civil Accounts Department had observed that more than 50 per cent of the staff and officers in the work of internal control and internal audit functions did not have the requisite background, training or experience either of finance or of accounts and the work was also accorded a lower priority than what it deserved. According to the Advisory Group these observations suggest that the system of internal audit and internal control, which has been in place for a long time, needs to be reviewed to make it more effective and meaningful as an instrument of internal management control. It can also be argued that not enough use is being made of internal audit as a critical management information tool to appraise performance.

## **India, Reducing Poverty, Accelerating Development, a World Bank Country Study, Oxford University Press, 2000**

53. This World Bank document includes a summary evaluation of financial management practices in India. On a scale of 1 (inadequate), 5 (adequate) and 10 (excellent) the components of financial management score as follows:

### **Financial Management**

Based on accounting standards.....	7
Efficient cash management.....	5
Timely disbursement of budgeted funds.....	3
Accountability for expenditure.....	1
Internal control systems.....	3
Audit of expenditure (professional, timely reporting).....	7
Budget/Accounting is consistent.....	8
Procurement is transparent and competitive.....	7

54. There is ex-ante rather than ex-post control of expenditure by the line Ministries through the institution of Financial Advisors and the performance budgeting for reporting of outputs and outcomes is divorced from financial reporting and budget preparation. Poor expenditure control facilitates leakages of budgetary resources. Arbitrary across-the-board cuts impair effective expenditure control. Poor maintenance in the capital projects and premature acquisition of capital goods and consumables has led to wasteful expenditure. Expenditure management focuses on spending of budgetary appropriations rather than on efficient and effective service delivery.

## **Mathur K. B. L.: Public Expenditure Management Japan Bank of International Cooperation, 2001**

55. The internal audit and control system is weak since it is confined mainly to the collection of information. Basically it is only an accounts oriented system; there is no audit or control over the objectives, tasks, outcomes and performance. The dimensions and complexities of the tasks of audit are very often responsible for restricting the scope of internal audit to routine checking of accounts.

56. The Programme Evaluation Organization (PEO) of the Planning Commission has no regular mechanism for evaluating all the programmes/schemes in a time-bound manner; the focus of evaluation has been only on finding constraints in implementation and general impact and most evaluation studies lack focus on the economy, efficiency and effectiveness of expenditure. A large number of major programmes continue to be financed despite some major weaknesses because either there has not been any evaluation or because the evaluation studies are not available in time and there are no visible lessons learnt.

57. Since the schemes are implemented by the States, sensitivity associated with the Centre State relations precludes a searching evaluation being made. There is also the unwillingness to accept poor performance for fear of adverse publicity.

**Government of India, Ministry of Finance, Report of the Task Force on Implementation of the Fiscal Responsibility and Budget Management Act, 2003, July 2004**

58. Public finance system in India has traditionally focused on expenditure and there is a need for a greater focus on public goods and outcomes.

59. There is a need to move gradually from 'itemized' control of expenditure to 'budgetary' control, with sophisticated exchequer control mechanisms, and effective implementation/delivery systems. This will require detailed and careful budgeting at the beginning of the year; significant delegation to line Ministries to operate within the approved budgets; well regulated cash flow; strong financial management system at all levels; and organizational restructuring/ process re-engineering to ensure 'value for money'.

60. A shift to 'budgetary' control of expenditure would also require appropriate capacity building and institutional arrangements within the line Ministries, for improved delivery and better realization of 'value for money'. Increasingly more financial powers may be delegated to the line Ministries at appropriate levels on demonstrating effective internal institutionalized arrangements to exercise those powers prudently and judiciously.

**Sahajpal Usha: Budgetary Control, Budgetary Reforms and Expenditure Management in Government, National Institute of Financial Management, Faridabad, 1999**

61. The powers of reappropriation vested in the line Ministries are restrictive and limited and the Ministries are hamstrung in the implementation of the approved schemes because of the withdrawal of powers for creation of posts from them.

62. Delays in the receipt of information and expenditure reports from the State Governments on the Centrally Sponsored Schemes creates difficulties in the release of further assistance to the States for these schemes.

63. Direct release of assistance for the implementation of these schemes to the autonomous vehicles created for the purpose may not be an unmixed blessing.

**Sarma K.S.R.N.: Fiscal Sector Reforms and Expenditure Management in Government, Budgetary Reforms and Expenditure Management in Government, National Institute of Financial Management, Faridabad, 1999**

64. The hedging of financial powers delegated to the line ministries with conditionalities renders them ineffective besides making the 'delegate' hesitant to make full use of the empowerment, leave alone think in terms of further re-delegation to the subordinate functionaries.

65. There is excessive reliance on input oriented expenditure controls. The controls should be decentralized, selective and minimal.

66. There should be a control mechanism that assesses the cost of control both by way of agency cost and the cost of efficiency loss.

**Prasad A.: Role of Financial Advisor, Budgetary Reforms and Expenditure Management in Government, National Institute of Financial Management, Faridabad, 1999**

67. The Financial Advisor has not been adequately equipped to perform the crucial functions assigned to him in planning, programming, budgeting, monitoring and evaluation in the Ministries. Staffing is a major weakness. In the background of the dual role and accountability of the Financial Advisor to the line Ministry and the Ministry of Finance there is also the need for an institutional mechanism to insulate the Financial Advisor from any subjective assessment of his performance.

**Budgetary Reforms and Expenditure Management in Government, Proceedings of Workshop for Financial Advisors, Government of India, National Institute of Financial Management, Faridabad, 1999**

68. According to the participants in the above workshop (1999) there was need for greater delegation of financial powers to the line Ministries. The opinion was divided on the issue whether the Financial Advisors should be made exclusively responsible to the

line Ministries. The participants, however, agreed that the Financial Advisors needed to be adequately equipped for the performance of their allotted functions through trained, specialized staff. The participants also agreed that the internal controls were not functioning properly and had failed to prevent cases of waste and overspending.

69. In the proceedings there are stray references to the report of Eswaran Committee which had examined the scheme of Financial Advisors. The said Committee had favoured that the Financial Advisors should be placed exclusively under the line Ministries. The Committee did not, however, favour the creation of specialized cadre of support staff for the Financial Advisors.

**Swarup D.: India: Developments in Government Accounting and Financial Management, Government Financial Management, Issues and Country Studies edited by A. Premchand, International Monetary Fund, 1990**

70. The conditions imposed by the Ministry of Finance while delegating financial powers to the line Ministries and the economy instructions issued by the Ministry of Finance from time to time have somewhat restricted the exercise of the delegated powers by the line Ministries. In fact, they create an ambience in which the officers are not always willing to accept the responsibilities and routinely refer the cases to the superior authorities.

**Government of India, Ministry of Finance, Report of the Fifth Central Pay Commission, 1997**

71. The restrictions imposed by the Ministry of Finance even on the exercise of delegated powers often act as a barrier in achieving the allotted targets and goals. The Ministry of Finance should only approve the over-all budget for different Ministries and thereafter allow sufficient flexibility to manage the resources in the most productive manner irrespective of the various heads under which it is spent.

72. The dual control over the Financial Advisor by the Ministry of Finance and the line Ministry should go and they should work under the control of the administrative secretaries as real financial advisors in respect of the delegated financial powers.

**Government of India, Tenth Report of the Expenditure Finance Commission, September 2001**

73. The outlay levels prescribed for approvals of Expenditure Finance Committee and the Public Investment Board should be reviewed every three years to sustain the extent of delegation of financial powers to the line Ministries.

**Government of India, Report of the Committee on Civil Services Reforms, 2004**

74. Each Department of the Government should be required to institute an evaluation mechanism of its programmes on the basis of laid down parameters. The result of such evaluation should be part of its Annual Report presented to the Parliament. Departments should be held accountable for their outcomes and there should be focus on service delivery.

75. The Secretary of a Ministry or Department should formulate annual performance targets as per Action Plans. To achieve the targets, he should also be given full freedom -- including delegated financial powers -- so that he can be held accountable for performance.

**Mahalik S. C.: Expenditure Control: The Role, Responsibility and Accountability of a Secretary to the Government of India, The Indian Journal of Public Administration, July-September 2004**

76. A Secretary to the Government of India exercises considerable power and influence in the deployment of Government resources. However, the role, responsibility and accountability of the Secretary have not been delineated<sup>26</sup>. He has no legal accountability either to Parliament or to the larger civil society and only an informal accountability to the Minister. The only occasion when his accountability for expenditure proposals is enforced and the physical performance of the Ministry is scrutinized is when he appears before the Departmental Standing Committee, which examines the budget proposals of his Ministry.

77. Although the Secretary has been designated as the Ministry's Chief Accounting Authority, not many Secretaries take their responsibility seriously. The emphasis is mainly on

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<sup>26</sup> Rule 64 of GFR's 2005 formally defines the duties and responsibilities of the Secretary/Chief Accounting Authority.

financial spending; in any case the Secretary can exercise only minimal oversight in respect of funds transferred to the State Governments or paid as grants to the non-government organizations.

78. The relationship between the Secretary and the Financial Advisor is beset with tension: the Secretary perceives the Financial Advisor as the outside representative of the Ministry of Finance and the Financial Advisor very often acts as such without due sensitivity to the implementation of the Ministry's programmes.

**Sarma Dr. E.A.S.: Quality of Government Expenditure: A Review *in* Fiscal Policies and Sustainable Growth in India, Oxford University Press, 2004**

79. There are inherent limitations in measuring the quality of Government expenditure: budget is on cash basis and not on accrual basis; hence expenditure spillovers from or to the current year are not reported, expenditure merely denotes release of funds, which is not the same thing as actual utilization; capital expenditure may not always result in the creation of assets; contingent liabilities are not fully assessed and reported. Further, many Government programmes have not institutionalized evaluation as a part of the programme design.

**Sivakumar S.N.V.: Physical and Financial Planning through India's Five Year Plans and Finance Commission Methodologies**

80. In this doctoral dissertation for the award of Ph.D., University of Hyderabad (reported in Finance India, The Quarterly Journal of the Institute of Finance Vol. XV No.1 March 2001) the author recommends the creation of an enforcement agency with respect to the utilization of statutory grants paid to the State Governments that would ensure the realization of the objective of a reasonable standard of social and administrative services. The treatment of Plan and non-Plan expenditure separately by the Planning Commission and the Finance Commission is creating difficulties since non-Plan expenditure in a current Plan period is directly related to the Plan expenditure in a previous Plan period. Despite the balanced regional development being a common objective for the Planning Commission and the Finance Commission, it is pursued through different routes i.e. Finance Commission through equity (by ignoring the Plan expenditure, which is very

much a leveler of regional disparities) and the Planning Commission through growth, ignoring the non-Plan expenditure.

## **Government of India, Fiscal Policy Strategy Statement, 2005**

81. According to the Fiscal Policy Strategy Statement, tabled by the Finance Minister while presenting the Budget for the year 2005-2006, the line Ministries will be vested with enhanced delegation of financial powers, including powers of reappropriation. The Ministry of Finance will focus on budgetary/exchequer control, formulation and modification of schemes, review of norms and tariff governing user charges, and scales of expenses, manpower ceilings, responsiveness to internal audit and follow up on CAG's Audit Reports and clearance of high value transactions and expenditures not conforming to prescribed norms.

82. In a gradual move towards Quarterly Budgeting and better Exchequer Control, quarterly ceilings and targets will be prescribed for expenditure and revenue collection. Expenditure in excess of the ceilings as well as individual cases not adhering to the prescribed norms will require clearance of the Ministry of Finance.

83. The release of fresh Central assistance will be made contingent upon the submission of utilization certificates, audit certificates and expenditure statements for the amounts already released.

84. The expenditure will be reoriented to extract better value for money; a mechanism will be put in place to measure the development outcomes for all major programmes.

## **Report of the Comptroller and Auditor General of India for the year ended March 2004, Union Government, Accounts of the Union Government, No. 1 of 2005**

85. This Annual Report of the CAG broadly reviews the overall financial management of Government receipts and expenditure.

86. The Report for the year 2003-2004 points out several deficiencies in budget implementation e.g.

- March rush of expenditure on capital outlay and investments and grants-in-aid to sub-national jurisdictions;
- Excess disbursements over grants requiring regularization by Parliament;
- Unnecessary supplementary grants since the actual expenditure did not come up even to the level of the original budget provision;
- Large number of cases of savings of more than Rs. 1 billion , some of which were attributed to the failure of schemes to take off;
- Unauthorized payments by the Pay and Accounts Officers in excess of the available budget provisions for which reappropriation orders were not issued;
- Failure to surrender funds not required as well as surrender of funds in excess of the available savings;
- Unauthorized re-appropriations beyond the competence of the line Ministries;
- Injudicious, excessive and inadequate reappropriation of funds that indicated failure of expenditure monitoring mechanism;
- Persistent savings under certain heads year after year.

87. The Report also points out that internal audit was not being conducted in the Ministry of Non-conventional Energy Sources; the position of internal audit in the Department of Secondary and Higher Education (Ministry of Human Resource Development) was not satisfactory since only 7 to 19 per cent of the total number of units had been audited during 2001-2002 to 2003-2004; and in the Department of Economic Affairs, Ministry of Finance, internal audit checked only the transactions generated through the drawing and disbursing officers and did not comment upon budget formulation, expenditure control, unspent provisions, excess expenditure and monitoring and implementation of schemes etc.

**Report of the Comptroller and Auditor General of India  
for the year ended March 2004, Union Government,  
Transaction Audit Observations, No. 2 of 2005**

88. The Report reviewed the functioning of the internal control systems/internal audit in the Ministry of Information and Broadcasting and pointed out that there was no effective monitoring to control the flow of expenditure; important control records such as bill registers, stock registers of receipt books and register of valuables, duplicate key registers had either not been maintained or were improperly maintained; physical verification of assets and stores was heavily in arrears; compliance with internal/external audit observations was tardy; there was laxity in monitoring the performance of grantee institutions; and certain policy matters had not been reviewed as prescribed.

**Rangachari A.: Expenditure Management – A Different Approach *in* Public Expenditure Round Table, Chennai, 2002**

89. The accent is on spending per se, with the emphasis on spending there is no focus on the necessity, efficiency and effectiveness of expenditure and there is no link between the budget provision, cost and outcome. The classification and accounting system is still compliance and control oriented and no systematic attempt seems to have been made to develop performance indicators for the range of Government activities.

90. The role of the Financial Advisor is perceived by the line Ministries as one of procuring higher budget allocations.

91. Decentralization of financial management has weakened the technical capability of the Ministry of Finance to undertake or participate in the fundamental review of expenditure policies and programmes. Excessive compartmentalization further complicates the situation since non- Plan segment of expenditure is under the direct

purview of the Ministry of Finance while the Plan outlays are jointly determined by the Ministry of Finance, the Planning Commission and the line Ministries. Classification of expenditure as Plan gives it automatic priority and immunity from cuts.

### **Krishnan S.: Have Democratic Processes of Control Failed?, Public Expenditure Round Table, Chennai, 2002**

92. The results of audit of individual transactions as reported in the CAG's Audit Reports suggest a deliberate disregard of the financial rules, arbitrary exercise of authority including violation of the limits of delegated powers, non-compliance with the orders of the superior authorities and negligent processing of tenders for procurements.

93. CAG's appraisals of the centrally sponsored /funded schemes suggest more or less a similar pattern of deficient planning and execution by the State Governments/ District Collectors and absence of control and monitoring in the sponsoring Union Ministries.

### **Government of India, Planning Commission, Induction Material 2003**

94. The Programme Evaluation Organization undertakes evaluation studies of selected programmes/schemes as per the requirements of the Planning Commission, Ministries and Departments. The evaluation studies are designed to assess the performance, process of implementation, effectiveness of delivery systems and impact of programmes. The studies are diagnostic and aim at identifying the factors contributing to the success or failure of various programmes and deriving lessons for improving the performance of the existing schemes through mid-course correction and better design of future schemes.

### **Govinda Rao M.: Role of the State and Public Expenditure Policy, The Control and Management of Government Expenditure: Issues and Experiences in Asian Countries, Development Paper No 13, United Nations**

95. Efficiency control is hindered by lack of an effective mechanism for making detailed evaluations of the completed projects and feeding the information back into the budgetary process. The reports of the Programme Evaluation Division of the Planning Commission

have not been very useful in pinpointing the causes of inefficiency, nor is there any effective mechanism by which the Division's evaluation could be incorporated into future Plans.

**Govinda Rao M.: Intergovernmental Transfers in India, Financing Decentralized Expenditures, An International Comparison of Grants; edited by Ehtisham Ahmed Edward Elgar Publishing Ltd., 1997**

96. Besides the discretionary element in these transfers, the conditionality imposed by the Centre, including those on staffing patterns, tends to affect States' own priorities and programmes. It is often pointed out that the proliferation of schemes has increased even the village level bureaucracy considerably with no visible gains to the people.

**Government of India Guidelines for the Implementation of Macro Management Schemes**

97. These guidelines prescribe and illustrate the manner and conditionalities of release of the Union Government assistance to the State Governments. According to these guidelines 50 per cent of the annual allocation is released to the States as the first installment of the year. The release of the second and final installment is to be considered on receipt of the utilization certificate for the funds released up to the preceding year, expenditure of at least 60 per cent of the available funds i.e. the amount released in the first installment plus unspent balance of the previous year, if any, and full release of the corresponding share by the State Government. The States are permitted to carry over the unspent balance in the first year of operation to the extent of 25 per cent that will be reduced by 5 per cent every year so that the permissible carry over is limited to 10 per cent over a period of four years.

**Government of India, Planning Commission, Report of the Working Group on Strengthening Monitoring and Evaluation System for the Social Sector Development Schemes in the Country for the Tenth Five Year Plan, 2001**

98. Concurrent evaluation studies need to be conducted in order to understand various aspects such as the reaction of the beneficiaries to the proposed project, the reasons for cost and time overruns, the impact of the project on the target group and whether some groups have become worse off as a result of the project. These studies may be conducted at the implementation stage. Impact studies may be conducted after the project has been completed.

99. There is need to pay attention on important aspects of monitoring and evaluation at three different levels. At the lowest or the micro-level, design of indicators for monitoring and evaluation must form an integral part of the programme design. At the secondary level, evaluation studies should focus on the impact of a set of similar/related schemes, and, finally, at the macro level the evaluation falling within the sub-sectors (taken together) has to focus on a geographical region or regions and evaluate the impact of all schemes being carried out within the region(s).

100. Before releasing funds in a financial year, the State Plan Division who recommends release of funds to the States should thoroughly monitor and evaluate the programmes implemented by the State in the preceding financial year. Similarly, other sectoral divisions of the Planning Commission should thoroughly monitor and review the performance of the line Ministries before recommending release of funds for a scheme. Performance-based release of funds to the States needs to be in place if monitoring is to play a role in improving the implementation of the social sector schemes.

101. Budgets of departments should be reviewed based on the performance of the schemes rather than on expenditure incurred on the scheme.

102. Financial monitoring to prevent diversion of development funds to non-developmental activities may be made a part of review when releasing funds to the States.

103. Review of programmes through monitoring should be made mandatory before the Annual Plan meetings. Monitoring of programmes must be supplemented by monitoring of action taken on the recommendations of the monitoring units.

104. The monitoring system should be reoriented from quantitative to qualitative in order to capture the complete picture of developments in the social sector. Development of indicators is an essential pre-requisite --- indicators must comprise of input indicators, output indicators and impact indicators.

105. The Working Group stressed the need for sharing the information with the stakeholders, use of information technology and involvement of the NGO's. It recognized the need for capacity building both in the Government and in the voluntary sector. Finally, the Working Group cautioned against the duplication of the related work by the CAG.

### **The World Bank, India Country Procurement Assessment Report, December 2003**

106. Despite the huge magnitude of procurement by the Government of India there is no single department or agency exclusively responsible for framing policies or regulating procurements. Also, there exists no separate legislation to regulate public procurements and there is no legal authority to the public procurement procedural framework, which is essentially a set of executive directives.

107. Although there does exist a reasonably good framework of rules, procedures and documents, the Ministries and the Departments tend to modify them, ostensibly to meet their specific requirements, but at the cost of credibility and public confidence in the system. Different agencies and Ministries use a multiplicity of documents for identical procurements.

108. No effective, quick and credible system exists for redressal of grievances in the award of tenders. Instructions for post-tender negotiations are confusing; negotiations lead to opaqueness in the system.

109. Delays in tender processing and award of contracts are endemic as much as in contract implementation with little appreciation of the cost of delays.

110. The two-envelope system tends to be misused to permit switching of price envelopes because of the time lag between the opening of the technical bids and the opening of the price bids. Since the price-envelopes of bids that are rejected are returned unopened, the approving authority and the auditors are prevented from knowing the additional price paid for a trivial or minor or unnecessary or avoidable requirement.

111. For works contracts the schedule of rates, which is the benchmark of assessing the reasonableness of bids, is neither computed scientifically nor updated regularly. The system of registration of contractors has become a vehicle of corruption and once a contractor is registered, he is automatically deemed qualified and bad contractors are not eliminated from the list of registered contractors.

112. Contracts do not provide for adequate price adjustment and fair claim and dispute resolution mechanism.

113. Not much use of institutional memory relating to the past performance of contractors has been made and no performance indicators have been developed.

## **Premchand A. Potter Barry: Woolley Mike, India: Public Expenditure Management, 1996**

114. While the dual responsibility of the Financial Advisor to the line ministry and to the Ministry of Finance remains, the balance has clearly shifted to the direct line Ministerial responsibility. It is inherently awkward to expect the Financial Advisor to act both as proposer and scrutinizer of expenditure programmes. There is need for closer contact between the Financial Advisor and the Ministry of Finance.

115. The Ministry of Finance should have a much stronger scrutiny function than at present in the matter of budget estimates.

116. Government accounts do not depict the true picture of excess expenditure over the approved grants since substantial amounts remain under the 'Suspense' heads and are not adjusted to the final heads of accounts, expenditures are carried over from one year to another and there are arrears in payments.

117. Most projects and programmes suffer from time and cost overruns. Although there are several procedures for the screening of the project before it is finally approved, the process of monitoring with a view to taking timely action is rather weak.

118. In order to ensure that the actual expenditure does not exceed the amount of the legislatively approved amount of grant and there is even, predictable flow of expenditure it is necessary for the line Ministries

- to prepare monthly estimates of cash flows and commitment levels and monitor these throughout the year;
- to set limits for cash on a monthly basis;
- to set commitment limits on a six-monthly basis; and
- to introduce and operate a small contingency reserve (not to be confused with the Contingency Fund of India) that will facilitate budget compliance.

119. The expenditure management system has, as yet, no focus on procuring efficiency in Government operations.

120. There is need for strengthened internal audit, setting of the programme performance targets, and the publication of material in the Annual Reports of the Ministry that would bring more emphasis on results and not just input costs. The internal audit function should redirect its attention to the efficacy of the delivery aspects of various programmes and the examination of the cost bases and measurements of those programmes.

121. The direction of internal audit should be at the behest of the Secretary of the Ministry who should endorse an annual internal audit programme at the beginning of each financial year. The internal audit programme should be prepared by an Audit Advisory Committee headed by the Financial Advisor and with membership drawn from the accounting staff, internal audit, and the policy and operation divisions of the Ministry. After some time, it might be desirable to form an Audit Advisory Committee at the central level to oversee developments and techniques in internal audit. This Committee might also ensure that internal audit is in place and effective. In some instances, experts from other disciplines may supplement internal audit teams for short periods.

122. The Ministry of Finance should review the results of internal audit and external audit with the Ministries; this is essential if the full benefits are to be obtained by using the results from investigations of the past in setting budgets for the future.

**Ghosh Amiya Kumar: Effective Budgetary Control for Expenditure Management and its Ramifications for Public Policy and Governance, Reading Material for the Workshop for Financial Advisors of the Government of India organized by the National Institute of Financial Management, Faridabad, September 1997**

123. The canons of financial propriety as laid down in the General Financial Rules have not been concretized by issue of detailed procurement procedures.

124. Although the Secretary to the Ministry has been made the Chief Accounting Authority, it appears that this responsibility is not being taken with adequate seriousness as evidenced by the variations between the Ministry's projection of its budget

requirement, the actual allotment by the Ministry of Finance and the plethora of Supplementary grants.

125. The rule of lapse whereby the budget allotment must lapse at the end of the year is a ready-made rule for wastage and causes distortion of priorities. For proper control over quality as well as quantity of expenditure, not more than 15 per cent of the allotted amount should be allowed to be spent in the month of March. A reserve fund may be created so that the allocation is available in the subsequent year(s).

126. For proper budgetary control two things are necessary:

- (a) Classification of expenditure object-wise in as much detail as possible with reference to the spending authority, project or programme to which it relates and whether it pertains to payments on account of past obligations; and
- (b) Allotment of funds as per these code heads at the beginning of the year that will help in control of expenditure object-wise; this would ensure better planning and prioritization of expenditure.

127. It is also necessary that a holistic view of the expenditure is taken with reference to its ultimate purpose for ensuring productivity of expenditure and avoidance of mismatches in the creation of assets that result in idling of investments.

**Handa K.L.: Management Accounting in Government, The Indian Journal of Public Administration, Vol. XXIV, No.4, 1978**

128. There is no need to maintain duplicate set of accounts by the administrative authorities, which are reconciled with the accounts prepared in the departmental accounting organization headed by the Chief Controller of Accounts. This requires fuller integration of the accounting set up at different levels with the Financial Advisor's hierarchy and also with the administrative and executive authorities in the Ministry/department at all levels (and not merely at the level of the Financial Advisor at which the finance and the accounts functions are currently integrated).

**Premchand A. and Chattoopadhyay Saumen: Fiscal Adjustment and Expenditure Management, Fiscal Policies and Sustainable Growth, Oxford University Press, 2004**

129. The public perception is that the expenditure management machinery is too process-oriented, focusing more on the procedural and legal aspects and less on the actual delivery of services, and notwithstanding the formulation of medium term (five-year) plans the actual operations are determined by the annual allocations released as distinct from those in the budget estimates.

130. The institution of supplementary budgets makes the initial budget a putative one; in addition, it contributes to a budget outcome that is different from the one initially intended.

131. The bulk of the budget outlays is devoted to transfers to other levels of Government and autonomous institutions, which makes the task of congruence between the funding agency and the provision of services difficult.

132. Most programmes are supply driven and personnel-oriented; in such situations under-funding leads to severe adjustments in the provision of services. The absence of a proper cash management system causes bunching of expenditure towards the end of the year and the delay in the releases of Central assistance to the sub-national levels causes further delays at the local levels.

133. The implementation of the programmes is not preceded by the specification of the cost, time and quantity schedules against which the actual services may be measured, the relationship between the resources provided in the budget and the services to be delivered is at best nebulous, there are no incentives for securing economies and the services are not costed.

**Kaura Dr. Mohinder N.: Administrative and Financial Accountability in India, Administrative and Financial Accountability, The ASEAN-SAARC Experience, 1994**

134. For improving the accountability of the departmental programmes and projects, administrative as well as financial, it is desirable to make a fresh base review of all activities of a department once in three or four years. This exercise should be independently conducted a couple of months before the budget formulation exercise begins. Such timing will ensure effectiveness of the efforts and scarce resources employed in the administrative activity, besides promoting financial discipline. The fresh base review will prove more beneficial than the traditional concept of zero-base budgeting. The primary purpose of the fresh base review is the improved planning of work and deployment of resources.

135. The executing agency should be more intimately and effectively associated at the project formulation stage through joint discussions. Review of performance in relation to budget should also follow the procedure of similar joint discussion. Hence budget formulation, implementation, evaluation of performance and decisions on corrective measures become the joint responsibility of both the parties.

**Tummala Krishna K.: Public Administration in India, Allied Publishers Ltd., New Delhi, 1996**

136. Instead of helping the line ministries in preparing efficient estimates as well as in expenditure, the Ministry of Finance often acts as a penny pinching, even petty, control agency. The prevailing belief among the line Ministries is that often the Ministry of Finance relishes standing in their way by saying “No” rather than giving a helping hand to them.

**Goel S.L.: Financial Administration, Deep and Deep Publications, New Delhi, 2002**

137. An effective cost control system is non-existent in most government departments; this needs to be developed to measure performance and also to develop a realistic system of planning and policy-making.

138. The Ministry of Finance should develop a positive attitude to inject greater initiative and enthusiasm in the line departments.

## **Defense Services Estimates for the year 2004-2005**

139. Appendix B and Appendix C to the Defense Services Estimates for the year 2004-2005 describe the procedure for control over defense services expenditure. The Financial Advisor Defense Services, (FADS) is responsible for the scrutiny of all proposals relating to defense expenditure for their necessity, propriety, justification, appropriateness etc. In his capacity as the Chief Accounting Officer for the Defense Services he prepares the Appropriation Accounts for the Defense Services.

140. The Controller General of Defense Accounts functioning under the FADS ensures that no expenditure is incurred unless it is in accordance with the appropriate authority or the relevant rules and regulations. The pre-audit and internal audit functions are performed by the Defense Accounts Department, which is also responsible for the audit of cash and stores accounts.

141. The Controllers of Defense Accounts function as Local Financial Advisors to the General Officers Commanding-in-Chief of the Commands. Internal Financial Advisors have also been positioned in the Services Headquarters for rendering financial advice on powers delegated to them.

142. The ultimate responsibility for ensuring that the expenditure does not exceed the budget allotment rests on the Services Headquarters who allot funds to the subordinate formations and monitor expenditure against such allotments. The Controllers of Defense Accounts render monthly statements of expenditure to the allottees and also keep a watch on the progress of expenditure against the sanctioned allotments.

## **Ghosh A.K.: India's Defense Expenditure and Expenditure Management in a Wider Context, Lancer Publishers, New Delhi, 1996**

143. The system of classification of defense expenditure and the Defense Budget continue to be object-wise, with programme element totally missing; consequently it has failed to function as an effective instrument of expenditure control.

144. The present system of a common Grant for the capital expenditure relating to the three Services, Army, Navy and the Air Force should be revisited. The 'capital outlay' is not a functional classification even in the broadest sense of the term.

145. The budgetary programmes should be made service-wise and organization-wise and the capital budget should be used along with the revenue budget for developing programmes. The very rationale of the distinction between revenue and capital in the context of defense expenditure is not very enlightening.

146. The 'rule of lapse' whereby any amount of the budgetary provision that remains unspent at the end of the financial year cannot be carried forward for utilization in the following year, is a ready made rule for waste since it leads to rush of expenditure in the last month without adequate scrutiny for its effectiveness.

147. A Task Force on 'Review and Rationalization of Accounting Classification of Defense Services for Expenditure and Budgetary Control (1992) had recommended:

- (i) *Introduction of decentralized resource management in the logistic areas with the concept of budget Centre.* The budget Centre would have the requisite authority and responsibility for achieving laid down objectives with adequately flexibility of management.
- (ii) *Control of commitment of expenditure through the mechanism of indicative budget for three to four years for each budget Centre.* Knowing the likely allocation of resources in the next five years would also help in planning by the officers responsible for the functioning of the budget Centre. Planning and budgeting should be brought together in the management of revenue expenditure through this mechanism of indicative budget.
- (iii) *Institution of proper information system through restructuring the classification code heads to enable management to exercise better control over the budget particularly on commitments.* Information should be available to the management before commitments are made.
- (iv) *Allocation of budget to be made detailed head-wise (under which expenditure was booked) both for earlier commitments as also fresh commitments;*
- (v) *There should be a clear segregation of funds for meeting the requirements of past commitments, which should be the first charge on the budget.*

## **Report of the Comptroller and Auditor General of India for the year ended March 2002, Union Government (Defense Services) Air Force and Navy, No.8A of 2002**

148. The Report describes the Ministry of Defense policies, practices and procedures relating to inventory management in the Indian Navy. It covers the predominant range of Navy's inventory holdings i.e. Naval stores and Equipment and spare parts handled by the Naval Logistics System.

149. The Report critically examines the Navy's practices and procedures of initial and replenishment provisioning, the types of demands, the procurement procedures, vendor performance, inventory holdings, demand satisfaction, etc. It also makes suggestions for introduction of more cost-effective and efficient inventory management.

## **Report of the Comptroller and Auditor General of India for the year ended March 2000, Review of Inventory Management in Ordnance Services, Union Government (Defense Services) No.7A of 2000**

150. The Report describes the policies, practices and procedures of inventory management in the Indian Army and examines whether these are contemporary and cost-effective, bearing in mind the imperative need for the Army to remain in a high state of operational readiness at all times.

151. The Report critically examines the essential functions of Army's inventory management relating to Provision, Supply Chain Management, Inventory and Budget Controls, Procurement, Stock Visibility, Disposal and Warehousing. The Report focuses essentially on Spares, General Stores and Clothing that are managed at the level of the Central Ordnance Depots.

## **The Indian Railway Financial Code, 1982**

152. The Railway finances were separated from the General Finances of the Government of India by a resolution of the Central Legislative Assembly of September 1924.

153. The Indian Railway Financial Code Volume I describes the various important aspects of financial management of the Indian Railways like project appraisal, budget construction reporting and control, award of contracts, allocation of expenditure, contingent expenses, allocation of expenditure between the Zonal Railways, investigation of losses etc. Volume II of the Code deals with the classification of earnings and expenditure of the Railways.

154. The Financial Commissioner, Railways, is the professional head of the Railway Financial Organization and represents the Ministry of Finance on the Railway Board, which is the apex body. In the event of a difference of opinion between the Financial Commissioner and other members of the Board, the former has the right to refer the matter to the Finance Minister. An expanded Board, which includes the Finance Secretary as one of its members, has been vested with the powers to decide on high value matters exceeding a specified amount.

155. The Railways have an elaborate scheme of delegation of financial powers to the Zonal Managers as well as the subordinate formations. Although the control of the

Accounts set up has been vested in the Zonal General Manager, the head of the finance and accounts wing is authorized to insist that any difference of opinion be brought to the notice of the Railway Board both in regard to matters of accounting propriety as well as matters of financial prudence.

156. The Railway Accounts Organization is responsible for the audit (internal as well as pre-audit) of the Railway receipts and expenditure and their accounting. The functions of the Railway Accounts Officers go beyond the traditional bounds of those of the Financial Accountants of tendering advice whenever required. The Finance officer's job as Management Accountants is to furnish and interpret financial statements, compile cost data and prepare cost reports, explore avenues of controlling staff and material costs, institute and operate budgetary control procedures, and participate in all capital expenditure and rating/pricing decisions.

157. Besides setting out the procedure for budget construction, the Indian Railway Financial Code Volume I describes in detail the methodology, criteria and techniques for the appraisal of different types of railway projects (construction of new lines, line capacity works like gauge conversion, yard remodeling and terminal facilities, traction change, introduction of new trains etc;) with the active involvement of the financial organization.

158. The Code also describes the procedure for the control over expenditure and the preparation of the Railways Appropriation Accounts for being presented to the Parliament after audit by the CAG.

159. The Code explains the procedure for exercise of exchequer control at length. The Code distinguishes between classification of expenditure and its allocation; the latter identifies its source of finance. It also sets out the basic principles of accounting. The procedure for reporting and investigation of losses of cash, stores, or other Railway property is also described in the Code.

160. There are separate codes and manuals that set out the procedure for procurement, receipt, accounting and custody of stores, contracting for engineering works, establishment matters etc.

## **Indian Railways Code for the Accounts Department**

161. The Indian Railways Code for the Accounts Department describes the transaction-level internal checks applied by the Accounts Department on different types of transactions. Ordinarily, all transactions, whether relating to receipts or expenditure, are required to be checked cent percent and no transaction can be brought to account before it has been completely checked. All claims against the railway are required to be checked before payment is made, except as prescribed otherwise e.g. in the case of payments made from imprest, or from the station earnings that may be permitted etc.

# Chapter 16

## REVENUE ADMINISTRATION

### The Constitution of India

1. Constitution of India prescribes that no tax can be levied without the authority of law. It prescribes the kind of taxes that can be levied by Union Government and those by the States. There are taxes which are levied, collected and retained by the Centre. Some taxes are levied, collected by the Centre but shared with the States. There are other taxes which are levied by the Centre but collected and retained by the States. Still others, which are levied and collected by the Centre, but assigned to the States.

### THE CENTRAL BOARDS OF REVENUE ACT, 1963

2. This was an Act to provide for the constitution of separate Boards of Revenue for Direct Taxes and for Excise and Customs and to amend certain enactments for the purpose of conferring powers and imposing duties on the said Boards. The Central Board of Revenue Act, 1924 was repealed.

3. The Central Board of Revenue, as the Department apex body charged with the administration of taxes, came into existence as a result of the Central Board of Revenue Act, 1924. Initially the Board was in charge of both direct and indirect taxes. However, when the administration of taxes became too unwieldy for one Board to handle, the Board was split up into two, namely the Central Board of Direct Taxes and Central Board of Excise and Customs with effect from 1.1.1964. This bifurcation was brought about by constitution of the two Boards u/s 3 of the Central Boards of Revenue Act, 1963.

4. **Income Tax Act, 1961** (Successor to The Indian Income-tax Act, 1922) governs the levy of personal income tax as well as corporate tax. The Act is administered by the Central Board of Direct Taxes (CBDT).

5. The Act is being constantly reviewed and rationalised. Rules are framed under the Act by the government. The department issues notifications and circulars, as needed, for the guidance of the tax authorities and the tax paying public.

6. The Act prescribes the constitution of an **Appellate Tribunal**, which is the second level of appeal after the appeals branch of the department. Further appeals on matters of law lie with High Court/Supreme Court.

7. The Act also prescribes the establishment of an Authority for Advance Ruling as well as for a Settlement Commission.

## **Authority for Advance Rulings (Procedure) Rules, 1996**

8. A person wishing to seek advance clarification of interpretation of income tax law can file a request for an advance ruling. The ruling given by the Authority is binding on the Income Tax Department. The proceedings before the Authority are deemed to be judicial proceedings.

9. **Income-tax Settlement Commission (Procedure) Rules, 1987** lays down the procedure for settling cases by the assesseees by seeking the intervention of the Settlement Commission set up under the law. The proceedings before the Authority are deemed to be judicial proceedings.

10. **Income-tax (Appellate Tribunal) Rules, 1963** lays down the procedure to be followed by the Appellate tribunals. The proceedings before the Authority are deemed to be judicial proceedings.

11. **The Central Board of Direct Taxes** is a statutory authority functioning under the Central Board of Revenue Act, 1963. The officials of the Board deal with matters relating to levy and collection of direct taxes and formulation of policy concerning administrative reforms and changes for the effective functioning of Income-tax Department.

12. **Website of the Income Tax Department** gives information regarding all aspects of income tax administration. All the relevant Acts, Rules, notifications circulars and downloadable forms are available. The department has also placed in its website a Citizen's Charter assuring the tax payers of the commitment of the department to excellence in their service to the taxpayer

## **Recent Initiatives of Income Tax Department in E- governance**

13. A recent major initiative in tax administration area relates to Tax Information Network (TIN) being implemented by National Stock Depository Limited. Among the services offered are Tatkal PAN (Immediate allotment of Permanent Index number), filing of IT returns by the individual subscribers, online payment of tax, refund of tax through electronic clearing facility directly to the bank accounts of the subscribers, online application from PAN, TDS cum return forms for assesses with less than Rs 1, 50,000 as income, online accounting system of tax receipts, reduction of number of forms of challan for payment of tax from seven to three. This is designed to make the tax administration more effective, furnishing of returns convenient, reduce compliance cost and bring greater transparency. In addition TIN is also intended to collect data from various agencies to collate information on the taxpayers.

## **Customs Act, 1962**

14. Customs Act governs the levy of customs duty. The Act prescribes the maximum duty that can be levied and the government notifies the effective rate through executive

orders. Rules, regulations, notifications, tariff, manuals and circulars are used to guide the revenue officials and taxpaying public.

### **Customs Manual 2001**

15. This book designed to guide the importers, exporters and the customs officials brings out in common man's language the procedures contained in the ACT, Rules, circulars and notifications.

### **Central Excise Act 1944**

16. The Central Excise Act governs the levy of central excise duties. The Act prescribes the maximum duty that can be levied and the government notifies the effective rate through executive orders. Rules, regulations, notifications, tariff, manuals and circulars are issued to guide the revenue officials and taxpaying public.

### **Central Excise Rules, 2001**

17. These Rules, issued under the Central Excise Act, consolidated and updated the existing rules under Central Excise Rules 1944.

### **Central Excise Manual, 2001**

18. This manual was issued for the first time in 2001 capturing therein all relevant procedures in central excise in a simple and easy to comprehend manner. The manual is meant to be a handy reference book for trade, industry and central excise field formations.

19. Chapter 15 deals extensively with the internal audit system which has been modernised (Excise Audit 2000).

### **Finance Act, 1994**

20. Finance Act, 1994 introduced Service Tax for the first time on a few services.

### **Service Tax Rules, 1994**

21. In terms of the Finance Act 1994, Service Tax Rules, 1994 were notified by the GoI on the 28<sup>th</sup> June 2004. These Rules prescribe the modalities of administration of the Service Tax.

### **Central Board of Excise and Customs (CBEC)**

22. This is a statutory authority functioning under the Central Board of Revenue Act, 1963 and functions under the Department of Revenue, Ministry of Finance. The officials of the Board deal with matters relating to levy and collection of indirect taxes,

formulation of policy concerning administrative reforms and changes for the effective functioning of the excise and customs department. The Customs Act and the Central Excise Act and the Rules thereunder are administered by Central Board of Excise and Customs. Administration of Service Tax has also been entrusted to CBEC.

### **The Customs, Excise & Gold (Control) Appellate Tribunal (Procedure) Rules, 1982**

23. The Customs Act, 1962 and Central Excise Act, 1944 were amended by Finance Act, 1980 to provide for the establishment of **Customs, Excise & Gold (Control) Appellate Tribunal (CEGAT)**. This tribunal has been functioning since 1982. It is now known as **Customs, Excise and Service Tax Appellate Tribunal (CESTAT)**.

24. It has judicial powers and appeal against the ordered of the Tribunal lies only with High court/Supreme Court on matters of law.

### **Central Excise and Customs Settlement Commission**

25. This Commission statutorily under the Customs Act, 1962 has powers to settle cases where a tax payer makes an application voluntarily offering to make good the taxes underpaid earlier.

### **Website of CBEC**

26. It is comprehensive giving all the information including the Act, the Rules, the tariff, the manual, notifications and procedures. As CBEC administers Service Tax also through Director General (Service Tax) (DGST), all relevant information regarding Service Tax is given in the website. The website of DGST also provides information on Service Tax comprehensively.

27. The list of defaulters of customs & central excise duties is given in the website zonewise.

28. CBEC has adopted a Citizen's Charter which is also featured in the site.

### **Authority for Advance Rulings, Customs & Central Excise**

29. Authority for Advance Rulings, Customs & Central Excise was set up under the Central Excise Act, 1944 to give binding advance rulings on taxation issues referred to it by the tax payers. Setting up this Authority is a measure to guide the potential investors about the tax ramifications. The legal provisions of Advance Rulings were introduced through the Finance Acts of 1998, 1999 and 2003.

### **Internal Audit**

30. There is an internal audit wing each in the Income tax, Customs and Central Excise departments. These work under separate directorates.

## **Court and Tribunal Judgments**

31. These have formed a large body of case law that governs the interpretation of tax laws. The judicial pronouncements have an impact on tax administration as well.

## **Finance Act, 1994**

32. It introduced the Service tax for the first time by imposing the tax on three services. Since then, the scope of the tax has been widened bringing in more services under the tax net (it was raised to 58 in Finance Act 2004).

## **Annual Reports of Ministry of Finance**

33. These reports which are placed in Parliament give the activities of all the departments under Ministry of Finance including the Revenue Department. Among other details, the report gives the initiatives taken by the department on the e-governance side to simplify tax administration procedures. Measures to strengthen the revenue administration during the year are given in the reports.

## **Finance Minister's address to the Chief Commissioners of Income Tax on the 26<sup>th</sup> July 2005**

34. The Finance Minister, concerned over a whopping Rs 876,750 million of direct tax arrears, said that a sizeable amount of it was undisputed and recoverable. He exhorted the officials to make a concerted effort to recover the taxes.

## **Budget speech of the Finance Minister presenting the 2005-06 Budget, 28<sup>th</sup> Feb 2005**

35. The Finance Minister acted on some of the recommendations of the Kelkar Task Force by removing some of the prevailing exemptions and making tax reductions upfront, especially on the direct taxes.

## **The Central Excise Tariff Act, 1985 (CETA) and the Customs Tariff Act, 1975**

36. The Central Excise Tariff Act, 1985 (CETA) classifies all the goods under 95 chapters (in fact 96 chapters out of which chapter No. 77 is blank) and specific code is assigned to each item. There are over 1,000 tariff headings and 2,000 sub-headings. This classification forms basis for classifying the goods under particular Chapter head and Sub-head to prescribe duty to be charged on that particular product. Salient features of the tariff are as follows.

37. As international trade increased, need was felt to have universal standard system of classification of goods to facilitate trade flow and analysis of trade statistics. Hence, International convention of Harmonized System of Nomenclature (HSN), called Harmonized Commodity Description and Coding System, was developed by World

Customs Organization (WCO) (That time called as Customs Cooperation Council). Indian Customs adopted this nomenclature w.e.f. 28.2.1986.

38. This is an International Nomenclature standard adopted by most of the Countries to ensure uniformity in classification in International Trade. HSN is a multi purpose 6 digit nomenclature classifying goods in 5019 groups of goods. It contains 241 headings at 4 digit level and 5019 at 6 digit level.

39. Customs Tariff has added two more digits for further precision. Thus, Customs Tariff uses 8 digit nomenclatures. Central Excise Tariff is also of 8 digit w.e.f. 28-2-2005.

40. WCO in its various committees discusses classification of individual products and gives classification opinion on them. Though their opinion is not binding in legal sense, it provides a useful guideline for classifying goods.

41. Since there are thousands of different goods, which are imported into India, it is not possible to prescribe rates of duty for each type of merchandise. Therefore, all goods are classified into categories (called "headings" and "subheadings") for the purpose of levy of duty. For each sub-heading, a specific rate of duty has been prescribed. The process of assigning the goods to a "headings" or a "subheadings" is known as "Classification of Goods" i.e. determination of heading or sub-heading under which a particular item is covered. The classification is as per the Schedules to the Customs Tariff Act, 1975, commonly referred to as the tariff, and is based on the Harmonized System of Nomenclature (HSN) which has been established by the World Customs Organization.

42. The rules to be followed while determining the classification have been given in the General Rules of Interpretation of the First Schedule to the Customs Tariff Act, 1975.

43. Though both Central Excise Tariff and Customs Tariff are based on HSN, they are not copies of each other. In *Tata Liebert Ltd. v. CCE 2000(117) ELT 817 = 35 RLT 933* (CEGAT 3 member bench), it was held that classification under Customs Tariff cannot be applied under Central Excise Tariff Act.

#### **Government of India, Administrative Reforms Commission Working Group Report on Central Direct Tax Administration, 1968**

44. The Working Group noted with concern the growing number of arrears in cases of assessment and suggested a number of measures to speed up. Committee gave a series of path breaking recommendations on arrears of tax revenue, simplification of procedures, and removal of complexities of law, tax evasion and tax administration.

#### **Government of India, Report of the Tax Reform Committee [Raja Chelliah Committee] August 1992**

45. The Tax Reform Committee gave two interim and two final reports.

46. The recommendations form the basis of major tax reforms of the 1990's. Reduction of rates, enlarging tax base, reforms in administration, introduction of CENVAT leading to full scale VAT are some of the major recommendations. The committee had also suggested tax on Services.

47. The committee listed the following problem areas in tax administration.

- a). High rates.
- b). Multiplicity of duty rates.
- c). Changes in law brought about without adequate public consultation and debate.
- d). Multifarious exemptions, concessions and deductions introduced in tax laws for achieving many and non revenue objectives and constant changes.
- e). Amending rules and exemptions throughout the year.
- f). Fixing unrealistic revenue targets for the year.
- g). Fear of audit.
- h). Lack of accountability of assessing officers.
- i). tendency to go for appeals without proper application of mind.
- j). Relentless pursuit of cases of small value.
- k). Inappropriateness of the reward system.
- l). Inadequacy of information system.
- m). Ineffective functioning of administration and interference by political authorities.

48. The report contains recommendations covering all the above areas. Some of the major recommendations were:

- The share of customs duties in total taxes be reduced and the share of direct taxes to be raised.
- Maximum rate of customs duty to be reduced progressively.
- More revenue needed to be mobilized via excise duties by transforming them into value added taxes.
- Maximum rates of personal and corporate income taxes were to be reduced. A simple three-tier personal income tax structure, with an entry rate of 20 per cent and a top rate of 40 per cent.
- A phased reduction of the corporate tax rate to 40 per cent, with the abolition of the distinction between widely-held and closely-held companies.
- Systematic elimination of the numerous prevailing exemptions and tax preferences in both direct and indirect taxes to broaden the base of the major taxes.
- Far-reaching reforms of the systems of tax administration, including the deployment of modern information technology and online linkage of new tax identification numbers to a national network.
- Service tax to be introduced.

**Government of India, Task Force on Direct and Indirect Taxes, Vijay Kelkar Committee Report, November 2002**

49. Government of India set up a task force under the chairmanship of Dr. Vijay Kelkar to look into all aspects of tax administration including tax policy and rate structure. The recommendations on tax administration are based on the basic premise that “tax administration is tax policy”. Twin objectives before tax administration should be to be user friendly to encourage voluntary compliance and should be able to come down heavily on the defaulter, if necessary.

50. The report, which was submitted in November 2002, contains wide ranging recommendations, covering micro issues as well, on tax administration for both Direct and Indirect taxes. Areas covered include role of administration, taxpayer service, taxpayer identification and registration, collection of information, verification and processing of tax returns, computerization of tax administration, collection and accounting of taxes, refunds, search and seizure, accountability and infrastructure, customs procedure, tax based system (Universal Green Channel), Central Excise procedural simplification and automation of indirect tax administration. These recommendations aim to simplify and rationalise the tax system, effectively reduce transaction costs, encourage voluntary compliance and bring Indian tax system at par with best international practices.

51. These recommendations were made available in the website of Ministry of Finance as Consultation Paper. Final reports were presented after considering the response to the Consultation Paper.

52. Apart from suggesting many changes in the administrative procedures, the report had suggested elimination of exemptions from both direct and indirect taxes, and increase in the tax base. In direct taxes, basic threshold level was sought to be raised, simultaneously removing many exemptions, including those relating to savings. It had also suggested moving towards EET (Exempt-Exempt-Tax) treatment for all savings instruments qualifying for IT concessions. Introduction of a full scale VAT harmonising the state and central taxes (Central Excise) was another major suggestion.

(Action has already been initiated on some of the recommendations)

**National Institute of Public Finance and Policy, Shome, Parthasarathy, Mukhopadhyay, Sukumar and Chattopadhyaya, Suman: Report on Reforms in Customs Law and Procedure, May 1997**

53. The report covers several aspects in customs administration especially the import and export of goods. Makes wide ranging recommendations to improve customs administration.

**Planning Commission, Report of the Advisory Group on Tax Policy and Tax Administration for the Tenth Plan 2001**

54. The report surveys the scene of tax administration and makes recommendations covering all areas.

55. On Direct Taxes, the report indicates the measures to be taken for improving tax structure and tax administration like increasing the number of assessees, reduction of tax burden and meaningful computerization.

56. On Indirect Taxes, it traces the reduction of rates as the reason for low buoyancy. It recommends that cenvat be modified allowing full credit for all inputs in order to eliminate distortion, multiple and complex exemptions to be removed and service tax to be expanded. The ultimate aim would be to have a harmonious VAT.

**Comptroller and Auditor General of India, “Conceptual Framework of Government Accounting System in India”, Ghosh, D. N. Committee Report 2004**

57. The Committee found the following shortcomings in the existing system of accounting of revenue, which is on ‘cash basis’:

- The tax collected in a year could represent the tax due in earlier years.
- The arrears, which are tax receivables, are not reflected in the accounts. Arrears are estimated to be 30per cent of the tax collected in a year.
- Refunds and interest paid thereon are not accounted for separately. They are netted against the tax collections. The refunds account for nearly 20per cent of the tax collections in a year.
- Interest paid on refunds is an expenditure that needs to be authorized by Parliament.
- There is no provision to capture the tax expenditure.

58. The Committee has suggested that adoption of an ‘Appropriate Accounting’ methodology which captures transactions on accrual basis where feasible and others on cash basis with appropriate disclosures. Revenue transactions have been categorized as

1. Non-exchange revenues
2. Exchange revenues

59. Non-exchange revenues are those that arise from transactions where the income is received by Government as a ‘right’ without any obligation on part of Government to provide any specific service in return. In these transactions which are primarily taxes, grants and private donations, Government receives value without being legally obligated to provide any direct service of equivalent value. In other words, there is no sufficient or direct quid pro quo for amounts received.

60. In contrast, in an exchange transaction, each party receives and gives essentially equal values.

61. The Committee has laid down the principles of classification and given the guidelines for accounting for each type of transaction on cash or accrual basis. The level of disclosure needed is also indicated in each case.

**Mehta, Pratap Bhanu: “Kelkar's Burdens”, The Hindu, 11<sup>th</sup> January, 2003**

62. The Kelkar committee reports as they address the problem of tax administration squarely. The report is based on the four premises of better tax administration, reduction of number of exemptions, lower tax for all and respect to tax payers too spend as they like instead of being directed to spend where the exemptions lead them. Only those who have been evading tax should fear the report as it contains specific suggestions to counter evasion.

**Ramanujam T. C. A.: “Tax admin: Reforms kept in arrears – Accountability factor”, The Hindu, 9<sup>th</sup> July, 2004**

63. The delay in refunds is a sore point with the taxpayers. Kelkar has shown vision in suggesting a more efficient way of using the banks to pay the refunds and introduction of information technology for the purpose.

**Narasimhan, C.R.L.: “VAT 2003 – the final push?”, The Hindu, 25<sup>th</sup> January, 2003**

64. All theoretical arguments have favored the introduction of VAT sooner rather than later. Because under VAT the cascading effect of the existing indirect tax structure will be avoided, manufacturers as well as consumers should benefit. The tax administration can be made more transparent.

65. The tax will be simpler to administer. The States' biggest worry has been over possible loss of revenue in the initial years. The Centre has promised to alleviate this particular aspect.

66. However, in the final analysis, it is to be seen whether the respective governments will muster the political will and be able to override the vested interests that invariably favor the status quo.

**Jhaveri, N J.: “Direct Tax Reform: A Critical Evaluation of the Task Force Paper”, Economic and Political Weekly, 30<sup>th</sup> November, 2002**

67. The Consultation Paper on Direct Taxes makes a strong and cogent case for the autonomy of tax administration, for transforming it into a taxpayer service department and for the abolition of fiscal incentives. But, given the government record of poor delegation of authority to Public Sector Undertakings, it is doubtful if the proposed autonomy to tax administrators would materialize. The recommendations assume that a user friendly tax department will improve compliance, ignoring the low ethical standards of the taxpayers.

**Godbole, Madhav: “Task Force Reports on Direct and Indirect Taxes Some Issues”, Economic and Political Weekly, 7<sup>th</sup> December, 2002**

68. In spite of some limitations and weaknesses, the Task Force reports on direct and indirect taxes have covered the large and highly complex canvas of tax administration competently. Their comprehensive treatment of issues, within the very short time given for their deliberations, is commendable. As the reports have underlined, the efficiency of the recommendations is likely to be seriously vitiated if individual components are selectively accepted or rejected and reforms continue in a piecemeal manner. Success of tax reform efforts depends on their implementation as an integral package.

69. The Task Force should have dealt with huge tax arrears issue and categorically recommended against any further tax amnesty scheme.

**Chelliah, R. J.: “Task Force Recommendations on Direct Taxes”, Economic and Political Weekly, 14<sup>th</sup> December, 2002**

70. The Kelkar Task Force (KTF) on direct taxes has gone much farther than its predecessors in respect of tax administration. However, not all its recommendations on structural changes are "congruent with generally accepted principles of taxation", though it was the KTF's objective to make them so. In respect of both personal income tax and corporate profits tax there are recommendations that are not really in accord with international practices based on accepted tax theory. However, the broad approach to reform the income tax enunciated by KTF would be endorsed by most fiscal economists.

**Karnik, Ajit: “Direct Tax Reform Merit in gradualist approach” in Economic and Political Weekly 14th December 2002**

71. The consultation paper of the Task Force on Direct Taxes has an evangelical flavor to it. Some of its suggestions for administrative simplification can be accepted without hesitation, but its other suggestions require more inputs before decisions can be made. The demand that the recommendations be accepted ‘in toto’ is completely unnecessary.

**Mukhopadyay, Sukumar: “Kelkar Committee on Indirect Taxes: A critique of the Final Report”, Economic and Political Weekly, 4<sup>th</sup> January, 2003**

72. The Kelkar Committee's final report on indirect taxes shows impressive clarity in its tariff proposals and provides ample evidence of much thought having gone into the framing of the recommendations. However, in respect of administrative and procedural aspects the committee has chosen to ignore many of the useful suggestions that had been made in response to its earlier consultation paper. What is more, no reasons have been advanced by the committee for doing this.

**Virmani, Arvind: Central Value Added Tax (CENVAT), Indian Council of Research on International Economic Relations, Feb 2003**

73. This is an introduction to CENVAT meant for the layman. Describes the system and modalities and claims it as a major advance in indirect tax administration. Lists out the advantages. The author says that the simplification is based on complete transformation of collection and administrative machinery.

**Bagchi, Amaresh: “Fiscal Reform”, The Hindu, 18<sup>th</sup> July, 2001**

74. The adverse tax-GDP ratio can be reversed only if the exemptions are removed and tax administration properly tightened. Tax buoyancy will improve if a full-fledged VAT is put in place. Enhancing the efficacy of tax administration significantly, however, will call for reforms of the civil services and also the legal system to see that officials are made accountable for jobs entrusted to them and tax offenders are brought speedily to book. Introduction of VAT would require constitutional amendments to permit its levy on an integrated base comprising goods and services. These reforms cannot come about without strong conviction among policymakers about their urgency.

**Rao, Govinda M.: “Tax Reform in India: Achievements and Challenges”, Asia-Pacific Development Journal, December 2000**

75. The article surveys the developments in tax reform in India since independence with special reference to the post reform period (1991 and beyond) and concludes that even after years of reform the tax system remains a major challenge. Concerted efforts are needed to create a proper management information system and automating tax returns. A co-ordinated consumption tax system leading to full-scale Value Added Tax (VAT) gradually is the need of the hour. The present system of taxation by all the tiers of government central, state and local governments lead to cascading and relative price distortions resulting in a totally non-transparent tax system.

**Rao, Govinda M. and Singh, Nirvikar: Political Economy of Federalism in India, Oxford University Press, 2005**

76. Chapter 14 brings out that the tax reforms of the 1990's has improved the Direct-tax-to GDP ratios from 2.16 per cent to 3.24 per cent, while the indirect-tax-to GDP ratio has declined from 8.84 per cent to 6.23 per cent. Number of assesseees in Direct taxes has increased from 6.1 to 17.8 million. These developments were due to reduction in tariff in indirect tax rates coupled with attempts to broaden tax base and a gradual movement from excise duties and sales tax to VAT.

**Thimmiah, G: “Evaluation of Tax Reforms in India” in Development, Poverty and Fiscal Policies, Decentralisation of Institutions, Edited by M Govinda Rao, Oxford University Press, 2002**

77. The developments in tax reform measures have been traced and an evaluation of the measures has been offered.

78. The recommendations of Tax Reform Committee (1993) headed by Dr. Chelliah helped to modernise the tax administration. Movement from Modvat system to Cenvat and further to Vat are major developments which helped India to globalise the tax system. Long term benefits of breaking down interstate barriers are likely to be immense.

**National Institute of Public Finance and Policy Reform of Domestic Trade Taxes in India: Issues and Options. Report of a Study Team, 1994**

79. The report recommended the introduction of destination based consumption type VAT would provide effective remedy for most of the ills of the present system. An attempt has been made to provide an idea of the revenue implications and economic impact of the proposed reform. The legal, administrative and institutional requirements are also gone into briefly.

**National Institute of Financial Management, Release function of the report on 'State Fiscal Reforms in India – Progress and Prospects' on 23 November, 2004. Reported in THE HINDU, 24 November, 2004**

80. According to Mr. Carter, World Bank Country Director for India, radical restructuring of State finances was not only necessary for faster development but a concerted effort was also needed in expenditure control, revenue augmentation and debt relief. He said the poorer and lagging States were particularly at risk and the Centre and the States would have to make concerted efforts to eliminate the revenue deficits of States by 2007-08. Mr. Carter also felt the proposed Value Added Tax (VAT) from April 2005 would significantly improve the financial health of States.

81. Pitching for early introduction of VAT, World Bank lead economist, Stephen Howes said the switchover to the new system should be voluntary and based on floor rates. Otherwise, there would be undue delay in implementing the new tax regime because of the apprehensions of a handful of States.

**White paper on Vat presented by the Empowered Committee consisting of the State Finance Ministers, Jan 2005**

82. The White Paper was a result of intense consultations among the state governments and the Centre over a five year period. The paper claims to have ironed out all the outstanding issues. The stage is set for introduction of state level vat in all the states from 1<sup>st</sup> April 2005.

83. This White Paper is a result of collective efforts of all the States in formulating the basic design of the State-level Value Added Tax (VAT) through repeated and candid discussions in the Empowered Committee of State Finance Ministers.

84. The State-level VAT, as elaborated in this White Paper, has certain distinct advantages over the existing sales tax structure.

- The VAT will not only provide full set-off for input tax as well as tax on previous purchases, but it will also abolish the burden of several of the existing taxes, such as turnover tax, surcharge on sales tax, additional surcharge, special additional tax, etc.
- Central Sales Tax will also be phased out. As a result, the overall tax burden will be rationalized, and prices, in general, will fall.
- VAT will replace the existing system of inspection by a system of built-in self-assessment by traders and manufacturers.
- The tax structure will become simple and more transparent. This will significantly improve tax compliance and will also help increase revenue growth.

85. While this State-level VAT has all these advantages, it is a State subject derived from Entry 54 of the State List, for which the States are sovereign in taking decisions. On these decisions on VAT, the States, through discussion in the Empowered Committee, have found it in their interests, to avoid unhealthy competition and have certain features of VAT to be common for all the States. These features will constitute the basic design of VAT. At the same time, the States will have freedom for appropriate variations consistent with this basic design. This White Paper is a collective attempt of the States to strike a balance between this needed commonality and the desired federal flexibility in the VAT structure.

86. The White Paper also strikes a balance between what is possible in the VAT design to begin with and what can be improved upon in subsequent years as more experience is gathered.

**Tewari, A C: Problem of Fiscal Management in the Government, Shipra Publications, Delhi, 1995**

87. Tax administration has become very difficult as the tax laws have become too complicated. Too many exemptions, each to satisfy some lobby, have cluttered the tax laws. The frequent resort to amnesty schemes to unearth black money is wrong as this rewards the sinner and punishes the honest tax paying citizen. Efficiency of tax structure and tax administration continues to be at a very low level. Economic cost of tax is high and many of the administrative methods are outdated. Stability of taxation policies and simplification of procedures are needed. He also advocates inflation indexing of threshold limits of personal taxation to protect honest tax payer and household savings.

**National Institute of Financial Management, Tiwari, A.C.: Budgetary Tasks before the Government, Workshop on Fiscal Responsibility of Government, February 2000**

88. The tax laws were unnecessarily complicated and were frequently changed, making tax compliance very difficult. He suggested better efforts at tax collection concentrating on the higher tax bracket.

**Shome, Parthasarathy: India's Fiscal Matters, Oxford, 2002**

89. The book surveys the fiscal position in a historical perspective and demonstrates the costly implications of consolidated fiscal deficit for sustainability of public debt.

90. The ramifications of tax administration practices on tax policy are discussed.

91. Following reforms have been suggested

1. Reform tax administration.
2. Develop better records management.
3. Establish a tax assessment and guidance cell.
4. Establish a refunds monitoring and research cell.
5. Develop an effective information system.
6. Computerisation.
7. Reorientation in training systems.

92. Computerization has helped to streamline tax administration in Indirect Tax area. However, the following concerns persist.

1. Continuing exemptions have reduced administrative transparency, exacerbating the official – taxpayer nexus.
2. There are too many lower staff and too little at higher level. Lower staff needs retraining.

**Ashok Lahiri: Lecture - Mid Year Review of the Indian Economy 1999-2000, India International Centre**

93. Among other things, the chapter on tax reforms says that multiple rates of any indirect tax is the root cause for major evasion, and often a source of distortion in revenue allocation. Tax administration needs improvement in the areas of information system, workload and manpower, assessment strategy, penalties, prosecution, settlement and immunity.

**Issues and Experiences in Tax System Reforms in Selected Countries of the Escap Region, United Nations, 1995**

94. In the chapter on “India: Salient features of the Tax System”, a comprehensive review has been made of the efforts made so far in the area of tax reform in India since independence. Among other things, the paper identifies the areas of tax administration, the enforcement machinery and the information system as needing immediate attention.

It notes the policy of search and seizure has not yielded much revenue. The amnesty schemes have also failed to improve revenue mobilisation on a sustained basis.

**Evasion of Excise Duties in India: Studies of Copper, Plastics and Cotton Textile Fabrics, National Institute of Public Finance and Policy, 1986**

95. This was a major attempt to examine the central excise tax structure with the specific aim of identifying the weak areas that lead to evasion. The research paper goes deeply into tax structure and quantifies the extent of evasion. It concludes that the tariff is very complicated making tax administration difficult and evasion easy. Resort to frequent changes as a reaction to every problem has created more complexities. This resulted in imbalances, encouraging misclassification, evasion and litigation.

**India: Reducing Poverty, Accelerating Development: A World Bank Country Study, Oxford University Press, 2000**

96. The study mentions stopping ad hoc exemptions from the year 1999 as a major tax reform. However, the tax reforms suggested by Tax Reforms Committee have not been implemented. Implicit subsidies contained in tax concessions are not quantified. Progress is slow in simplifying procedures, automation and institutional and organizational reform. This study by World Bank gives the following suggestions to improve revenue administration.

1. Minimum tenure of Chairman and members of tax boards.
2. Autonomy and control expenditure allocations and personnel matters within their departments.
3. Budget for tax administration with revenue budgets linked to measured revenue and equity performance.
4. Statutory powers to vest with only Chairmen and not with the assessing officers.

**Public Accounts Committee (PAC) Recommendations.**

97. The Public Accounts Committees have been making many suggestions for improvement in revenue administration both in Direct and Indirect taxes.

**Forty-first Report of the Public Accounts Committee (PAC) 2002-2003**

98. In response to PAC's criticism that the system of assessments and revenue administration was weak, Central Board of direct taxes circulated to all field formations a list of typical failures in assessments pointed out by audit.

**Forty fourth Report of the PAC**

99. In its recommendations in para 3.21 and 3.25 of their 44<sup>th</sup> report (1980-81/7th Lok Sabha), Public Accounts Committee had stressed the need to improve the efficiency of Internal Audit Department of the Department of Revenue, being a very important tool of internal control through which the Board could keep an effective watch over the standard

of performance of their field formations in bringing about substantial improvements by pointing out errors and omissions of common occurrence and had also stressed timely completion of audit work within six months so as to avoid the operation of time bar.

### **Reports of the Comptroller and Auditor General of India (CAG) on Direct Taxes and Indirect Taxes**

100. CAG conducts audit of the revenue departments and submits separate reports every year on Direct and Indirect Taxes. The reports contain findings of the CAG on the system of assessment, collection and accounting of the tax receipts. Statistical analysis of data relating to tax demanded, collected, arrears, number of cases pending, etc, are available.

101. The reports contain individual cases of failure as well as review of systems, which include review of major revenue raising schemes.

102. The points made in the reports individually and collectively point to the areas of failure in revenue administration.

103. A special report was presented in 2000 (Report 12A on Direct Taxes) on Voluntary Disclosure of Income Scheme, 1997. Main points that emerged are:

- Scheme was complex compounded by circulars and clarifications, some of them inconsistent with the Finance Act, 1997. Parliament was not informed of these changes, as was required under the law. They provided the window of opportunity for widespread misuse by undervaluation of jewellery, bullion, shares and real estate and ‘creation’ of capital loss to be set off against income in future.
- Ineligible persons took advantage of the scheme.
- Multiple declarations by the same assessee.
- Same assessees had taken advantage of the previous amnesty schemes also.
- The scheme was not in the interest of revenue and in fact provided one of more opportunity to dishonest assessees to pay tax at a preferred rate and then retire to the old habit of concealing income.

104. Some of the issues that were brought out in the report for 2004 (Report number 11 of 2004 based on the audit conducted up to 2003) are:

- Revenue receipts are consistently overestimated in the budget; actual realisation falls short of the projections.
- System review on “Call Book” revealed that the call book, which is supposed to be an interim arrangement where cases could be kept till they were ripe for adjudication, contained
  - a) 540 cases for Rs. 4,135.8 million in violation of prescribed norms
  - b) 4820 cases for Rs 26,220 million were kept pending for want of clarification/decision from the Board of excise and Customs for a number of years.

105. The report gives a recommendation that there is an urgent need for streamlining the monitoring system by effective monthly review, and stipulation of time limit for giving decision in such cases.

- The cost of collection has been steadily going down.
- During the year 2002-03, 1127 cases of outstanding Demands were cleared for Rs. 181,250 million; however, outstanding Demands at 67275 cases for Rs. 364,950 million was large.

106. Individual cases of underassessment, based on test check, amounted to Rs. 14,450 million termed as “leakage of revenue”. The department accepted audit observations in 133 cases for Rs. 2,876.1 million and recovered Rs. 318 million.

107. CAG’s Audit Report on Direct Taxes for the year 2003-04, brought out that non-recovery of direct tax demands was worth over Rs 88,000.

108. Of the total direct tax demand of Rs 1,931,060 million, about Rs 880,170 million — Rs 570,640 million of earlier years and Rs 309,530 million of 2003-04 — was uncollected. The percentage of recovery of tax demands declined to 19 per cent in 2003-04 from 22 per cent in 2002-03, with “81 per cent of the certified amount remained uncollected at the end of 2003-04.”

109. In the Report on Indirect Taxes Customs 2003-04, the following main points were brought out.

- Collection of customs duty has been consistently below the budgeted amounts for the last five years from 1999-2000. In 2003-04 it was nearly 1.5 per cent. The shortfall was nearly 25 per cent in 2001-02 and 13 per cent in 2000-01.
- There are many export schemes like advance license, duty exemption pass book (DEPB), export promotion capital goods (EPCG), export promotion zone (EPZ), export oriented units (EOUs) and refund of duty under the drawback. The amount of the duty foregone due to these schemes duty foregone under export promotion schemes has gone up from 43 per cent of customs duty receipts in 2000-2001 to 82 per cent in 2003-2004.
- The amount of customs duty assessed up to 31 March 2004 which was still to be realized as on 30 June 2004 was Rs. 11,679.4 million in 20 custom houses.

110. A review on internal audit in customs department brought out that it is weak and lacking uniformity. Targets were evidently not fixed, pursued or monitored by the Board through any centralized agency on account of both manual as well as EDI systems in operation.

111. The Report included three reviews namely ‘Recovery of arrears of revenue’, ‘Import general manifest/export general manifest (IGM/EGM)’ and ‘Inland container depots (ICD)’ involving financial implications to the tune of Rs.64,889.50 million. Besides there are 251 paragraphs (including 54 cases of Total Under Assessment) featured individually

or grouped together, arising from important findings from test check in audit pointing out leakage of revenue aggregating Rs. 9411 million. Of this the Department/Ministry of Finance had till January 2005 accepted audit observations in 177 paragraphs involving non/short levy of duty of Rs. 944.40 million and reported recovery of Rs.100.60 million.

112. In the report on Indirect Taxes Central Excise for 2003-04, the following major points were reported:

- The revenue from central excise consistently fell short of the budget estimates in all the five years starting from 1999-2000. In 2002-03, the shortfall was 6.23 per cent.
- Arrears in assessment were heavy: A total of 54,560 cases involving duty of Rs. 232,757.70 million were pending finalization on 31 March 2004 with different authorities.
- Non-recovery of confirmed demands and non-adjudication of demands resulted in blockage of revenue of Rs. 5453.20 million.
- Internal audit of the central excise department did not function satisfactorily: data base of the assesseees was inadequate, non-mandatory units were audited when audit of mandatory units was in arrears, response to internal audit was poor.
- Interest not demanded or realized or penalty not imposed in cases of delayed payment of duty amounted to Rs. 4,859.50 million.
- Wrong valuation of goods for the purpose of levying ad valorem rates led to short collection of duty; instances of incorrect adoption of assessable value of goods manufactured by export oriented units/job work or incorrect adoption/non-adoption of assessable value on the basis of MRP or incorrect adoption of transaction value etc. were noticed. Duty levied short amounted to Rs. 686.50 million.

113. Other points of interest included misclassification, wrong interpretation of notifications, failure to regulate modvat credit correctly, incorrect refunds.

114. Audit reports on revenue department contain similar observations year after year.

**Devarajan. R: “Income Tax Department cases”, Chartered Accountant, November 2003**

115. The Income Tax officials work under a difficult system and their position needs to be appreciated. Not all officials are sinners. Tax compliance must improve.

**Rajaratnam, S.: “Forcible recovery need not be unduly aggressive”, The Hindu, 11th October, 2004**

116. The tax officials make additions to the assessable income driven by a fear complex, fear of audit—internal and external, fear of inspection and fear of vigilance. Only a tax administration bereft of such panic can do justice not only to tax payers but to revenue

because voluntary compliance ultimately depends on fair treatment of tax payers, who comply with the law.

**Pandey, T. N.: “Shouldn't reforms be in better form?”, The Hindu, 25th September, 2004**

117. The tax law cannot be reformed by a patchy approach. The following committees have been set up since independence in the area of tax reforms: the Direct Taxes Enquiry Committee (Indrajeet Singh Committee); the Tyagi Committee; the Law Commission's examination of the 1922 I-T Act as amended by the 1939 Amendment Act with a view to enact a new I-T law; Prof Kaldor's Report; the Wanchoo Committee; the Choksi Committee; A.L. Jha's exercise on tax reforms for the Administrative Reforms Commission; the Boothalingam report; the Chelliah Committee's reports on the feasibility of imposing an expenditure tax — April 1987; the Report of Tax Reforms Committee headed by Dr Raja Chelliah to, inter alia, rationalize and simplify the tax law (1992); the Tax Expert Group's report on simplification of tax laws (February 1997) — appointed by Mr. P. Chidambaram in August 1996; the Advisory Group appointed by the Planning Commission under Shome for giving recommendations concerning tax policy and tax administration for the Tenth Plan — July 2000 (Report given in May 2001); and the Kelkar Task Force-I (2002) report. The latest is the second report of the Kelkar Task Force, constituted to look into the implementation of the Fiscal Responsibility and Management Act, 2003.

118. The approach to tax reform, in general, has been ad hoc and the changes, piecemeal. With the tax law being long-winding and complex, no attempt has been made to take a consolidated view of the Act, taking into account issues that affect taxpayers, the tax administration, tax counsels, economic development, and so on. Expert bodies constituted to reform the tax law have not been given adequate time to give in their recommendations.

119. The important aspects that need consideration in the context of tax reform can be summed up thus:

- The basic requirement for a successful tax reforms program is to decide what is expected from the tax system, say, in the next five years, and formulate a long-term fiscal policy.
- In spite of more than nearly 14 studies done in the past 50 years, there have been no major tax reforms, implying a thorough re-examination of the legal and procedural provisions, including some of the basic assumptions of the system.
- Ad hoc legislative changes cannot be said to be the product of serious planning; these are made only to address contingencies.
- Changes in law consequent to courts' decisions are but sporadic and are made mainly to address emerging situations without looking at possible impact on revenue or effects on other tax provisions/payers.

- While making changes to tax laws, practically no attention is paid to administrative reforms. The success of tax reform depends on the motivation, enthusiasm and ability of the tax administration.
- Neither while introducing a provision nor after its withdrawal are empirical studies carried out. For example, there is no data with regard to tax revenues foregone consequent to exemptions, concessions and deductions or to show that the loss suffered has been compensated for by achieving the cherished objectives.
- Changes relating to basic exemption and standard deduction limits in the case of salaried employees have been based more on gut feeling rather than studies or data.

**Acharya, Shankar: “Thirty Years of Tax Reform in India”, Economic and Political Weekly, May 14, 2005**

120. This paper sketches the contours of India’s tax reform story from the mid-1970s to the present and finds that enormous progress has been made in the last 30 years, judged by the standards of economic efficiency, equity, built-in revenue elasticity and transparency. However, key issues for further reform include the plethora of complex exemptions plaguing customs tariff, low buoyancy of excise, integration of CENVAT with state VAT and the broad-basing of direct taxes. Sustaining programs to deploy IT and modern risk management methods in tax administration will be critical, for the dictum ‘tax administration is tax policy’ is quite true.

**Mahalingam, Sudha: “VDIS the tip of the iceberg”, Frontline, 10th January, 1998.**

121. VDIS 1997 has enabled a very large number of people to launder their black money. But the total assets declared under the scheme - Rs. 330,000 million - may represent only a small part of the black economy. Tax amnesty schemes are intrinsically odious. They are seen to legitimize money-laundering. They are an admission of a government’s failure to ensure compliance with the laws of the land. They are also unfair to honest tax-payers who have paid taxes at higher rates in previous years. Five earlier tax amnesty schemes in India failed to coax any significant amounts of black money out of the closet.

**Ramanujam, T C A.: “Budget: Will there be an amnesty scheme?”, Hindu, 15<sup>th</sup> February, 2005**

122. Another amnesty scheme to unearth black money should not be introduced. While there must be every attempt to check tax evasion, there must, equally, be every attempt to stop whimsical taxation. The proposal for a blanket amnesty scheme to tap black money will be both arbitrary and whimsical. The government had assured the highest court that there would not be another amnesty scheme. They should not circumvent that by issuing an infrastructure bond with no questions asked. Studies by Mr. Arvind Virmani have shown that the revenues fall in the years after the “scheme” year.

**Gowda, K. Venkata Giri: Evaluation of Black Wealth and Black Money, World View Publications, 1986**

123. This is a book on the causes of generation of black money and analysis of some attempted remedies. It contains a critical analysis of the Report of National Institute of Public Finance and Policy on black money and suggests alternative mechanisms of controlling black money including reforms in tax administration.

**Das Gupta, Arindum and Mookherjee, Dilip: Incentives and Institutional Reforms in Tax Enforcement, Oxford University Press, 1998**

124. In the chapter on “Tax amnesties and their effects”, the authors argue that amnesty schemes are undesirable as they tend to weaken tax administration. There is no evidence of amnesties increasing tax revenue. There is no substitute for better tax administration.

125. In the chapter on “The functioning of Indian income tax administration”, the authors analyse the functioning of the Income tax department in all its aspects including assessment, summary and scrutiny assessments, search and seizure, settlement cases, prosecution, manpower and workload and information systems. They point out many weaknesses in the existing system.

**Editorial in The Hindu on 3<sup>rd</sup> June 2004, “Funding the CMP”.**

126. The editorial says that the government should not resort to another amnesty scheme to raise funds for the increase in social expenditure: amnesty rewards the guilty and penalizes the honest taxpayer. This would send wrong signals.

## Chapter 17

### ACCOUNTABILITY OF GOVERNMENT FOR PUBLIC SECTOR ENTERPRISES

#### **The Company's Act 1956**

1. The Companies Act 1956 governs the incorporation, governance and all related issues of companies registered in India as public limited or private limited companies. Department Company Affairs in government of India is the administrative Ministry administering the Act.

#### ***Public Sector Enterprise/Undertaking [PSE/PSU]***

2. For the purpose of Companies Act, Government company [Public Sector Enterprise/Undertaking (PSE/PSU)] means any company in which not less than fifty-one percent of the paid up capital is held by the Central Government, or by any State Government or Governments, or partly by the Central Government and partly by one or more State Governments and includes a company which is a subsidiary of a Government company as thus defined.

#### ***Deemed PSEs***

3. A company in which not less than fifty-one per cent of the paid-up share capital is held by one or more of the following or any combination thereof, will be treated as if it were a Government company (Deemed Public Sector Enterprise), namely:-

- (a) the Central Government and one or more Government companies;
- (b) any State Government or Governments and one or more Government companies;
- (c) the Central Government, one or more State Governments and one or more Government companies;
- (d) the Central Government and one or more corporations owned and controlled by the Central Government;
- (e) the Central Government, one or more State Governments and one or more corporations owned or controlled by the Central Government;
- (f) one or more corporations owned or controlled by the Central Government or State Government; and
- (g) more than one Government company.

#### ***Audit arrangements***

4. The Act lays down special audit arrangements for the PSEs in the following manner.
- 1) The auditor of a Government company shall be appointed or re-appointed by the Comptroller and Auditor-General of India:
  - 2) The Comptroller and Auditor-General of India shall have power-

- (a) To direct the manner in which the company's accounts shall be audited by the auditor appointed in pursuance of sub-section (2) and to give such auditor instructions in regard to any matter relating to the performance of his functions as such.
  - (b) To conduct a supplementary or test audit of the company's accounts by such person or persons as he may authorize in this behalf; and for the purposes of such audit, to require information or additional information to be furnished to any person or persons, so authorized, on such matters by such person or persons, and in such form, as the Comptroller and Auditor-General may, by general or special order, direct.
- (3) The auditor aforesaid shall submit a copy of his audit report to the Comptroller and Auditor General of India who shall have the right to comment upon, or supplement, the audit report in such manner as he may think fit.
- (4) Any such comments upon, or supplement to, the audit report shall be placed before the annual general meeting of the company at the same time and in the same manner as the audit report.

### ***Annual Reports of PSEs***

5. The Act also lays down specific directions to the Central Government to place before the Parliament the Annual Report of the companies.
6. "Where the Central Government is a member of a Government company, the Central Government shall cause an annual report on the working and affairs of that company to be -
- (a) prepared within three months of its annual general meeting before which the audit report is placed under sub-section (5) of Section 619; and
  - (b) as soon as may after such preparation, laid before both Houses of Parliament together with a copy of the audit report and any comments upon, or supplement to, the audit report, made by the Comptroller and Auditor General of India."

### **Statutes creating Corporations**

7. Government of India created many wholly owned Corporations through separate statutes. These Corporations are governed by individual Acts of Parliament and they are answerable to the Parliament through the administrative Ministries. Audit arrangements have been laid down in the respective Acts. In many cases Comptroller and Auditor General of India (CAG) has been nominated as the sole auditor, but not all of them attract the audit by the CAG.

### **Supreme Court Judgments**

8. Article 12 of the Constitution defines the expression 'State' to include local or other authorities within the territory of India or under the control of the Government of India.

9. In various judgments the Supreme Court has held that the international Airport authority of India, Projects and Equipment Corporation of India, Hindustan Steel Ltd, State Financial Corporation, Bharat Petroleum Corporation, Registered Societies run by the State, Coffee Board, Steel Authority of India, State Electricity Boards are covered under Article 12.

10. These judgments have made it clear that all the PSEs have the characteristic of a State.

### **Industrial Policy Resolution, 1956**

11. This is a landmark step in the history of evolution of Public Sector in India. The public sector was to be developed to reach the commanding heights of the economy. Certain sectors of the economy were reserved exclusively for public sector. Schedule A contained list of core industries reserved exclusively for State enterprises; and Schedule B of industries where State enterprises were to acquire a dominant position.

12. The major objectives of setting up of public enterprises were broadly:

- (i) to help in rapid economic growth and industrialization of the country and create necessary infrastructure for economic development;
- (ii) to earn a return on investment and thus generate resources for economic development;
- (iii) to promote redistribution of income and wealth;
- (iv) to create employment opportunities;
- (v) to promote balanced regional development;
- (vi) to assist the development of small scale and ancillary industries; and
- (vii) to promote import substitutions, save and earn foreign exchange for the economy.

### **New Industrial Policy, July 1991**

13. This was a landmark change in the policy on industrialization in India. It moved away from the dominance of public sector. Further dilutions of the role of public sector were periodically made including the sale of public sector units either fully or partially. The new Industrial Policy of 1991 which started the trend contained the following measures.

- Abolished licensing for all projects except in 18 industries.
- MRTP Act amended to eliminate prior approval for large companies for capacity expansions.
- The requirement of Phased Manufacturing Programs (PMP) discontinued for all new projects.
- Schedule A of industries reserved exclusively for State enterprises cut down from 17 to 8.
- Schedule B of industries where State enterprises were to acquire a dominant position abolished.
- Small scale enterprises allowed to offer up to 24 per cent of shareholding to large enterprises.

## **Website of Department of Public Enterprises, Government of India**

<http://dpe.nic.in>

14. Department of Public Enterprises (DPE) functions as the coordinating department for all Central Public Sector Enterprises (PSE) issuing uniform policy guidelines. PSEs are supervised by different administrative Ministries based on functional distribution.

### *Liberalization initiatives*

15. DPE has made available on its website information regarding the measures taken to liberalize the controls over the Public Sector Enterprises. Many measures were taken to give more autonomy to the PSEs. Based on certain criteria, some PSEs were classified as Navratnas (Nine Gems) and Miniratnas (Small Gems). Additional financial powers were delegated to these companies. Their boards were restructured inducting more independent members (one third) and more powers given. All the circulars issued in this connection are featured there.

16. Details of the Memorandum of Understanding scheme, the guidelines issued, The Annual Survey of Public Enterprises, and Annual Report of the DPE are given in the website.

### **Memorandum of Understanding (MOU)**

17. MOUs are signed between the related administrative Ministry and the PSE. This system was introduced in 1987-88.

18. MOU is a freely negotiated agreement between the public enterprise and the administrative Ministry. Under the agreement the enterprises undertake to achieve the targets set in the agreement at the beginning of the year. The MOU covers both financial performance as well as non-financial performance. Under this system performance of the company is categorized into five categories namely: excellent, very good, good, fair, and poor.

19. All PSEs that have not been referred to the BIFR and are not insignificant in size are expected to sign an MOU.

20. The objectives of the MOU system are to:

- Improve the performance of public enterprises by increasing autonomy and accountability of the management.
- Remove the fuzziness in the goals and objectives the enterprise is to pursue through clearly laid down performance targets at the beginning of the year in a MOU entered into between Chief Executive and Secretary of the Administrative Ministry.

- Enable the evaluation of managerial performance through objective criteria and provide a mechanism to reward good performance through performance incentives to stimulate improved performance.

21. The MOU system was introduced based on the recommendations of Arjun Sengupta Committee.

22. “The MOU system has been adopted in response to the following:

- Widely held perception that the PSEs are less efficient than their private sector counterparts.
- PSEs are unable to perform at efficient levels because there are a variety of agencies within the Government who feel that they have a mandate to run public enterprises. These agencies having their own agenda to keep, setting different objectives for the enterprises which are always conflicting.
- Because of lack of clarity of objectives and confused signals imparted to the management, the accountability of the management is vastly diluted. The management of PSEs thus ceases to be accountable for the performance of the enterprise.

23. At the same time, the Management of PSEs is handicapped in their operation due to absence of functional autonomy.”

*Administrative Set-up (MOU)*

24. Ad-hoc Task Force (ATF) is an independent, third party, body of senior experienced professional and administrative experts set up for negotiating MOU at the beginning of the year and evaluating MOU performance at the end of the year.

*High Power Committee (MOU)*

25. High Power Committee on MOU is a Committee of Secretaries set up under the Chairmanship of Cabinet Secretary to assess the performance of MOU signing enterprises with reference to the commitments made in the MOU. It also assesses how far the administrative ministries have been able to provide the necessary administrative and financial support committed by them in the MOU. It oversees the functioning of the MOU system, provides guidelines and gives directions to strengthen and improve the system besides taking general decisions on broader issues pertaining to the improvement of the performance of public enterprises

26. Department of Public Enterprises issues detailed guidelines in October/November each year to all PSEs and the administrative Ministries on how to draft the MOU. The MOU is prepared in the following parts.

- |         |                                 |
|---------|---------------------------------|
| Part I  | Mission & Objectives of the PSE |
| Part II | Commitments of the PSE          |

## Part III Delegation of Powers

Part IV Assistance from the Government

Part V Frequency of Monitoring and Information Flow

27. The guidelines are available in the DPE web site.

### *MOU Formulation.*

28. The draft MOUs indicate the performance targets on a five point scale as proposed by the PSE for the ensuing financial year for all crucial parameters like production, sales, profits, etc. Additionally, the PSEs are also expected to include dynamic parameters of significance for strengthening the future potential of the enterprise, such as project implementation, R&D, Human Resource Development, etc. Appropriate weights are assigned to each of these parameters.

29. The appropriateness of the parameters and weights and the soundness of the targets as also the commitments of the Government are examined in detail at the negotiation meetings arranged by the DPE between the PSE and the Administrative Ministry on the one hand and the Ad Hoc Task Force (ATF) on the other. The draft MOUs as finalized thereafter are placed before HPC for approval. After approval, they are signed by Chief Executives and Secretaries.

### *MOU Evaluation*

30. The evaluation of the MOU signing enterprises is done at the end of the year by the Ad-hoc Task Force (ATF) on the basis of actual achievement vis-à-vis the MOU targets. Where the performance exceeds the target by the predetermined stipulated level the enterprise is ranked as 'excellent' and when the target is just met, the enterprise is ranked as 'very good'. In other cases, where the targets are not met the enterprise is ranked either 'good' or 'fair' or 'poor'.

31. After completing the evaluation of the performance of the MOU signing enterprises the ATF submits the results to the High Power Committee (HPC), for its approval.

32. Once the HPC gives its seal of approval to the evaluation done by the ATF, the composite score and the consequent rankings of the enterprises become final.

### *MOU Award*

33. Based on the evaluated performance, there is a system of giving awards to the management. The award is not a cash award, but recognition of merit designed to motivate the top echelons of the company.

## **Guidelines**

34. DPE issues detailed guidelines on all aspects of the running of a PSE. These ran into two volumes of over 1100 pages. As a measure of allowing more autonomy to the PSEs, the guidelines have now been pruned substantially. Only 200 directives survive now. Current guidelines are given in the website. These cover issues relating to accountability, financial policies, construction management policies, personnel policies, wage policies, disinvestment commission, memorandum of understanding, price preference and miscellaneous issues. As per one of the directives, all PSEs are required to provide in their Articles of Association a clause relating to issue of Presidential Directive to the companies.

### **Navratna Companies**

35. Government of India selected nine PSEs which were perceived to have comparative advantages and issued a series of instructions on 22<sup>nd</sup> July 1997 delegating the following financial and administrative powers in order to support them in their drive to become global giants.

- (i) To incur capital expenditure on purchase of new items or for replacement, without any monetary ceiling.
- (ii) To enter into technology joint ventures or strategic alliances.
- (iii) To obtain by purchase or other arrangements, technology and know-how.
- (iv) To effect organizational restructuring including establishment of profit centers, opening of offices in India and abroad, creating new activity centers, etc.
- (v) Creation and winding up of all posts including and up to those of non-Board level Directors i.e. Functional Directors who may have the same pay scales as that of Board level Directors, but who would not be members of the Board. All appointments up to this level would also be in the powers of the Boards and would include the power to effect internal transfers and redesignation of posts.
- (vi) To structure and implement schemes relating to personnel and human resource management, training, voluntary or compulsory retirement schemes, etc.
- (vii) To raise debt from the domestic capital markets and for borrowings from international market, which would be subject to the approval of RBI/Department of Economic Affairs as may be required and should be obtained through the administrative Ministry.
- (viii) To establish financial joint ventures and wholly owned subsidiaries in India or abroad with the stipulation that the equity investment of the PSE should be limited to the following:
  - a. Rs.2000 million in any one project
  - b. 5 per cent of the net worth of the PSE in any one project
  - c. 15 per cent of the net worth of the PSE in all joint ventures/subsidiaries put together.

36. The companies should not depend on government for any budgetary support. Boards were to have a minimum of one third independent part time members to be selected through a search committee under the auspices of Public Sector Enterprises Selection

Board (PESB), an independent advisory body. Audit committees were to be set up with independent members of the Board.

37. These Companies were called Navratna companies.

### **Miniratna Companies**

38. Government granted vide letter DPE OM No.11/36/97-Fin. dated 9th October 1997 enhanced autonomy and delegation of powers to the profit making public sector enterprises, subject to prescribed eligibility criteria and guidelines. The companies should have made profit at least for three years and have a positive net worth. The companies were classified into two categories depending on the level of profit made and delegated separate levels of additional powers to them. Category-I PSEs can incur capital expenditure up to Rs. 3000 million or equal to their net worth while the Category II Rs. 1500 million or equal to 50 per cent of their net worth. Powers were also delegated for establishing joint ventures, subsidiaries and to enter into technology arrangements subject to some monetary limits. The companies should not depend on the government for any budgetary support.

39. Each Board was to have at least three independent members on the Board selected through a search process under the auspices of PESB. The companies have to form audit committee consisting of independent Board members.

40. These companies were called Miniratna companies.

### **Committee on Public Undertakings (COPU)**

41. The COPU consist of 22 members each: 15 from the Lok Sabha and 7 from the Rajya Sabha representing broadly the composition of each House and have a term of one year. A Minister cannot be a member of either of the Committee.

42. The COPU examines the accounts and the reports of the Public Sector Undertakings (PSU), and the reports of the CAG, if any, on these undertakings. The Committee is assisted by the CAG in the examination of his Audit Reports. Committee also takes up suo motto some companies for examination. It also examines, in the context of economy and efficiency of these undertakings, whether the affairs of these undertakings are being managed in accordance with sound business principles and prudent commercial practices.

### **Shakdher S L: The Budget and the Parliament, National Publishing House, First published in 1979**

43. The book is a comprehensive study of the procedure of parliamentary approval of the budgets in many countries including India. It explores the form and preparation, presentation and discussion, execution of the budget and the control thereon by Parliament. The last chapter offers valuable suggestions for increasing the control of the parliamentary scrutiny of the budget.

44. Cross country comparisons give useful information. Indian Parliament had accepted the suggestion of having Departmental Standing Committees to examine the budget in detail, department wise, before they are passed. A separate parliamentary committee to supervise the working of the Public Undertakings almost on the pattern of Departmental Standing Committee was also suggested. More supervision on the revenue collection has also been suggested.

### **Standing Conference on Public Enterprises, Government Policy for the Management of Public Enterprises - Volumes I & II**

45. This is a compendium of guidelines issued by the government, mostly through the Department of Public Enterprises to the Public Sector Enterprises. These volumes have been published by the Standing Conference on Public Enterprises. Volume I contains detailed guidelines, given from time to time, on macro and micro management issues like accountability, consultancy, delegation of powers, labor relations, personnel policies, reservation of posts for scheduled castes and tribes, publicity and advertisement, wage and salary, financial management issues, investment issues, government approvals, etc.

46. Volume II deals with construction management, production and materials management. Detailed guidelines cover project planning, project estimates, tender procedures, civil works, returns and reports, production and material management, industrial engineering, new projects, purchase procedures, etc.

47. These guidelines covered almost every aspect of functioning of Public sector Undertakings (PSUs). Role of government in running the PSUs is also given. Primarily, these were meant for uniform practices across all PSUs.

[Many of these guidelines have been withdrawn recently as a part of giving more autonomy to the PSUs.]

### **Standing Conference on Public Enterprises, Dynamics of Public Enterprises, Edited by Waris R. Kidwai and Sahai, Baldeo, 1989**

48. In this book, seasoned managers heading public sector enterprises candidly discuss their experiences in running their industries. The then Prime Minister, Rajiv Gandhi had given the foreword for the book. Of the many issues discussed, the relationship between government and the public sector units and the issues relating to autonomy figured prominently.

49. Rajiv Gandhi recognized autonomy as a major issue facing the public sector units and said that Memorandum of Understanding (MOU) concept had been introduced precisely to meet the concerns of the public sector on this front.

50. Vengal Rao, the then Minister for Industries said that the autonomy has to be balanced with accountability. MOU was an instrument designed for the purpose. Baldeo

Sahai traces the history of public sector in India and brings out that the question of autonomy has always engaged the attention of different committees since the formation of public sector units. The first five year plan ( autonomy cannot be secured if the public enterprises are under a government department), Estimates Committee (1955) of the Parliament (public sector units have become adjunct to the Ministries), Sachar Committee report (1978) (mere appendages), L K Jha Commission (1984) (A mere extension of the government and the public sector units are ‘under’ a ministry) and Arjun Sengupta Committee have consistently flagged the issue of lack of autonomy to the public sector units and too much control by the ‘controlling Ministries’.

51. Waris R Kidwai says that apart from numerous (1100 pages) ‘guidelines’ containing wisdom of the government covering all and sundry matters, the real danger is the oral and telephonic advice given by the persons in authority and it is far more devastating.

52. U S Awasti is of the view that the informal advice, persuasion and pressure give wrong signals. He lists his recommendations for improvement in the relationship between the public sector units and government.

53. Prof. Laxmi Narain has dealt extensively with government – public sector enterprises relationship.

54. P C Luther surveys the entire set of relationships and says that there is much scope for improvement.

### **Department of Public Enterprises, Public Enterprises Survey 2002-03**

55. Brought out on the recommendations of the Estimates Committee (1959-60) of the Parliament, this is an annual compilation of the Department of Public Enterprises, Government of India giving the performance, at the macro and micro level, of the central public sector enterprises during the previous year. The contents and the format of the report also take into account the recommendations of the Committee of the Public Undertakings of the Parliament. The information covers a period of three years to give perspective.

### **Mathur, B.P. : Public Enterprise Management, Macmillan, Second Edition in 1999**

56. Chapter 7 on “Government –Public Enterprise relationship”, the author details the main areas reserved for government action/intervention.

- a) Appointment of chairman and members of the board of directors,
- b) Financial matters like capital expenditure and matters connected with borrowing, distribution of profits, etc.
- c) Appointment of auditors on the advice of the Comptroller and Auditor General of India.
- d) The power to issue such directions or instructions as may be considered necessary.

57. The government approval was also necessary for investment decisions, wages and employment policies and price policy.

58. Only a lip service is made on the issue of the autonomy to Public Enterprises. Government control is too pervasive for any independent management. At the same time, there is a compulsion for the government to have control over the public enterprises as ministers are ultimately responsible to the Parliament in a democratic system. This concept of control conflicts with the perception of the chief executives who want to be given sufficient autonomy. A system of 'managed independence' where both parties would work together in a 'Reconceptualised Autonomy' has been recommended. The introduction of the Memorandum of Understanding scheme was the most important piece of reform towards giving some autonomy to the PSEs. The mechanics of the scheme in detail is described in the book.

59. The science of management as developed in the western countries are based on profit maximization, was not adequate to cover Indian public sector companies which have a social role.

**Tiwari, A. C.: Problems of Fiscal Management in the Government, Shipra Publications, Delhi, 1995**

60. This book attempts a critical analysis of financial management practices in India, while at the same time benchmarking selectively with practices in some other countries.

61. Given the nature and the social expectations of the public sector, it would not be fair to compare the performance of the public sector with private sector. The first point of major departure from the originally stated objectives was the New Industrial Policy Statement of 24<sup>th</sup> July 1991 which contained the following decisions: focus the public sector only in strategic areas, high-tech and essential infrastructure. The rest of the sectors would be opened to private sector. Public sector units, which are chronically sick, would be referred to Bureau for Industrial and Financial Reconstruction (BIFR). A part of the government holding would be disinvested.

62. There is lack of clarity about the role of the public sector and this confusion has done a lot of damage to the effectiveness of the public sector. The Memorandum of Understanding scheme is by far the best scheme for monitoring.

**India: Reducing Poverty, Accelerating Development: A World Bank Country Study, Oxford University Press, 2000**

63. Liberalization of economy has removed many shackles of the private sector, but the public sector continues to be shackled. Majority ownership has created many masters in Members of Parliament, ministers and civil servants, none of whom has a financial stake in the enterprise. Civil servants who are process oriented and risk averse cannot be expected to give lead in a situation which demands results in a competitive environment. Recent initiatives like signing the Memorandum of Understanding have not helped either.

It is unlikely for the Public Sector Enterprises to achieve results while being under government control. All Public Sector Enterprises except those which have strategic importance need to be privatized, as stated in the Finance Minister's Budget speech in 1998.

**Report of the Committee to Review Policy for Public Enterprises (Arjun Sengupta Committee), 1984**

64. This report has seminal importance inasmuch as the government accepted many of the recommendations for implementation. The report deals with the Organizational Structure of Public Enterprises, Autonomy and Accountability Technology Upgradation, Financial Viability of Loss Making Units, Capital Restructuring and Closure and Pricing in Public Sector Enterprises (PSE)

65. Major recommendations on Accountability issues are:

- A new Performance evaluation method based on agreed parameters set in a Memorandum of Association to be adopted. The obligations of the Ministries to be included in this MOU.
- Projects to be monitored through macro parameters.
- Parliament questions not to be allowed on day to day functioning of the Public sector Enterprises.
- Enough freedom to be given to the units for pricing the products.
- Government not to interfere in the award of contracts.
- All matters relating to below Board level employees to be dealt with finally by the Board.
- Existing detailed guidelines of the BPE on the various operations of the PSEs to be reviewed.

**Sastry K. S. and Dhameja Nand: Performance Evaluation of Public Enterprises, Indian Institute of Public Administration**

66. The book captures the context in which Public enterprises were set up, the inherent constraints and causes of poor performance. The various methodologies of performance evaluation are given. History of performance evaluation is traced from Committee on Public Undertaking's examination, to Ministry's quarterly review meetings to the Memorandum of Understandings (MOUs) (1986). Describes the components of MOUs where the administrative Ministry also has to undertake certain obligations. Even after the introduction of MOU system, there is a multiplicity of controls like audit, budgets, reports etc. The whole exercise of MOU is meaningless in the absence of reward and punishment.

**Brief History of Industrial Regulatory regime in India: 1947 to 1998, web site [home.uchicago.edu/~jmsivada/reg\\_history1.doc](http://home.uchicago.edu/~jmsivada/reg_history1.doc)**

67. In 1988-89, the government introduced the concept of Memorandum of Understanding in order to improve the performance of the PSEs. The MOU was an attempt to grant greater autonomy to the PSEs in their day-to-day operations, while increasing accountability by rating the PSEs based on agreed performance measures. The 1988-89 MOUs contained only performance indicators (mostly financial and physical targets) without negotiated 'weights' and 'values' for the different performance measures. In 1989-90, the list of measures was broadened to include qualitative aspects of performance (eg 'on-time performance' for Indian Airlines) and measures of "dynamic efficiency" (eg 'corporate planning', 'preventive maintenance', etc). Also, weights were attached to these performance measures to arrive at a composite measure of the performance. The focus on a broad range of criterion continued in 1990-91. After the reforms in July 1991, the emphasis shifted to profitability.

**National Institute of Financial Management, Singh, Surendra: Memorandum of Understanding, Lecture material for Management Development Program on Government Finance, September 1998**

68. The concept of Memorandum of Understanding (MOU) between the government and the Public Sector Undertakings is described in the context of international experience of introducing autonomy and accountability. Mechanics of structure of MOU system, methodologies, performance evaluation, interpretation and monitoring are dealt with in great detail. MOU system is a fair way to inculcate accountability in Public Sector Undertakings.

**Iyer, R. R.: "The Memorandum of Understanding System" (MOU system) in Reforming State Owned Enterprises, edited by S. L. Rao**

69. The growth of MOU system has been traced. The advantages and disadvantages have been analyzed. On balance the system has delivered. MOU is an important measure of reform and it is a significant improvement over the past. Despite the changes in economic policy, it continues to be relevant and important. While MOU is not a panacea for all problems of public sector enterprises, but it helps clarity of objectives and professional evaluation of performance. The MOU system is improving from year to year.

70. A good financial incentive system linked to MOU system must be introduced as soon as possible.

**Gedam, Ratnakar: Public Sector Management Performance and Efficiency, Deep and Deep Publications, New Delhi**

71. Performance evaluation of Indian Public Sector Undertakings is dealt with comprehensively, giving international comparisons. The modern theories of performance evaluation are explained alongside. Other subjects dealt with are issues in performance evaluation, political problems, industrial sector, rationale behind PSEs, accountability etc.

**Sebastian Morris: “Performance and Market Evaluation of the Public Sector Today” in the India Infrastructure Report, 2004. 3iNetwork.**

72. Total State control has compromised the managerial independence and successful companies are being stretched by demand for large dividend. The State is incapable of taking strategic decision and is unable to manage labor. The court rulings declaring the public sector undertakings as ‘a State’ has further led to poor control over the labor.

**Sharma, R.N.: “Memorandum of Understanding”, Financial Management and Accountability in the Public Sector, Edited by Ravi Kathpalia, 1995**

73. This is a compilation of talks given in an international seminar on Public Sector in 1994. The entire range of issues facing Public Sector Enterprises was covered during the seminar.

74. R.N. Sharma deals with the issue of Memorandum of Understanding (MOU) of public enterprises, commends its continued use on the following grounds,

- New MOU system has taken care to see that performance evaluation is comprehensive, impartial and objective as far as possible.
- Care has also been taken to weigh the relative importance of different objections of the enterprise.
- Controls aimed to be exercised by aggregate results and not by procedures or day to day monitoring.

75. But as the failure to perform is not followed by any punishment, MOU ultimately is not effective. There is no incentive to perform, either. Moreover, the data collection is suspect.

**P K Misra, D. Geeta and B. Navin: “Memorandum of Understanding and Public Enterprises” in the Working Paper Series 2001, Institute of Public Enterprises, Hyderabad**

76. The Memorandum of Understanding (MOU) scheme has made little impact regarding autonomy and accountability.

77. The paper gives the following reasons for poor performance of the Public Sector

- Entry of Public Sector Enterprises in non core sectors.
- Uncertain tenure of the Chief Executive Officers.
- Varying interests of the chiefs.
- Political interventions and interests.
- Lack of autonomy and accountability.
- Lack of flexibility and adaptability.
- Changing role of the State.

**Saxena, Anjali: “Trends, Problems and Prospects of Restructuring Public Enterprises” in the Indian Journal of Public Administration, Jan – Mar 2002**

78. The MOU system has not been a success as the controlling ministries have not been distanced from the Public Enterprises. The system of multiple agencies overseeing the Public Enterprises like Comptroller and Auditor General, Chief Vigilance Commissioner and Parliament Committees eat away the valuable time of management.

**Robert Casoen and Vijay Joshi: India: Future of Economic Reform, Oxford University Press**

79. The Memorandum of Understanding is being claimed by official sources as a major instrument of roll back of State’s involvement. However, it does not address the real problems of autonomy and accountability. Much more needs to be done to distance the government from the public sector undertakings.

**R K Misra: “Navaratna and Mini Ratna Public Enterprises, Financial and Operational Autonomy” in the Working Paper Series 2003, Institute of Public Enterprises, Hyderabad**

80. The author conducted a survey among the public sector chief executive officers (CEO) in respect of financial and operational autonomy, corporate governance and board dynamics of the Navaratna and Miniratna enterprises.

81. The author conducted a survey among the public sector chief executive officers (CEO) in respect of financial and operational autonomy, corporate governance and board dynamics of the Navaratna and Miniratna enterprises.

82. On operational freedom the CEOs felt that interference from the government and frivolous rules of Department of Public Enterprises obstruct the operational freedom.

83. They felt that the powers delegated were good but more freedom was needed in financial matters.

84. There was a consensus that the working style of the companies have changed for the better, becoming more commercial and market oriented. There is more autonomy in the board meetings with many independent directors. The boards have become more strategic and dynamic.

85. The ‘Ratna’ concept has not delivered in full measure as there are still some impediments like too much time being taken in appointing in non official/part time directors. Flexibility is still limited due to government rules, salary and perks, not comparable with industry standard.

86. In Miniratna companies, the limitations on capital expenditure are a constraint.

**Standing Conference of Public Enterprises (SCOPE), Jain, C.P.: Address at the Annual General Meeting (October 2004) as Chairman, published in Kaleidoscope, November 2004**

87. Executive freedom is a must for good governance in Public Sector Enterprises and the freedom must be used within the framework of effective accountability and transparency.

88. The speech contained a survey of the performance of public sector, challenges and need for empowerment.

**Dewan, Dr. S. M.: Director General SCOPE, 'Towards a Framework of Corporate Governance for Public Sector', Kaleidoscope, December 2004**

89. The key is to make the PSEs board-driven, the state confining itself to policy. Further devolution of effective operational and commercial autonomy with maintenance of accountability is needed.

**Dhawan, K N: 'Thank God We Are Public Sector Enterprises', Kaleidoscope, December 2004**

90. There may be many instances of lack of corporate governance and lapses on the part of private entities in conforming to laws. But in the public sector, the system of accountability and natural checks and balances virtually rule out such possibilities.

**Board for Reconstruction of Public Sector Enterprises**

91. The Government of India has constituted a Board for Reconstruction of Public Sector Enterprises through a Resolution notified vide OM NO 16(25)/2004-Fin. Dated 6<sup>th</sup> December 2004. Briefly the terms of reference are:

- To advise the government ways and means to strengthen public sector enterprises in general and making them more autonomous and professional.
- To consider restructuring –financial, organizational and business (including diversification, joint ventures, seeking strategic partners, merger and acquisition)-of Central Public Sector Enterprises (CPSEs) and suggest ways and means to fund such schemes.
- To examine the proposals for restructuring/revival of loss making CPSEs for their turn around.
- To advise the government on disinvestment/closure/sale, in full or part, in respect of chronically sick/loss making companies that cannot be revived.
- To monitor incipient sickness in CPSEs.

**Government of India, Department of Public Enterprises. OM NO 18(24)/2003-GM dated 11/11/2004**

92. To advise the government on disinvestment/closure/sale, in full or part, in respect of chronically sick/loss making companies Government of India has set up an ad hoc committee to consider issues relating to autonomy, delegation of financial powers of Central Public Sector Enterprises vide OM NO 18(24)/2003-GM dated 11/11/2004 with Dr. Arjun Sengupta as the Chairman.

**Standing Conference of Public Sector Companies**

93. The annual conference of the chiefs of public sector enterprises on 4<sup>th</sup> September 2004 had “**Corporate Governance in Public Sector**” as its main theme and it flagged many important issues relevant to public sector.

- “Memorandum of Understanding (MOU) system being revamped.” Dr. Adarsh Kishore, Secretary (Heavy Industries & Public Enterprises).
- “Unshackle government control over Public Enterprises”.
- “Every aspect of functioning of public sector enterprises need rethinking and reorientation to meet the challenges of competition and changing economic set up” Dr. Manmohan Singh, Prime Minister.
- “In my opinion, the path to improving the performance lies in greater authority with responsibility and quicker decisions and simultaneous accountability” Santosh Mohan Dev, Minister of State (Heavy Industries and Public Enterprises).
- “PSE boards should have ultimate responsibility in making operational decisions” Professor Y R K Reddy.
- “Induction of independent directors in the Board of Directors in PSEs has added value to corporate governance” V.S. Jain, Chairman SAIL.

**Prajapathi, Trivedi: A critique of Public Enterprise Policy, International Management Publishers, 1992**

94. This is a collection of articles by the author centering on public enterprises policy, the issues, problems and solutions. He says that there are multiple principals with multiple goals which are often conflicting. Performance evaluation, including Memorandum of Association and the role of Department of Public Enterprises have been extensively discussed. The report of Arjun Sengupta committee has been analyzed.

**Y.V. Reddy: Golden Jubilee Endowment Lecture, Osmania University, December 1996**

95. In the new economic liberalized environment the PSEs have much strength and should plan to cope with the challenges, as many opportunities are available. One of the main constraints could be the lack of autonomy arising from government ownership. It would be necessary to choose an appropriate level of government ownership to give PSEs adequate autonomy.

## Chapter 18

### ACCOUNTABILITY OF GOVERNMENT FOR AUTONOMOUS BODIES AND GOVERNMENT-AIDED NON-GOVERNMENT ORGANISATIONS

1. The autonomous institutions may be categorized into two broad groups: autonomous bodies within the Government sector (such as universities, health care institutes) and the institutions that are engaged in the provision of services that are partly or fully funded by Government. The Planning Commission has been declared as the nodal agency for the Government-voluntary sector interface.

#### **The Societies Registration Act, 1860**

2. This law regulates the legal condition of societies established for the promotion of literature, science, the fine arts, the diffusion of useful knowledge, the diffusion of political education, or for charitable purposes. State-specific amendments have been made to the Act by various State Governments. The Memorandum of Association and the Articles of Association, which must accompany an application for registration of a body under the Act, prescribe the requirements of maintenance of accounts and their audit.

3. The Societies Registration Act, 1860, does not contain any specific provision for the audit of accounts of bodies registered thereunder. Any such institution seeking Government assistance must however submit its audited statement of accounts along with the other prescribed documents.

#### **The Companies Act, 1956**

4. The Act envisages the registration of company as a charitable company.

#### **The Supreme Court of India, Shetty R.D. v International Airport Authority (1979) 3 SCC 489**

5. Where a corporation is wholly controlled by Government not only in its policy making but also in carrying out the functions entrusted to it by the law establishing it or by the charter of its incorporation, there can be no doubt that it would be an instrumentality or agency of Government and covered under the meaning of the 'State' as defined in Article 12 of the Constitution.

#### **The General Financial Rules, 1963<sup>27</sup>**

6. Rules 148 to 164 of the General Financial Rules, 1963 (GFR's) regulate the payment of grants-in aid and loans to autonomous bodies.

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<sup>27</sup>Rules 206 to 233 of GFR's 2005 effective from July 2005

7. The general principle of grant-in-aid is that it can be given to a person or a public body or an institution having a legal status of its own. Institutions or organizations set up by Government as autonomous bodies either under a statute or as a society registered under the Societies Registration Act, 1860 or otherwise, voluntary organizations having an all India character which satisfy certain well-defined criteria qualify for eligibility for Government assistance.
8. The GFR's prescribe the basic conditions of eligibility for Government funding, the manner of computation of Government assistance, the standard set of attaching conditionalities and the procedure for monitoring the utilization of Government assistance for the intended purpose.
9. Any institution seeking Government assistance is required to submit its application in the prescribed form with all relevant information such as the Articles of Association, Byelaws, audited statement of accounts, sources and pattern of income and expenditure and clearly spell out the need for assistance.
10. The assisted institutions are required to submit audited statements of their accounts to the sanctioning authorities, certificates of utilization of Government assistance for the intended purpose and achievement-cum- performance reports. They must also maintain the prescribed sets of records including the proper records of assets built out of the amounts provided by Government. The achievement-cum-performance report is required to be included in the Annual Report of the grantee that is presented in the Parliament, or, in cases of small amounts of grant-in-aid, included in the Ministry's Annual Report.
11. The Ministries are required to conduct a periodic review, once in three to five years, of the performance of the institutions that are provided financial assistance of Rs. one million.
12. The line Ministries are required to get the approval of the Ministry of Finance to the pattern of assistance.<sup>28</sup>
13. In regard to loans the GFR's, additionally, prescribe the number of instalments and the period by which the loans should ordinarily be recovered.
14. In both cases the GFR's prescribe the standard set of records that the sanctioning authorities should maintain for the purpose of proper monitoring and control.
15. The Ministries are required to obtain the certificates of utilization of Government assistance from the assisted bodies and forward the same to the Controller General of Accounts.

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<sup>28</sup> In terms of Rule 209(2) of GFR's 2005 the Internal Finance Wing of the Ministry concerned should prescribe the pattern of assistance as per the broad guidelines of the GFR's and the instructions issued by the Ministry of Finance from time to time.

16. All grantee institutions that receive more than 50 per cent of their expenditure in the form of grants-in-aid are ordinarily required to formulate terms and conditions of service of their employees, which are by and large not higher than those applicable to corresponding categories of Government employees. Government reserves the right to nominate its representatives on any grantee institution that depends upon Government grant-in aid for more than 50 per cent of its annual expenditure.<sup>29</sup>

## **The Delegation of Financial Powers Rules, 1978**

17. These Rules define the powers of the line Ministries to sanction grants-in-aid to autonomous bodies. The line Ministries have full powers to sanction grants-in-aid and loans provided that-

- (i) such grants-in-aid and loans are in accordance with the rules or principles and the pattern of assistance prescribed with the previous consent of the Ministry of Finance<sup>30</sup>; and
- (ii) the rate of interest on a loan and the period of its repayment are fixed with the previous consent of the Ministry of Finance or are in conformity with any general or special order of that Ministry.

18. Grants-in-aid and loans in excess of the specified amounts are required to be exhibited separately in the budget documents.

*Note: Two documents containing the Guidelines issued by the Ministry of Human Resource Development that include the pattern of assistance are mentioned later by way of illustration. The scheme of Mother NGOs mainly implemented by the Department of Family Welfare Ministry of Health and Family Welfare is also mentioned.*

## **Government of India, Ministry of Finance, Annual Budget Circular**

19. The Annual Budget Circular issued by the Ministry of Finance requires the line Ministries to keep in view the provisions of the General Financial Rules while making proposals for grants-in-aid for the autonomous bodies and institutions.

## **Government of India, Ministry of Human Resource Development, Department of Education, Scheme for**

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<sup>29</sup> This enabling provision has not been included in GFR's 2005 but the Memoranda of Association and /or Articles of Association of the Central Autonomous Bodies generally prescribe the representation of the Government of India on their governing bodies.

<sup>30</sup> In terms of Rule 209(2) of GFR's 2005 the Internal Finance Wing of the Ministry concerned should prescribe the pattern of assistance as per the broad guidelines of the GFR's and the instructions issued by the Ministry of Finance from time to time.

## **Strengthening Boarding and Hostel Facilities for Girl Students of Secondary and Higher Secondary Schools, Financial Assistance to Voluntary Agencies**

20. This document describes the salient features of the scheme of assistance to voluntary agencies for strengthening boarding and hostel facilities for girl students of secondary and higher secondary schools. It lays down the criteria for determining the eligibility of voluntary agencies for assistance, the nature and extent of recurring and non-recurring assistance, the manner of submission of applications for assistance, the procedure of scrutiny of applications, the release and disbursement of grant, the attaching conditionalities and the procedure for monitoring and evaluation.

### **Government of India, Ministry of Human Resource Development, Department of Education, Guidelines for Assistance to Voluntary Agencies for Innovative Programmes, Scheme of Environmental Orientation to School Education**

21. This document sets out the guidelines for regulating grant of assistance to voluntary agencies for taking up experimental and innovative programmes for environmental orientation to education at school level. It defines the criteria for determining the eligibility of voluntary agencies for assistance, the nature and extent of Government assistance, the procedure for application, scrutiny, release and disbursement of assistance, the attaching conditionalities and the procedure for monitoring and evaluation.

### **Government of India, Ministry of Health and Family Welfare, Department of Family Welfare, Mother NGO (MNGO) Scheme**

22. The Department of Family Welfare, Ministry of Health and Family Welfare, has a number of schemes, under the Reproduction and Child Health Programme that are implemented fully/partially through public-private partnership. The Mother NGO (MNGO) scheme is one of them. Under this scheme NGOs with fixed assets amounting to Rs. 2 lakhs, with experience of 3-5 years in health and family welfare, are eligible for assistance. Applications for MNGO status are invited through advertisements and the applications are initially screened and selection is made by the State Selection Committee after field visit, desk review etc. The final approval rests with the Department of Family Welfare.

23. The MNGOs are responsible for identification, appraisal, selection, monitoring and appraisal of the small NGOs. The small NGOs do not have to approach Government for assistance nor do they have to report to Government about their work. The grant-in-aid received by the MNGO is passed on to the field NGOs retaining only the institutional costs for overseeing the project implementation and for providing technical assistance to the field NGOs. The MNGOs have been permitted full latitude in the selection of NGOs, content wise, area of work, and choice of activities subject to certain norms. Each MNGO is allotted 2 to 10 districts. (*Source Government of India, Planning Commission, Report of the PPP sub-Group on Social Sector, Public Private Partnership, November 2004*)

24. An internal review by the Department of Family Welfare, Ministry of Health and Family Welfare, has shown the soundness of the MNGO concept as a delivery mechanism.
25. The Planning Commission has also recommended the MNGO model.

## **The Constitution of India**

26. The Constitution of India provides the basic framework for the audit jurisdiction of the CAG with reference to the audit of autonomous bodies and voluntary organisations. In terms of Article 149 of the Constitution the CAG shall perform such duties and exercise such powers in relation to the accounts of the Union and of the States and of *any other authority or body* as may be prescribed by or under any law made by Parliament.

### **The Comptroller and Auditor General's (Duties, Powers and Conditions of Service) Act, 1971**

27. The Comptroller and Auditor General's (Duties, Powers and Conditions of Service) Act, 1971 defines *inter alia* the audit jurisdiction of the CAG in relation to autonomous bodies including the bodies registered under the Companies Act 1956.

28. Under Section 19 (2) of the Act, the duties and powers of the CAG in relation to the audit of the accounts of corporations (autonomous bodies) established by or under law made by Parliament shall be exercised in accordance with the provisions of the respective legislations.

29. Under the Companies Act, 1956, the auditor of a Government company shall be appointed on the advice of the CAG, the CAG is authorized to issue directions to the auditor and also to conduct a supplementary or test audit. The statutory auditor is required to submit a copy of his report to the CAG, and the latter has the right to comment upon or supplement the audit report of the statutory auditor and such comments shall be placed before the Annual General Meeting of the company.

30. Section 14 of the CAG's Act authorizes the CAG to audit all receipts and expenditure of any body or authority that is substantially financed by Government grants or loans. A body or authority is said to be substantially Government funded if the amount of Government funding is not less than Rs. 2.5 million and also not less than 75 per cent of its total expenditure in a year. With the prior approval of the President, the CAG may also audit all receipts and expenditure of a body or authority if the amount of Government funding is not less than Rs. 10 million in a year.

31. Under Section 15 of the Act the CAG is authorized, in other cases, to scrutinize the procedures by which the sanctioning authority satisfies itself as to the fulfillment of the

conditions attaching to Government funding and, for this purpose, to have access to the books and accounts of the assisted body or authority.

32. Sections 19 and 20 of the Act authorize the President to entrust the audit of accounts of any corporation, body or authority to the CAG. Likewise the CAG may also propose to the President that the audit of any authority or body may be entrusted to him because a substantial amount of Government money has been invested in or advanced to such a body or authority.

## **Audit Reports**

33. The Audit Reports on the accounts of the autonomous bodies are submitted to the Government and barring a few exceptions the Government is required to lay these reports before the Parliament. These reports mainly contain the audit comments on the accounts of the autonomous bodies.

34. The CAG also submits to the President a separate volume of his Audit Reports on the Autonomous Bodies and the President causes the said Report to be laid before the Parliament. The Audit Report on the Autonomous Bodies contains the results of CAG's performance appraisals of these bodies as well as the results of transaction audit of these bodies.

## **Legislative Oversight**

35. The arrangements for legislative oversight are as follows:

(i) Public Accounts Committee: The CAG's Audit Reports on the Autonomous Bodies automatically stand remitted to the Public Accounts Committee for follow up action. (For further details refer Chapter 23 on Legislative Oversight).

(ii) Committee on Public Undertakings: The CAG's Audit Reports on charitable Government companies registered under the Companies Act, 1956, stand remitted to the Committee on Public Undertakings for follow up action. (For further details refer Chapter 23 on legislative oversight).

(iii) Committee on Papers: In addition, a Committee on Papers monitors the timely submission of the Annual reports and the Audited Accounts of the autonomous bodies to the Parliament.

36. The Committee on Papers laid on the Table is constituted under Rule 305A of the Rules of Procedure and Conduct of Business in Lok Sabha. It consists of 15 members nominated by the Speaker for a term not exceeding one year. The Chairman of the Committee is appointed by the Speaker from amongst the members of the Committee.

37. The function of the Committee is to examine all papers laid on the Table of the House by Ministers (other than those which fall within the purview of the Committee on Subordinate Legislation or any other Parliamentary Committee) and to report to the

House (a) whether there has been compliance of the provisions of the Constitution, Act, rule or regulation under which the paper has been laid, (b) whether there has been any unreasonable delay in laying the paper, (c) if there has been such delay, whether a statement explaining the reasons for delay has been laid on the Table of the House and whether those reasons are satisfactory, (d) whether both the Hindi and English versions of the paper have been laid on the Table, (e) whether a statement explaining the reasons for not laying the Hindi version has been given and whether such reasons are satisfactory, (f) such other functions in respect of the papers laid on the Table as may be assigned to it by the Speaker from time to time.

38. According to the time schedule prescribed by the Committee the Annual Reports and the Audited Accounts of the autonomous bodies are required to be tabled in the Parliament within a period of nine months from the close of the financial year. For this the autonomous bodies must submit their accounts for audit within three months of the close of the financial year.

**Report of the Comptroller and Auditor General of India for the year ended March 2004, Union Government (Civil) Autonomous Bodies, No. 4 of 2005**

39. The Report brings out *inter alia* the following:

- The Ministries had not furnished utilization certificates for grants aggregating to Rs.106 billion disbursed up to March 2003; in some cases since 1976-77; (this did not include the grants disbursed by the Ministry of Human Resource Development, which did not supply the requisite information to the CAG, but another Report of the CAG for the same year, No1 of 2005, points out that one Department alone of the said Ministry viz; the Department of Secondary and Higher Education had not furnished utilization certificates for Rs. 38 billion for the grants released during 2000-2001 to 2002-2003);
- While a very large number of utilization certificates were outstanding, some of the Ministries continued release fresh grants to the defaulting organisations;
- The autonomous bodies did not adhere to the time schedule prescribed by the Committee on Papers for making available their accounts for audit; some of the autonomous bodies had not submitted their accounts from 1999-2000 onwards;
- There had been delays in the presentation of the Audit Reports on the accounts of the autonomous bodies to the Parliament; in several cases the Audit Reports had not been presented for the years 1999-2000 and onwards;
- The internal control framework of some of the autonomous bodies reviewed in audit suffered from severe deficiencies; there were instances of non-compliance with the rules and the Government instructions were disregarded;
- The autonomous bodies reviewed in audit were found to be under-performing in terms of their stated purpose and objectives.

**Report of the Comptroller and Auditor General of India for the year ended March 2004, Union Government (Civil) Transaction Audit Observations, No. 2 of 2005**

40. In a review of the functioning of the internal control systems including internal audit in the Ministry of Information and Broadcasting, the Report points out that the Ministry had neither properly maintained the prescribed records of Government assistance to the autonomous institutions nor carried out the mandated review of the performance review of the grantee institutions.

**Inaugural Address of the Comptroller and Auditor General of India in the XX Conference of the Accountants General, 1999**

41. The increasing tendency of assigning public money to recipients through intermediaries has resulted in a situation where there is very little to see in the records of the authority charged with intermediation and absence of audit in the recipient and actual users. If funds made available by the Parliament to any institution are to be accounted for, then the Constitutional arrangement for auditing such funds should not be outside the purview of the Constitutional institution set up by the founding fathers for this express purpose.

**Government of India, Report of the Expenditure Reforms Commission on Autonomous Institutions, 2001**

42. According to the Commission there existed no reliable information regarding the number of autonomous institutions set up by Government of India. The Commission placed the number of such institutions at nearly 500 with an estimated budgetary outgo of over Rs. 100 billion (1999-2000).

43. There is no formally laid down procedure for the establishment of these bodies; some of the bodies have been set up under separate Acts of the Parliament while some others have been registered under the Societies Registration Act, 1860. Some of the bodies were set up with the approval of the Cabinet, while in some cases the decision for their establishment was taken at the level of the Minister of the line Ministry.<sup>31</sup>

44. There has been steady increase in the number of bodies whose accounts were either delayed or not provided for audit. There has also been a progressive increase in the arrears in their annual accounts as well as the number of overdue utilization certificates. The monitoring arrangements are weak; no structured periodical meetings are held between the nodal Ministry and the autonomous body. No worthwhile study has been conducted to ascertain whether the bodies are fulfilling their stated objectives and whether there exists sufficient justification for their continuance.

45. All such bodies have adopted Government rules for regulating employee benefits. The institutions function like attached offices of Government, without at the same time

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<sup>31</sup> In terms of Rule 208 of GFR's 2005 no new autonomous body should be created without obtaining the approval of the Cabinet.

being subject to the close scrutiny of the other wings of the Government. In many bodies reduced accountability and non-reporting seems to have been construed as essential element of autonomy.

46. The nomenclature of some of the bodies suggested that some of these might be carrying out identical or duplicate functions.

47. Stringent criteria should be laid down for the establishment of new autonomous bodies, and need for the continuance of the existing bodies and/or the functions performed by them should be carefully reviewed. Ex post facto approval of the Cabinet should be sought and obtained for the bodies that were established without such approval. Autonomous bodies that do not furnish their accounts should be denied further assistance by Government.

48. There should be emphasis on internal resource generation; the budget support currently extended should be progressively reduced having regard to the scope for maximizing internal resource generation and restraining expenditure growth.

49. There is need for strengthening the monitoring and oversight mechanism by Government; bodies that are granted budgetary support of more than Rs. fifty million in a year may be required to enter into a performance-related memorandum of understanding with the nodal Ministry. A system of peer review once in every three or five years should be instituted. At the same time well-performing autonomous bodies should be encouraged to grow with enhanced financial support and autonomy.

50. The annual performance reports of the autonomous bodies should be placed before the Parliament or annexed with the annual report of the administrative Ministries.

**Premchand A., Potter Barry, and Woolley Mike: India: Public Expenditure Management, 1996**

51. The autonomous bodies can be categorized into two broad groups: autonomous bodies within the government sector (such as universities, health care institutes) and the bodies that are engaged in the provision of services that are partly or fully funded by Government.

52. The Ministry of Finance should maintain a centralized registry of autonomous bodies within the Government sector indicating the degree of Government financial support, the level of fees and charges or other revenues, and the service that the Government is funding.

53. In regard to the other bodies, since these provide services, a performance arrangement that combines both the financial and the services aspect should be concluded with them. The agency receiving Government funding should regularly report the progress to the funding agency and at the end of the year its accounts should be subjected to a supplementary audit by the CAG.

**Ministry of Finance, Report of the Committee of Experts on Uniform Format for Central Autonomous Bodies, November 2000**

54. The Expert Committee was set up following the Sixtieth Report of the Parliamentary Committee on Papers (March 1998) that had expressed concern at the dismal state of accounts of Government-funded autonomous bodies, the lack of transparency and the absence of any set standards of presentation of accounts.

55. The Expert Committee recommended that the financial statements of the Central autonomous bodies should be prepared and presented in the following formats:

- Balance Sheet;
- Income and Expenditure Account;
- Schedules to the above Financial Statements;
- Instructions and Accounting Principles;
- Notes and Instructions for the Schedules; and
- Statement of Receipts and Payments.

56. Within the common format of accounts, further additional information may be given/ prescribed by Government for the Central Universities and other educational institutions and for the District Rural Development Agencies.

57. The accrual system of accounting will be followed and the concept of going concern will be maintained. The provision for depreciation on fixed assts should be made.

58. Observing that the laws relating to the autonomous bodies generally prescribe the accounting procedures, the Committee was of the view that a separate law may have to be enacted that would override the relevant provisions in the existing laws.<sup>32</sup>

59. The recommendations of the Committee were not to apply to the Port Trusts and the nationalized banks.

**Government of India, Planning Commission, Proceedings of the All India Conference on the Role of the Voluntary Sector in National Development, April 2002**

60. The conference, which was inaugurated by the Prime Minister, recommended inter alia the creation of an enabling environment to facilitate quick redressal of grievances of the voluntary organisations, transparency in funding procedures, system of monitoring and evaluation of projects, adoption of appropriate standards of accountability and transparency by the voluntary organisations, capacity building for project formulation, implementation, report writing, financial and administrative management, networking, social audit, and monitoring and evaluation. The Conference considered the Mother NGO

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<sup>32</sup> Rule 209 of the GFR's 2005 enjoins upon the grant sanctioning authorities to ensure that the autonomous bodies maintain their accounts in the standard format.

model of the Department of Family Welfare as the ideal and recommended its adoption by other Ministries with adequate safeguards for the interests of the smaller voluntary organisations. Monitoring and evaluation should be a part of the implementation process. As a matter of policy Government should support growth of sector specific networks.

**Government of India, Planning Commission, Report of the Task Force on Laws relating to the Voluntary Sector, 2002**

61. The Task Force reviewed *inter alia* the laws relating to the registration of the voluntary agencies as “societies” under the Societies Registration Act, 1860, and the corresponding laws enacted by the State Governments, and concluded that the Act could remain as it was. However, it recommended that the registration should be granted within 60 days of receipt of application and completion of formalities, and if registration was refused, the Registrar of Societies should record the reasons for refusal. It also recommended that the requirement of periodic renewal of registration as stipulated in the legislations of some of the State Governments should be done away with and the registration should be invariably at the district level and at no higher level. In the interest of greater transparency, it recommended that the Registrar should be adequately equipped to take care of the documents including the annual report and the financial accounts that are required by law to be filed in his office, which any person can under the law inspect or ask for copies.

62. The Task Force carefully considered whether there should be a provision in law to ensure good governance, good financial management and so on and concluded that in the interest of democratic health of a society, the members will themselves to have tackle the issue; an external official or other agency taking upon itself to deal with such matters would probably be worse than the disease.

**Government of India, Planning Commission, Report of the Steering Committee on Voluntary Sector for the Tenth Five Year Plan, 2002**

63. According to the Steering Committee, validation/accreditation of voluntary agencies would be useful for both private and public sector donors and international donors. The Committee recommended that the concerned NGO networks, intermediary organisations and the Government Ministries might evolve suitable methodologies for the purpose.

64. The Committee recommended that the sanctioning system for schemes through the voluntary sector should be decentralized and follow the Mother NGO (MNGO) model. A designated MNGO or a Nodal NGO may be allowed to take care of three or four related sectors; at the same time care should be taken to ensure that this does not hamper the growth of smaller/newer NGO's.

65. According to the Committee the Ministries may consider providing long-term grants to the established voluntary organisations to mitigate the sense of insecurity in terms of sustaining the core activities and staff. It recommended the active support of the Ministries and Departments for capacity building on a holistic long-term basis.

66. The Committee also recommended that the concerned Ministries and Departments should evolve systematic monitoring and evaluation practices in respect of various types of projects and should make available a concrete list of check-points to the agencies involved in the monitoring and evaluation of voluntary sector projects. There should be mid-term appraisals, the formats for reporting periodical progress should be streamlined and the committee empowered to sanction a particular project should as far as possible be associated with its monitoring and evaluation. Monitoring and evaluation should be outcome focused and it should try to elicit how much has actually reached the people. For that suitable checklists of measurable social indicators should be developed. The reports of monitoring and evaluation should be published and placed on the websites of the Ministries.

#### **Government of India, Planning Commission, National Policy on the Voluntary Sector 2003 (Draft)**

67. The main objectives as envisaged in the draft National Policy are to create an enabling legal environment for the promotion of the voluntary sector, consolidate and enhance its capacity in the design and delivery of economic and social services and to provide a framework for adequate flow of financial resources for the discharge of its functions without undue hindrance or compromises.

68. The draft National Policy envisages a review of all existing laws that govern the formal or statutory recognition of the voluntary sector. According to the draft Policy the voluntary organisations are expected in the main to generate their own resources, but where public funds need to be transferred for carrying out the specified activities, accreditation procedures are inescapable. Recognising the diversity of voluntary organisations, Government will evolve a graded system of accreditation with different financial limits in consultation with the representatives of the voluntary sector. The existing norms of accountability as per the provisions of the laws governing the voluntary sector are inadequate from the point of transparency and shall be reviewed. Government shall also endeavour to develop model accounting standards in consultation with the Institute of Chartered Accountants of India, the CAG and representatives of the voluntary sector.

#### **Government of India, Planning Commission, Guidelines for Voluntary Sector, 2002**

69. These guidelines were issued following an All India Conference on the role of the Voluntary Sector in National Development in April 2002 that was addressed by the Hon'ble Prime Minister (paragraph 60 above). These guidelines sought to streamline the procedure for Government funding, including the revision and simplification of form of application for Government assistance, greater transparency in the process of sanctioning

project proposals through a decentralized committee-based sanctioning procedure in which participatory appraisal, monitoring and evaluation as well as sustainability are incorporated and recommended earmarking of 5 per cent of the project cost for monitoring and evaluation. The project support to a voluntary organisation should be preferably for a period of five years coterminous with the period of the Five Year Plan. The system of release of funds should be streamlined, 50 per cent of the annual project outlay may be released by 30<sup>th</sup> October and the balance amount by 28<sup>th</sup> February.

**Government of India, Planning Commission, Report of the PPP Sub-Group on Social Sector, Public Private Partnership, November 2004**

70. The Report documents the programmes and schemes in the social sector that are under implementation through public-private partnership, in the different Ministries and departments of Government of India. The Report describes the objectives of the programmes, the nature of service provider, contract structure, selection criteria, payment mechanism, monitoring arrangements etc. The Report placed the total budgetary (Plan) allocations to the voluntary organisations in the social sector at over Rs.380,000 million during 2004-2005.

71. According to the Report the concept of public-private partnership brings in greater professionalism in the association of voluntary sector compared with the traditional concept of grants-in-aid in the implementation of social sector schemes. The most stable partnership between Government and the voluntary agency is in the form of contract that is binding on both the parties. Observing that the poor performance of public utilities and social services is due to the monopoly characteristic of such services, the Report stresses the need for the selection of service providers through competitive bidding or competitive negotiation, constant monitoring and evaluation of the performance of the selected service provider and putting in place independent regulatory systems for protecting consumers' interest. There should be transparency at all levels in all activities being implemented through public-private partnership. Since competitive negotiation is less transparent than competitive bidding, it has been suggested that the 'contract' should be brought under the purview of Government auditor. There should also be room for ex post evaluation. Government retains the ultimate step-in rights for appointing another provider if the original provider fails to perform.

**Mohanty Manoranjan and Singh Anil K.: Voluntarism and Government, Policy, Programme and Assistance, Voluntary Action Network India (VANI), October 2001**

72. The book discusses *inter alia* the role of Government in voluntary action, NGO-Government relationship and Government policies towards NGOs, programmes and assistance provided by the various departments and Ministries of Government of India. The book describes nearly three hundred schemes under which Government of India provides assistance to NGOs.

73. The book also describes the scheme of Mother NGOs and the national level NGOs that are patronized mainly by the Department of Family Welfare, Ministry of Health and Family Welfare.

**Nabhi's Hand Book for NGOs: A Nabhi Publication 2005**

74. This is a comprehensive reference book that details the institutional and legal framework relating to the NGOs, the applicable laws, the procedure of formation of NGOs, management of NGOs, preparation of project reports, project implementation, funding of NGOs, operations, accounts and accountability etc. The book also describes the schemes of assistance of various Ministries.

**Society for Services to Voluntary Agencies (SOSVA), Report on the setting up a National Evaluation and Monitoring Agency for Voluntary Sector, March 2003**

75. SOSVA is a nodal promotional agency providing a range of services to voluntary agencies in terms of technical, financial and marketing assistance on the lines that is currently available to the industrial and cooperative sector. SOSVA organized a study at the instance of the Ministry of Health and Family Welfare, Department of Family Welfare, for creating a National Evaluation and Monitoring Agency (NEMA) for the voluntary sector. The Report provides a broad overview of the voluntary sector, examines the need for the creation of a NEMA and suggests a framework for the establishment of such an institution including its operationalisation.

**PRIA, A study of the non-profit sector in India, December 2002**

76. PRIA is a civil society organisation, undertaking development initiatives for the weaker sections of the society by encouraging and enabling their participation in the process of their governance. This study by PRIA provides a broad census of the non-profit sector in India. The study placed the number of non-profit organisations in the country at 1.2 million, of which nearly half are unregistered. Grants and donations comprised 41.9 per cent of their receipts.

**Goel S.L. and Kumar R.: Administration and Management of NGOs, Text and Case Studies, Deep and Deep Publications Pvt. Ltd. New Delhi, 2004**

77. NGOs obtain funds through a number of schemes and from different Government agencies; this dilutes accountability. There seems to be no coordination among the agencies implementing social development programmes and the NGOs and between NGOs. The schemes/pattern of assistance, prescribed years ago, have not been rationalized and revised despite the rising costs, changing requirements and even the target groups. The amount of financial assistance bears little nexus with the minimum expected standard of service; this renders the system of supervision, counseling, monitoring and internal evaluation superfluous. There is no single source which the NGOs can access for information on schemes projects and procedures. The NGOs are

handicapped because of the uncertainty regarding the future continuance of Government assistance.

**Kaul, V.N.: Keynote address at the IPAI Seminar on Development Initiatives: Voluntary Sector in Partnership with Government and International Organizations, December 2003**

78. There is need to evolve a clear public-private partnership in view of the growing participation of the voluntary agencies in public expenditure and service delivery. The accounting arrangements within the Government also need to be strengthened. The role of the players under the emerging arrangement needs to be defined. On the part of the voluntary sector there is need to promote sound management practices, standardization, transparency and much greater accountability. It would be ideal if the sector could devise a system of self- regulation and third party mediation in evaluation and peer review.

**Swarup, Vrinda: Funding Issues and Issues related to Monitoring and Evaluation of Funded Programmes, IPAI Seminar on Development Initiatives: Voluntary Sector in Partnership with Government, December 2003**

79. Given that the projects are funded out of Government funds, it is important to focus on several key factors, including the development of procedures that are easy to use, transparent, and helpful in modernizing the delivery of Government services, and the development of quantifiable evaluation systems that can measure actual performance against agreed targets.

80. Just as the Government has a responsibility to develop transparent procedures, the voluntary sector too has a responsibility to develop transparent procedures, and must accept its accountability towards Government and the larger society.

81. In the case of voluntary agencies the concept of accountability can be particularly complex due to the range of stakeholders to whom these are responsible; apart from Government, there is the original client or the funding group of community, trustees, funders and so on. There is need to put in place clear performance evaluation systems, which determine the actual achievements of an organization in terms of the goal set for it while sanctioning financial assistance. There must be a well-defined set of rules for decision-making, agreed procedures for employing staff and a clear definition of roles and responsibilities of all the concerned partners. The effort put into developing such systems should be proportionate to the amount of funding involved, as well as appropriate to the activities of the organization. It is necessary to move beyond the current system of seeking information in a routine manner, largely for the release of further installments of Government funding.

82. Monitoring and evaluation systems need to be seen as an instrument of learning about the achievements and problems so as to improve project management and impact. Any good system of monitoring and evaluation must therefore go beyond the mere reporting of physical and financial indices to the preparation of a detailed situation analysis, which

in turn helps to plan for capacity development and sustainability, in addition to learning and adaptation.

**Makhija B.N.: Regulation, Ethics and Accountability Development of the Best Practice Guide for the Voluntary Sector, IPAI Seminar on Development Initiatives: Voluntary Sector in Partnership with Government and International Organizations, December 2003**

83. The transparency requirements of the registration laws are minimal and differ across the States due to lack of uniformity. There are variations even in the minimum basic norms prescribed for Government agencies. For example, while CAPART's eligibility criteria require that the voluntary agency should have a bank account/Post Office account, the Department of Social Justice guidelines require only two years of existence. The donor guidelines and practices on project follow-up and evaluation leave large gaps. The regulatory provisions relating to accounts and audit contained in the basic statutes of the voluntary sector are very skeletal and their enforcement perfunctory. Accountants employed by the voluntary sector are not the most professional and the auditors subscribing their signature to the accounts are not the most motivated. The auditing profession has only recently become conscious of the need for the development of a separate set of the Generally Accepted Accounting Practices for the voluntary sector.

84. Concerned at the negative reports on the functioning of the voluntary sector, several voluntary agencies have formed a Credibility Alliance to emphasize the need for self-regulation. The Credibility Alliance has formulated norms at three levels of sophistication:

- (a) *Minimum norms*, which all consenting members must voluntarily adopt;
- (b) *Desirable norms*, towards which organizations must move over a period of time;
- and
- (c) *Good practices*, which are recommendatory in nature.

85. In the meantime a study funded by the Ministry of Health, Department of Family Welfare, has recommended the establishment of an autonomous agency largely to be managed by the voluntary agencies for the accreditation of organizations through a system of peer review.

**Dutta, Rangan, Approach to Policy Framework for Civil Society, IPAI Seminar on Development Initiatives: Voluntary Sector in Partnership with Government and International Organizations (December 2003)**

86. According to one estimate, there are currently around 1.2 million non-profit organisations in the country.

87. Analysis of the information available in the Tenth Five Year Plan Document shows that NGO's are active in the fields of Education, Health, Poverty Eradication, Watershed Development and Drought Proofing, Operation and Maintenance of Rural Drinking Water Facilities, Urban Development, Agriculture Food and Nutrition Security, Forest and Environment, Science and Technology and Calamity Relief and Disaster Management.

88. Largely due to the policies of the funding agencies and the Government, a hierarchy has emerged in the voluntary sector as shown below:

- Managing Agency NGOs; this is a relatively new concept, as it recognizes the corporatization of NGO activities;
- National Level NGOs having regional Branches like Development Alternatives, Delhi, Voluntary Health Association of India, Delhi etc.
- Mother NGOs (MNGOs) usually specialize in certain sectors; the MNGOs provide base facilities, train the field NGOs, and carry out Government programmes and activities;
- Established Voluntary Organisations (EVOs);
- Technology Research Centres;
- NGOs operating at the regional level;
- NGOs operating at the district level; and
- Grass root NGOs/Self Help Groups mostly informal and unorganized.

89. An internal review by the Department of Family Welfare, Ministry of Health and Family Welfare has shown the soundness of the MNGO concept as a delivery mechanism. A network of about 40 MNGOs has been created.

90. Some of the main problems besetting the NGOs are (a) lack of a policy and institutional framework; for example the requirement of a central annual renewal of registration; (b) lack of forum at national/State/district level for redressal of grievances of

the NGOs; and (c) an unclear system of transparency and accountability and evaluation of project results including accounting and financial norms.

**Summary of the Discussions, Conclusions and Recommendations of the IPAI Seminar on Development Initiatives: Voluntary Sector in Partnership with Government and International Organizations, December 2003**

91. There is urgent need for a friendly and experienced financial guidance and training from well-known institutes that are well versed in the evaluation and analysis of Government system programmes and development projects. There should be an inbuilt system of subsidy for such training and technical guidance to the personnel of not so well off agencies.

# Chapter 19

## ACCOUNTABILITY OF CENTRE FOR TRANSFER TO STATES

### The Constitution of India

1. Constitution of India is the basic document that defines the relationship between the Centre and the States. The various aspects of the relationship have been woven in different articles of the Constitution.
2. Articles 268 to 274 deal with powers of taxation as distributed between the Centre and the States.
3. Article 275 provides for transfer of resources to the States as grants-in-aid on the recommendations of the Finance Commissions.
4. Article 280 deals with setting up of a Finance Commission every five years with the following mandate.

“It shall be the duty of the Commission to make recommendations to the President as to—

  - (a) the distribution between the Union and the States of the net proceeds of taxes which are to be, or may be, divided between them under this Chapter and the allocation between the States of the respective shares of such proceeds;
  - (b) the principles which should govern the grants-in-aid of the revenues of the States out of the Consolidated Fund of India;
  - (bb) the measures needed to augment the Consolidated Fund of a State to supplement the resources of the Panchayats in the State on the basis of the recommendations made by the Finance Commission of the State;
  - (c) the measures needed to augment the Consolidated Fund of a State to supplement the resources of the Municipalities in the State on the basis of the recommendations made by the Finance Commission of the State;
  - (d) any other matter referred to the Commission by the President in the interests of sound finance.”
5. By convention, GoI accepts the recommendations of the Finance Commissions *in toto*.
6. In terms of Article 281, the report of the Finance Commission has to be placed before each house of the Parliament along with memorandum giving the action taken on each of the recommendations.
7. Article 282 gives powers to the Centre to make grants to the States depending on the need of each State. These are used mainly to cover plan expenditure.

8. Article 292 gives the power to the Centre to borrow money on the security of the Consolidated Fund of India and give guarantees, within limits, if any, imposed by Parliament. Article 293 deals with borrowing powers of the States. States can borrow within the territory of India and give guarantees on the security of the Consolidated Fund of the State within limits, if any, imposed by the State legislature. A State government needs the prior approval of the central government to borrow from open market, if the State government owes any money to the GoI. As all States owe money to the Centre, no State can actually borrow without central approval. GoI also prescribes the borrowing limits which include the guarantees given by the State government. It is under 293 that the Centre gives loan to the States.

### **National Development Council**

9. This is the highest political body coordinating the Centre–State relations. This is chaired by the Prime Minister with all the Chief Ministers of the States as members, apart from some union cabinet ministers and others.

### **Sarkaria Commission Report on Centre State Relations 1986**

10. The terms of reference of the Commission were comprehensive. The report laid down many of the ground rules that govern the relations between the Centre and the States.

### **Gadgil Formula on distribution of plan assistance to the States**

11. The Finance Commission dealt exclusively with non plan grants to States and the awards, once accepted become mandatory transfers to the States. There were no guidelines governing the distribution of plan grants which are discretionary in nature. As many States complained of discrimination, a formula, called the Gadgil Mookerji Formula was evolved in 1969 to lay down criteria for plan transfers also. The formula essentially lays down that all plan assistance would be in the ratio of loan to grant 70:30, except in the case of special category States where the ratio would be 10:90. The assumption behind the ratio was that plan has a capital component of 70 per cent which should be financed through loan. The formula continues with minor modification (1980). Eleventh Finance Commission had suggested a re-look at the Gadgil Formula as it does not cater to changed circumstances where the States are encouraged and are able to attract private investments.

### **Ministry of Finance Guidelines on transfers to the States**

12. Most of the Transfers of funds to the States for specific plan schemes, especially for many Centrally Sponsored Schemes and Externally Aided Schemes were being done to through the State budgets. Many central Ministries felt that the money was not being given by the States to the designated programs, instead diverted to revenue needs of the government. The Central Ministries changed the procedure, and the funds started flowing to the field implementing agencies by direct transfers to Personal Ledger Accounts. Such a scheme of transfer was provided in the relevant schemes. The Chief Ministers of the

States protested against this procedure and demanded that the Central Funds should flow through State Budget to enable them to have proper control over the schemes implementing agencies. In response to the demand of the States, Ministry of Finance issued a general circular In April 2003 to all the Central Ministries directing them not to send the money directly to the implementing agencies, but route them through the State Governments.

### **Approach Paper to the Tenth Five Year Plan, Planning Commission, Government of India, 2001**

13. Centrally Sponsored Schemes (CSS) need to be pruned by transfer to the States, merging duplicates schemes as they have grown to unmanageable levels. The proliferation of CSS is a case of government over stretching itself. The share of the CSS has reached 70per cent from 30per cent in the early eighties.

14. The document quotes the report of the Comptroller and Auditor General (CAG) to list the shortcomings of the CSS and offer analysis and solutions for improvement.

15. Shortcomings as pointed out by the CAG are:

- a). Inability of the Central Ministers to control the execution of the schemes resulted in the programs being executed in uncontrolled and open ended manner without quantitative and qualitative assessment of delivery.
- b). The controlling Central Ministries confined themselves to mechanical release of funds without reference to the effective utilization of funds.
- c). Data received form the States were doctored and the Central Ministries did not have a mechanism to check the accuracy of the data.
- d). Large amounts of money were released in the last month of the year in an effort to exhaust the budget allocation.
- e). The attitude of the States to the CSS was indifferent; they were more interested in getting the money from the Central Government than in usefully spending it.
- f). Nobody could be responsible for shortfall in performance or poor delivery of services.

16. The paper gives the following reasons for such a state of affairs:

- a) There are too many schemes to be executed. At a block level there are as many as 167 schemes requiring attention. This makes monitoring by even local authorities difficult.
- b) Many similar schemes each having its own systems and procedures.
- c) Central Ministries find it difficult/unwilling to monitor schemes executed in the States.
- d) Capacity to monitor so many schemes often do not exist.
- e) Unwillingness to accept shortcomings for fear of reprisals. Independent evaluation not encouraged.
- f) Most schemes have top down approach leaving little flexibility to field formations.
- g) States do not always make available their share of the funds, leading to failure of the schemes.

- h) Emphasis is on collecting data, but not in using them.
- i) CSS are not run on the lines of Externally Aided Programs which are run on project mode.

17. Suggestions for improvements.

- a) Limit the number of CSS; merge similar schemes, weed out schemes that are not yielding results.
- b) Increase flexibility to field formations; avoid top down approach.
- c) Use the CSS funds to fund well conceived State programs.
- d) Use CSS funds for funding the State component of the Externally Aided Programs.

**Eleventh Finance Commission 2000**

18. Eleventh Finance Commission (E1.FC) recommended that there should be some incentive for the States to move towards fiscal consolidation in response to the additional terms of reference by GoI to the Commission. E1.FC was tasked, inter alia, to draw up a monitorable fiscal reforms program aimed at reduction of revenue deficits of the States and recommend the manner in which the grants to States to cover their assessed deficit in their Non-plan revenue account may be linked to progress in implementing the program.

19. Accordingly, the Commission recommended a Fiscal Reform Facility fixing a single monitorable parameter of controlling revenue deficit to reward the States by way of incentive of additional grants. Each State was expected to achieve a minimum improvement of 5 per cent in the revenue deficit/surplus as a proportion of its revenue receipts each year till 2004-05 measured with reference to the base year 1999-2000. 15 per cent of what was due to the States was withheld in the initial phase to be given on reaching the revenue deficit parameters. GoI was to add a matching amount. GoI invited all the States to prepare a Medium Term Fiscal Restructuring Program (MTFRP) and sign a Memorandum of Understanding (MOU) with the Centre to enable monitoring the fiscal reforms program.

20. Eleventh Finance Commission also recommended nearly Rs 110,000 million to all States during the award period for meeting the needs of the Panchayati Raj Institutions (PRI) and Urban Local Bodies (ULB). The expenditure on accounts and audit and creating data base was to be the first charge on this devolution. GoI was advised to involve the Comptroller and Auditor General in all matters concerning accounts and audit of local bodies.

**Report of the National Commission to review The Working of The Constitution, 2002**

21. The Commission reviewed the entire gamut of Central-State financial relationship in the light of many suggestions received and concluded that the Constitutional provisions have stood the test of time and do not call for any change. The fiscal imbalances are more due to political institutions than the Constitutional provisions. These deficiencies are capable of being corrected without any change in the Constitution.

22. The Commission considered the suggestion that the scope of the Finance Commission should be widened to include additional terms of reference on matters of sound finance in consultation with the States. The Commission held that the institution of the Finance Commission has been one of the major success stories of the Constitution. The Commission was not in favour of an amendment of Article 280(3)(d) to enable such enlargement of the scope of the Finance Commission, However, it recommended that terms of reference of the Finance Commission should be broader and comprise matters which would take care, in a comprehensive way, aspects of the financial relations between the Union and the States. The broadening of such terms of reference could also be discussed earlier by the National Development Council.

23. The Commission debated the issue of whether the recommendations of Finance Commissions both at the Central level and the State level should be made as awards through a Constitutional amendment. Suggestions to this effect had been made in the context of some of the States not implementing the State Finance Commissions recommendations for devolution to the third tier administration. The Commission has held the view that in Central Government there is already a convention of accepting the recommendations of Finance Commission *in toto*. The State Finance Commissions are a comparatively new constitutional mechanism. They would take some time to strike roots in the constitutional soil. Politicians at the State level have also to find their bearings in the new landscape where the old landmarks of patronage at the State level have yielded place to a non-discriminatory passage of resources from the State exchequer to the local government institutions. Keeping in view the factors pointed out above the Commission did not consider it necessary to recommend the amendment of the Constitution to provide for the recommendations of either the Finance Commission constituted under article 280 or of the State Finance Commissions constituted under articles 243-I and 243-Y being treated as awards.

24. The Commission suggested that some of the items of service taxes now being levied and collected by the Centre be given to the States in order to augment their revenue. The items should such as to be amenable for easy administration by the States. An illustrative list of such items of service tax was also given. Necessary amendment to the Constitution was proposed.

### **Budget 2001-2002. State Fiscal Reforms**

25. Pursuant to the recommendations of the Eleventh Finance Commission, an Incentive Fund of Rs.106,070 million was earmarked for the next five years to encourage States to implement monitorable fiscal reforms. In the fiscal year 2001-02, an amount of Rs. 42,430 million was provided in the Budget towards Incentive Fund.

### **Twelfth Finance Commission 2005**

26. Twelfth Finance Commission (TFC) was asked to review the Fiscal Reforms Facility (FRF) recommended by the Eleventh Finance Commission (El.FC).

27. TFC came to the conclusion that the FRF had not been effective in inculcating fiscal discipline in the States. Fiscal reform facility seems to have imparted a certain measure of discipline in the States in that they have been persuaded to draw up MTFRPs and sign MOUs and had sensitized them to the need for fiscal consolidation, but in terms of actual fiscal performance the scheme had not been effective. “While many other factors were also at work during this period, it is difficult to avoid the conclusion that the FRF did not play a significant role in bringing about an improvement in the States’ fiscal position in the past five years.”

28. TFC recommended against continuing the FRF and instead recommended a debt relief scheme subject to the condition that each State must enact fiscal responsibility legislation prescribing specific annual targets with a view to eliminating the revenue deficit by 2008-09 and reducing fiscal deficits based on a path for reduction of borrowings and guarantees. The outstanding debt equivalent to the absolute reduction in revenue deficit would be written off. Debt write-off would have a prospective effect from the year fiscal responsibility legislation is enacted.

29. The other recommendations on the fiscal accountability front are: every State should set up a guarantee redemption fund through earmarked guarantee fees and a sinking fund for amortization of all loans.

30. While recommending the grants to the panchayats and municipal bodies, TFC observed that no conditionality over and above those recommended by TFC need be imposed by the central government for releasing the grants-in-aid.

31. “The normal practice of insisting on the utilization of amounts already released before further releases are considered, may continue and the grants may be released to a State only after it certifies that the previous releases have been passed on to the local bodies. The amounts due to the States in the first year of our award period i.e. 2005-06 may be released without such an insistence.”

32. Some of the other recommendations of the TFC are:

- The Central Government should not act as an intermediary for future lending and allow the States to approach the market directly. If some fiscally weak States are unable to raise funds from the market, the Centre could borrow for the purpose of on lending to such States, but the interest rates should remain aligned to the marginal cost of borrowing for the Centre.
- External assistance may be transferred to States on the same terms and conditions as attached to such assistance by external funding agencies, thereby making government of India a financial intermediary without any gain or loss. The external assistance passed through to States should be managed through a separate fund in the public account.”

**Reddy DR Y.V.: Role of RBI in the process, Address at the Workshop on Fiscal Responsibility of Government, National Institute of Financial Management, Faridabad, February 2000**

33. “It is useful to explain the role of the RBI in the events leading up to the current proposal for legislation on Fiscal Responsibility (FR). Firstly, the RBI has been in the forefront of sensitizing the policy makers to the consequences of fiscal dominance. Secondly, automatic monetization of budget deficit by the RBI was discontinued. Thirdly, some caution, if not a limit, on the RBI’s net support to Government’s borrowing programme has been accepted in the arrangements leading to the scheme of Ways and Means Advances for Government of India. Fourthly, the RBI had already highlighted the importance of a statutory ceiling on debt through a Technical Paper published in the RBI Bulletin of December 1997. Fifthly, the RBI has been trying to advocate prudence in extending sovereign guarantees, which has resulted in some States passing legal enactments and Government of India creating a guarantee fund. Sixthly, State Finance Secretaries are already working as a Committee assisted by the RBI, on issues relating to integrity of budget process and transparency in budget. Seventhly, RBI conducted a seminar a few months ago, in which senior officials of Centre and State participated, on matters relating to fiscal rules and related international practices.”

**Reddy Dr. Y.V.: Address on ‘Fiscal Reforms at State level: Review and Prospects’, India States Reform Forum, The World Bank, New Delhi, November 24, 2000**

34. Many initiatives were taken by the RBI independently, and sometimes in coordination with the Centre to bring about fiscal discipline in the States. RBI convened seven conferences of State finance secretaries with GoI officials also attending. Professional inputs were provided by the RBI. A report on *State Level guarantees* helped many States to bring about legislation on guarantees. A Core Group on Disclosure Norms for State Budgets helped improve the design and coverage of budget documents. Many States have adopted economic and functional classification with the assistance of RBI.

35. Assistance was extended to States in cash management area to maximize returns on deployment of temporary surpluses. The Ways and Means arrangement was redesigned in consultation with the States. RBI has devised a scheme of consolidated sinking fund for the States.

**Annual Report of Reserve Bank of India 2004, Article on Public Debt Management**

36. A Working Group comprising Finance Secretaries of States that have already enacted the Fiscal Responsibility legislation (or placed the bill before the Legislature), a representative each from the Central Government and the Reserve Bank was constituted in October 2003 to draft a model fiscal responsibility legislation at the State level in recognition of the importance of a rule-based fiscal policy to achieve fiscal sustainability. The draft report was discussed in the 14th Conference of the State Finance Secretaries held on August 13, 2004.

**Press release of RBI “State Finance Secretaries Reaffirm Commitment to Fiscal Discipline” on 3<sup>rd</sup> August 2003**

37. The Governor RBI, Dr. Bimal Jalan said while addressing the conference that while the States, the Centre and the Reserve Bank had different responsibilities, they had one common objective of getting the country's growth rate accelerated by strengthening fiscal balance. They shared the responsibilities of achieving this objective through this forum, he pointed out. The Governor expressed satisfaction that the central Government had taken several initiatives to find longer term solutions to the issues concerning the States and the Centre after discussing them at this forum. Evolution of debt swap mechanism to provide relief to the States by switching high cost debt with low cost debt, evolving a scheme of ways and means advances that gave more flexibility to the States but at the same time imposed certain financial discipline on them, allowing the State Governments to raise market borrowings through auction method, sensitizing the State governments regarding the issue of the contingent risk of guarantees were some illustrations of the decisions that had emerged out of the discussions held in these conferences.

38. The State Finance Secretaries welcomed the collective initiative of the Centre, States and the Reserve Bank of India on several important policy issues during the last few years. They highlighted the need for fiscal adjustment, but felt that in view of the existence of legacy problems, a consolidated approach was likely to be the most effective. The Finance Secretaries reaffirmed their commitment to fiscal discipline and concurred on the desirability of enacting fiscal responsibility legislation as had already been done by some States. Monitoring of any emerging contingent liabilities was receiving high priority so that appropriate action could be taken in a timely fashion.

**Vithal, B.P.R. and Sastry, M.L.: Fiscal Federalism in India, Oxford**

39. This book analyses the recommendations of various Finance Commissions. Of particular interest is the discussion on the views taken by Finance Commissions on Plan and Non plan conundrum. Plan includes revenue expenditure which is not capital and should be legitimately looked into by the Finance Commissions. However, only non plan revenue is considered by the Finance Commissions for devolution between Centre and States. Eleventh Finance Commission was specifically asked to take into account the revenue component of plan expenditure of schemes to be completed by 31<sup>st</sup> March 2000. But, the commission chose not to do so.

40. The book explores the debate on the relative roles of Finance Commissions and the Planning Commission in the transfer of funds to the States.

**Thakur, Ramanand: Finance Commissions and Centre State Relations in India, Deep and Deep Publications, New Delhi, 1989**

41. This book covers the entire gamut of Centre State financial relations. The role of successive Finance Commissions till the Eighth Finance Commission has been explained with critical comments. The process of transfer of funds in addition to the Finance

Commission recommendations has been analyzed critically. The relative roles of Finance Commission and Planning Commission have come in for extensive treatment. The mandatory and unconditional transfer under Article 275 of the Constitution on the basis of Finance Commission's recommendations have become negligible compared with the discretionary and conditional grants by Planning Commission under Article 282 of the Constitution.

**Thakur, Anil Kumar: Fiscal Federalism in India, Deep and Deep Publications, New Delhi, 1988**

42. The theoretical framework of Centre State finances under the Constitution has been covered. Fiscal centralization has taken place through the mechanism of Planning Commission. He critically reviews the approaches made by different Finance Commissions and makes an empirical analysis of the impact of federal transfers and concludes the gap between poorer States and developed States has grown in terms of development indicators. He pleads for a new approach and has given many suggestions ranging from fiscal correction to changes in the method of sharing the taxes.

**Sastry, M. L. and Reddy G. R.: Centre State Financial Relations, Centre for Economic and Social Services, Hyderabad, 1988**

43. This is a research work, based on extensively on empirical data, analyses the Central State relations, including the extent of borrowing permitted by the Centre to the States. Issues of grants under various provisions of the Constitution, including the discretionary transfers have been dealt with extensively. The authors explain the working of Gadgil Formula (1969) and its subsequent modification (1980) to reduce fiscal disequilibrium among the States.

**Centre-State Financial Relations in India, Edited by Dr. R.K. Sinha, Deep and Deep Publications, New Delhi, 1986**

44. This book is a collection of articles by eminent economists written in the backdrop of setting up of Sarkaria Commission in 1986 to review the whole range of central State relations. Some of the points made by the writers are:

- Planning Commission is an extra constitutional body and is used to help in central financial imperialism.
- Compulsory submission of State Five Year plans, including the items within the sphere of their own responsibility, to the Planning Commission and interference and control by the latter dilutes accountability systems and robs the States of initiative.
- The loan component of plan assistance for a plan centrally conceived and imposed is iniquitous.
- Central assistance for natural calamities should not be extended as loan; totally unacceptable.
- Scheme of loans for plan schemes have made States heavily indebted.

- The scheme of distribution of grants/loans has made the States heavily dependent on the Centre and fiscally irresponsible.
- Central government, which is a party to the dispute acts as a referee to its own dispute by appointing the Finance Commission and giving the terms of reference.

**Fiscal Federalism in India, edited by Chaubey, P.K., Deep and Deep Publications, New Delhi, 2003**

45. This book contains a series of articles on fiscal federalism built on and around the Finance Commission transfers.

**Karunakaran Pillai: ‘Decentralised Public Finance: The Role of Eleventh Finance Commission (El.FC)’**

46. The devolution to the local bodies through the States is undesirable. Rs 80,000 million earmarked for 2004-05 is only 5.43 per cent of the requirement, which is not adequate. El.FC has, however, done a good job.

**Singh, Shovan K: ‘Federal Transfers in India: An introduction’**

47. El.FC has set a new benchmark by introducing the element of fiscal discipline as a measure of determining the distribution of central revenues to the States. It has also provided an incentive for the States to avoid fiscal profligacy and be rewarded by pushing for fiscal consolidation. Finance Commission and Planning Commission do overlap and should be merged.

**Chaubey, P.K: ‘Evolution of Union State Financial Relations in India: Two steps forward and one step backward’**

48. All aspects of Union State financial relationship, including the role of Finance Commissions and Planning Commission are discussed. The types of grants/loans given by the Planning Commission and the Constitutional basis for it are explained.

**Rao, Govinda. M and Singh, Nirvikar: Political Economy of Federalism in India, Oxford University Press, 2005**

49. In Chapter 14 of the book, the authors strongly argue for restricting the role of the Planning Commission and correspondingly increase the role of the Finance Commissions. The present regime of Planning Commission having the power to transfer a larger part of the resources to the States is not conducive to fiscal discipline; it encourages profligacy, interferes with State’s choice of allocation (through Centrally Sponsored Schemes) , promotes a truncated view of State finances and makes it difficult to fulfill the objectives of the transfer system. In the liberalized regime, Planning Commission should deal only with subjects that cover more than one State like roads and power and should largely have an advisory role in planning infrastructural facilities. All transfers to States should reside with one body, preferably the Finance Commission, a

constitutional entity. The Finance commissions should be serviced by a permanent secretariat.

**Singh, S. K.: Functional and Financial Devolution on Panchayati Raj Institutions in Kerala, 1999.**

50. The Eleventh Finance Commission sponsored a series of 11 studies in different States in the area of Rural Local Bodies. These research studies trace the flow of funds and devolution of functional responsibilities as seen on the ground. Role of the States and the State Finance Commissions have also been covered.

51. This is one such study sponsored by the Eleventh Finance Commission on Rural Local Bodies. An interesting point made in this study is that the central assistance given for Local Bodies as mandated by the Finance Commission under Article 275 gets merged with State funds and do not get passed on to them. The author reveals, after extensive field study, that the Rural Local Bodies do not seem to be even aware of the fact of central devolution for them.

**Siva Subramaniam K. and Choudhury. R. C.: Functional and Financial Devolution on Panchayats in India, National Institute of Rural Development, Hyderabad**

52. This is a study commissioned by Eleventh Finance Commission to cover on the ground situation relating to devolution of functional responsibilities and financial resources on the panchayats at various levels in 20 States. The report brings out that basic data is not available. The major point made by the study is that in spite of the recommendations of the Tenth Finance Commission, the conditions imposed by the central government is one of the reasons for the Gram Panchayats being unable to receive and use the money given by the central government. In fact, many States did not get the earmarked money from central government as they could not fulfil the prescribed conditions.

53. The study concludes that 73<sup>rd</sup> Amendment did not make much difference to the finances of rural local bodies.

**Shalini, Rajneesh: Rural Development through Democratic Decentralization, Deep and Deep Publications, 2002**

54. The book details the deliberations of various committees to augment the resources of the Panchayati Raj Institutions (PRI). Though the 73<sup>rd</sup> Amendment to the Constitution mandates the constitution of a State Finance Commission every five years to decide on the quantum of transfers to the Local Bodies, the State governments do not give the Local Bodies their due.

**Goel, S. L. and Shalini, Rajneesh.: Panchayati Raj in India - Theory and Practice, Deep and Deep Publications**

55. The main point that emerges from the book is that the plethora of centrally sponsored schemes has killed the local initiative for having locally relevant schemes.

**Dr. Atmanand: Financing of Panchayati Raj Institutions, Excel Books, New Delhi, 1999**

56. This is a compendium of 18 articles by eminent persons deeply associated with local self government issues. These articles study the impact of the 73<sup>rd</sup> and 74<sup>th</sup> Amendment to the Constitution on various aspects of Panchayati Raj Institutions. It covers the financial aspects of Panchayati Raj, democratic decentralization, decentralized local planning, role of political parties, financing local services, functional responsibilities, etc. It also contains case studies relating to functioning of Panchayati Raj Institutions in Bihar, Haryana, Andhra Pradesh and Tamil Nadu.

57. Of special interest are the role and the scope of the State Finance Commissions.

**Technical guide on Financial Reporting in Urban Local Bodies, Issued by the Institute of Chartered Accountants of India**

58. Urban Local Bodies such as municipal corporations, municipalities etc. are important constituents of the system of governance in India. In a changing environment, attempts are being made to make the government and its agencies more accountable for their actions. Proper financial reporting by urban local bodies is perhaps the most important means to achieve the objective of accountability.

59. The Technical Guide attempts to cover various facets of accounting and financial reporting by urban local bodies. The Technical Guide seeks to provide a broad framework for accounting and financial reporting by urban local bodies.

**Comptroller and Auditor General of India (CAG), Task Force on the “Formats for Accounting and Budget for Urban Local Bodies” 2001**

60. In terms of the 73<sup>rd</sup> Amendment to the Constitution which enjoins upon the CAG to prescribe the accounting formats, CAG had set up a Task Force. The Task Force laid down the guidelines for Budget and Accounting formats, cost of important utilities, management Information systems and major issues in transition. The Task Force had drawn upon the guidelines which had earlier been prepared by the Institute of Chartered Accountants of India. Essentially, the Task force recommended the introduction of accrual accounting in Urban Local Bodies.

## Chapter 20

# GOVERNMENT ACCOUNTS

### **The Constitution of India**

1. The basic features of maintenance of Government accounts are laid down in the Constitution of India.
2. Under Article 266 of the Constitution all revenues received by the Government of India, all loans raised by Government and all moneys received by Government in repayment of loans shall form the Consolidated Fund of India. All other public moneys received by or on behalf of Government shall be credited to the Public Account.
3. As authorized under Article 267 of the Constitution, Parliament has established by law a Contingency Fund in the nature of an imprest called the Contingency Fund of India with a predetermined corpus which has been placed at the disposal of the President to enable advances being made for the purpose of meeting unforeseen expenditure pending the authorization of such expenditure by the legislature.
4. In terms of Article 112(2) of the Constitution the estimates of expenditure embodied in the annual financial statement (budget) that are required to be presented to the Parliament every year shall show separately the sums required to meet expenditure described in the Constitution as expenditure “charged” on the Consolidated Fund of India and other expenditure. The statement shall also distinguish between expenditure on revenue account from other expenditure.
5. Under Article 150 of the Constitution the accounts of the Union and of the States shall be kept in such form as the President may prescribe on the advice of the Comptroller and Auditor General of India.

### **The Comptroller and Auditor General’s (Duties, Powers and Conditions of Service) Act, 1971**

6. Under the Act it is the duty of the Comptroller and Auditor General of India (CAG) to compile the accounts of the Union Government from the initial and subsidiary accounts rendered to his offices by the treasuries, offices or departments responsible for keeping such accounts. The Act authorizes the President to relieve the CAG from the responsibility of compiling the accounts after consultation with the latter.

7. A series of Presidential orders issued in 1976 relieved the CAG from the responsibility of compiling the accounts of the Union Government, except the accounts of the Indian Audit and Accounts Department.

### **Allocation of Business Rules 1961**

8. These Rules prescribe *inter alia* the duties of the Controller General of Accounts (CGA). According to these Rules the CGA is responsible for:

- General principles of Government accounting relating to the Union or the State Governments and form of accounts, and framing or revising the related manuals;
- Reconciliation of the cash balances of the Union Government with the Reserve Bank of India (RBI) in general and in particular of Reserve Bank Deposits pertaining to the Civil Ministries or departments;
- Overseeing the maintenance of adequate standards by the Central Civil Accounts offices;
- Consolidation of monthly accounts, preparation of review of trends of revenue realizations and significant features of expenditure etc; and preparation of annual accounts (including Summary Civil Appropriation Accounts); and
- Coordination and assistance in the introduction of management accounting system in the civil Ministries and departments.

### **Government of India, Ministry of Finance, Department of Expenditure Controller General of Accounts Civil Accounts Manual - Volumes I and II**

9. This compilation describes the main features of the scheme of departmentalization of accounts of the Union Government Civil Ministries and Departments and the organization of the Controller General of Accounts and prescribes the detailed instructions and procedures for payment by the departmental Pay and Accounts Offices and the cheque drawing Drawing and Disbursing Officers, the system of controls and checks, expenditure control, delegation of financial powers, compilation and consolidation of accounts, inter-departmental and inter-governmental adjustments. It also contains detailed instructions for bank reconciliation in general and specific instructions for bank reconciliation of receipts of direct and indirect taxes. The arrangements with the RBI and the accredited public sector bank are described in an Appendix to the Manual. Specific departmental manuals of individual Ministries and Departments supplement the Manual.

### **Government of India, Ministry of Finance, Department of Expenditure, Controller General of Accounts, Government Accounting Rules, 1990**

10. These Rules have been issued by the President on the advice of the CAG in exercise of the powers conferred by Article 150 of the Constitution of India and prescribe the basic rules relating to the form of accounts of the Union and the State Governments. The compilation also incorporates the general principles of accounting laid down by the CAG.

The compilation describes the general outline of the system of accounts, the role of the RBI, the basic structure of the form of accounts, period of accounts, cash basis of accounts, basis of classification of transactions in accounts, criteria for determining whether expenditure should be classified under Revenue Section or under Capital section, accounting of loss or gain by exchange, accounting of receipts and recoveries etc.

### **The Central Government Accounts (Receipts and Payments) Rules, 1983**

11. Framed under Article 283(1) of the Constitution, these rules regulate the custody of the Consolidated Fund of India and the Contingency Fund of India, the payment of money into such Funds, the withdrawal of money therefrom, the custody of public moneys other than those credited to such Funds received by or on behalf of the Government of India, their payments into the Public Account of India and the withdrawal of money from such Account.

### **Chandersekharan, R.K.: The Comptroller and Auditor General of India, “Analytical History 1947-89”, Ashish Publishing House, New Delhi, 1990**

12. The author recounts how the original provision in the Constitution of India, whereby the CAG was the designated authority to prescribe the form of accounts with the approval of the President, was amended by a Constitutional Amendment made in 1976. According to the amended provision the form of accounts was to be prescribed by the President in consultation with the CAG. The Constitution was again amended in 1977 whereby the form of accounts shall be prescribed by the President on the advice of the CAG.

### **Introduction to Government Accounts and Audit, Swamy’s Compilation, Swamy Publishers, Chennai and Delhi, 1999**

13. Originally a Government of India publication, the book is a useful primer for introducing the uninitiated to the Indian accounts and audit systems.

### **Government Accounting Standards Advisory Board**

14. The Government Accounting Standards Advisory Board (GASAB) has been constituted by the CAG under the Chairmanship of the Deputy Comptroller and Auditor General (Accounts) and with the Controller General of Accounts, the Financial Commissioner, Railways, the Controller General of Defense Accounts, the Additional Secretary (Budget), and nominees of the Reserve Bank of India, the Institute of Chartered Accountants of India the National Council of Applied Economic Research and Finance Secretaries of four States by annual rotation as members. The responsibilities of GASAB are:

- (i) To formulate and propose standards that improve the usefulness of the financial reports based on the needs of the financial report users;
- (ii) To keep standards current and reflect changes in the Governmental environment;
- (iii) To provide guidance on implementation of standards;

- (iv) To consider significant areas of accounting and financial reporting that can be improved through the standard setting process; and
- (v) To improve the common understanding of the nature and purpose of information contained in financial reports.

15. Addressing the inaugural meeting of GASAB on November 7, 2002 Shri V.N.Kaul, the CAG, observed: “The standards will delineate the basic principles that represent the basic practices of Government accounting and financial reporting, as it should be. They will provide a framework for performing and promoting a broad range of value-added activities concerning financial reporting and accounting in the Government. The standards will establish the basis for measurement of performance. They will foster improvement in government processes and operations.”

### **Classification of Government Transactions in Accounts and Plan: Second Report of the Team on Reforms in Structure of Budget and Accounts, 1972**

16. The Team on Reforms in Structure of Budget and Accounts set up in the wake of the report of the Administrative Reforms Commission made a comprehensive examination of the then prevailing system of classification of transactions in Government accounts and recommended its thorough revamping so as to bring about greater alignment between the Plan heads and the accounts heads. The report of the team explains the philosophy and the rationale of the revised system of classification. Its recommendations were implemented from April 1974 with the introduction of the revised system of classification of transactions in Government accounts simultaneously in the Union and the State Governments. The system has continued except for certain refinements made from April 1987 to cure the divergences that had since crept in between the Plan heads and the accounts heads.

17. The classification system follows a six-tier pattern comprising the Sector (General Services, Economic Services, etc;) to which the transaction relates; Major Head (e.g. Medical and Public Health) that indicates the Function; Sub-Major Head (e.g. Urban Health Services) that indicates the programme; Minor Head (e.g. Hospital and Dispensaries) that denotes the scheme; Detailed Head (e.g. Pant Hospital) that represents sub-scheme or organization at the subordinate administrative level; and the Object Head (salaries, wages, etc;) that indicates the cost of the input.

18. The multi-tiered classification is intended to facilitate the appreciation of resource allocation, provide a link between budget outlays on the one hand and functions, programmes, schemes and sub- schemes on the other, and ensure itemized control over expenditure as may be required.

### **Tewari A.C.: Problems of Fiscal Management in Government, Shipra Publications, Delhi, 1995**

19. A distinctive feature of the system of Government accounts in India is the minute elaboration of the financial transactions of Government with both receipts and payments

being differentiated and classified in detail. The accounting system is designed to give information in terms of constitutional provisions related to the Fund (Consolidated Fund, Contingency Fund and Public Account) its nature (revenue or capital), function (economic, social or general services), programme, etc.

### **List of Major and Minor Heads**

20. This is a dictionary of the classifications used for Government accounts that has been prepared in line with the structure mentioned under *Classification of Government Transactions in Accounts and Plan: Second Report of the Team on Reforms in Structure of Budget and Accounts (1972)*. The accounts of Government are kept in the following three parts:

Part I	Consolidated Fund
Part II	Contingency Fund
Part III	Public Account

21. In Part I, namely, Consolidated Fund there are two main divisions, viz;

- (1) Revenue-consisting of sections for Receipt heads (Revenue Account) and Expenditure heads (Revenue Account);
- (2) Capital-consisting of Public Debt, Loans etc. and containing sections for Receipt heads (Capital Account), Expenditure heads (Capital Account) and Public Debt, Loans and Advances, etc.

22. The Revenue division accounts for the proceeds of taxation and other receipts classed as revenue and the expenditure met therefrom, the net result of which represents the revenue surplus or deficit for the year.

23. In Capital division, the section Receipt Heads (Capital Account) accounts for the receipts of capital nature that cannot be set off against capital expenditure.

24. The section 'Expenditure Heads (Capital Account)' accounts for the expenditure met mostly from the borrowed funds with the object of creating concrete assets of a material and permanent character or investing outside the Government. It also accounts for receipts of a capital nature as are set off against expenditure.

25. The section 'Public Debt Loans and Advances' etc; accounts for loans raised and their repayment by Government such as Internal Debt of the Union Government and Loans and Advances made (and their repayment) by Government. This section also accounts for certain special transactions relating to 'Appropriation to Contingency Fund' and 'Inter-State Settlement'.

26. In Part II, namely, Contingency Fund, the accounts of transactions connected with the Contingency Fund are recorded.

27. In Part III, namely, Public Account, the accounts of the transactions relating to 'Debt' (other than those included in Part I), 'Deposits', 'Advances', 'Remittances' and 'Suspense' are recorded. The transactions under 'Debt', 'Deposits', and 'Advances' in this Part are such in respect of which Government incurs a liability to repay the moneys received or has a claim to recover the amounts paid together with repayments of the former ('Debt' and 'Deposits') and the recoveries of the latter. 'Remittances' in this Part account for remittance of cash between treasuries and currency chests, transfers between different accounting circles, etc. The initial debits or credits to these heads are cleared eventually by corresponding receipts or payments either within the same circle of account or in another circle of account. The transactions pending adjustment in the final booking in the accounts are recorded under Suspense heads.

**National Academy of Audit and Accounts, Shimla, Background Paper on Accounting for Government Assets - Ensuring Accountability and Transparency, September 2003**

28. Certain medium and long term items such as computers, vehicles, furniture, etc., which have life extending beyond the year of purchase, are not classified as assets but as dead stock and the expenditure incurred thereon gets merged with and is depicted as revenue expenditure

29. The investments made by Government are not revalued or written off if the entity ceases to exist on liquidation. There is no system of revaluing the assets for disclosure in Government accounts, and while there is a prescribed procedure for writing off the assets, the financial implications of such write offs are not reflected in the accounts.

30. Grants-in-aid paid to autonomous bodies for capital expenditure and creation of assets are classified in Government accounts as revenue. Although expenditure incurred on several schemes of Government of India like Jawahar Rozgar Yojana, Employment Assurance Scheme etc; results in the creation of assets like roads, buildings etc; the Government Accounts classify the expenditure as revenue expenditure only and the true value of assets created by incurrence of Government expenditure is not captured in the accounts.

**Government of India, Ministry of Finance, Report of the Expert Group Constituted to Review the Classification System for Government Transactions, 2004**

31. According to the Expert Group the current norms for distinguishing between revenue and capital expenditures are based on sound accounting principles and are in line with international practice. On the specific issue of classification of transfer payments (grants in-aid) to the sub-national level, which are intended for creation of assets, the Group was of the view that it is the ownership of assets that decides whether the expenditure is treated as capital or revenue expenditure. The expenditure can be classified as capital if it results in the creation of assets that are controlled by the entity incurring the expenditure and that are likely to serve the entity over several accounting cycles. The Group recommended that for the sake of disclosure such transfers that are meant for capital

expenditure by the transferee may be classified as “Capital Grants” under the revenue section in the books of the transferor.

32. A Sub-Group appointed by the Working Group to examine the need for Structural Changes in the Classification System was of the view that with the advent of information technology and with the increased demands of good governance there was urgent need to remodel the system of classification into one that is MIS oriented and helps Governmental performance evaluation. According to the Sub-Group the existing system of classification is uni-dimensional as it flows in one direction namely from Fund to sector/sub-sector to functions/programmes to schemes etc. The relationships between functions, programmes and schemes are not always linear and cut across functions. There is a gap between the heads of development operated by the plan implementation and the Heads of accounts. The system does not permit the classification of the transfer payments so as to relate these to the specific programme or function. If a programme has revenue, capital and loan components, the accounting data is scattered over a number of accounts heads and considerable effort is required to translate the accounting information into Plan formats. There are also instances of programmes cutting across various functions; this further creates a distance between the accounting format and the Plan format.

33. In order to overcome the aforesaid limitations the Sub-Group suggested the revamping of the existing system of classification and its replacement by a multi-dimensional classification structure having four separate segments representing Fund, Economic Categories, Functions and Programmes. Each of these segments may have its own hierarchy. According to the Sub-Group the proposed system would not merely permit easy capturing of accounts data on a particular function or programme but would also allow for Fund-based accounting and facilitate transition to accrual accounting.

34. The Expert Group recommended that the proposed multi-dimensional hierarchy of classification may be tested on pilot cum parallel run basis in the departments of Education and Health in the Union Government.

**Ghosh D.N.: Study on Conceptual Framework of Government Accounting System in India, ICRA Management Consulting Services, 2005**

35. According to the study the existing cash-based system is deficient on the dimensions of transparency and user-friendliness on the following counts:

- The system is primarily focused on inputs, almost to the total exclusion of outputs and outcomes and cannot therefore be used as an effective tool for measuring accountability for performance.
- Only those transactions where cash has been paid are recorded; transactions where no cash has been paid or received are not recorded, even if the value has been received or a liability has been incurred.
- Accounting records reflect transactions for current year only; past transactions relating to assets and liabilities are not an integral part of the system of accounts.

- The accounting system tends to understate the liabilities and commitments of the Government; leading to issues of inter-generational equity and lack of transparency.
- Inability of Government to keep track of assets, which results in poor stewardship, is a big lacuna in the system.
- Government departments that offer commercial services are not in a position to know their full costs.
- Decision-makers (including Government itself) are unable to look ahead and estimate whether they can continue with the services they are currently delivering or whether they can afford new services.
- Although the Indian Railways have adopted commercial accounting system to a significant extent, there is scope for improvement in certain key-areas such as accounting for assets or provision of necessary details for costing purposes.

36. The study recommended introduction of accrual accounting phased over a period of six to twelve years. According to the study small savings are in the nature of borrowings by Government and should be shown under Loans instead of under the Public Account. The borrowings from the Public Account to fund the deficit in the Consolidated Fund should be explicit and transparent and Government may issue securities to borrow from the Public Account.

### **Monthly Accounts**

37. Monthly accounts:

(a) The Pay and Accounts Officer prepares the following sets of accounts every month:

The Classified Abstract: This shows the receipts and payments during the month classified to the detailed head of accounts level.

The Consolidated Abstract: This shows the receipts and payments for and up to the month classified to the detailed head level of accounts.

(b) The Chief Controller of Accounts consolidates the accounts of the Ministry as a whole classified up to the detailed head level. He also prepares group minor head-wise totals for the purpose of check against the budget.

(c) The Controller General of Accounts prepares the accounts of the Union Government from the inputs provided by the Ministries' Controllers of Accounts and the inputs provided by the Ministries of Railways and Defence and Departments of Post and Telecommunication.

### **Annual Accounts**

38. The Chief Controller of Accounts prepares the Statement of Central Transactions relating to the Ministry for the year classified up to the major head level.

39. The Controller General of Accounts prepares a similar statement for the Union Government.

**Institute of Public Auditors of India, New Delhi, How to Read Civil Accounts**

40. This volume prepared by the Institute of Public Auditors of India New Delhi explains the nuances and intricacies of Government accounts and financial reports in a lucid and reader friendly manner.

**Pant U.S. and Srivastava R.S.: Payment and Accounting System in Government of India, Good Publishing Company, New Delhi, 1996**

41. The book describes in a lucid manner the departmentalized system of accounts in the Government of India including the role and responsibilities of various functionaries such as the drawing and disbursing officers.

**Ganguly S. P.: Fundamentals of Government Budgeting in India, Eastern Express and Publication Ltd., Guwahati, Reprint Concept Publishers, Delhi, 2000**

42. The Chapter on Government Accounts in this book explains the rationale of the system of classification of transactions of receipts and expenditure in Government Accounts as introduced from April 1974 and as further refined from April 1987 to bring greater closeness between Plan classification and accounts classification.

**Government of India, Planning Commission, Report of the Sub-Group on Expenditure Accounting System, 1996**

43. The introduction of accrual accounting in Government will greatly add to the depth and transparency of Government accounts. It will also improve the quality of fiscal decision making by bringing into sharp focus the claims and commitments. However, the introduction of accrual accounting requires a strong data basis that will take time. A beginning may be made by compiling and publishing certain additional information, e.g. statement of outstanding revenues, statement of commitments, statement of incomplete works, statement of net return to Government from public sector undertakings, pension commitments, money value of tax incentives and concessions and the total liabilities of Government including the liabilities of the public sector undertakings and autonomous bodies. The statements should be prepared by the administrative departments and vetted by the accounts and over time the CAG may also audit them.

44. The Sub-Group also recommended that the monthly accounts should be prepared in the same format in which the budget is presented.

**Government of India, Ministry of Finance, Report of the Twelfth Finance Commission, November 2004**

45. The Central Government should gradually move towards accrual basis of accounting. In the interim period additional information in the form of statements should be appended to enable more informed decision- making. The additional information may relate to

subsidies, expenditure on salaries, expenditure on pensions, committed liabilities, maintenance expenditure segregation of salary and non-salary portions and liabilities and repayment schedule on outstanding debt.

**Government of India, Planning Commission, The Report of the Sub-Group on Non-Plan Expenditure, June 1996**

46. Because of the priority accorded to the Plan there has been a tendency to classify items that were earlier put under the non-Plan side as “Plan” outlay blurring the distinction between the two.

47. It is also not desirable to make a distinction on the basis of “developmental” and “non-developmental” expenditure rather than “Plan” and “non-Plan” since it is not wise to treat growth of current expenditures as permissible if funded with borrowing, provided even if they are developmental in nature.

48. It is necessary to avoid too many classifications in budget heads.

**Basu Anuradha: Public Expenditure Decision Making, The Indian Experience, Sage Publications, New Delhi, 1995**

49. The initial rationale for the distinction between Plan expenditure and non-Plan expenditure was to distinguish expenditure on new projects (established in accordance with the country’s development strategy as outlined in the prevailing five-year Plan) from expenditure on existing projects (which may have been set up under an earlier Plan). In addition there was a procedural aspect to this distinction, in terms of a division of responsibility between the Ministry of Finance and the Planning Commission (for allocating resources among central line Ministries) and between the latter and the Finance Commission (for allocating resources among the different States).

50. However, the current economic usefulness of the distinction between Plan expenditure and non- Plan is questionable. It no longer serves the purpose of focusing the public expenditure agenda on inter-sectoral developmental needs since Plan maintenance expenditures on existing projects are much larger than before. Despite their growing importance in total expenditure, there is no formal agenda or medium-term fiscal plan to guide the non- Plan expenditure decisions. Coordination and control of aggregate public expenditure are also adversely affected as a result.

**Prasad A.: Expenditure Management in India: A Perspective, *in the background literature for Workshop on Fiscal Responsibility in Government, National Institute Of Financial Management, Faridabad, February 2000***

51. Since maintenance expenditure on investments during an earlier Plan period is classified as non-Plan expenditure, there is sizeable increase in non-Plan expenditure and diversion of large parts of revenue to meet such expenditure. The balance from current

revenues thus gets seriously depleted to meet the needs of Plan finance and the resultant resource gap is met by taking loans, which only adds to the vicious circle of increasing interest burden and increasing non-Plan expenditure.

52. The distinction between Plan and non-Plan expenditure has resulted in sub-optimal use of resources since new schemes often take priority over maintenance.

53. The concept of accrual accounting in Government is required to be more broad-based than in a commercial enterprise. In Government it should cover commitments for expenditure as well so that the liabilities incurred but not discharged before the end of the year are properly taken into account for resource planning and budgetary purposes during the following year. The introduction of accrual accounting in Government will add to the depth and transparency of accounts and greatly improve the quality of decision-making by bringing into sharper focus claims and demands that otherwise remain hidden from public view.

**Shome Parthasarathi, Sen Tapas K. and Gopalakrishnan S.: Public Expenditure Policy and Management in India: A Consideration of Issues, Paper presented at a Seminar on Expenditure Management, Ministry of Finance, March 1996**

54. The illusory difference between the Plan and non-Plan expenditures (expenditure on Plan schemes started during a particular plan period becomes non-plan expenditure once that Plan period is over) is partly responsible for continuously adding to schemes on which resources have to be spent. There is no inherent difference between a Plan scheme and a non-Plan scheme; there are several examples of large development projects (e.g., power projects in Karnataka) outside the Plan. The time may be ripe to take a thorough review of the planning process – particularly its financing – and of the traditional distinction between Plan and non-Plan expenditures, which has generally prevented a holistic view of Government finances.

55. Although the formal distinction between current and capital expenditures appears to be on a more stable foundation, this does not rule out the presumption that certain expenditures are analogous to consumption in the sense that they are not expected to yield any returns and these current expenditures are qualitatively different from capital expenditures from which returns are expected. If this distinction is not maintained there would be no way of judging the performance of investments made by Government, as there would be no way of knowing what part of the expenditure is in the way of investments.

**Srivastava D.K.: Budget Process and Expenditure Management in India (1997) Reading Material for Training Course on Fiscal Policy for IA&AS Probationers (1999), National Institute of Public Finance and Policy, New Delhi**

56. The excessive categorization of expenditure between Plan and non-Plan expenditure and between developmental and non-developmental expenditure has led to complexities to budgetary handling of Government expenditure. Excessive emphasis on Plan

expenditure has under-emphasized the maintenance of capital expenditure as an objective.

**Govinda Rao Dr. M.: State Finances in India: Issues and Challenges, Economic and Political Weekly, Volume XXXVII, No. 31, August 3-9, 2000**

57. The artificial and often meaningless distinction between Plan and Non-Plan expenditure is an important cause of expenditure proliferation at the State level. Implicit in such a division is the assumption that Plan expenditures are productive, and non-Plan expenditures are not. This is not correct, for, a number of projects classified as 'Plan' in the revenue account are merely salary payments that are not productive. Similarly, while the expenditures on completed schemes are classified as non-Plan, maintenance expenditures on roads, buildings, irrigation works are certainly productive.

**International Monetary Fund, Report on the Observance of Standards and Codes (ROSC) India, February 2001**

58. The present distinctions between Plan and non- Plan spending and between development and non-development spending are problematic. In particular, they do not appear to have facilitated coherent longer-term budgeting and they create incentives for misclassification. One specific concern is that the bias towards plan/development projects has meant that inadequate account is taken of their recurrent costs.

**Ramaswamy P. R.: Better Financial Management - Need for Clarity in Plan and non-Plan Expenditures, Quarterly Journal of the Indian Institute of Public Administration, July-September 2004**

59. The article traces the genesis of the distinction between Plan and non-Plan expenditure with the advent of planning in the 1950's, which segregated the maintenance expenditure from developmental expenditure, and points out that such distinction gave clarity to public expenditure proposals, objectivity to Government officials and vision to the departments. A conscious and considered decision was to be taken on the classification of each scheme as Plan or non-Plan in consultation with the Planning Commission and the Ministry of Finance. These categorizations have not been defined in the financial rules of Government. However, with the passage of time the original rationale for the distinction between Plan and non-Plan has been lost sight of and now the Planning Commission, at the commencement of each Plan, specifies what constitutes Plan expenditure and what comes under non-Plan expenditure. The guidelines for the classification of expenditure for the 10<sup>th</sup> Plan are not in conformity with the original purpose of distinction between developmental and non-developmental expenditure in quite a few cases.

60. The distinction between Plan and non-Plan expenditure should be retained and should be codified in the financial rules of Government. The schemes should be defined as Plan or non- Plan strictly with reference to their aims and the interpretation of expenditure as Plan or non- Plan with reference to the plan period, nature, etc should be avoided.

**Handa K.L.: Management Accounting in Government, The Indian Journal of Public Administration Vol. XXIV, No.4, 1978**

61. There is need for integration of the finance and accounts functions not merely at the level of the Financial Advisor but also at all levels down below in order to secure maximum participation of accounting and financial experts at the stage of formulation of proposals and taking of management decisions.

62. The present structure of financial accounts is not adequate to serve the purpose of management accounting since the accounts classification is not designed to relate to the cost centers that makes it difficult to allocate cost to a responsibility Centre and to evaluate the actual cost against the standard cost. The classification needs to be improved further to provide for subsidiary set of accounts to correspond to cost centers, and to facilitate responsibility accounting.

**Government of India, Ministry of Finance, Controller General of Accounts, Proceedings of the Silver Jubilee Seminar, April 2002**

63. The Seminar recommended a review of the existing system of budget and accounts classifications to enable development of meaningful management information systems for the Ministries.

**Gupta, M. P.: Government Accounting and Control, Ashish Publishing House, New Delhi**

64. This book gives a broad over-view of the accounting in Government and sets out the main points of difference between Government accounts and commercial accounts.

65. According to the author the system does not facilitate prompt availability of information on flow of expenditure.

**Government of India, Report of the Eleventh Finance Commission 2000-2005**

66. The Eleventh Finance Commission recommended that Government might review all expenditure classification other than revenue and capital.

**Thapliyal B.S. and Pattanayak S.S.N.: in the Select Papers brought out by the Controller General of Accounts for the International Seminar on Accounting For Results, June 2003**

67. The accounts data is not sufficiently comprehensive to provide micro level information for taking timely corrective measures. Resting on cash basis, the accounting system is unable to produce adequate data since it does not record or report State-owned assets, specifically the tangible fixed assets, accrued revenues and expenses, expenses

made on assets in need of capitalization, price and quantity changes etc. There is no mechanism to record the commitments entered into, the expenditure arrears or the contingent liabilities.

**Premchand A., Potter Barry, Woolley Mike: India: Public Expenditure Management**

68. Plan expenditures have always been considered as different in that public investments were first subjected to initial scrutiny, and thereafter the annual provision in the budget for approved projects was moderated in the light of availability of resources. A greater part of the Plan is, however, now devoted to current outlays, even though they are partly funded by borrowing. In turn as the costs of debt servicing go up, there is an upward pressure on containing non-Plan current outlays. The distinction between Plan and non-Plan outlays seriously inhibits national resource planning and allocation. The principal distinctions should be between current and capital expenditure. If, for presentational reasons, some kind of developmental concept is required, the outlays should be divided into those that are developmental and that are non-developmental.

**Gupta N.D. and Gupta Naveen: Government Accounting; A Re-examination, The Chartered Accountant (Journal of the Institute of Chartered Accountants of India), November 2002**

69. The authors discuss the need for the introduction of accrual accounting in Government and also explain how some of the connected issues can be resolved e.g. asset valuation, power to tax (whether it is an asset or not), opening balance sheet, reporting entity and so on.

**Goel S.L.: Public Financial Administration, Deep and Deep Publications, New Delhi, 2002**

70. The accounting rules need to be written in a user-friendly manner; there is need to train administrative heads in accounts; and there should be better rapport between the accounts and the executive wings. The accounts should become effective management tool.

**Indian Railways Code for the Accounts Department**

71. The Indian Railways Code for the Accounts Department describes the system of accounts in the Indian Railways (IR) in the context of its being a Government-owned departmental commercial undertaking. The accounts of the IR are maintained on a commercial basis outside the regular Government accounts and a link is established between the two to show how much is coming into Government revenues through the railways and how much is being spent by the Government whether as revenue or capital expenditure in carrying out the activities of the railways. IR has its own separate accounts organisation with the Financial Commissioner, Railway Board, as its professional and administrative head.

72. The Railway Administration maintains the following set of accounts described as the “General Books”:

- The Daily Abstract of Cash Transactions
- The Monthly Classified Abstract of Cash Transactions or the General Cash Abstract Book
- The Journal
- The Ledger

73. From this the Railway Administration prepares the following two financial reports called the “Account Current” viz. The Revenue Account Current and the Capital Account. An Account Current is basically a statement showing the receipts and disbursements duly classified under the prescribed heads of accounts.

74. The Account Currents prepared by the various Railway Administrations are consolidated in the office of the Railway Board and a statement of Receipts and Charges is prepared and sent to the Ministry of Finance.

**Government of India, Ministry of Railways, Report of the Railway Fare and Freight Committee, December 1993**

75. A study on the Railway Costing System conducted by the Institute of Cost and Works Accountants of India for the Committee observed that there were certain inherent limitations in the Accounting Method based costing system followed by the Indian Railways. The main problem is the translation of expenses in the accounts for a year to the relevant costs. The adjustments are not made for extraordinary items of expenditure or arrears/throw forward expenditure. The assessment of Demands Payable and Miscellaneous Advances (Revenue) is subjective. The prevalent methodology of preparing the cost accounts is also in need of improvement.

**Expert Group on Indian Railways, The Indian Railways Report 2001: Policy Imperatives for Reinvention and Control, July 2001**

76. The existing system of the Railway accounts does not give a true and fair picture of the Indian Railways (IR); one that could be easily understood by a trained financial analyst or a Chartered Accountant. The IR do not maintain a register of assets, the balance sheet does not show separately gross block, depreciation and net assts, the leased assets are not shown separately. Capital work-in progress is not shown separately, there is no clear indication how the inventories are valued, there is neither a proper classification of sundry debtors, nor any provision for bad and doubtful debts.

77. The net block of the IR cannot be ascertained in the absence of the depreciation provisions in the balance sheet; there is no clear separation between revenue and capital, or between top of the line and below the line.

78. The contributions to the Development Reserve Fund tend to be fixed in an ad hoc manner. As regards the Pension Fund, IR follow the system of pay as you go. The accounts do not provide a clear segregation of cost of staff, the value of the opening and closing stock and consumption of stores and spares.

79. The system precludes the establishment of tight financial discipline and targeting, the accounts do not allow the managers to set revenue and other operational targets whose returns can then be measured against the corresponding cost of capital. The IR need to follow the Generally Acceptable Accounting Standards if they have to tap the market for investible funds.

## **Chapter 21**

# **FINANCIAL REPORTING**

### **The Constitution of India**

1. Financial Reporting flows from the system of Government accounts. The basic features of maintenance of Government accounts are laid down in the Constitution of India.
2. Under Article 266 of the Constitution all revenues received by the Government of India, all loans raised by Government and all moneys received by Government in repayment of loans shall form the Consolidated Fund of India. All other public moneys received by or on behalf of Government shall be credited to the Public Account.
3. As authorized under Article 267 of the Constitution, Parliament has established by law a Contingency Fund in the nature of an imprest called the Contingency Fund of India with a predetermined corpus which has been placed at the disposal of the President to enable advances being made for the purpose of meeting unforeseen expenditure pending the authorization of such expenditure by the legislature.
4. In terms of Article 112(2) of the Constitution the estimates of expenditure embodied in the annual financial statement (budget) that are required to be presented to the Parliament every year shall show separately the sums required to meet expenditure described in the Constitution as expenditure “charged” on the Consolidated Fund of India and other expenditure. The statement shall also distinguish between expenditure on revenue account from other expenditure.
5. Under Article 150 of the Constitution the accounts of the Union and of the States shall be kept in such form as the President may prescribe on the advice of the Comptroller and Auditor General of India (CAG).

### **The Comptroller and Auditor General’s (Duties, Powers and Conditions of Service) Act, 1971**

6. Under the Act, the CAG is responsible for compiling the accounts of the Union Government from the initial and subsidiary accounts rendered to his offices by the treasuries, offices or departments responsible for keeping such accounts. The CAG is also required to prepare accounts showing under the respective heads annual receipts and disbursements of Government and submit these accounts to President on or before such dates as he may determine with the concurrence of the Government.

7. The Act authorizes the President to relieve the CAG from the responsibility of compiling the accounts after consultation with the latter.

8. A series of Presidential orders issued in 1976 relieved the CAG from the responsibility of compiling the accounts of the Union Government, except the accounts of the Indian Audit and Accounts Department.

**Introduction to Government Accounts and Audit, Swamy's Compilation, Swamy Publishers, Chennai and Delhi, 1999**

9. Originally a Government of India publication, the book is a useful primer for introducing the uninitiated to the Indian accounts and audit systems.

**Government Accounting Standards Advisory Board**

10. The Government Accounting Standards Advisory Board (GASAB) has been constituted by the CAG under the Chairmanship of the Deputy Comptroller and Auditor General (Accounts) and with the Controller General of Accounts, the Financial Commissioner, Railways, the Controller General of Defence Accounts, the Additional Secretary (Budget), and nominees of the Reserve Bank of India, the Institute of Chartered Accountants of India the National Council of Applied Economic Research and Finance Secretaries of four States by annual rotation as members. The responsibilities of GASAB are:

- (i) To formulate and propose standards that improve the usefulness of the financial reports based on the needs of the financial report users;
- (ii) To keep standards current and reflect changes in the Governmental environment;
- (iii) To provide guidance on implementation of standards;
- (iv) To consider significant areas of accounting and financial reporting that can be improved through the standard setting process; and
- (v) To improve the common understanding of the nature and purpose of information contained in financial reports.

11. Addressing the inaugural meeting of GASAB on November 7, 2002 Shri V.N.Kaul, the CAG, observed: "The standards will delineate the basic principles that represent the basic practices of Government accounting and financial reporting, as it should be. They will provide a framework for performing and promoting a broad range of value-added activities concerning financial reporting and accounting in the Government. The standards will establish the basis for measurement of performance. They will foster improvement in government processes and operations."

**Chanda A.K., A Profile of Financial Administration in Financial Administration, Indian Institute of Public Administration, New Delhi, 1986**

12. While there is nothing inherently wrong in the concept of Public Account, the way its balances are treated comes in the way of applying Parliamentary control over

withdrawals from the Consolidated Fund. The balances of this account are not held separately and are merged in the cash balance of the Government. Consequently, the balances of the Public Account are frequently drawn upon for meeting expenditure debitable to the Consolidated Fund. This has frustrated the legislative control over Government expenditure since it is not possible to know at any time whether the Consolidated Fund has run dry or not.

**Government of India, Administrative Reforms Commission, Report of the Study Team, 1968**

13. The segregation of balances between the Consolidated Fund and the Public Account is neither necessary nor feasible. However, the monthly cash balances in the Consolidated Fund should be calculated and exhibited separately for general information, so that the extent of utilization of balances in the Public Account for meeting expenditure authorized to be met from the Consolidated Fund is brought into clear focus.

**Civil Accounts Manual - Volumes I and II, Ministry of Finance, Department of Expenditure, Controller General of Accounts**

14. This compilation describes the main features of the scheme of departmentalization of accounts of the Union Government Civil Ministries and Departments and the organization of the Controller General of Accounts and prescribes the detailed instructions and procedures for the preparation of the financial reports. Specific departmental manuals of individual Ministries and Departments supplement the Manual.

**Finance Accounts**

15. The Finance Accounts of the Union Government is an annual financial report comprising the accounts of the Central Government as a whole, i.e. the accounts of the civil Ministries, the Railways, the Defence Services, and Post and Telecommunication. These accounts are prepared and signed by the CGA, countersigned by the Secretary, Department of Expenditure, Ministry of Finance and presented to the Parliament after audit by the CAG.

16. The Finance Accounts show the receipts and outgoings of the Government for the current year, together with the financial results disclosed by the revenue and capital accounts, the accounts relating to public debt, and liability and assets of the Government.

17. Apart from a brief write up captioned as Introductory, which explains mainly the system of classification of transactions in Government accounts, the Finance Accounts comprise a series of statements in two Parts:

### ***Part I Summarized Statements***

- (i) *Statement No.1* depicts major headwise details of the entire receipts into and expenditure from the Consolidated Fund, the Contingency Fund and the Public Account;
- (ii) *Statement No.2* gives the summary of debt position, which includes borrowings from internal debt, external debt, and other obligations such as Small Savings, Provident Funds, Reserve Funds, etc;
- (iii) *Statement No.3* gives the summary position of loans and advances given by Government to the State Governments the foreign Governments etc;
- (iv) *Statement No.4* gives information on the guarantees given by the Union Government for raising loans and the payment of interest thereon;
- (v) *Statement No.5* gives the summary of balances on which Government has a liability to repay the money received or has a claim to recovery of the amount paid;

### ***Part II Detailed Accounts and other Statements***

- (i) *Statement No.6* details the percentage of receipts and expenditure under different heads to the total receipts and expenditure respectively;
- (ii) *Statement No.7* gives the distribution of total expenditure between charged and voted expenditure;
- (iii) *Statement No.8* provides the detailed account of revenue and capital receipts classified up to the minor head level;
- (iv) *Statement No.9* gives the detailed accounts of revenue expenditure by minor heads and capital expenditure by major heads and also distinguished between plan, non-plan, charged and voted expenditure;
- (v) *Statement No.10* gives the detailed accounts of capital expenditure during the year and up to the year classified up to the minor head level;
- (vi) *Statement No.11* provides information on the investments made by the Government in statutory corporations, Government companies, joint Stock companies, cooperative institutions etc; and the amount of dividend received thereagainst;
- (vii) *Statement No 12* shows the Capital and other expenditure (outside the Revenue Account) to the end of the year and the principal sources from which funds were provided for the expenditure;
- (viii) *Statement No.13* contains details of transactions relating to Debt, Deposit and Remittances by minor head;
- (ix) *Statement No.14* shows the minor head wise details of internal debt, external debt and other interest bearing obligations of Government;
- (x) *Statement No.14A* shows the loan wise details of internal debt raised, discharged and outstanding at the end of the year;
- (xi) *Statement No.15* gives the details of loans advanced and recovered during the year together with the closing balances; and

(xii) *Statement No.16* gives the details of transactions relating to the National Savings Fund.

18. The provisional annual unaudited accounts are generally ready within two months of the close of the financial year; duly audited and certified accounts are generally presented in the Parliament's budget session in the following year.

### **Appropriation Accounts**

19. Appropriation Accounts is an annual financial report that compares the amounts of expenditure of the Government with the amounts authorized by the Parliament with explanations for variations between the two by way of Saving or Excess. The Appropriation Accounts contain a Summary showing the total amount of funds provided by the Parliament under each Grant and Charged Appropriation, the amount of actual expenditure thereagainst and the amount of consequential Saving or Excess. This is supplemented by Headwise account of each Grant or Appropriation which contains figures of authorization under each grant head, the transfer of funds by way of reappropriations, the amount of expenditure and the amount of savings/ expenditure. Notes and Comments under each Grant highlight cases of injudicious surrender and reappropriation of funds, incorrect accounting of expenditure, unauthorized expenditure beyond the scope and intent of Grant etc;

20. The Appropriation Accounts are prepared by the Chief Controller of Accounts in respect of the Grants relating to the Ministry and then consolidated for the civil Ministries by the Controller General of Accounts. The Appropriation Accounts are signed by the Controller General of Accounts, countersigned by the Secretary, Department of Expenditure, Ministry of Finance, and carry the Audit Certificate of the CAG and laid before the Parliament.

The Ministries of Railways, Defence, Post and Telecommunication prepare their own Appropriation Accounts. These are also presented to the Parliament after audit by the CAG.

### **Accounts at a Glance**

21. This annual financial report gives a broad overview of the Government finances as seen from the Finance Accounts and the Appropriation Accounts. It also provides time series data on tax and non-tax receipts, capital receipts, revenue and capital disbursements, debt position, fiscal deficit, returns from investments etc;

22. The report is published by the Controller General of Accounts.

### **Monthly Financial Reports**

23. The Pay and Accounts Officers compile the accounts of transactions relating to receipts and payments during and up to a month in a Ministry or department classified up

to the final level of classification and the accounts so compiled are sent to the Chief Controller of Accounts. The Pay and Accounts Officers also send flash accounts classified up to the major head level of classification to the Chief Controllers.

24. The Chief Controller of Accounts compiles the accounts of the Ministry as a whole and forwards the Ministry's accounts to the CGA. The Chief Controller of Accounts also prepares Monthly Review Report/ Schemewise monthly analysis for the information of the Secretary and/or the Controller General of Accounts.

25. The CGA prepares the consolidated accounts of the Government of India. The monthly accounts are generally ready by the end of the succeeding month.

26. The monthly accounts are placed on the website and comply with the IMF requirements of Special Data Dissemination Standards. .

27. The CGA also prepares an analysis based on the monthly accounts. The analysis covers trends in receipts, expenditure and deficit and provides an input for monitoring the general fiscal position. The analysis profiles comparative status of fiscal deficit, borrowings, ways and means advances and tax and non-tax revenues. It also contains a macro-level picture of the resources transferred to the sub-national levels in terms of grants, loans and the share of taxes and duties.

28. The Chief Controllers of Accounts of the Direct and the Indirect Taxes departments send flash reports of receipts on the 4<sup>th</sup> of each month to the Ministry of Finance.

29. According to the Fiscal Policy Strategy Statement, tabled by the Finance Minister while presenting the budget for the year 2005-2006, in order to promote transparency and accountability, the Union Government Ministries will be expected to release a monthly summary of their receipts and expenditure to the general public (through their websites etc) and in particular disclose scheme-wise funds released to the State Governments

### **How to Read Civil Accounts: Institute of Public Auditors of India New Delhi**

30. This volume prepared by the Institute of Public Auditors of India New Delhi explains the nuances and intricacies of Government accounts and financial reports in a lucid and reader friendly manner.

### **Government of India, Planning Commission, Report of the Sub-Group on Expenditure Accounting System, 1996**

31. The introduction of accrual accounting in Government will greatly add to the depth and transparency of Government accounts. It will also improve the quality of fiscal decision making by bringing into sharp focus the claims and commitments. However, the introduction of accrual accounting requires a strong data basis that will take time. A beginning may be made by compiling and publishing certain additional information, e.g. statement of outstanding revenues, statement of commitments, statement of incomplete

works, statement of net return to Government from public sector undertakings, pension commitments, money value of tax incentives and concessions and the total liabilities of Government including the liabilities of the public sector undertakings and autonomous bodies. The statements should be prepared by the administrative departments and vetted by the accounts and over time the CAG may also audit them.

32. The Sub-Group also recommended that the monthly accounts should be prepared in the same format in which the budget is presented.

**Government of India, Ministry of Finance, Report of the Twelfth Finance Commission, November 2004**

33. The Central Government should gradually move towards accrual basis of accounting. In the interim period additional information in the form of statements should be appended to enable more informed decision-making. The additional information may relate to subsidies, expenditure on salaries, expenditure on pensions, committed liabilities, maintenance expenditure segregation of salary and non-salary portions and liabilities and repayment schedule on outstanding debt.

**Prasad A.: Expenditure Management in India: A Perspective, *in the background literature for Workshop on Fiscal Responsibility in Government, National Institute of Financial Management, Faridabad, February 2000***

34. The concept of accrual accounting in Government is required to be more broad-based than in a commercial enterprise. In Government it should cover commitments for expenditure as well so that the liabilities incurred but not discharged before the end of the year are properly taken into account for resource planning and budgetary purposes during the following year. The introduction of accrual accounting in Government will add to the depth and transparency of accounts and greatly improve the quality of decision-making by bringing into sharper focus claims and demands that otherwise remain hidden from public view.

**Handa K.L.: Management Accounting in Government, *The Indian Journal of Public Administration Vol. XXIV, No.4, 1978***

35. The present structure of financial accounts is not adequate to serve the purpose of management accounting since the accounts classification is not designed to relate to the cost centers that makes it difficult to allocate cost to a responsibility Centre and to evaluate the actual cost against the standard cost. The classification needs to be improved further to provide for subsidiary set of accounts to correspond to cost Centres, and to facilitate responsibility accounting.

**Administrative Reforms Commission, Report of the Study Team, Financial Administration, 1967**

36. The accounting data should facilitate the formulation of a policy and also throw up material that will make possible the assessment of working of the policy. It should also render the action of each agency accountable to the higher agency or to the legislature and through it to the public in the ultimate analysis.

37. Specific dates should be statutorily prescribed for the submission of the audited appropriation accounts to the President (Ministry of Finance) and by the Ministry of Finance to the legislature.

**The World Bank, State Financial Accountability Assessment, Government of Uttar Pradesh, 2003**

38. The Report benchmarks the Form of Finance Accounts, Government of Uttar Pradesh (GoUP), against the standards promulgated by the International Federation of Accountants, Public Sector Committee (IFAC-PSC), both mandatory and additional standards, and shows how GoUP accounts relate to the IFAC-PSC standards

<b>Comparison of GoUP Accounts with IFAC Standard</b>	
<b>IFAC-PSC Cash Basis Standard – Part 1</b>	<b>GoUP (per Finance Accounts 1999/2000)</b>
Statement of receipts, payments and cash balances	Provided in Statement No. 1
Disclosure of accounting policies	Some explanation of items and summaries of results, but no statement of accounting policies
Amounts received and paid on behalf of GoUP (such as offshore payments by donors for supplies, equipment, etc)	Not shown
Separate annual financial statements for each Department and other entity, and consolidated statements for GoUP	No separate statements for lower level entities. GoUP only, and some entities under Government control omitted
Statements understandable, relevant to users and presented within six months of end of year, reliable, and complete	Appropriation Accounts understandable, but Finance Accounts obscure. FY 2000 accounts issued after just over six months. Accounts are believed to be reliable and complete, subject to the omission of non-cash aid.
Statements to show date of issue, and who has authorized them for issue	Yes, in CAG certificate
Information about the entity – its operations, controlling legislation, and	Not shown

departments and other entities included	
Any cash balances that are subject to restrictions on their use, and undrawn borrowing facilities	Not shown
Comparative information for the previous year	Shown

**Additional Disclosures Encouraged under Part 2**

Assessment whether entity is a going concern (in the case of a lower-level entity)	Not applicable
Extraordinary items (such as disaster relief)	Not identified, if any
Classification of payments by function and/or nature of payment, and receipts by type	Yes. Payments are classified by function, and by standard object within function. Receipts classified by type
Proceeds from borrowing, by type and source	Shown
Assets and liabilities of the entity	Only financial assets and liabilities listed, no physical assets
Comparison with budgets	Yes, for revenue and expenditure only (in Appropriation accounts)
Proportion of ownership interest in controlled entities	No definition of controlled entities
If intending to convert to accrual accounting, classification of cash flows into operating, investment and financing activities	Not done

39. According to the Report GoUP accounts, though they score well on a number of parameters, do not meet the IFAC-PSC standard, mainly because of a lack of definition of their coverage, and lack of a statement of accounting policies. The Report also observed that the CAG's Audit Certificate on the Annual Accounts to the effect that, according to the best of his information, the accounts read together with his observations, are correct statements of receipts and outgoings did not meet the INTOSAI reporting standards.

**Government of India, Ministry of Finance, Controller General of Accounts, Proceedings of the Silver Jubilee Seminar, April 2002**

40. The Seminar recommended a review of the existing system of budget and accounts classifications to enable development of meaningful management information systems for the Ministries.

41. The CGA should monitor, analyze and report on the utilization of Plan funds allocated to various Plan schemes in order to enable the Planning Commission to keep a close watch on the sectoral growth. The Monthly Review of Expenditure prepared by the CGA should be made available to the Planning Commission and the economic Ministries and a copy should also be submitted to the Cabinet. Additionally, monthly analysis should be prepared for each Ministry. The existing format of the Finance Accounts should be reviewed for making the statements more user-friendly.

**Combined Finance and Revenue Accounts**

42. The Combined Finance and Revenue Accounts are compiled by the CAG's organization from the Finance Accounts of the Union Government and the State Governments. This document presents a common format and comparable statistics of various Governments in the country. These accounts are presented in two parts:

- General Accounts which provide (a) a summary of Receipts and Disbursements of all Governments by sectional heads of accounts; and (b) accounts of receipts and disbursements by Major heads of Accounts of all Governments in the Revenue, Capital and all other sections: and
- Subsidiary Accounts which provide details by Minor heads of all figures shown in the General Accounts relating to the type of activity.

**Pant U.S.: Budgeting and Financial Management in India, Impact Books, New Delhi, 1998**

43. Except for a few MIS reports and reduction in the time period of reporting, the financial statements and analysis of accounting data have not been given priority to provide meaningful information for managerial decision making. The voluminous information available in the annual accounts does not serve any purpose other than the statutory formality. One of the reasons for this is the multiplicity of institutions involved in the process like the CGA, the CAG, the Budget Division of the Ministry of Finance and the Department of Expenditure of that Ministry.

**Report of the Comptroller and Auditor General of India, Accounts of the Union Government**

44. This annual report is prepared by the CAG for submission to the President under Article 151 of the Constitution. The President causes the report to be laid before both Houses of Parliament.

45. The report gives a critical analysis of the state of Government finances over time as seen from the Finance Accounts. It analyses the time series trends in the growth and composition of Government receipts and expenditure, the results of Government financial operations by way of revenue deficit, primary deficit, fiscal deficit etc; growth in assets and liabilities of Government and provides a general evaluation of the over all management of Government finances.

46. The report may also carry CAG's critical comments on the quality of Government accounts like amounts kept under 'Suspense' and not adjusted to final heads of accounts, the variations in Governments cash balances as per the books of accounts and the amount as per the Reserve Bank of India, cases of adverse and inefficient balances in accounts etc.

47. The report also contains CAG's observations on Government control over expenditure vis a vis the budgetary authorizations and failures to monitor its expenditure.

**Tewari A.C.: Problems of Fiscal Management in Government, Shipra Publications, Delhi, 1995**

48. Although the accounting system is designed to give information in terms of constitutional provisions related to the Fund (Consolidated Fund, Contingency Fund, Public Account) its nature (revenue or capital), function (economic, social or general services), programme etc., a major drawback is the complex character of the mass of data presented in the Accounts that has undermined their reader friendliness.

**Gupta M. P.: Government Accounting and Control, Ashish Publishing House, New Delhi**

49. This book gives abroad over-view of the accounting in Government and sets out the main points of difference between Government accounts and commercial accounts.

50. According to the author the system does not facilitate prompt availability of information on flow of expenditure.

**Reserve Bank of India, Report of The Advisory Group on Fiscal Transparency, 2001**

51. The Advisory Group set up by the Reserve Bank of India benchmarked the public financial and accountability system in India against the IMF Code of Good Practices on Fiscal Transparency (May 2001). It pointed out that while the coverage of the Finance Accounts is comprehensive, these are not presented in the same format as the budget. Also, there is also no law that prescribes the timing and coverage of the accounts.

**Thapliyal B.S. and Pattanayak S.S.N.: the Select Papers brought out by the Controller General of Accounts for the International Seminar on Accounting for Results, June 2003**

52. The accounts data is not sufficiently comprehensive to provide micro level information for taking timely corrective measures. Resting on cash basis, the accounting system is unable to produce adequate data since it does not record or report state-owned assets, specifically the tangible fixed assets, accrued revenues and expenses, expenses made on assets in need of capitalisation, price and quantity changes etc. There is no mechanism to record the commitments entered into, the expenditure arrears or the contingent liabilities.

**Burman Soma Roy: An Examination of Certain Liabilities in the Public Account of India and their Impact on Budget and Accounts, Select Papers brought out by the Controller General of Accounts for the International Seminar on Accounting for Results, June 2003**

53. There should be a detailed note in the Finance Accounts explaining the genesis and age of the balances under Suspense and Remittance heads, reasons for delay in their liquidation and the financial implications of their continuance.

54. There is no delineation in the balances in Suspense Accounts between the outstandings that have an expenditure impact and the items that impact the cash balance of Government.

**National Academy of Audit and Accounts, Shimla, Background Paper on Accounting for Government Assets - Ensuring Accountability and Transparency, September 2003**

55. The investments made by Government are not revalued or written off if the entity ceases to exist on liquidation. There is no system of revaluing the assets for disclosure in Financial Statements, and while there is a prescribed procedure for writing off the assets, the financial implications of such write offs are not reflected in the Financial Statements.

56. The statement relating to capital expenditure in the Finance Accounts is not supported by the list of assets created thereby.

57. Grants-in-aid paid to autonomous bodies for capital expenditure and creation of assets are classified in Government accounts as revenue. Although expenditure incurred on several schemes of Government of India like Jawahar Rozgar Yojana, Employment Assurance Scheme etc; results in the creation of assets like roads, buildings etc; the Government Accounts classify the expenditure as revenue expenditure only and the true value of assets created by incurrence of Government expenditure is not captured and disclosed in the Financial Statements.

**Premchand A., Potter Barry, Wooley Mike: India: Public Expenditure Management**

58. The accounting and reporting system need to provide an efficient, timely and responsive service. There will also be need to move towards a balance sheet presentation for appropriate programmes within Ministries, departments and enterprises. A natural progression is to introduce accrual accounting that presents a fuller picture of the Government's position in terms of assets and liabilities (including commitments) than a cash-based system. At present, the accounting system is very detailed and services many of the current needs based on a disaggregated single entry system that has perhaps been developed to its limits. The introduction of a self-balancing General Ledger System will be crucial in this regard.

**Government of India, Ministry of Finance, Department of Economic Affairs, Report of the Committee on Fiscal Responsibility Legislation, July 2000**

59. As a one-time measure, the Government should place before Parliament a statement of accounting standards, principles and practices. Thereafter, significant changes in the standards, principles and practices, especially those affecting the reckoning of debt, deficit or other fiscal indicators should be clearly disclosed in the Union Budget.

60. As the existing system of accounting is cash-based it does not bring out accrual aspects of accounting such as liabilities arising from unpaid bills, unrealized tax revenue and other receipts as well as the cost of using existing resources (i.e. depreciation, etc.). Although the Finance Accounts exhibit liabilities of outstanding external loans additionally at the current rates of exchange, this is not integral to the accounting system. The Committee discussed the question of switching over to an accrual system of accounting.

61. Responding to the suggestion for the introduction of accrual accounting in Government, the Controller General of Accounts (CGA) who was a member of the Committee expressed the view that most of the information needed for managerial purposes was already available with the Administrative Ministries e.g. in the register of liabilities, management information system (for committed liabilities, in respect of ongoing work/supply contracts, outstanding tax and non-tax revenue arrears). On the other hand, the compilation of this information by the CGA would require opening of numerous ledgers.

62. On behalf of the CAG, it was pointed out that accrual accounting was not necessary in order to enforce fiscal responsibility since the extent of unpaid carry-over bills was rather limited. Accrual accounting is untested, difficult to implement and not really useful. There were practical problems, huge costs and timeframes involved and it would not be cost effective. Since the accounting system is common for both the Centre and the States, accrual accounting could not be started at the Centre without examining its implications for the State accounts; the State Governments are not adequately equipped for the purpose and there may be delays in the compilation of the State Government accounts, consequential delays in the preparation of the CAG's Audit Reports and the

discharge of the CAG's Constitutional obligation of submission of the Audit Reports to the Governor for being presented to the legislatures.

### **Indian Railways Code for the Accounts Department**

63. The Indian Railways Code for the Accounts Department describes the system of accounts in the Indian Railways (IR) in the context of its being a Government-owned departmental commercial undertaking.

64. The Railway Administration prepares the following two financial reports called the "Account Current" viz. The Revenue Account Current and the Capital Account. An Account Current is basically a statement showing the receipts and disbursements duly classified under the prescribed heads of accounts.

65. The Account Currents prepared by the various Railway Administrations are consolidated in the office of the Railway Board and a statement of Receipts and charges is prepared and sent to the Ministry of Finance.

66. In addition to the Account Current, the Financial Advisor of the Railway Administration also prepares a critical analysis of earnings, expenditures, operating ratio, over all physical and financial performance, cash flows etc. for the Railway Board. The Railway Administration also prepares 10-day statements of earnings for the Railway Board.

67. IR prepare the following Annual financial reports

- (i) The Capital and Revenue Accounts;
- (ii) The Finance Accounts;
- (iii) The Debt Head report;
- (iv) Statement of Voted and Charged Expenditure; and
- (v) Appropriation Accounts and connected Returns. .

### **Expert Group on Indian Railways, The Indian Railways Report 2001: Policy Imperatives for Reinvention and Control, July 2001**

68. The existing system of the Railway accounts does not give a true and fair picture of the Indian Railways (IR); one that could be easily understood by a trained financial analyst or a Chartered Accountant. The IR do not maintain a register of assets, the balance sheet does not show separately gross block, depreciation and net assts, the leased assets are not shown separately. Capital work-in progress is not shown separately, there is no clear indication how the inventories are valued, there is neither a proper classification of sundry debtors, nor any provision for bad and doubtful debts.

69. The net block of the IR cannot be ascertained in the absence of the depreciation provisions in the balance sheet; there is no clear separation between revenue and capital, or between top of the line and below the line.

70. The contributions to the Development Reserve Fund tend to be fixed in an ad hoc manner. As regards the Pension Fund, IR follow the system of pay as you go. The accounts do not provide a clear segregation of cost of staff, the value of the opening and closing stock and consumption of stores and spares.

71. The system precludes the establishment of tight financial discipline and targeting, the accounts do not allow the managers to set revenue and other operational targets whose returns can then be measured against the corresponding cost of capital. The IR need to follow the Generally Acceptable Accounting Standards if they have to tap the market for investible funds.

## Chapter 22

### EXTERNAL AUDIT

#### The Constitution of India

1. Articles 148-151 of the Constitution of India deal with the institution of the Comptroller and Auditor General of India.

2. India's Supreme Audit Institution called the Comptroller and Auditor General of India is an authority created by the Constitution of India. Article 148 of the Constitution prescribes that there shall be a Comptroller and Auditor General of India (CAG) who shall be appointed by the President of India under his own hand and seal and shall only be removed from office in like manner and on like grounds as a judge of the country's apex judiciary. He shall not be eligible for further office either under the Government of India or under the Government of any State after he has ceased to hold his office. The terms and conditions of his service cannot be varied to his disadvantage after his appointment and the administrative expenses of his office shall be charged upon the Consolidated Fund of India. The conditions of service of persons serving in the Indian Audit and Accounts Department and the administrative powers of the CAG are prescribed by the President in consultation with the CAG.

3. In terms of Article 149 of the Constitution the CAG shall perform such duties and exercise such powers in relation to the accounts of the Union and of the State Governments and of any other authority or body as may be prescribed by or under any law made by Parliament. Such a law was enacted by Parliament in December 1971.

4. Under Article 151 of the Constitution, the Audit Reports of the CAG shall be submitted to the President of India (Union Government) or the State Governor (State Governments) who shall cause them to be laid before the appropriate legislature.

5. The accounts of the Union and of the States shall be kept in such form as the President of India may on the advice of the CAG prescribe vide Article 150 of the Constitution.

6. In the Seventh schedule to the Constitution, which describes the legislative powers of the Union Government and the State Governments, 'Audit of the accounts of the Union and of the States' is mentioned in List I--Central List; this confers on the Union Government the exclusive right and authority to make laws in respect of the Supreme Audit Institution.

7. Under Article 279 of the Constitution the CAG shall certify the net proceeds of the shareable amount of taxes collected by the Union Government and his certificate shall be final.

## **The Comptroller and Auditor General's (Duties, Powers and Conditions of Service) Act, 1971**

8. The Union Parliament enacted the aforesaid law in 1971 to determine the conditions of service of the CAG and to prescribe his duties and powers and for matters connected therewith and incidental thereto. Under the Act the CAG shall hold office for a term of six years or until he attains the age of 65 years, whichever be earlier.

9. It is the duty of the CAG to audit all expenditure from the Consolidated Fund of India or of any State and to ascertain whether the moneys shown in the accounts as having been disbursed were legally available for and applicable to the service or purpose for which they have been applied or charged and whether the expenditure conforms to the authority which governs it. It is also the duty of the CAG to audit all transactions of the Union and the States relating to the Contingency Funds and the Public Accounts.

10. The Act requires the CAG to audit all receipts of the Union and the State Governments and satisfy himself that the rules and procedures in that behalf are designed to secure an effective check on the assessment, collection and proper allocation of revenue and are duly observed and to make for this purpose such examination of the accounts as he thinks fit and report thereon.

11. In regard to the Government-aided bodies, the CAG is required to audit all receipts and expenditure of any body or authority that is substantially financed from the Union or the State revenues. A body or authority is said to be substantially financed from Government revenues if the amount of grant or loan to that body or authority is not less than Rs. 2.5 million in a financial year and also not less than 75 per cent of its total expenditure. With the approval of the President CAG may also undertake audit of a body or authority in case the amount of Government grant or loan is not less than Rs. 10 million. In the case of other Government-aided bodies and authorities it is the duty of the CAG to scrutinize the procedures by which the sanctioning authority satisfies itself as to the fulfillment of the conditions subject to which Government assistance was provided.

12. The CAG shall audit the accounts of statutory corporations established by or under law as per the requirements laid down in the respective legislations. In regard to the Government companies he shall perform his duties and exercise his powers as prescribed in the Companies Act, 1956.

13. The CAG shall audit the accounts of any other authority or body (not otherwise falling within his audit jurisdiction) as the President or the concerned State Governor may request him to do after prior consultation with him; likewise the CAG may *suo moto* propose to the President or the concerned State Governor to authorize him to undertake the audit of accounts of any other authority or body if he is satisfied that such audit is necessary because substantial amounts of Government have been invested in, or advanced to, such an authority or body.

14. The Act authorizes the CAG to inspect any office falling within his jurisdiction, to demand production of accounts, books, papers and other documents which deal with or form the basis of or are otherwise relevant to audit and to put such questions to or make such observations or call for such information as may be necessary.

15. The CAG is also authorized to make regulations for the performance of his duties and determine the scope and extent of audit checks to be applied. The Act empowers the CAG to lay down the general principles of Government accounting for the guidance of the Government Departments and the broad principles in regard to the audit of receipts and expenditure.

16. The Act also provides that the accounts of the Union and the State Governments shall be compiled by the CAG. A series of Presidential Orders relieved the CAG from the duty of compiling the accounts of the Union Government from 1976-77. However, with the exception of the State of Goa the CAG continues to compile the accounts of the State Governments.

### **The Companies Act, 1956**

17. Article 619 of The Companies Act, 1956, specifies the duties and powers of the CAG in relation to Government Companies. A Government Company is defined as any company in which not less than 51 per cent of its paid-up equity is held by Government and includes a company, which is a subsidiary of a Government Company so defined. The Act also prescribes that a company in which not less than 51 per cent of its paid-up equity is held jointly by Government and any other Government Company or by more than one Government Company or by a corporation owned and controlled by Government shall be deemed as a Government Company.

18. Under the Companies Act, the auditor of a Government Company shall be appointed on the advice of the CAG, the CAG is authorized to direct the manner in which the auditor so appointed shall audit the accounts of the company and also to conduct a supplementary or test audit of the company's accounts. The statutory auditor shall submit a copy of his report to the CAG and the CAG has the right to comment upon or supplement the audit report and any such comment shall be placed before the Annual General Meeting of the company.

19. The CAG has set up Audit Board for conducting performance appraisals of Government companies and Corporations comprising a Chairman and four other members; the Chairman and two of the members are officers of the CAG and Government appoints the remaining two members in consultation with and with the concurrence of the CAG. The Audit Board is an internal mechanism for conducting performance appraisal of selected Government companies and Corporations and has no separate or legal status but works under the supervision and guidance of the CAG. The performance appraisal reports are sent to Government who shall cause them to be placed before both Houses of Parliament.

**Salve N.K.P.: Powers and Duties, in National Herald, 22 August 1989**

20. Examining the provisions of the CAG' (Duties, Powers and Conditions of Service) Act, 1971, Salve argues that the audit of expenditure does not include audit of transactions related to the expenditure. While Section 13(b) of the Act authorizes the CAG to audit all transactions relating to the Contingency Fund and the Public Account, Section 13(a) *ibid* authorizes the CAG to audit all expenditure from the Consolidated Fund and to ascertain whether the moneys shown in the accounts as having been disbursed were legally available and applicable for the service or purpose to which they have been applied or charged and whether the expenditure conforms to the authority which governs it. In view of this clear distinction between the scope of audit relating to the Consolidated Fund on the one hand and that to the Contingency Fund and the Public Account on the other, the CAG does not have the authority to audit the transactions related to the Consolidated Fund.

**Murlidhar C. Bhandare: Bofors and the CAG, The Hindustan Times, 11 July 1989**

21. The scope of Audit as defined in the law enacted by Parliament viz, the CAG's (Duties, Powers and Conditions of Service) Act, 1971 is to satisfy the test of legal availability (i.e. whether voted and included in the appropriation); applicability to the service or purpose to which applied and finally whether there is due authority underlying the expenditure. It is not the function of audit to decide whether 'the country is receiving value for its worth'.

**Dharam Vir, Value For Money Audit, Golden Jubilee Commemorative Volume, National Academy of Audit and Accounts, Shimla, 2000**

22. The expression "Audit" has not been defined anywhere in the Constitution of India or the Comptroller and Auditor General's (Duties, Powers and Conditions of Service) Act, 1971. This has left the scope of audit open-ended and thereby enabled public audit to respond to the changes in the pattern of Government activities and expenditure, keep pace with the developments in the profession of audit and match the rising expectations of the stake holders regarding public accountability.

**Laxmi Narayan: Principles and Practice of Public Enterprise Management, S. Chand and Co. Ltd., Delhi, 1980**

23. While there is no specific authority in the CAG's Act for efficiency audit of government companies and corporations, such efficiency audit can be justified on wider considerations. The CAG reports to the Parliament with a view to assisting the evaluation of expenditure voted by it. With a very large increase in the level of developmental expenditure, an expert agency is needed to evaluate the performance of developmental agencies and to ensure that the best use is made of the resources at their disposal. No autonomous agency can be a power unto itself. It has to be accountable to the legislature. As CAG's Audit Reports are meant to help the COPU, which is expected to judge the

efficiency and performance of the public enterprises, one can justify efficiency audit by the CAG.

**Swaroop S.N.: Supreme Audit Institutions in different countries, Ashish Publishing House, New Delhi, 1991**

24. The book describes the audit mandates/laws of the Supreme Audit institutions in 65 countries.

**Government of India, Report of the Joint Committee to enquire into Irregularities in Securities and Banking Transactions, December 1993**

25. Holding that there were grave shortcomings in the present objective and methodology of audit of the public sector banks, the 30-member Committee of both Houses of the Parliament suggested establishment of an independent Central Audit Authority for the consideration of Government. In a separate note annexed to its main report, 13 members of the Committee observed as under:

Any authority as may now be created by the Parliament, or even through constitutional amendment, will take much too long to acquire the historical ethos, rationale, tradition, status, experience, countrywide contact with the community of chartered accountants which has been the unique attribute of the authority of the C&AG of India. Even the statute establishing the Reserve Bank contemplates that the C&AG could be appointed the statutory auditor by the Bank, Somehow it was not done. The facts revealed in the enquiry report underline the need for the same. We also point out that the C&AG is largely concerned with the audit of public enterprises and this further justifies the need for extension and strengthening of the authority of the C&AG by entrusting the audit of public sector banks and financial institutions...The C&AG has the authority to ask for documents not only from the banks under audit but also the related information from the Government and the public sector and facts about inter-linked institutions can be brought forth to ensure accountability to Parliament. The fragmentation will only dilute, through duplicating the existing authority for united audit as enshrined in the Constitution, without lending significance and adequacy as required, to the novel innovation of the proposed centralized authority for audit.

26. In an Annexure to the aforesaid note one of the members of the Committee provided information regarding the audit jurisdiction of the Supreme Audit Institutions over the banking sector in some of the foreign countries like Australia, Canada, Israel, Japan etc. The Annexure also suggested the broad framework of audit of the banking sector by the C&AG.

27. Government did not accept the above suggestion and in an Action Taken Report presented in July 1994 stated that with the Board of Financial Supervision having audit follow up as one of its functions, there was no need for the establishment of a Central Audit Authority.

**Government of India, Fourth Report of the Standing Committee on Finance (1993-94) Tenth Lok Sabha, Ministry of Finance, Banking Division, Working of the Public Sector Banks**

28. The audit of the nationalized banks and other financial institutions, which are Government-owned or Government-controlled, should be brought under the purview of the CAG. The CAG should select and appoint statutory auditors for audit of these institutions and also carry out a supplementary audit through his own officers just as is done in the case of Government companies and other public sector undertakings. This would ensure that a vital component of the economy is not left outside the purview of CAG's jurisdiction.

29. There is no merit in the argument that the CAG's audit is primarily rule-bound and banking activity necessarily involves a measure of discretion. There is also no matter that this would place these institutions at a disadvantage vis a vis the foreign banks.

**Reports of the Comptroller and Auditor General of India**

30. The Audit Reports of the CAG on the Union Government are submitted to the President who shall cause them to be laid before both Houses of the Parliament. In a financial year the CAG may present a number of Audit Reports in separate volumes on the Civil Departments, Indian Railways, Defence Expenditure and Autonomous Bodies.

31. The Audit Reports on the Civil Departments may be presented in several volumes containing the results of accounts and financial audit, transactions audit and performance appraisals.

32. The performance appraisals include the appraisals of the centrally sponsored all-India programmes that are funded by the Union Government but executed by the State Governments with or without their own additional contribution. In the case of these programmes, the field arm offices of the CAG in the States viz; the State Accountants General prepare the performance appraisals on their implementation in their respective States in accordance with the CAG's audit plan. The State appraisals are included in the CAG's Audit Reports on the accounts of the State Governments and submitted to the Governor. A consolidated all-India appraisal is prepared from the State appraisals and included in the CAG's Audit Report on the accounts of the Union Government.

33. Separate Reports are prepared on the audit of direct and indirect tax receipts as well as the scientific departments. The Audit Reports on the Railways and Defence include the results of accounts and financial audit, audit of receipts, audit of transactions as well as performance appraisals.

34. The Audit Report on the autonomous bodies contains the results of audit of transactions and performance appraisals of these bodies. Additionally the CAG issues Separate Audit Reports on the accounts of those bodies the audit of accounts of which falls within his jurisdiction or has otherwise been entrusted to him. The Parliamentary

Committee on Papers laid on the Table of the House has prescribed that the annual reports and audited accounts of the autonomous bodies should be laid before Parliament within nine months after the closing of the accounting year. A statement of the reasons for delay is required to be submitted to the Parliament if the prescribed time schedule is not adhered to.

### **Reports of the Comptroller and Auditor General of India, Union Government (Commercial)**

35. The CAG issues three standard annual reports on the accounts of the Central Government Companies and Corporations to Government, and Government places them before both Houses of Parliament:

- 1) Report No.1 (Commercial) – ‘Review of Accounts’ gives an overall appreciation of the performance of the Companies and Corporations as revealed by their accounts and information obtained in audit;
- 2) Report No.2 (Commercial) – ‘Comments on Accounts’ contains extracts from the important comments of the CAG on the accounts of the Companies and Corporations and a resume of the reports submitted by the statutory auditors (Chartered Accountants) on the audit of the Companies in pursuance of the directions issued by the CAG; this also includes the results of CAG’s supplementary or test audit of the accounts indicating the number of entities, in respect of which comments were issued and the number of entities that revised their accounts following CAG’s observations;
- 3) Report No.3 (Commercial) – ‘Transaction Audit Observations’ contains the observations on individual topics of interest noticed in the course of audit of Companies and Corporations and short reviews on aspects of their working.

36. In addition to the above, the reports of the CAG based on the performance appraisal through the Audit Board are issued to Government as separate reports for being laid before both Houses of Parliament.

### **Synopsis of Audit Reports**

37. The CAG publishes annually a synopsis of the main contents of the Audit Reports titled “What the CAG’s Audit Reports say”.

38. The annual administrative reports of the Ministries carry a summary of important audit observations on their working taken from the most recent Audit Reports; the material for the summary is provided by the CAG’ organization.

### **Activity Report**

39. This is an annual publication of the CAG that outlines the audit activities and highlights the major audit findings during the year of report. It is a comprehensive report of the functioning of the entire organization of the CAG including the impact of audit and

the follow up on Audit Reports. In his foreword to the first report for the year 1984-85 the then CAG had observed as under:

“This is...primarily intended to be in the nature of internal stock-taking and will, I hope, facilitate planning of our future activities leading to a more purposive and qualitative improvement in our working. The report is not meant to be either simply a chronicle of achievements or a dissertation in defence of its shortcomings or inadequacies. It is broadly factual in its orientation and in is in the nature of self-audit so that we ourselves comprehend the limits and possibilities of our task in our quest for improved performance.” (R. K. Chandrasekharan The Comptroller and Auditor General of India Analytical History 1947-1989)

### **Audit Reports in Public Sector: The Institute of Chartered Accountants of India, 2004**

40. This background book covers the role of public sector in economic development, characteristics, control and management of public sector undertakings, audit of PSU's by the professional auditors and by the CAG. The book describes the form and content of the statutory auditor's report and the directions issued by the CAG to the statutory auditors in exercise of the powers vested in him under the Companies Act, 1956.

41. The book gives a bird's eye view of some of the typical comments of the CAG on accounting issues (inventory valuation, revenue recognition, capitalisation of revenue expenditure, contingent liabilities, events occurring after the balance sheet date and before authentication of accounts etc.), Notes on Accounts (wrong/ inadequate disclosures, non-compliance with Government orders, directives etc.). The book also provides an illustrative list of CAG's observations on the reports of the statutory auditors like the failure to comment upon the inadequacy of the effect of Notes on Accounts.

42. Some of the typical examples of comments of the CAG are annexed to the book.

### **Journal of Management and Training**

43. This is published periodically by the CAG's organization. The basic objective of the Journal is to share experiences and ideas amongst the persons working in the CAG's organization in the areas of Management, Auditing and Accounting.

### **Introduction to Government Accounts and Audit, Swamy's Compilation, Swamy Publishers, Chennai and Delhi, 1999**

44. Originally a Government of India publication, the book is a useful primer for introducing the uninitiated to the Indian accounts and audit systems.

### **Audit Advisory Board**

45. The CAG has set up an Audit Advisory Board consisting of eminent persons from different walks of life, which, besides its advisory role, is also expected to provide a degree of oversight on public audit arrangements of CAG's organization.

### **Auditing Standards**

46. Promulgated for the first time by the CAG in 1994 the Auditing Standards prescribe the norms of basic principles and practices which Government Auditors are expected to follow. According to the latest 2002 version, the Auditing Standards consist of four parts: Basic Postulates, General Standards, Field Standards and Reporting Standards. It is one of the Basic Postulates that Government Auditors should comply with the INTOSAI auditing standards in all matters that are deemed material.

### **Audit Manuals**

47. The Auditing Standards are supplemented by the guidelines contained in the CAG's Manual of Standing Orders (Audit) and other Manuals that govern the work in the CAG's organization including on site inspections, raising of objections, preparation, issue and pursuance of inspection reports and preparation, development and pursuance of material for the CAG's Audit Reports and follow up action thereon.

### **Audit Plans and Strategic Plan**

48. CAG's organization prepares a two-year rolling strategic audit plan for the performance of the audit tasks. (Journal of Management and Training, April-September 1999).

49. CAG's Strategic Plan 2002-2008 issued in 2002 sets forth the strategic perception of the organization for the subsequent years over the following: Human Development, Economic Liberalization, Infrastructure Modernization, Technology Upgradation and National Security.

### **Comptroller and Auditor General of India, Performance Auditing Guidelines 2004**

50. These guidelines provide a comprehensive framework for the entire process of performance auditing within the CAG's organization and lay down the implementation standards in relation to such audit.

51. These guidelines prescribe the best practices that the auditors need to follow in planning, implementation, reporting, follow-up processes and quality assurance in all performance audits. The guidelines seek a better participatory role of the auditee organisation at each stage.

52. An important instrument of quality assurance prescribed in these guidelines is the system of peer review and technical supervision review.

**Comptroller and Auditor General of India, Guidelines on Performance Audit of Regulatory Bodies, 2004**

53. These guidelines seek to determine the scope of regulatory audit, listing out the issues to be covered in the audit of a regulatory audit, the audit objective for each identified area and the aspects requiring detailed scrutiny. The principal focus is on the effectiveness with which the regulators carry out their tasks. The central orientation of the guidelines is to ascertain the existence and adequacy of controls and procedures, to be established by these bodies, for attaining the desired objectives followed by compliance testing.

**Asian Organisation of the Supreme Audit Institutions, Audit of Public Works and Projects, 1995**

54. The Chapter on India in this research publication of the Asian Organization of Supreme Audit Institutions mentions the (self-imposed) limitation of the CAG about absolute reliance upon documents to the total exclusion of evidence based upon physical and visual inspections. (A recent innovation is the engagement of private survey organizations for undertaking beneficiary surveys for assessing the effectiveness of developmental programmes).

**Government of India, Ministry of Finance, Standing Guard File on Constitutional and Statutory Provisions relating to CAG and Speedy Settlement of Audit Objections/ Inspection Reports and Timely Disposal of Draft Audit Paragraphs**

55. This compendium issued by the Ministry of Finance contains the orders issued by Government of India from time to time on speedy settlement of audit objections/ inspection reports, timely disposal of draft paras proposed for inclusion in the Audit Reports and the follow up action on the Audit Reports. It also incorporates the constitutional and statutory provisions relating to the CAG; his duties and powers; and timely supply of records, documents and information etc; to Audit authorities.

56. In January 1955 the Ministry of Finance issued instructions that files required by Audit should be readily made available without any apprehension that objections may be taken in audit merely based on contradictions in the views expressed in notes by subordinate officials and higher authorities. Subsequently, in September 1976, the Ministry of Finance informed all Ministries that confidential files containing the views of the Government officers at different levels, Cabinet notes and decisions etc; in the course of formulation of Government policies were excluded from the scope of instructions issued in January 1955. These revised instructions were withdrawn in September 1978 and the status quo ante as per the instructions of January 1955 was restored.

57. It has been explicitly accepted in the Government instructions that it is for the Comptroller and Auditor General of India to decide what documents and information are

needed for the purpose of Audit and reporting as required in Article 151 of the Constitution. Denial of documents and information on grounds of relevancy or otherwise, or delay in furnishing them, will prevent the Comptroller and Auditor General from discharging the functions entrusted to him under the Constitution.

**Appleby Paul H.: Re-examination of India's Administrative System with Special Reference to Government's Commercial and Industrial Enterprises, 1956**

58. The author asks the question: Who audits Audit? More importantly, who examines the Audit Department with a scrutiny more significant than mere auditing?

59. The author also observes that the CAG is today a primary cause of a wide spread and paralyzing cause of unwillingness to act.

**Ramayyar M.S.: Indian Audit and Accounts Department, Indian Institute of Public Administration, 1967**

60. This is a source book that traces the history of State accounts and audit systems in India from ancient times through the East India Company days to the present times. It has wealth of detail relating to the evolution of the Indian Audit and Accounts Department, particularly during the times of the Constitutional changes from the Government of India Act, 1919 onwards.

**Chandrasekharan R.K.: The Comptroller and Auditor General of India, Analytical History 1947-89, Ashish Publishing House, New Delhi, 1990**

61. This four-volume book traces the history and growth of the Supreme Audit Institution of India from 1947 to 1989 including the enactment of the Comptroller and Auditor General's (Duties, Powers and Conditions of Service) Act, 1971 and the departmentalization of Union Government accounts from 1976.

62. The book recalls the convention established since 1966 in regard to the disposal of the CAG's proposals by the Ministry of Finance. Briefly, it has been agreed that any proposal that bears an indication that it has the personal approval of the CAG will be placed before the Finance Minister before it is turned down. A personal discussion between the CAG and the Finance Minister may be arranged if so desired by the CAG. According to the author this convention has suffered considerable erosion with the passage of time and in actual practice the CAG's organization has been treated largely as a subordinate office of the Ministry of Finance in disregard of its special position and mandate. He also recalls the evidence before the Joint Parliamentary Committee at the time of framing of the Comptroller and Auditor General's (Duties, Powers and Conditions of Service) Act:

- *Late Shri A.K. Chanda (CAG, 1954-60):* CAG should be left to make his own budget which the Parliament could consider and finalize after consulting him;

- *Late Shri A.K. Roy (CAG, 1960-66)*: CAG had no means of implementing the powers granted to him since he was completely in the hands of the Ministry of Finance, which came in his audit purview.
- *Late Shri S. Ranganathan (CAG 1966-72)*: He had no difficulty with the Ministry of Finance and the convention had on the whole been working satisfactorily.

63. The book raises a few fundamental issues relating to the grant of legal immunity to the CAG, the administrative and financial powers of the CAG, the adequacy of the existing provisions in the laws for public audit arrangements in relation to the public sector banks and financial institutions and negotiated contracts, the practical difficulties experienced in the accessibility of records, the inadequacy of executive response, the continued arrangement of compilation of accounts of the State Governments by the CAG's organization and the need for certain internal reforms within the CAG's organisation for the effective discharge of its mandate.

64. In his Foreword to the book, T.N. Chaturvedi, the then Comptroller and Auditor General of India, has observed that the CAG is an autonomous constitutional authority, neither an officer of Parliament nor a functionary of Government, and the position assigned to him as a Supreme Audit Authority common to both the Union and the States could be regarded as part of the basic structure of the Constitution of India. According to him it is desirable to have a clear constitutional or legal provision to avoid any action or proceedings against the Comptroller and Auditor General or any other person authorized by him for or in respect of the findings of any audit carried out in exercise or purported exercise of his functions.

65. Chaturvedi also suggests the enlargement of the audit jurisdiction of the CAG to include within its ambit financial institutions, public sector banks and cooperative institutions in order to "enable a more integrated appraisal of the national economy from the stand-point of accountability".

66. He also suggests vesting in the CAG adequate authority to enforce compliance with the statutory provision relating to the production of records for audit.

67. The CAG needs to be authorized to utilize the services of experts, official or non-official, in the performance of audit tasks.

68. Addressing the doubts that are some times raised about the scope of audit, Chaturvedi also makes the point that performance and accountability go together.

**Mookherjee Sameer C.: Role of the Comptroller and Auditor General in Indian Democracy, Ashish Publishing House, New Delhi, 1989**

69. The independence of the CAG as visualized by the founding fathers has been hedged inter alia by the lack of full control over his staff, restraint of the Executive (Ministry of Finance) on his budgetary autonomy and absence of direct access to the Parliament which, in the words of a former Speaker of the Lok Sabha (as recalled by the author)

renders him an “orphan”. The law leaves out a large number of public sector enterprises from the audit jurisdiction of the CAG.

70. The author expresses the view that the absence of any prescribed qualification for the office of the CAG has been a source of apprehension and recalls a statement made by a former CAG before the Parliamentary Joint Select Committee on CAG’s DPC Act that there was a “grave danger of this appointment being turned into a political appointment”. Recalling the debates and discussions in the Constituent Assembly the author suggests that experience as an Accountant General should be prescribed as one of the qualifications for appointment to the Office of the CAG. He also suggests that the advice and consent of the Parliament should be obtained for the appointment.

71. The book suggests the need for revisiting the currently prescribed estoppel on the eligibility of the CAG for further appointment when no such disability exists for the members of the country’s apex judiciary. Another interesting suggestion made in the book relates to the accountability of the CAG’s organization; it has been suggested that the audit of the CAG’s offices maybe conducted under the overall control of the Comptroller and Auditor General of India by a Civil Audit Board which may co-opt on it experts by the Public Accounts Committee of the Parliament.

**Krishan Y: AUDIT in India’s Democracy, Clarion Publishers, New Delhi, 1990**

72. While audit is a pillar of democracy, for various reasons it has remained a weak and ineffective pillar mainly because of the rather indifferent attitude of Government and the legislature to audit findings. Audit works under certain limitations, functional as well as jurisdictional.

73. The auditors have also been responsible for making it a faceless institution making little positive contribution to public life. They have failed to put before the public the work they do in a language easily comprehensible by them nor have they made any effort to tell the public about their activities.

74. The author suggests the creation of a unified civil service that will make auditors good administrators (adequately sensitized to the constraints of administration) and vice versa and till then a more liberal appointment of auditors on administrative jobs on temporary secondment.

75. As regards the CAG’s audit of the Public Sector Undertakings the author makes the point that by virtue of their approach, orientation and position the statutory auditors are incapable of doing justice to the public accountability of these undertakings.

**Tiwari A. C.: Problems of Fiscal Management in the Government, Shipra Publications, Delhi, 1995**

76. The author lists the following areas of concern viz; the lack of response to the CAG’s reports and well-meaning suggestions, the absence of any powers to summon officials to

give evidence, and totally unfounded and sometimes vitriolic attacks not only on the institution of the CAG but also on the incumbent personally against which he has no effective remedy.

**Government of India, Administrative Reforms Commission, Report on Finance Accounts and Audit, 1968**

77. The CAG should be authorized to audit, in his discretion, the accounts of contractors with whom contracts exceeding Rupees 10 million are settled by Government through direct negotiation and not as a result of competitive bidding.

78. The CAG should be authorized to audit the accounts of bodies receiving Government assistance in the shape of substantial investments or grants-in-aid with a view to ascertaining that the funds provided have been used only for the purpose intended.

**Government of India, Report of the Commission on Centre State Relations (The Justice Sarkaria Commission) 1988**

79. The Commission did not favour a suggestion made before it for the creation of independent audit authorities at the State level. According to the Commission the merits of the (present) unified system in terms of uniformity and economy are obvious. There is functionally a close interaction between the Union and the State Governments in fiscal and financial matters. Application of uniform principles and procedures in the maintenance of accounts at the two levels of Government and their supervision by a common independent Constitutional authority, early detection of any irregularities and initiation of timely remedial action are the hallmarks of the system. It will indeed create complications both in administration and understanding if multiplicity of authorities come into being and prescribe their own systems of accounting and procedures. There is also the advantage in the present uniform authority in cost and audit services.

**Efficacy of Public System in India: C&AG - Reforming the Institution, A Consultation Paper Issued by the Constitution Review Commission, January 2001**

80. The Consultation paper issued by the Commission in January 2001 for generating a public debate and eliciting public response, raised the following issues with reference to the institution of the CAG:

- (i) Should the appointment of the CAG be taken out of the exclusive jurisdiction of the executive and a high level independent committee consisting of the Prime Minister, leader of the opposition in the Lok Sabha and Chairman of the PAC be constituted to select him?
- (ii) Should the Audit systems conform to the federal structure and constitutional status and autonomy be given to the State Accountant General and his status be made equivalent to a High Court Judge so that he can effectively discharge his functions?

- (iii) Should the office of the CAG be restructured and broad-based by creating an Audit Commission which should have existing Dy. CAG's enjoying the status of High Court Judge as members and function on the principle of collegiate decisions for all policy matters relating to audit and accounts?
- (iv) Should quasi-judicial powers as available under the Commission of Enquiry Act be given to senior members of the Audit Department who should have the authority to summon public officials to give evidence on oath, surcharge if they find that an official has caused loss of State money and property through fraud, negligence and improper use and if that is not possible to advise the department where he may be working to take disciplinary action against him?
- (v) What should be the audit arrangement for audit of PSU's, which should fulfil the requirements of public accountability without impairing their commercial autonomy?
- (vi) Should constitutional provision be made that all bodies that are publicly funded fall within the ambit of CAG's audit?
- (vii) What should be the accounting and audit arrangements of the Panchayats and Municipalities?
- (viii) Should a time limit, of say 18 months, be prescribed for the PAC to examine the report of the CAG and submit its recommendations? To develop expertise should the life of the PAC be made co-extensive with the term of the legislature, with one third of its members retiring every year? Should Constitutional status be given to PAC with clearly defined duties and responsibilities?
- (ix) What should be the relationship between the Parliament and the CAG? Should the CAG be made an officer of the Parliament as in the United Kingdom?
- (x) What should be the audit arrangements for the audit of the office of the CAG?

**Mathur B.P.: Public Audit: An Agenda for Reform, Public Audit Good Governance and Accountability, The Institute of Public Auditors of India, 2000**

81. The Officers of the Audit Department should have the power of surcharge to enable them to take action against erring officials who may cause loss of State money and property. With a view to bringing about collegiate decision-making, there is need for democratizing the institution of the CAG by setting up an Audit Commission that should have senior functionaries of the Audit Department as members. The State Accountants General should have greater autonomy and enjoy legal status in line with India's federal structure as was originally recommended by the Drafting committee headed by Dr. B. R. Ambedkar when the Constitution was being drafted.

**Hussain Abid: A Background Paper on Some Ideas on Governance, prepared for the National Commission to Review the Working of the Constitution**

82. CAG's Audit Reports have not been treated with the seriousness and sincerity they demand. At times they are treated in a somewhat cavalier fashion.

83. Presentation of the CAG's Reports is understandably time consuming and by the time they appear, the officers indicted for financial malpractices or some other grave lapses

have retired or gone to pastures new and in the process the domain of accountability gets a severe jolt. The constitutional office of the CAG therefore needs some teeth to expeditiously and effectively book individual malefactors and delinquent agencies even if virtually speaking some of them are half lying in grave.

**Dharam Vir, Efficacy of Public Audit System in India, Reforming the institution through empowerment, The Tribune, July 18, 2001**

84. The weakness of the public audit system in India is located in the absence of any powers to enforce adequate and deterrent follow up action on cases of financial malfeasance reported by the CAG. But vesting the Audit Department with power to order the delinquent officials to make good the financial losses caused by their actions is not the solution. It is contrary to the accepted principles of separation of powers that is the bedrock of governance and equity since it vests in a single authority the power to investigate, the power to prosecute and also the power to judge and award punishment.

85. What needs to be considered is the establishment of accountability tribunals for trying cases of financial malfeasance which will have the power to award punishment by way of recovery of financial loss caused in proven cases. Such a tribunal should be a triumvirate comprising experienced persons of proven competence, probity and fair-mindedness drawn one each from the judiciary, public administration and audit.

**Dharam Vir, Efficacy of public audit system, Autonomous Auditors - General not the answer, The Tribune, September 18, 2001**

86. The Union Government audit and State Government audit are inextricably intertwined in India in view of the country's sui generis quasi-federal polity that has been best encapsulated in the textbook adage that India is a federation of States with a unitary bias. The issue needs to be considered in the basic context of the requirements of audit of Union Government revenues collected in and expenditure incurred through the States. Independent State-level Auditors General are not the answer.

**Government of India, Report of the National Commission to Review the Working of the Constitution, 2002**

87. While no change is needed in the existing provisions of the Constitution insofar as the appointment of the CAG and other related matters are concerned, a healthy convention should be developed for consulting the Speaker of the Lok Sabha before the Government decides on the appointment of the CAG so that the views of the PAC are also taken into account.

88. The Commission recommended the introduction of a system of external audit of the CAG's organization to fulfil the canons of accountability.

89. In regard to the proposals mooted before the Commission to confer quasi-judicial powers on audit officers to summon witnesses, to record evidence on oath and to ask the delinquent officials to make good the losses, the Commission observed as under:

“The infirmities and deficiencies of the present system in obtaining precise and accurate information in regard to questions and issues formulated by the audit organization, and subsequent lack of disciplinary action in respect of officials shown to have caused loss of public money, is not so much on account of lack powers of the audit agencies as due to a general atrophy of administrative organizations. Merely providing more legal powers for the present audit functionaries will not restore administrative vitality and vigour needed for prudent and effective implementation of policies in the public realm. This is an issue that is better addressed by administrative reform than by accumulation of legal powers in the hands of authorities that have not used their already existing powers as well as they should have.”

90. In regard to the excessive centralization of authority in the existing organization of the CAG, the Commission recommended the constitution of an Audit Board for the better discharge of the vital function of public audit. The number of members of the Board, the manner of their appointment and removal and other related matters should be dealt with by appropriate legislation, keeping in view the need for ensuring independent functioning of the Board.

91. The Commission also recommended grant of greater authority by the CAG to the State Accountants General, while maintaining its general superintendence, direction and control to bring about a broad uniformity of approach in the sphere of financial discipline. By the same token, the CAG should evolve accounting policies and norms for all bodies and entities that receive public funds, such as autonomous bodies and the Panchayati Raj Institutions.

### **Report of the National Audit Office of the United Kingdom, 2003**

92. According to the Report by far the key strengths of the CAG’s organization are the strong legally independent framework in which it operates and the very effective process of developing a well-respected cadre of senior staff to lead it. There is no question that the organization has made serious contribution to better governance in the country through its audit work. The Report made a series of recommendations for the further improvement of the efficiency and effectiveness of the public audit function.

### **Report of the High Powered Committee on Response of the State Governments to the Audit Reports, 1993**

93. The High Powered Committee appointed by the CAG under the Chairmanship of Shri S. L. Shakder, formerly Secretary General of the Lok Sabha, to review the response of the State Governments to the Audit Reports recommended in its report (1993) that an additional clause may be inserted in the Comptroller and Auditor General’s (Duties, Powers and Conditions of Service) Act, 1971 to the effect that the Government

Departments to whom any matters proposed for inclusion in the CAG's Audit Reports are referred for comments shall, within a specified period time frame, furnish their replies, and the CAG shall take them into account when finalizing the Audit Reports.

**Lakshminaryanan S.: Comptroller and Auditor General's Duties and Powers Act - Need for a Review, The Golden Jubilee Commemorative Volume, National Academy of Audit and Accounts, Shimla, 2000**

94. Definite time limits need to be prescribed in law within which the executive must respond to audit observations and there should be a specific authority in law for conducting value for money audit.

95. Specific provisions need to be made in the Comptroller and Auditor General' (Duties, Powers and Conditions of Service) Act in regard to the audit of Government Companies; this will render the authority for such audit independent of the provisions of the Companies Act and will make CAG's audit of such companies immune to any amendment to the latter.

96. A Central legislation is required for the CAG's audit of the Panchayati Raj Institutions, which is otherwise a State subject.

**Golden Jubilee Commemorative Volume, National Academy of Audit and Accounts, Shimla, 2000**

97. In the Peter Drucker Commemorative Lecture delivered at the Bangalore Chapter of the Institute of Cost and Works Accountants (August 1996) on Changing Emphasis in Audit -- in India and Abroad reproduced in the Golden Jubilee Commemorative Volume of the National Academy of Audit and Accounts, Shimla, Somiah C.G. refers inter alia to the progressive withdrawal of the State from direct economic activity and the creation of regulatory bodies in its wake and the position of audit vis a vis these regulatory bodies. Vijay Kumar examines the issue with reference to the statues governing the establishment of these bodies in his essay on Changing Role and Function of State Audit---The Indian Experience.

98. Oza, B.M. looks at the scope of audit of the regulatory bodies in his essay on Economic Regulation and Audit, also in the same publication.

99. The related issue of the right of audit to access books and records of the private service providers for examining the reasonableness of the pricing of services has been flagged in the 'Overview' to the research project publication on Audit of Public Works and Projects of the Asian Organization of Supreme Audit Institutions.

**Iyer Ramaswamy R.: Curbing Corruption - the Use of Audit in the Golden Jubilee Commemorative Volume, National Academy of Audit and Accounts, Shimla, 2000**

100. Ramaswamy R Iyer examines the role and limitations of audit in detection and pursuance of cases of corruption. He suggests institutional changes in the system of selection for appointment to the office of the CAG through well-defined job specifications and selection criterion and adoption of a more transparent and broad-based selection mechanism, providing statutory powers to the CAG to obtain evidence on oath, prescribing a time limit, say three weeks, within which the Audit Reports must be laid before the legislature and a reorientation in the mindset of auditors that accepts their role as financial and accounting detectives. The auditors must be prepared to accept the need to look beyond the records of departmental authorities and should be willing to network with other organizations like the Central Vigilance Commission and the Central Bureau of Investigations that have been specifically set up to track cases of corruption.

**Dharam Vir, Institution of Government Audit, Enforcing accountability can curb corruption, The Tribune, December 4, 2001**

101. An ally in the battle against corruption whose potential has not been fully comprehended and exploited is the institution of public audit. A legal definition of corruption involves proof of mens re that is not investigated and reported in CAG's Audit reports. But what is finally included in the CAG's Audit Reports is expected to be based on confirmed and proven facts and figures, backed by departmental records, the result of careful examination in CAG's organization and after fullest opportunity has been provided to the departmental authorities to state and explain their position.

102. Unfortunately, the currently available institutions of follow up action on CAG's reports have not proved to be sufficiently effective. There is need for establishment of independent multi-member accountability tribunals comprising mature and experienced persons drawn one each from the administration, audit and the judiciary (chairman) for following up on audit reports.

103. Such tribunals will have full powers to call for departmental records, summon officials and determine the extent of their involvement in and responsibility for acts of financial wrongdoing and award punishment where appropriate. An appeal against the order shall lie only with the Supreme Court.

104. Action-backed enforcement of accountability will not merely reduce waste and misutilization of public funds but also substantially reduce the incidence of corruption.

**Inaugural Address of the Comptroller and Auditor General of India in the XX Conference of the Accountants General, 1999**

105. The increasing tendency of assigning public money to recipients through intermediaries has resulted in a situation where there is very little to see in the affairs of the authorities charged with intermediation and absence of audit in the recipient and

actual users. If funds made available by the Parliament to any institution are to be accounted for, then the Constitutional arrangement for auditing such funds should not be outside the purview of the Constitutional institution set up by the founding fathers for this express purpose.

106. A democratic framework at the village level or in the urban set up is not sufficient to ensure accountability; this requires outside audit. (Journal of Management and Training, April-September 1999)

**Inaugural Address of the Prime Minister on the occasion of the XXII Conference of Accountants General, 2003**

107. There is need for a serious relook at the accountability framework within which the State-owned enterprises (SOE's) and Government officers operate in the context of the growing competition between the SOE's and their private sector counterparts. The system has to empower and trust the executive and there is need for a change in the mindset of auditors.

108. The focus should shift from spending based audit to outputs and outcomes.

109. The lack of adequate follow up on audit is a cause for concern. There should be a comprehensive mechanism within the CAG's organization for the purpose. (Journal of Management and Training, January-September 2003)

**Address of the Finance Minister on the occasion of the inauguration of XXII Conference of Accountants General, 2003**

110. There is need for a paradigm shift in the role of the CAG as a performance appraiser. The performance reporting should be the responsibility of the Government rather than that of the CAG. The responsibility of the CAG could then become the expression of opinion based on his own standards.

111. There is also need for integration of modern techniques of fraud examination in the audit practices. (Journal of Management and Training, January-September 2003)

**India Infrastructure Report 2003, Public Expenditure Allocation and Accountability, Oxford, 2003**

112. Dysfunctional and corrupt bureaucracies tend to emphasize on the procedural (regularity) audit and evolve mechanisms to evade responsibility arising out of value for money audit. The CAG's audits, like any other, are carried out with informational constraints since it is too costly and therefore impossible for any auditor to verify everything, the relevant information for audit is the information at the time of the decision, which may not be available later and the audit observations if they rely too much on hindsight are also likely to be biased.

113. While conceptually at least value for money audit can play an important role in improving the effectiveness or efficiency of public expenditure, for that to happen, the legislature and the public need to enforce accountability on the bureaucracy and unless the interest of the legislature is aligned with that of the public, and the interest of the executive with that of the legislature, it is difficult to achieve such an idealized outcome.

**Ramanathan R.: Executive Perception of Audit, Public Audit, Good Governance and Accountability, Institute of Public Auditors of India, 2000**

114. The executive officers are not indifferent to audit, the impact of audit is positive, the system appraisals are very useful, audit comments are seldom frivolous, though sometimes these are uninformed, audit is useful and necessary and the consequences of abolition of audit would be serious. In system appraisals audit does not give due credit for good performance. The audit reports should be in time to be of use.

**Goel S.L.: Public Financial Administration, Deep and Deep Publications, New Delhi, 2002**

115. The auditors should generate a climate of fearlessness and mutual understanding with the administration and appreciate the circumstances in which a particular decision might have been taken. There is need to develop expertise and specialization amongst the auditors. The audit reports must be timely; audit should be completed within one year of the transaction when the executives can more readily produce the relevant records and also answer audit queries. The auditors should not be hostile to administration.

116. The CAG should keep a watch on the conduct of his staff for the observance of highest standards of personal and professional integrity.

**Ranade M. Y.: Audit: A Window on Government, Public Audit, Good Governance and Accountability, Institute of Public Auditors of India, 2000**

117. Ranade advocates the enlargement of the jurisdiction of audit to all areas where Government has control as distinct from mere financial control. He also raises issues of a structural nature including those relating to the method of selection for appointment to the office of the CAG, the need for a more effective mechanism for follow up on the Audit Reports, and the desirability of creating independent audit authorities at the State level.

**Shunglu V. K.: Reflection on Government Audit, Public Audit, Good Governance and Accountability, Institute of Public Auditors of India, 2000**

118. While the framers of the Constitution provided the lawmaker the flexibility in defining comptrollership function of the CAG through appropriate legislation, the issue was not addressed in the Comptroller and Auditor General's (Duties, Powers and Conditions of service Act) 1971.

119. The Act did not adequately provide for audit of bodies and authorities financed by Government, which are basically instrumentalities of “State” within the judicial interpretation of Article 12 of the Constitution.

120. The inexorable failure of the executive to furnish records with due dispatch frustrates the good intentions of the framers of the Constitution and the Act. The record of the executive to respond to audit observations explaining reasons for their transgressions or conduct has been exceptionally poor.

**Shunglu V. K.: Role of the Comptroller and Auditor General of India in Fifty Years of Indian Administration, Retrospect and Prospects, Indian Institute of Public Administration, New Delhi, 1998**

121. As the CAG takes on sensitive issues of high-level political and bureaucratic corruption and lack of accountability, his organization will be vulnerable to criticism of over-stepping his competence and even of partisan attitude. The standing of the CAG and his influence on administrative structure will be dependent not only on his own initiatives, but also on how the legislature and the executive react on these initiatives.

**Godbole Madhav: Public Accountability and Transparency: The Imperatives of Good Governance, Orient Longman, 2003**

122. There should be greater transparency in the process of selection for appointment to the post of the CAG to dispel the impression that the claims of the more meritorious persons tend to be otherwise ignored. The CAG should be declared an officer of the Parliament; this will enable him to place the Audit Reports directly before the legislature instead of submitting them to the President.

123. The threshold for a Government-aided autonomous body or authority to attract CAG’s audit should be brought down to 50 per cent of its total expenditure from the level of 75 per cent currently prescribed in the Comptroller and Auditor General’s (Duties, Powers and Conditions of Service) Act, 1971.

124. The Central Vigilance Commission and the Central Bureau of Investigations should be directed to indicate in their respective Annual Reports to the Parliament the action taken by them on Audit points that have a vigilance angle.

125. The question of authorizing the CAG to examine executive officers on oath should be considered.

**Asian Organisation of Supreme Audit Institutions, Government Revenues--Accountability and Audit, 1998**

126. The India chapter of this research publication details the impact of external audit of Government revenue receipts by way of (a) additions/deductions in revenue due to cases

of underassessment/overassessment pointed out in audit and (b) legislative or systemic changes brought about as a result of audit study of taxation systems and procedures.

**Attri Ashwani and others: Public Audit in India - Is and Ought, Journal of Management and Training, January- September 2003**

127. The article examines a number of issues relating to the institution of the CAG including the role of audit in curbing corruption, manner of presentation and dissemination of CAG's Audit Reports, arrangements for whistle blowing, empowerment of the CAG to compel production of records and information required for audit, search and seizure powers, penal powers etc. The article also suggests rewriting of the existing provisions in law relating to audit of Government-aided authorities and bodies besides a specific legislation authorizing the CAG to take up audit of the Panchayati Raj Institutions at his discretion.

**Government Auditing, Ashish Publishing House, New Delhi, 1987**

128. This book is a compilation of essays on Public Auditing in India. Part I of the book contains essays on Principles and Role of Government Audit, the essays in Part II deal with Audit Methodology and Techniques while PART III essays cover Government Audit in Selected Areas like Railways, Tax Assessment and Receipts, Government – aided Autonomous Bodies. Besides the then Comptroller and Auditor General of India and a retired CAG the contributors are the Officers of the Indian Audit and Accounts Service.

129. In his Foreword to the book and in his own contribution, the then Comptroller and Auditor General of India, T.N. Chaturvedi has discussed the following main issues:

- (i) The need for a common Supreme Audit Institution for the Union and the State Governments in the backdrop of centralised planning a unitary audit in a federal set up.
- (ii) Delays in supply of information, documents and records to Audit.
- (iii) Delayed executive reaction to audit observations.
- (iv) The need for association of experts with audit.
- (v) The absence of performance indicators, which seriously handicaps perform audit appraisals.
- (vi) The somewhat weaker position of the Indian CAG in the matter of the service conditions of his staff and his administrative powers vis a vis his counterparts in more developed countries and the need for legislative measures to safeguard his independence.
- (vii) The need for a more positive public relations approach on the part of the audit that will help establish identity of purpose between the Supreme Audit Institution and the people at large in securing effective utilization of resources since public opinion is a relentless master in securing effective utilization of resources.

- (viii) The accountability of the Supreme Audit Institution that should focus on its overall performance with the available resources. A perception that the institution is doing too little and too late in enforcing accountability of audited institutions needs to be avoided.
- (ix) The need for having the safeguards that are available in the British law whereby the Auditor General is required to submit his reports to the Speaker of the House of Commons by a specified date and the latter is enjoined to lay such report before the House of Commons forthwith or, if the House is not in session, on the first day of its next session.

130. In his essay on State Audit and Social Development R.C.Suri observes that the two essential requirements for effective social audit are: (a) performance indicators or the quantifiable expression of programme objectives and (b) performance standards for the desired level of achievement. He emphasizes that for every social development programme the executive authorities must state clearly and in quantifiable terms the results that are expected. It is not the function of audit to prescribe the performance indicators.

**Government of India, Lok Sabha Secretariat, Accountability in Administration: Report of the Sub-Committee constituted by the Conference of Chairmen of Public Accounts Committees, held in September 1986 (February 1987)**

131. There could be no difficulty or objection as to why such of those Audit paras which prima facie establish loss of public funds should not be registered as First Information Reports and should not be made the subject-matter of investigations by the concerned Vigilance Officers or the Anti Corruption Bureau and the Central Bureau of Investigations. If necessary, a suitable amendment in the Criminal Procedure Code can also be made so as to obviate the necessity of examining the first informant by drawing a statutory presumption in favour of the correctness of the Audit para.

132. Observing that the present system of reporting, registering, investigating and prosecuting cases for corruption, bribery, misappropriation and breach of trust in relation to public funds is pitifully inadequate, the sub-committee recommended establishment of a special forum that will determine not only the civil, tortious and departmental liability but also criminal liability of the delinquent officials

**Hundred and Thirteenth Report of the Public Accounts Committee (1995-96) Tenth Lok Sabha, Out-of-Turn Allotment of Government Residential Accommodation, Ministry of Urban Affairs and Employment (Department of Urban Development)**

133. This Report, which examined paragraph 9.10 of the CAG's Audit Report for the year ended 31st March, 1994, No.2 of 1995, Union Government (Civil) describes how the Ministry resisted the production of records relating to out-of-turn allotments of Government residential accommodation for audit on the plea that there really was no audit point involved. The Ministry finally agreed to make the relevant records for audit scrutiny only after the CAG took up the matter with the Prime Minister after having

failed to secure access to the records by writing to the Minister. By then, however, the CAG had already finalized his report on the basis of such limited number of records as could be accessed.

134. The PAC expressed its unhappiness over this and recommended that Government should evolve a procedure whereby all Ministries are asked to nominate a nodal officer, preferably the Financial Advisor, who should be made personally responsible to ensure that the documents and information requisitioned by Audit in discharge of their statutory obligations are made available by all concerned within a reasonable time.

**Report of the Comptroller and Auditor General of India for the year ended 31st March, 1999, Union Government (Direct Taxes) No. 12A of 2000**

135. This report, which examined the Voluntary Disclosure of Income Scheme, 1997, points out that notwithstanding a specific provision of the Scheme and the law, the Ministry of Finance did not make available the relevant records for audit on the plea of assessee confidentiality. The Ministry sought the opinion of the Attorney General in the matter. The Ministry finally agreed to CAG audit only after a delay of eight months.

**Bhandari Loveesh: Public Sector Reforms in India; Urgent Need and Hesitant Steps in the Indian State in Transition, National Council of Applied Economic Research, New Delhi, 2001**

136. The author quotes a PSU chief as saying that the system of stringent and repetitive external audit scrutiny of the Public Sector Undertakings has created on the part of the public sector managers an unhealthy degree of defensiveness, an attitude that discourages swift decision making and makes the public sector managers to opt invariably for the safer but timid alternatives. Innumerable CAG allegations of financial impropriety adduced on the basis of rejecting the lowest bid have taught the PSU managers that propriety dominates profitability.

**Mathur K.B.L.: Public Expenditure Management, Japan Bank for International Cooperation, 2001**

137. The CAG audit focuses mainly on financial irregularities and the accountability aspect remains relatively weak despite the existence of an elaborate system of finding faults and irregularities.

138. The effectiveness of audit is impaired since the PAC scrutinizes only some of the reports.

139. The system is not fully equipped to meet with the requirements of meaningful audit of activities/programmes of public expenditure in newly emerging areas of science like nuclear energy, biotechnology etc; because of the complexities and technicalities involved.

### **Government of India, Report of the Eleventh Finance Commission 2000-2005**

140. The CAG should be entrusted with the responsibility of exercising control and supervision over the proper maintenance of accounts and their audit for all the tiers of panchayats and the urban local bodies. The Director, Local Fund Audit or any other agency made responsible for the audit of accounts of the local bodies should work under the technical and administrative supervision of the CAG in the same manner as the Chief Electoral Officer operates under the supervision and control of the Central Election Commission.

141. If the work of the maintenance of accounts of the gram panchayats and intermediate level panchayats is outsourced, the CAG may lay down the qualifications and experience for the outsourced agency.

142. The audit of the local bodies should be entrusted to the CAG. The report of the CAG relating to the audit of the accounts of the Panchayati Raj Institutions and municipalities should be placed before a committee constituted for the purpose on the lines of the Public Accounts Committee.

### **Reserve Bank of India Report of the Advisory Group on Fiscal Transparency, 2001**

143. The report benchmarked the institutions of public financial management and accountability against the IMF Code of Good Practices and Fiscal Transparency (May 2001). According to the assessment of the Advisory Group the requirement that a national audit organization, which is independent of the executive, should provide timely reports on the financial integrity of Governments for the legislators is fully met in India in view of the CAG's reports on the accounts of the Union presented to the Parliament.

### **India; Reducing Poverty, Accelerating Development, A World Bank Country Study, Oxford University Press, 2000**

144. The institution of the CAG has been unable to curb mismanagement of public expenditure. The CAG audit focuses on financial irregularities; the system or performance appraisals fall short of management audits and do not indicate how management can be strengthened. Also physical inspection is rarely undertaken.

145. There is no effective system to establish individual accountability for lapses pointed out by the CAG; the problem stems, in part, from the nature of programme management since individual accountability is not easy to establish under the existing management procedure. Responsibility for lapses and fraud are divided among three offices: the CVC, the CBI and the CAG and there is only limited cooperation between these three offices.

146. The PAC scrutinizes only a few of the CAG's reports and furthermore has tenure of one year only. Besides Action Taken Notes that the Ministries are required to submit, there is no effective system of follow up to ensure corrective management action. Even for Action Taken Notes the responses are delayed or not given.

**Bandopadhyay D.: Policing Public Expenditure, New Tasks and Possibilities, in Economic and Political Weekly, December 16, 2000**

147. CAG's Audit Reports should 'name the names, as that would put pressure on the defaulting organisations to start departmental proceedings against the persons responsible for the financial malfeasance instead of defending them'.

**Government of India, Report of the Fifth Central Pay Commission, January 1997**

148. Audit should reorient itself to look more at the objectives of the programme or action and whether these have been achieved, instead of being unduly concerned with whether the letter of a rule or a procedure has been flouted. Also, audit should try to be as concurrent as possible; scandals and scams are known even while they are being planned and executed.

149. There should be adequate follow up to ensure that disciplinary action is taken against those found guilty. Government departments have also to develop a high degree of sensitivity to comments by audit. The approach should not be to close ranks and rush to the defence of the delinquent official. The systemic defects should be removed and individual lapses punished with the utmost expedition.

**Das S. K. Institutions of Public Accountability, Public Institutions in India Performance and Design edited by Devesh Kapur and Pratap Bhanu Mehta Oxford 2005**

150. The shifting of focus on higher types of audit has adversely affected the conventional expenditure audit function of the CAG. The exclusive reliance on documents and records for the purposes of audit is inconsistent with the prevailing standards of personal integrity and probity and auditors should take recourse to independent investigations beyond the replies provided by the department. The excessive secrecy observed in audit procedures has made the working of the institution a black box and to that extent repugnant to the executive departments.

151. The institution has built up knowledge resources which are commensurate with its tasks but the delays at various stages of the accountability mechanism starting from the audit itself to the follow up on audit reports by the impair its effectiveness. The lack of effectiveness of the institution has largely stemmed from how other institutions have responded to it; the financial committees of the legislature have been negligent in assisting it while the executive departments have done their best to thwart it.

**Government of India, Report of the Economic Administration Reforms Commission on Government and Public Enterprises (L.K.Jha Commission Report 1983-84)**

152. The desirability of a double audit in the case of PSU's (which places them in a disadvantageous position vis a vis the private sector) should be reviewed and they should

be allowed to complete their accounts, get them audited and submit them to the Annual General Meeting of the shareholders in accordance with the same procedures and subject to the same formalities as the private sector.

153. Instead of duplicating the kind of audit that the Chartered Accountants do, the CAG should play a wider, higher and more positive role of preparing comprehensive appraisals once in three years. Such appraisals should go beyond the audit in the usual sense, and should be guided by the kind of approach and orientation that a development bank or a management consultancy organization would bring to the task.

154. The 'audit paragraph' approach that consists of a micro-audit of isolated actions, decisions, judgments etc. should be avoided, as this undermines the confidence and initiative of the executive and promotes evasion of responsibility; any reference to individual cases or actions should be exceptional and should be for illustrative purposes only, as a part of the overall report. (Reports/Recommendations of various Committees on Public Enterprises: A Scope Publication 1990)

**Government of India, Report of the Committee to Review Policy for Public Enterprises (The Arjun Sengupta Committee Report 1986)**

155. The general consensus in the committee was that the performance audit of the CAG should continue. CAG's performance audit reports served a very useful purpose and had generally earned the respect and admiration of the legislators and the discerning public.

156. As regarding supplementary audit of accounts, the committee noted that in the PSU's common accounting policies and accounting standards had not yet evolved, but once the common accounting policies and standards came into being, supplementary audit by the CAG may not be necessary in respect of profitable non-core companies. However, for large enterprises, supplementary audit should continue, but the attention should be focused on major policies. (Reports/Recommendations of various Committees on Public Enterprises: A Scope Publication 1990)

**Tiwari A.C.: Public Sector Accounting and Auditing Standards; Institute of Management and Technology, Ghaziabad IMT Research Series 01**

157. The public sector audit by the CAG has undoubtedly given a very good account of itself. The instances of failures of oversight and negligence have been few and far between. Even so, the CAG has to give a hard look at the role of public sector audit in the context of the changed conditions. In the past the audit comments have tended to be repetitive, the time taken for audit appraisals too long and the audit reports have been hesitant to bring in sharp focus the failures of the management. Equally necessary is the need for change in response to audit by the management and the Government. Both have to be much more responsive than so far.

**Parmeswar R., Relook at the Audit of Public Enterprises in Renewing Governance: Issues and Options, Tata McGraw–Hill Publishing Company Ltd., New Delhi, 1996**

158. When the public Enterprises are crying for a level playing field, the CAG's comments on their accounts could damage their over-all image if not seen in proper perspective. But if there is willingness on the part of Government to give meaningful autonomy to even a few selected companies, it might be possible to get CAG's support for a flexible implementation of super-imposed audit.

159. The selection of entities by the CAG for super-imposed audit may relate to the quality of their accounts, rather than the amount of capital invested. The incorporation of the management replies to audit comments in CAG's Report would enable the reader to view the matter in proper perspective.

160. There is need for a more sophisticated manner of presentation by audit to rate the entities on criteria and weights and values on different aspects of systems that are reviewed by the statutory auditors on directives issued by the CAG.

161. The entities should be judged by their over-all results, and insistence that they should be subjected to general guidelines would be wholly counter-productive. If the entities cease to make demands on Government budget and are able to raise resources for their expansion, these alone should be the test of performance.

**Singh N.K.: Some Basic Issues, in Dynamics of Management of Public Enterprises: A SCOPE publication, 1989**

162. It would be worthwhile to establish a separate organisation that would go into details of performance of the PSU's and an approach of "freedom of decision making but strong post-decision audit" should be exercised. But if such an organisation is established, the concerned Ministries and departments should not undertake the task of audit; the performance of PSU's and the report of such an organisation should be placed before the apex board or the holding company periodically.

**Luxmi Narain, Public Enterprises Autonomy and Management with special reference to Parliament's Committee on Public Sector Undertakings - A Study for the Scope in The Journal of Institute of Public Enterprise, January-March; April-June, 2004**

163. Public enterprises would be greatly benefited if the CAG evaluates their performance in over-all terms through inter-firm, intra-firm and inter-time comparisons. The CAG should be guided by the golden rule prescribed by the Parliament for the COPU, namely to review the working of the public sector undertakings in the context of their autonomy and efficiency and evaluate whether they are operating on sound business principles and prudent commercial practices.

**Interactive Seminar on Audit of PSU's by CAG – An Appreciation December 2003, Kaleidoscope Journal of SCOPE, February 2004.**

164. The PSU's pleaded for a review of the methodology and scope of supplementary or superimposed audit of the PSU's by the CAG in the light of the changed scenario with the advent of economic reforms. There has been a sea change in business environment with several of the PSU's being now listed on the bourses and also having to compete with the private sector. Improved corporate governance has resulted in greater transparency and disclosures in the financial statements.

165. SEBI has prescribed stringent listing requirements including publication of quarterly financial results with limited review, constitution of audit committees with independent directors, and insistence on compliance with accounting standards.

166. The Companies Act has made internal audit system mandatory and there is the Directors' responsibility statement. The Institute of Chartered Accountants has issued a large number of Accounting Standards in line with international best practices and introduced the system of peer review of the work of statutory auditors and the financial reporting review board.

167. The companies are required to publish financial results of the first quarter of the current financial year by 31st July; hence there is need to hold the Annual General Meeting by 30th June and completion of CAG's supplementary audit well before that date.

168. There should be a system of concurrent audit by the CAG before the completion of audit by the statutory auditors so that the necessary compliance/ rectification could be incorporated in the accounts.

169. There is need for a fresh look at the approach to CAG's propriety audit. The focus should be on the adequacy of the systems and due consideration should be given to the aspect of materiality of transaction. Audit should cover both positive and negative aspects and the circumstances prevailing at the time of decision- making should be appreciated. Business risks are inevitable and all decisions cannot be perfect. Any commercial settlement made by the management with the vendors/contractors involving abandonment of some of the claims needs to be viewed in the overall interest of the organization. Due consideration needs to be given to issues that are judgmental in nature and a situation whereby the management becomes judgment/decision/risk shy needs to be avoided.

## Chapter 23

### LEGISLATIVE SCRUTINY

#### The Constitution of India

1. Under Article 151 of the Constitution of India the Reports of the Comptroller and Auditor General of India on the accounts of the Union shall be submitted to the President, who shall cause them to be laid before each House of the Parliament.
2. In terms of Article 118 of the Constitution each House of Parliament may make rules for regulating, subject to the provisions of the Constitution, its procedure and conduct of business.
3. Under Article 115 of the Constitution, any amount spent on any service during a financial year in excess of the amount of the original grant requires regularization by the Parliament.

#### **The Comptroller and Auditor General's (Duties, Powers and Conditions of Service) Act 1971**

4. The reports of the Comptroller and Auditor General of India in relation to the accounts of the Government companies and corporations shall be submitted to the Central Government; and the Central Government shall cause every such report to be laid before each House of the Parliament.

#### **Lok Sabha Secretariat, New Delhi, Rules of Procedure and Conduct of Business in Lok Sabha**

5. The Constituent Assembly (Legislative) Rules of Procedure and Conduct of Business in force immediately before the commencement of the Constitution of India were modified and adopted by the Speaker in exercise of the powers conferred on him under Article 118 (2) of the Constitution and published under the title "Rules of Procedure and Conduct of Business in the House of People" in 1952. The Rules were formally approved by the House in December 1956 under Article 118 (1) of the Constitution and have been amended and revised from time to time. The Committee on Public Accounts (PAC) and the Committee on Public Undertakings (COPU) are established under these Rules. The Reports of the CAG stand automatically remitted to these Committees after being presented to the Parliament.
6. PAC consists of 22 members: 15 members from the Lok Sabha elected according to the principle of proportionate representation and 7 members from the Rajya Sabha nominated

by that House for being associated with the PAC. The PAC examines the CAG's Reports on the accounts of the Union Government. The PAC also examines cases of excess of expenditure beyond the legislatively approved amounts and makes suitable recommendations before the excess amounts can be regularized by the Parliament.

7. *COPU* also consists of 22 members similarly elected. The *COPU* examines the reports and accounts of the public sector undertakings and the reports, if any, of the CAG, on these undertakings. It also examines, in the context of the autonomy and efficiency of the public undertakings, whether the affairs of the undertakings are being managed in accordance with sound business principles and prudent commercial practices.

8. A Minister cannot be a member of either of the Committees. The term of office of the members of the Committees is one year. The Chairman of the Committee is appointed by the Speaker from amongst its members; the Chairman of the PAC is from the Opposition. Both the Committees are assisted by the CAG in their examination of the Audit Reports.

9. Both the Committees are empowered to call for records, documents and information and take oral evidence of the officials. The proceedings of the Committees are not open to the press and the public and the verbatim record of proceedings of the Committee's sittings is, ordinarily, treated as confidential. The Committees may, however, issue press notes of their sittings.

10. A Committee may appoint one or more sub-Committees, each having the powers of the undivided Committee, to examine any matters that may be referred to them, and the reports of the sub-Committee(s) shall be deemed to be the reports of the whole Committee, if they are approved at the sitting of the whole Committee.

11. The Committee's Chairman presents its report to the Parliament; the reports are ordinarily unanimous representing the non-partisan approach of the Committees and these reports are also generally not discussed in the House.

12. The Ministries and the Departments are required to furnish Action Taken Notes on the Reports of the Committees within a period of six months. The Committee may also present Action Taken Reports in the light of the replies received from the Ministries and Departments.

13. In view of the large number of the Audit Reports of the CAG every year, the Committees follow a selective approach for the detailed examination and discussion; the Ministries and Departments are required to furnish *suo moto* Explanatory Notes on the paragraphs not selected for detailed examination within a period of four months from the presentation of the Audit Reports. These Notes are sent to the CAG's organisation for categorization as (a) Accepted; (b) Partially Accepted; and (c) Not Accepted and thereafter circulated to the members of the Committee for deciding further course of action.

14. The Controller General of Accounts in the Ministry of Finance, Department of Expenditure, is the nodal officer responsible for ensuring compliance.

**Kaul M.N. and Shakder S.L.: Practice and Procedure of Parliament; Fifth edition edited by Malhotra G.C., Metropolitan Book Co. Pvt. Ltd., 2001**

15. The book provides an authoritative, comprehensive and exhaustive description of the nature of powers of the Parliament and procedure of the Lok Sabha as laid down in the Constitution, the Rules of Procedure and Conduct of Business in the Lok Sabha and the Directives issued by the Hon'ble Speaker from time to time with authentic case law by way of past decisions and rulings.

16. *Supply of Secret Documents to the Committees:* A document may not be supplied to a Parliamentary Committee on the ground that its disclosure would be prejudicial to the safety or interest of the State; this plea has to be entered only by the Minister himself. In other cases secret documents are made available confidentially to the Chairman in the first instance; the latter gives due consideration to the wishes of the Ministry before making any such document available to the members of the Committee. Any difference of opinion in this regard is settled by reference to the Speaker.

17. *Evidence of Officers of the State Governments:* If an officer of a State Government is required to be examined by a Parliamentary Committee, or if a paper, document or record of a State Government is required to be produced before a Committee, the orders of the Speaker should be obtained.

18. *Rank of witnesses:* Normally the Secretary of the Ministry should appear before the Committee; if for any reason such an officer is not able to appear before the Committee, the Chairman may on request permit any other officer to appear before the Committee on that particular occasion.

19. *Contempt of the House:* The failure of a witness to appear before the Committee amounts to contempt of the House and the Committee may report accordingly to the House.

20. *Evidence of the Minister:* A Minister is not called to appear before the Committee. When a Minister makes a specific request to appear before the Committee, he may be permitted only if the Chairman considers it desirable after he has had a talk with the Minister. The normal practice is that after the deliberations are concluded, the Chairman may, when he considers it necessary, have an informal talk with the Minister in order to apprise the latter of (i) any matter of policy with which the Committee does not agree; and (ii) any matter of secret and confidential nature which the Committee would not like to bring on record in its report.

21. *Evidence of the representatives of private companies:* When the Committee takes up examination of an agreement entered into by Government or the public sector undertaking with a private company or any other non-Government body, the Committee

may summon or give an opportunity to the representatives of the latter to appear before the Committee for evidence.

**Report of the National Commission to Review the Working of the Constitution, 2002**

22. The Commission recommended that a system needs to be evolved whereby the PAC consider all reports and report to the legislature within a time limit of 12 to 18 months, if necessary, by sharing the work with the standing committees of the legislature. The Commission also recommended that the findings of the PAC should be accorded greater weight and the PAC should be treated as the conscience-keeper of the nation in financial matters.

**Financial Committees of Parliament: Journal of Management and Training, IAAD April-December 1997**

23. This article (author not mentioned) provides a broad over-view of the role, functions and procedures of the Committees of Parliament in providing legislative oversight.

**Kaura Dr. Mohinder N.: Administrative and Financial Accountability in India, in Administrative and Financial Accountability, The ASEAN-SAARC Experience, 1994**

24. While the Ministers take decisions, it is the bureaucracy that has been justifying these decisions before the parliamentary committees. However, a new beginning was made in summoning the Ministers to appear before the Joint Parliamentary Committee that probed the Securities Scam in 1993. Thus, the earlier convention of the bureaucrats alone justifying the decisions to the committees, which practice is now dysfunctional, will hopefully be replaced requiring the Ministers to justify their actions.

**Chandrasekharan R.K.: The Comptroller and Auditor General of India, Analytical History 1947-89, Ashish Publishing House, New Delhi, 1990**

25. The PAC had adopted the system of taking oral evidence only in respect of selected paragraphs of the CAG's Audit Reports from 1968. In respect of the remaining paragraphs, which were not selected for oral examination, the Government Departments are required to furnish written replies duly vetted by Audit. In the absence of an effective mechanism to monitor the responsiveness of the Government Departments to paragraphs not selected for oral examination, such paragraphs have been virtually left out in the cold, which, perhaps encouraged the executive to play the game of "wait and see" until the paragraphs died a natural death.

26. The COPU had decided in 1973 to take up for examination even those Public Sector Undertakings (PSU's) that had not featured in the CAG's Audit Reports. However a very large number of CAG's Audit Reports have not been followed up by the COPU for examination and consequently the PSU's that had come in for adverse comment by the

CAG escaped legislative scrutiny. The procedure adopted by the COPU has eroded the system of accountability enshrined in the system of parliamentary control over PSU's and has tended to become discriminatory, which has not only enabled several Chief Executives and their managements to escape any examination by the Committee on CAG's Reports, but also has affected substantially the utility and effectiveness of Audit Reports as tools to enforce accountability by the COPU and the Parliament.

**Krishan Y.: Audit in India's Democracy, Clarion Publishers, New Delhi, 1990**

27. The ineffectiveness of audit is due to the ineffectiveness of the PAC and the COPU. Most members do not take adequate interest in the work of the Committees, sometimes the deliberations are influenced by political considerations, and even the unanimous reports of the Committees do not get implemented. The Committees have not been able to cope with the increasingly large volume of work in the wake of the ever-expanding activities and the ever-increasing volume of expenditure of Government. Since the PAC and the COPU do not consider a very large number of paragraphs of the CAG's Audit Reports, the executive also tends to be casual in its response to audit thereby diminishing its effectiveness.

28. Although the Ministries are required to furnish Action Taken Notes, the Reports (of the PAC) beget Reports on Action Taken, which again beget low level follow up paper work surgically evacuated of all punitive/preventive overtones. The nation takes no lessons, even if takes notice.

29. In the case of the COPU, the combination of the functions of the erstwhile PAC and the Estimates Committee has tended to the COPU devoting uneven and inadequate attention to CAG's Audit Reports. It also does not have the expert assistance of the CAG in the examination of departmental witnesses to the same extent as the PAC has.

**Mookerjee Sameer C.: Role of the Comptroller and Auditor General in Indian Democracy, Ashish Publishing House, New Delhi, 1989**

30. The book traces the history of the evolution of the PAC and the COPU and discusses the relationship of the CAG with the two Committees.

31. An important limitation on the PAC is caused by the timelag between the commission of an irregularity, its detection in audit and its reporting by the PAC.

**Address of the Hon'ble Prime Minister of India at the inaugural function of the XX Conference of Accountants General, 1999**

32. The PAC often found it difficult to go through in detail all the Audit Reports. The PAC could only recommend remedial action to Government but the acceptance and implementation of the recommendations was the prerogative of Government. Consequently the financial control that the legislature is supposed to exercise over the executive is weak.

**Inaugural Address of the Hon'ble Speaker, Lok Sabha, at the Seminar on "Legislature and Audit Interface for Enforcing and Strengthening Accountability Mechanism" July 2005**

33. The procedure of Action Taken Note is largely formal rather than substantive since there is no system of examination of the *suo moto* Action Taken Notes by the PAC. In order to cope with the increasing volume of work the sub-Committees could be empowered to deal with the subjects referred to them by the whole Committee in a cocclusive manner and allowed to record evidence of the executive. The sub Committees could also be constituted depart-wise for major departments like the Railways and Defence. Another suggestion would be to have a separate committee for the Receipt Audit Reports of the CAG.

## **Activity Report**

34. This annual publication of the CAG gives the over-all picture of the total number of paragraphs in the Audit Reports of the CAG, the number of paragraphs selected by the PAC and the COPU for oral examination and discussion and the number of paragraphs actually so discussed. . According to the information given in the CAG's Annual Activity Report for the year 2003-2004 the PAC and the COPU listed only 105 out of 1413 paragraphs of the CAG's Audit Reports for discussion and actually discussed 11 paragraphs.

35. The Activity Report also gives the position of the Action Taken Notes. According to the Activity report *ibid*, Government departments had not furnished Action Taken Notes on 1321 paragraphs.

**Tiwari N.D.: Chairman, PAC, Notes on Agenda of Study Group on PAC's in Commonwealth Parliaments, Venue Toronto, Canada, May 27 - June 1, 2001**

36. Government has implemented 3709 out of the 6112 (nearly 61 per cent) of the PAC recommendations made during 1980 to 1999. Many more recommendations have also been implemented after the PAC reiterated them. Although the PAC does not ordinarily venture into policy matters, its recommendations have served as inputs for policy formulation/revision. A number of amendments to the tax laws have been made in consequence of the PAC's recommendations.

37. However, the PAC recommendations for fastening individual responsibility have not been implemented faithfully. It has become almost tendentious on the part of the bureaucracy to defend even the blatant acts of omission and commission of their predecessors and subordinates on one ground or the other. If the power to punish the officials under question were made external to the department, it would act as a great deterrent.

## **Malhotra G.C.: Public Accounts Committee: Its Role in Ensuring Executive Responsibility, Public Audit, Good Governance and Accountability, Institute of Public Auditors of India, 2000**

38. Out of a total number of 6112 recommendations made by the PAC during the years 1980-1999, Government accepted 3709 recommendations representing 60.68 of the total number. Government also subsequently accepted some of the remaining recommendations after the PAC reiterated them. Thus on an average Government accepts more than three fourths of the recommendations of the PAC. The article also includes a few illustrative cases of the impact of the recommendations of the PAC.

## **Pandey Ashok Kumar: Enforcement of Accountability through Public Accounts Committee, Public Audit, Good Governance and Accountability, Institute of Public Auditors of India, 2000**

39. The main arguments in favour of opening the proceedings of the PAC to the press and the public are that this will ensure greater transparency and that it would put indirect pressure on Audit, Government and the PAC to do a better job. The flip side is that this might introduce political overtones into the working of the PAC undermining the non-partisan and non-political approach that has characterised the working of the PAC. This might also inhibit the departmental officers from expressing their views frankly and freely. Also, subjective reporting and pre-publicity to the conclusions and findings of the PAC might cause damage to the objectivity of the PAC Report.

## **Dharam Vir: Address at the National Institute of Public Finance and Policy, New Delhi, January 1995, reproduced in the Journal of Management and Training April-December 1997**

40. The power of reappropriation of funds between different heads vested in the administrative ministries has led to the erosion of the legislative supremacy over the executive. Legislative supremacy over the executive has also been eroded by the practice of transfer of funds to Public Account without actual incurrence of expenditure.

## **Ayyangar M.Annanthashahanam: Some Thoughts on the Public Accounts Committee, The Public Accounts Committee (Parliament of India) 1921-71, Golden Jubilee Souvenir**

41. The Finance Minister should be called upon to place monthly statements on the Table of the House regarding the status of implementation of PAC recommendations and explain to the House the reasons for the delays, if any, in implementing them. The discussion of PAC Reports in the House will give added support to the recommendations. The CAG should be present in the House when the PAC Reports and the Audit Reports are discussed. (*The PAC Reports were discussed in the House prior to the independence.*)

### **Ranga N. G.: Public Accounts Committee, The Public Accounts Committee (Parliament of India) 1921-71, Golden Jubilee Souvenir**

42. Once in every year Parliament may go into a Committee of the whole House and discuss publicly or in camera such of the points as are placed on the agenda by the Speaker in consultation with the Chairman. The pre-independence practice of printing and publishing the evidence recorded by the PAC should also be restored.

### **Morarka R. R.: PAC - How to Make it More Effective, The Public Accounts Committee (Parliament of India) 1921-71, Golden Jubilee Souvenir**

43. In its 52<sup>nd</sup> Report (Third Lok Sabha) the PAC had recommended that a convention should be developed that if there is any difficulty in implementing a recommendation reiterated by the PAC the matter should be submitted to the Cabinet and its decision communicated to the PAC.

44. In view of the increasing interest taken by the Ministers in executive, as distinguished from policy, matters, when the PAC examines any matter in which the decision has been taken at the level of the Minister, the Minister should be at liberty to appear before the PAC and there should be no bar in making appropriate comments on the role of the Minister.

45. Private persons who may be involved in a transaction should also be summoned for evidence.

### **Government of India, Lok Sabha Secretariat, Accountability in Administration: Report of the Sub-Committee constituted by the Conference of Chairmen of Public Accounts Committees held in September 1986 (February 1987)**

46. There could be no difficulty or objection as to why such of those Audit paras which *prima facie* establish loss of public funds should not be registered as First Information Reports and should not be made the subject –matter of investigations by the concerned Vigilance Officers or the Anti Corruption Bureau and the Central Bureau of

Investigations. If necessary, a suitable amendment in the Criminal Procedure Code can also be made so as to obviate the necessity of examining the first informant by drawing a statutory presumption in favour of the correctness of the Audit para.

47. Observing that the present system of reporting, registering, investigating and prosecuting cases for corruption, bribery, misappropriation and breach of trust in relation to public funds is pitifully inadequate, the sub-committee recommended establishment of a special forum that will determine not only the civil, tortuous and departmental liability but also criminal liability of the delinquent officials.

#### **Fifty-fourth Report of the Public Accounts Committee (2003-2004) Thirteenth Lok Sabha Review of Procurement for OP Vijay**

48. Government did not agree to supply the Report of the Central Vigilance Commission (CVC) to the PAC in the context of examination of the CAG's Audit Report on Review of Procurement for OP Vijay Army on the plea, entered with the approval of the Minister, that the CVC report was "based on 'Secret' and 'Top Secret' documents" and therefore "it would be prejudicial to the interest of the state". The Ministry had offered to show the CVC Report to the Chairman of the PAC. In the circumstances the PAC regretted its inability to give its findings on the defence procurement transactions reported in the CAG's Report.

#### **Sixty Second Report of the Public Accounts Committee (2003-2004) Thirteenth Lok Sabha Ganga Action Plan**

49. In connection with the examination of the CAG's Audit Report on the Ganga Action Plan, co-funded by the Union and the State Governments and executed by the State Governments, the PAC called for the evidence of the Chief Secretaries of the State Governments of Uttaranchal Pradesh, Haryana, Uttar Pradesh, Bihar and West Bengal with due permission of the Hon'ble Speaker. None of the Chief Secretaries appeared before the PAC and only the Secretaries of the concerned departments attended the sittings of the PAC. But in the case of Bihar neither the Chief Secretary nor any other officer of the State Government turned up. The Chief Secretary did not even respond to the queries raised by the PAC. The PAC strongly deplored the attitude of the State Government officials and particularly of Bihar Government and recommended that responsibility should be fixed on the erring officials of the State Government.

#### **Pant U. S.: Budgeting and Public Financial Management in India, Impact Books, New Delhi, 1998**

50. The time lag between occurrence of a transaction, its reporting in audit and its coming up before the PAC has contributed to the erosion of the effectiveness of the PAC. The PAC does not focus attention on individual officers but mainly on systems: this coupled with the rather diffused decision-making system, allows the erring, negligent, inefficient

and corrupt public servants to escape unpunished. The PAC should look into matters of the individual's accountability so that Government as employer of the individuals can fasten individual accountability.

## **Government of India, Report of the Eleventh Finance Commission 2000-2005**

51. Scant follow up of the observations in the CAG's Reports is responsible for not providing the necessary feedback, which could improve the quality of budgeting, and management and control of expenditure.

52. Government should lay down a maximum time limit within which the reports of the CAG are scrutinized by the PAC and examined by the Parliament.

## **Krishnan S.: Have Democratic Processes Failed? Public Expenditure Round Table Chennai, 2002**

53. The Audit Reports of the CAG, despite their rich contents, are seldom taken note of in the discussions on budget in the Parliament. The executive hardly appears to be bothered and the Reports merely gather dust. Also, the extent of examination by the PAC and the COPU is quite inadequate in comparison to the total number of paragraphs in the Audit Reports.

## **Avasthi and Avasthi: Public Administration in India, Lakshmi Narain Agarwal, Agra, 2001**

54. While the PAC findings are of value as guidance and warning, it is not an executive body. It conducts post-mortem examination of the public accounts and its probes relate to transactions completed and to damage done. The regular recurrence and ever-changing pattern of official neglect or default brought to light year after year does suggest that the value of PAC's deliberations is limited.

## **Arora Ramesh K. and Goyal Rajni: Indian Public Administration, Institutions and Issues, Wishwa Prakashan New Delhi.**

55. It is one of the weaknesses of the existing system of legislative oversight that there is no obligation on the part of the executive to adopt the Reports of the Committees. The

investigations of the Committees are also in the nature of post mortem and unless the Committees' Reports focus on the immediate past, the value and effectiveness of the Reports is bound to suffer. Since the Reports are not discussed in the Parliament, a number of important suggestions and recommendations may be glossed over.

56. Whenever the executive does not accept the recommendations of the Committees, these should be discussed in the whole House, but without the matter being put to vote.

**Kashyap Subhash C.: Renewing Parliamentary Polity, Renewing Governance: Issues and Options, Tata McGraw- Hill Publishing Company Ltd., New Delhi, 1996**

57. Since the Reports of the Finance Committees are not discussed on the floor of the House, some very useful recommendations may remain unimplemented. It would be desirable that the Committees Reports are discussed in the Parliament, particularly in cases of disagreement between the Committee and the executive.

58. There should be a Standing Committee of the Parliament on national economy with specific subject-oriented study groups, aided by experts and concerned with policy formulation and implementation. The study groups would make internal study reports to the main Committee, based on operational research, in performance evaluation against physical targets. The Committee would, in turn, make annual reports to Parliament. These reports would provide valuable information to various Ministries and Departments of Government. Also, they would serve the purpose of constant vigilance and constructive appraisal directed to prevent erosion of credibility, plugging of loopholes and strengthening the system as a whole. The Committee's recommendations would help to evolve and better means of monitoring, analyzing and evaluating performance, and implementing policies and prescribing correctives to ensure the better use of available resources. The reports would provide valuable feedback to Parliament and should be discussed by both Houses.

59. The functions of the PAC should be integrated with those of the Standing Committees of the Parliament.

**Luxmi Narain: Public Enterprise Autonomy and Management with special reference to Parliament's Committee on Public Undertakings, The Journal of the Institute of Public Enterprise January-March; April-June 2004**

60. The COPU was originally designed to ensure a broad supervision of the PSU's by the Parliament without interference in their activities and the legislative control was not intended to appear as challenge or hindrance to the initiative of the man at the desk. However, there is widespread perception that at present the COPU greatly relies on the Audit Reports of CAG.

61. It is necessary that the COPU reduce its dependence on the CAG so long as the latter continues with its fault-finding and weakness-targeting approach. There is need to re-iterate the terms of reference of COPU as contained in the Lok Sabha resolution setting up the COPU, namely, that the PSU's have to be judged "in the context of their autonomy and efficiency" and to ensure that they are being managed "in accordance with sound business principles and prudent commercial practices."

**Goel S.L.: Public Financial Management, Deep and Deep Publications, New Delhi, 2002**

62. The CAG is a source of strength as well as weakness to the PAC; the weaknesses of audit limit the performance of the PAC. The irregularities and losses come to the notice of the Parliament quite late; there is scope for expediting the reports of the CAG on which the work of the PAC is based and also the reports of the PAC. Another weakness is that the PAC cannot order recovery of losses; and there is no obligation on the executive to adopt the recommendations of the PAC.

63. The author quotes the following from an address (September 1986) of the then Prime Minister Rajiv Gandhi: "The PAC has been a failure; not that they have not done their job well --- they cannot be accused of this --- but that they have not been able to take the result of their labour to its logical conclusion. Unless Parliament asserts itself and tells the Government to mend its ways in the light of suggestions and proposals from the expert panels, the Estimates committee and the PAC will be reduced to the status of powerless bodies comprised of back-benchers in quest of minor perks of office."

64. The author also quotes from an article (September 1995) by a former CAG T.N.Chaturvedi: "The follow up action on the PAC reports is lackadaisical and evasive. The Government has the support of the ruling party and they consider any criticism to be a fault of the party instead of the administration. Therefore the PAC and the other Parliamentary committees are losing their edge."

65. The author stresses the need to involve the civil society in the process of public accountability; for this the PAC reports should be widely circulated.

## Chapter 24

### ACCESS/RIGHT TO FINANCIAL INFORMATION

#### The Constitution of India

1. Article 19(1) of the Constitution guarantees to all citizens the right to freedom to speech and expression as a fundamental right subject to the restrictions specified in sub-Articles (2) to (6) thereof.

#### **Supreme Court of India, State of Uttar Pradesh vs. Raj Narain AIR1975 SC 865**

2. Examining a claim for privilege for certain documents, the Hon'ble Supreme Court stated, "While there are overwhelming arguments for giving to the executive the power to determine what matters may prejudice the public interest, those arguments give no sanction to giving to the executive exclusive power to determine what matters may prejudice the public interest. Once considerations of national security are left out, there are few matters of public interest which cannot be safely discussed in public...The right to know which is derived from the concept of freedom of speech, though not absolute, is a factor which should make one wary, when secrecy is claimed for transactions, which can, at any rate, have no repercussion on public security...The responsibility of officials to explain or to justify their acts is the chief safeguard against oppression and corruption."

#### **Supreme Court of India, Secretary, Ministry of Information and Broadcasting vs. Cricket Association of Bengal, Supreme Court Cases 1995 (2)**

3. According to the Honourable Supreme Court, the freedom of speech and expression guaranteed by sub-clause (a) of clause (1) of Article 19 of the Constitution of India includes the right to acquire information and to disseminate it... If the people are to perform their role as sovereign and instruct their Government, they must have access to all information, ideas and points of view.

#### **Supreme Court of India, Vineet Narain vs. Union of India, (AIR 1998 SC 889)**

4. The Honourable Supreme Court referred with approval to the recommendations of the U.K. Lord Nolan Committee on Standards in Public Life and commended *inter alia* the principle of openness whereby the holders of public office should be as open as possible about all the decisions and actions they take; they should give reasons for their decisions and restrict information only when the wider public interest clearly demands.

### **United Nations Universal Declaration of Human Rights, 1948**

5. Article 19 of the UN Declaration proclaims that every one has the right to freedom of opinion; this includes freedom to hold opinions without interference and to seek, receive, and impart information and ideas through any media regardless of frontiers. India is a signatory to the Declaration.

### **The Official Secrets Act, 1923**

6. The Act makes it a penal offence for any person holding office under the Government willfully to communicate any official information to any person other than a person to whom he is authorized to communicate it. It is equally an offence for any person to receive such information. The retention of any official document after a person has ceased to have a right to retain it, or when it is contrary to his duty to retain it, is also a penal offence.

### **The Central Civil Services (Conduct) Rules, 1965**

7. In terms of Rule 11 of these Rules, no Central Government servant shall, except in accordance with any general or special order of the Government or in the performance in good faith of the duties assigned to him, communicate, directly or indirectly, any official document or any part thereof, or information to any Government servant or to any other person to whom he is not authorized to communicate such document or information.

8. An analogous Rule exists in the All India Services (Conduct) Rules, 1968 that are applicable to the members of the All India Services, namely, the Indian Administrative Service, the Indian Police Service and the Indian Forest Service. .

### **Maheshwari S.R.: Theories and Concepts in Public Administration, Allied Publishers, New Delhi, 1991**

9. According to Maheshwari the Official Secrets Act, 1923, is ridiculously out of accord with the spirit of independence and the kind of polity established by the Constitution. The underlying spirit of the Act is to let the citizen know as little as possible about the Government's functioning whereas the polity expects that the citizen should have access to the workings of the Government unless withholding of the information is considered to be absolutely essential for purposes of national security or national interest. The denial of information as to how Government functions has the effects of keeping the people alienated from public administration, stifling intelligent criticism of Government and promoting arbitrariness in decision-making.

**Chaturvedi T.N.: Secrecy in Government, Indian Institute of Public Administration, New Delhi, 1980**

10. In the “Preface” to Secrecy in Government, Chaturvedi points out that the Official Secrets Act, 1923, is not directly concerned with openness in Government; it primarily deals with information that needs to be protected from unauthorized disclosure. A reasonable way, in general, to prevent leakage of sensitive information is obviously by proper classification of documents and by strictly enforcing the rule of ‘need to know’ among top civil servants, with the added provision of a regular procedure of declassification of documents, periodically, when they cease to be sensitive any more. Another safeguard can be to devise a system that really works regarding the correctness of classification of information by entrusting this responsibility to a group of ministers who can exercise the necessary political judgment.

**National Commission to Review the Working of the Constitution, A Consultation Paper on Probity in Governance**

11. The Working Paper considered the citizen’s right to information in a wider sense beyond the merely financial information. Referring to the Freedom of Information Bill, 2000, then pending before the Parliament, the Working Paper observed that it would have been better if the Bill also provided for the Government making information public, without a request therefor from anyone.

**Report of the National Commission to Review the Working of the Constitution, 2002**

12. The Commission considered the issue of the citizen’s right to information in a wider sense and recommended that right to information should be guaranteed and needs to be given real substance. In this regard, Government must assume a major responsibility and mobilize skills to ensure flow of information to citizens. The traditional insistence on secrecy must be disregarded. The Commission recommended that there should be an oath of transparency in place of an oath of secrecy. Administration should become transparent and participatory. Right to information can usher in many benefits, such as speedy disposal of cases, minimizing manipulative tactics of the bureaucracy, and, last but most importantly, putting a considerable check on graft and corruption. The Commission recommended that the Union Government should take steps to move the Parliament for early enactment of the Freedom of Information Legislation that was then pending before it.

**Government of India, Ministry of Finance, Report of the Fifth Central Pay Commission, January 1997**

13. According to the Commission, nothing should be held back just to subserve the interests of the individual bureaucrats and politicians. Experience of other countries shows that the process will have to be initiated by passing a Right to Information Act ..... An independent authority will have to be constituted to decide whether a document can be made public or not. In this context, the Commission recommended the creation of

a National Information Authority to be headed by a retired Supreme Court Judge or a retired Chief Justice of a High Court. It should also include independent and eminent persons as its members. The decision of the Authority should be appealable only in the Supreme Court.

14. The existing public relations wings in Government Departments should be converted into Public Relations-cum-Information Wings with their functions enlarged to include dissemination of information to citizens on payment of prescribed fee. Additionally, the Departments should also publish information of general interest and keep copies in their libraries.

15. The Commission also recommended that every significant decision involving a shift in policy should invariably be accompanied by a White Paper in the nature of an explanatory memorandum. Whenever a Government decision brings about any pecuniary benefit to any particular individual, group or company, whether in form of licences, tax relief or award of large contracts, an elaborate press 'communiqué' explaining the origin of the issue, factors taken into account while arriving at the decision and names of the particular groups/individuals that it has benefited should be released within 24 hours of the decision.

#### **International Monetary Fund, Report on the Observance of Standards and Codes (ROSC), India Fiscal Transparency, February 2001**

16. The Report provides an assessment of fiscal transparency practices in relation to the *IMF Code of Good Practices on Fiscal Transparency-Declaration on Principles*. According to the report India has achieved a reasonably high level of fiscal transparency, especially as regards the amount of fiscal information that is made available to the public. Particularly noteworthy is the detailed information that is made available in connection with the budget. A large amount of fiscal information is also made available through the annual reports of the Ministries, the reports of the Reserve Bank of India and the reports of the Comptroller and Auditor General of India. However, there is need for better reporting on general government finances, contingent liabilities (particularly, implicit guarantees) and quasi-fiscal activities and the analysis of fiscal risks. A report on the tax expenditures should also be included in the budget documents.

#### **Reserve Bank of India, Report of the Advisory Group on Fiscal Transparency**

17. The Report benchmarked the fiscal practices in India against the *IMF Code of Good Practices on Fiscal Transparency (May 2001)* and observed that the Indian practice fully complies with the international standards regarding public availability of information for the budget year and also for the preceding years. However, the absence of data on forward projections is a major weakness and an impediment to any effort to assess fiscal sustainability. Information provided on contingent liabilities is inadequate. No information is provided on tax expenditures. Information on quasi-fiscal activities is also not provided. There is no quantification of the fiscal risks to which the budget estimates are subject.

### **The Fiscal Responsibility and Budget Management Act, 2003**

18. According to the Act the Central Government shall take suitable measures to ensure greater transparency in the fiscal operations in the public interest and minimize as far as practicable secrecy in the preparation of annual financial statement (budget) and the demands for grants. Government is mandated under the Act to present the medium term fiscal statement, the fiscal policy strategy statement and the macro-economic policy framework with the budget.

### **The Fiscal Responsibility and Budget Management Rules, 2004**

19. Framed under the Fiscal Responsibility and Budget Management Act, 2003, these Rules prescribe the forms and the contents of the medium term fiscal policy statement, the fiscal policy strategy statement and the macro-economic policy framework mandated under the Act. The Rules also stipulate that, not later than the budget for 2006-2007, the Central Government shall make disclosure of the following with the annual budget:

- (a) Any significant changes in the accounting standards, policies and practices affecting or likely to affect the computation of the prescribed fiscal indicators;
- (b) Statements of receivables and guarantees; and
- (c) A statement of assets both physical and financial.

### **Fiscal Responsibility and Budget Management Act, 2003, and its Implementation Seminar Compendium, National Institute of Financial Management, Faridabad, October 2004**

20. The Seminar discussed *inter alia* the issue of transparency of fiscal practices in the background of the FRBM Act, 2003, and observed that the following would further enhance the level of fiscal transparency:

- The budget or the budget-related documents should include a detailed commentary on each revenue and expenditure programme; non-financial performance data, including performance targets should be incorporated.
- The budget should include medium term perspective; the current year budget proposals should reconcile with the forecasts contained in the earlier fiscal statements and significant deviations should be explained.

- Earmarked revenue and user charges should be clearly accounted for separately even where a particular incentive system provides for retention of some or part of the receipts by the collecting agencies.
- The estimated cost of key tax expenditures should be disclosed.
- Borrowings should be classified by maturity profile of the debts as also whether the debt carries fixed or variable rate of interest and whether it is callable.
- Loans advanced to other entities should be listed by major categories, reflecting the nature, and historical information of defaults should be disclosed.
- Accounting policies and any significant changes therein should be disclosed.

## **Government of India, Ministry of Personnel, Public Grievances and Pensions, Report of the Working Group on Right to Information and Promotion of Open and Transparent Government, 1997**

21. The Working Group was of the view that legislation for freedom of information should be enacted by the Parliament as a Central law in order to ensure uniformity of its application throughout the country. The authority for this was conferred by the last entry in the Union List in the Constitution that reserved the residuary powers with the Union Government.

22. The Working Group also suggested a draft law; governed by the following three broad principles: (a) disclosure of information should be the rule and secrecy the exception; (b) the exceptions should be clearly defined; and (c) there should be an independent mechanism for adjudication of disputes between the citizens and the public authorities. According to the Working Group since the right to information had already received judicial recognition as part of the fundamental right to free speech and expression, the legislation should be appropriately titled as the Freedom of Information Act so as to reflect its true purpose of providing a statutory framework of the said right.

23. The draft model law recommended by the Working Group cast an obligation on the public authorities for *suo moto* disclosure of specified categories of information, providing reasonable assistance to persons requesting for information, waiver of prescribed fees where the disclosure of information is in the larger public interest, the categories of information exempt from its application, the internal review of cases of refusal of information and the entrustment of appellate function to machinery created under the Consumer Protection Act. The provisions of the proposed legislation would over-ride the provisions of any other law.

24. The Working Group also made recommendations for amending the provisions of the Official Secrets Act, the Indian Evidence Act, Government servants' conduct rules and the rules relating to the classification of Government records.

**Government of India, Report of the Committee on Civil Service Reforms, 2004**

25. The Official Secrets Act, 1923, should include only the minimum requirements of national security, public order and individual privacy. Other than items included in a negative list, information on all other items should be placed in the public domain and the burden of proving whether any information not disclosed relates to the negative list should be on the Government.

**Madhav Godbole: Public Accountability and Transparency: The Imperatives of Good Governance, Orient Longman, 2003**

26. Examining the Freedom of Information Bill then pending in the Parliament, Godbole questioned its very title on the ground that it had the effect of watering down the right to information as guaranteed by the Constitution. He also suggests that the law should equally apply to the private sector, registered societies, charitable trusts and other organisations that are registered under any law.

**Government of India, Planning Commission, Draft Approach Paper to the Tenth Five Year Plan (2002-2007), May 2001**

27. Review the Official Secret Act and replace it by a Right to Information Act. The oath of secrecy that every civil servant takes at the time of joining the service should be replaced by an oath of transparency.

**Government of India, Planning Commission, Approach Paper to the Tenth Five Year Plan (2002-2007)**

28. Review the Official Secrets Act, and supplement it by a Right to Information Act. The relevant provisions of the service rules that prevent information from being provided by a Government servant to any ordinary citizen should be deleted, and another rule should be added highlighting the intention of government in favour of transparency and stating that all such information as is generally provided to the legislature should also be provided to a member of the public.

**Government of India, Planning Commission, Tenth Five Year Plan (2002-2007)**

29. To a great extent the task of developmental administration would become easier if steps are taken to make available information, as a matter of right, to the citizens. The right to information has to be a starting point for much of the (governance) reforms. The

right to information is so important because very often people do not even know what programmes and schemes are available and what they are entitled to. Also, policy and procedural reforms can be effective only if people know that such changes have been made. The Right to Information Act must be enacted expeditiously and implemented in letter and spirit.

**PREM Notes, Legislation on freedom of information: trends and standards, The World Bank, October 2004**

30. According to the article, the right to information derives from the Universal Declaration of Human Rights, which states that everyone should enjoy freedom of opinion and expression, including right to seek, receive, and impart information and ideas. There is a growing consensus that the right to information is a crucial element of democratic, accountable and responsive information.

31. The right to information laws provides a range of practical benefits, such as fostering democratic participation, controlling corruption, enhancing accountability and good governance, and promoting efficient information exchange between Government and the public, including businesses. Civil society has a crucial role in triggering the movement for freedom of information.

32. The freedom of information should be based on the principle of maximum disclosure, subject only to narrow exceptions to protect legitimate concerns that should be clearly listed in the legislation. The public bodies should *suo moto* actively disseminate key types of information even in the absence of a request.

33. Three levels of appeals should be available for enforcement of the right freedom of expression, internal machinery, courts and independent administrative bodies. In order to overcome the culture of secrecy, an independent promotional body should be established.

**Article 19, London, The People's Right to Know, Principles on Freedom of Information Legislation, International Standard Series, June 1999**

34. Article 19, London, has developed a set of nine principles against which the right to information laws can be benchmarked:

- (1) *Maximum Disclosure*: Freedom of information legislation should be guided by the principle of maximum disclosure; the right to information should be enshrined in the country's Constitution; where a public authority seeks to deny access to information it should bear the onus of justifying the refusal.
- (2) *Obligation to Publish*: Public bodies should be under an obligation to publish key information such as that relating to its objectives, costs, audited accounts, standards, achievements, the type of information held by the body, the content of any decision or policy affecting the public and so on.
- (3) *Promotion of Open Government*: Public bodies must promote open Government; the law must require that adequate resources and attention are devoted to

- promoting the goals of the legislation through information, education and communication.
- (4) *Limited Scope of Exceptions*: Exceptions should be clearly and narrowly drawn and subject to strict “harm” and “public interest” tests; a refusal to disclose information is not justified unless the public authority can show that the information sought for meets the following strict three-part test viz; (a) the information must relate to a legitimate aim listed in the legislation, (b) the disclosure must threaten to cause substantial harm to that aim and (c) the harm to the aim must be greater than the public interest in having the information.
  - (5) *Processes to Facilitate Access*: Requests for information should be processed rapidly and fairly and an independent review of any refusals should be available.
  - (6) *Costs*: Individuals should not be deterred from making requests for information by excessive costs.
  - (7) *Open Meetings*: Meetings of the public bodies should be open to the public; freedom of information includes the public’s right to know what the Government is doing on its behalf and to participate in the decision-making process; meetings may be closed, but only in accordance with the established procedures and where adequate reasons for closure exist.
  - (8) *Disclosure Takes Precedence*: Laws that are inconsistent with the principle of maximum disclosure should be amended or repealed; the regime of exceptions provided for in the freedom of information law should be comprehensive and other laws should not be permitted to extend it; officers should be protected from sanctions where they have, reasonably, and in good faith, disclosed information pursuant to a freedom of information request.
  - (9) *Protection for Whistleblowers*: Individuals who disclose information on wrongdoing must be protected from any legal, administrative or employment related sanctions for releasing information on wrongdoing.

**Opening Budgets to Public Understanding and Debate, A study of 36 countries by the Centre on Budget Policy and Priorities, Washington, October 2004**

35. According to the study, India scores 59 per cent on Executive Budget Documents (average for all 36 countries: 56 per cent), 30 per cent on Monitoring and Evaluation Reports (average for all 36 countries: 44 per cent) and 37 per cent on Encouraging Public and Legislative Involvement (average for all 36 countries 40 per cent).

**Toby Mendel: Parliament and Access to Information: Working for Transparent Governance, conclusions of a CPA-WBI Study Group on Access to Information, held in partnership with the Parliament of Ghana, 5-9 July 2004 (December 2004)**

36. The main conclusions of the Study Group were as follows:

- The Right to Information legislation should apply to all bodies that carry out public functions, including bodies that provide services under public contracts.
- Public bodies should be required by law to publish and disseminate widely a range of key information; develop publication schemes; and make use of new information technologies for the purpose. Where information has been disclosed pursuant to a request, that information, subject to third party privacy be routinely disclosed.
- Processes should be in place to facilitate the access to information, with definite time limits within which information must be supplied, right of appeal against denial of information requested, and penalties for willful denial and destruction of information. It should be ensured that the costs for information should not be so high as to act as a deterrent to seeking information.
- The right of access to information should be subject to carefully defined narrow exceptions that should be unambiguously listed.
- There should be concerted effort to address the problem of a culture of secrecy including training programmes on the implementation of the access to information regime. Parliamentarians should play a leadership role and set a positive example through their own openness including the openness of the meetings of the Parliamentary committees.
- There should be an independent body, which should be tasked to ensure effective implementation of the Right to Information. The legislature too should play an effective oversight role.

**The Freedom of Information Act, 2002**

37. The Act provided for freedom to every citizen to secure access to information under the control of public authorities, consistent with public interest, in order to promote openness, transparency and accountability in administration. Under the Act, citizen-friendly Public Information Officers were to be appointed to deal with requests for information and render reasonable assistance to any person seeking such information.

Information was to be provided on payment of fee within 30 days of receipt of request. The Act specified the categories of information for suo moto disclosure, categories of information that were exempt from disclosure, the grounds of rejection of requests for information and the right to appeal in the event of rejection. The provisions of the Act were to over-ride the provisions of the Official Secrets' Act 1923.

38. The Act remained un-implemented as Government did not issue the necessary notification for its coming into force.

### **Bharat Dogra: Power Shift: Information Law will Empower Citizen against the State, The Hindu, 15 December 2004**

39. According to Dogra, the Freedom of Information Act, 2002, fundamentally failed to empower the citizen. To be effective, the Right to Information should meet at least three conditions: Provide for an independent appeal mechanism when information is refused; Slap a penalty for supplying wrong information or adopting delaying tactics; and Ensure minimum exemptions. The Freedom of Information Act, 2002, lacked in all these.

## **The Right to Information Bill, 2004**

40. The Bill that was introduced in the Parliament in December 2004 seeks to provide for setting out the practical regime of right of information for people to secure access to information under the control of public authorities, in order to promote transparency and accountability in the working of every public authority and the constitution of a Central Information Commission as the ultimate appellate authority in the event of rejection of a request for information.

41. The Bill goes farther than the Freedom of Information Act, 2000; the right to information is secured not merely for citizens but also to others by virtue of its application to people, the categories of suo moto information are sought to be enlarged, failure to comply with request for information is automatically to be treated as denial and an independent statutory commission is to be established as the appellate authority. The Chief Justice of India will be one of the members of the committee for making recommendations for appointment to the Commission.

42. The Bill restricts the scope of exemptions and contains an omnibus provision that information that cannot be denied to the legislature shall not be denied to any person. The Bill also seeks to protect the right to privacy; information that relates to personal information, the disclosure of which has no relationship to any public interest or which would cause unwarranted invasion of privacy of the individual is exempt from disclosure unless the larger public interest justifies the disclosure of such information. The disclosure of any of the exempted categories may be allowed if public interest in disclosure outweighs the harm to the public authority.

43. The Act would automatically come into effect on the hundred and twentieth day of its enactment.

### **Government of India, Report of the Parliamentary Standing Committee on Personnel Public Grievances and Law and Justice, 2005**

44. The Parliamentary Committee recommended the enlargement of the scope of the proposed Right to Information Law to include bodies owned, controlled and financed by the State Governments, local bodies, and aided NGO's, apart from those that come under the Union Government. The Committee also recommended restriction of the 'exemption list' to information affecting the sovereignty and integrity of the country, relations with other countries, information that the courts have ordered not to disclose, legitimate trade secrets, information about informers or ongoing investigations, private information and cabinet papers.

### **The World Bank, India, Public Access to Financial Information, Background Paper for the Orissa State Financial Accountability Assessment, April 2004**

45. Public access to information is an instrument of accountability; it enhances the effectiveness of institutions like the CAG that are mandated to promote public accountability. Although the principle of citizen's right to information is enshrined in the Constitution and featured in the international conventions the country has signed, in practice the functioning of Government and its agencies is characterized by lack of sufficient transparency and accountability.

46. Public access to financial information can be successfully ensured only when a culture of openness and transparency pervades the Government and its agencies, with the creation of a civil society constituency committed to the application of the transparency laws, and with the commitment of political leadership. It is also necessary that the information management is suitably upgraded for the timely supply of information.

47. The main criteria for reviewing the right to information laws are: clear statement of objectives of the legislation; clear and stringent definition of the exclusions both in terms of the type of information and the excluded institutions; the existence of the principle of severability; independent adjudication mechanism for dispute resolution; provision for sanctions against willful and malafide refusal of information; provision for *suo moto* disclosure; affordable charges for providing information; creation of an institutional advocate for ensuring public access to information; protection for whistle blowers; and periodic supervision by the legislators.

48. The main criteria for reviewing the operating practices are: effective reorientation of public servants attitude; effective implementation of penalties for the prescribed

penalties; efficient information management; promotion of a culture of openness; proactive encouragement of demand for information etc.

49. The Government of India Freedom of Information Act, 2002 did not fully satisfy the aforesaid criteria. It did not prescribe any penalty for deliberate and willful non-supply of information; protection of whistle blowers; creation of independent dispute resolution body and the creation of institutional advocate; the exclusions were large and the private sector was kept outside its purview.

### **The Right to Information Act, 2005**

50. The Act seeks to provide for setting out the practical regime of right of information for people to secure access to information under the control of public authorities, in order to promote transparency and accountability in the working of every public authority and the constitution of a Central Information Commission and State Information Commissions as the appellate authorities in the event of rejection of a request for information. The Act extends to the whole of India, including the States that have their own similar legislations. The Act also applies to any body, owned, controlled, or substantially financed and any non-Government organisation substantially financed directly or indirectly by funds provided by Government.

51. The Act envisages wide-ranging suo moto disclosures of information like the procedure followed in decision-making process including the channels of supervision and accountability, the manner of execution of subsidy programmes, including the amounts allocated and the details of beneficiaries of such programmes, particulars of recipients of concessions, permits or authorizations etc. The Act also makes it obligatory to publish all relevant facts while formulating important policies or announcing the decisions that affect the public.

52. The Act envisages several pro-active measures for facilitating access to information. The fee for providing information shall be prescribed by subordinate legislation, but persons below the poverty line are exempt from payment of fee.

53. The Intelligence and Security Organisations of the Union Government as well as the State Governments are outside the purview of the Act. The Act also specifies the categories of information that may not be disclosed; but any information that cannot be denied to the Parliament or a State legislature shall not be denied to any person. Also, a public authority may allow access to information, if public interest in disclosure outweighs the harm to the protected interests. The principle of severance has also been incorporated in the Act. The Act provides safeguards for protection of information relating to the third parties. The provisions of the Act shall have effect notwithstanding anything inconsistent therewith contained in any of the existing laws like the Official Secrets Act, 1923.

54. The Act prescribes a maximum time limit of 30 days for providing information, with penalties for willful denial of or delay in supply of information. The first representation

lies with the authority superior to the designated Information Officers. Under the Act Central Information Commission and State Information Commission shall be appointed as the independent appellate authorities, with powers of civil courts, for redressal of complaints relating to the denial of information. The members of the Central Commission shall be appointed on the recommendations of a committee comprising the Prime Minister, the leader of the Opposition and a Cabinet Minister to be nominated by the Prime Minister. The composition of the committee for the appointment of members of the State Commission shall be similar with the Chief Minister, the Leader of the Opposition and a Cabinet Minister nominated by the Chief Minister as its members. The members of the Commission will enjoy the privileges and protection available to the members of the Election Commission.

55. In any appellate proceedings the onus to prove that a denial of information was justified shall be on the authority that denied the information. The decision of the Information Commissions is binding.

56. The Act automatically comes into force within 120 days.

**Power to People, The Pioneer, New Delhi, May 16, 2005**

57. In this editorial, the Pioneer advises that Government should inform ordinary people how to use the new law (The Right to Information Act, 2005) to their advantage and with responsibility. The bureaucracy should also be included in this exercise, because unless the culture of transparency pervades all levels of Government, it will be akin to starting from the wrong end.

58. The editorial also expresses the apprehension that Section 8(i)(a) of the Act, which exempts information whose disclosure may prejudicially affect the sovereignty and integrity of India, the security, strategic scientific or economic interests etc; can be misused to block the supply of information.

**Maja Daruwala: Eyes wide shut, The Hindustan Times, New Delhi, May 12, 2005**

59. The absence of provision for the imposition of strong penalties on civil servants who willfully violate the law is one of its weaknesses. The existing provision is much too stringent, and in any case the power to impose penalty does not lie with the appellate authority, but with the departmental officials only.

60. The exclusion of security and intelligence agencies from the scope of the law is fraught with the consequence of allowing these agencies to get away with cases of violation of human rights. The provision relating to the exclusion of cabinet papers is open to abuse. Similarly the provision relating to the exemption of the notes and records of secretaries and other officials is extremely liberal.

**An inch too little, The Hindustan Times, May 13, 2005**

61. This editorial in the Hindustan Times describes the Right to Information Act as a passport for the citizen for unprecedented access to information including inspection of documents and extraction of data. However, there are some grey areas, particularly in the matter of exemptions. While some restrictions on information regarding national security, defence, foreign policy and law enforcement are understandable, these should have been made case-specific rather than putting them categorically out of reach. It is also necessary to ensure that the proposed Central Information Commissions are truly independent bodies.

**Milind Deora: Information, lifeblood of democracy, the Economic Times, New Delhi, May 16, 2005**

62. The Right to Information Act will remove the cynicism associated with governance by holding the transitory (elected representatives) and the permanent (bureaucracy) governments accountable. Propagating the values of the new law is crucial for its success. This can be done by including the subject in the academics at the school stage as well as through the media.

**Welcome right to information, The Economic Times, May 16, 2005**

63. This editorial in the Economic Times argues that the Right to Information Act would make governance more amenable to public control and scrutiny. The new law is an improvement on the Freedom of Information Act, 2002, because the exemptions in the new law are more narrowly defined and an independent authority has been prescribed for adjudication of cases of denial of information. A Duty to Publish Act would complement the Right to Information Act.

**Will Right to Information Act help?, The Economic Times, New Delhi, May 20, 2005**

64. Subrahmanyam K. is of the view that the Right to Information Act may have some impact on local and petty corruption, reduce bureaucratic delays and marginally improve accountability, But big ticket high level corruption cases do not leave any paper trail. In view of this and in view of the prevailing culture of non-accountability, the nation can expect only limited improvement in the quality of governance.

65. Bhattacharya B. is of the view that the requirement in the Act that the information, which cannot be denied to Parliament shall not be denied to any person, is a very positive feature. There are two areas of concern: (a) the law does not provide any remedy for the failure to discharge the obligations relating to suo moto disclosures; and (b) the obligation cast under the Act on the Central Government for propagating the provisions of the Act has been hedged with considerations like the availability of resources.

**Accountability and the right to information, The Hindu, May 14, 2005**

66. According to this editorial in the Hindu, the Right to Information Act goes a long way in putting together a comprehensive mechanism for citizens to secure information under the control of the Government and thereby (as the statement of objects and reasons asserts) promotes “transparency and accountability in the working of every public authority.” An outstanding feature of the law is the provision for the establishment of Information Commissions that are dedicated to encouraging the citizens’ right know and enforcing the provisions of the Act. By empowering these commissions to act as appellate authorities and by vesting them with the powers of a civil court, these bodies have been given the teeth to discourage public authorities from refusing to part with information. However the exclusion of the Chief Justice of India from the selection committee for appointment of Information Commissioners, as provided in the draft bill, has made the selection process somewhat more partisan. Also, the effectiveness of the law will depend on how the Government implements it, both in letter and spirit.

**For Info, Break Seal, The Indian Express, New Delhi, May 13, 2005**

67. The government will have to ensure that its own information systems are in order so that the officials can comply with the requirements of the law. Also, there will have to be a change in the mindset of Government officials; they will have to learn with the new reality that Government has no longer the discretionary power over information. And most importantly they will have to operate on the assumption that they will be held accountable.

**Be Informed, The Times of India, May 13, 2005**

68. The Act provides third parties the right to appeal against the requests for information. By allowing Government agencies to be categorized as the third parties, the law provides scope for collusion between an erring official and the Government bodies to block supply of information. The exclusion of the Chief Justice of India from the committee for the selection of the Information Commissioners has made the process less objective and independent.

**Power to the People, The Economic and Political Weekly, May 21, 2005**

69. The exclusion of the Chief Justice of India from the selection committee, as originally envisaged in the draft bill, has weakened the selection committee for appointment of Information Commissioners. Though various types of information would be made available *suo motu*, the exclusion of information about proposed development projects is unfortunate.

70. If people are to be empowered and governments made answerable, it has to be ensured that offences exposed through the use of RTI laws do not go unpunished. Therefore, there is an urgent need to strengthen the investigative and judicial systems. The government also has to manage its records better, for otherwise it will never be able to meet its obligations under the act. Civil society groups have to function as information clearing houses for the people, helping them to access and demystify government data.

They need to analyze the information accessed and to highlight its significance. They also need to make people aware of the law and its provisions and help them get over their inherent hesitation and apathy, by demonstrating to them that this is one law that can make a difference.

71. As governments and people begin to operate in this new era of transparency, it is inevitable that the culture within and outside the government will change. Within the government, the realization will sink in that in a true participatory democracy the government is constantly, and not just once in five years, answerable to the people, and not merely for its achievements and failures, but for each specific action and process. Among the public, it would create a new sense of empowerment and also a sense of responsibility that, along with the right to participate in governance, they also now have an obligation to do so.

**Narrain Siddarth: Affirming the Right to Know, The Frontline, June 04 –17, 2005**

72. The Right to Information Act has several positive features; e.g. those relating to suo moto disclosures; proactive approach to disclosures; time limit for supply of information; exemption of below the poverty line applicants from payment of fee; institution of external appellate authorities that enjoy high degree of independence; levy of penalty for delay or denial of information. Although the Act lists the categories of information that can be refused, a public authority may allow access to information, if public interest in its disclosure outweighs the harm to the protected interests. If the Government is to be in a position to service requests for information under the Act, it will have to start managing information better and this will in turn help the Government to function better, as officers will begin accessing information in their own offices much faster. Also the members of the Central and State Information Commissions will require careful selection.

**LIST OF PERSONS INTERVIEWED**

1. Mr. D.Swarup Secretary, Expenditure, Ministry of Finance, Government of India, New Delhi (Since retired)
2. Mr. Vijay Chauhan, Director, Ministry of Finance, New Delhi
3. Ms. Usha Thorat, Executive Director Reserve Bank of India, Mumbai
4. Dr. R.K.Pattnaik, Advisor, Reserve bank of India, Mumbai
5. Dr. M. Govinda Rao, Director, National Institute of Public Finance and Policy, New Delhi
6. Dr. S. M. Dewan, Director General, Standing Conference of Public Enterprises, New Delhi
7. Dr. Suman K. Berry, Director General, National Council of Applied Economic Research, New Delhi
8. Dr. R. K. Mishra, Dean, Institute of Public Enterprise, Hyderabad
9. Mr. Lalit Mathur, Director General, National Institute of Rural Development, Hyderabad
10. Mr. A. N. Chatterji, Director, National Institute of Financial Management, Faridabad
11. Dr. S.D. Khan Librarian, National Institute of Financial Management Faridabad
12. Dr. N. G. Satish, Librarian, Administrative Staff College of India, Hyderabad
13. Mr. R. Ashok, Advisor, Railway Board, Ministry of Railways, New Delhi
14. Mr. Ranjan Rao Yerdoor, Credibility Alliance, New Delhi
15. Dr. Mohanty, Centre for Good Governance, Hyderabad
16. Mr. Nand Damija, Professor, Management Development Institute, Gurgaon

**LIST OF LIBRARIES VISITED**

Libraries of the following

1. The National Institute of Financial Management Faridabad
2. The Administrative Staff College of India Hyderabad
3. The Office of the Comptroller and Auditor General of India New Delhi
4. The International Centre for Information Systems and Audit, NOIDA, of the Comptroller and Auditor General of India
5. Director General of Audit Central Revenues, New Delhi
6. The Planning Commission, Government of India, New Delhi
7. The Ministry of Finance New Delhi
8. The Reserve Bank of India Mumbai
9. The Indian Institute of Public Administration New Delhi
10. The National Institute of Public Finance and Policy New Delhi
11. The National Council of Applied Economic Research New Delhi
12. The Institute of Chartered Accountants of India New Delhi
13. The Standing Conference of Public Enterprises New Delhi
14. The Management Development Institute Gurgaon
15. The Advance Level Technical Training Centre Ghaziabad
16. The Institute of Secretariat Training and Management New Delhi
17. The Centre for Good Governance, Government of Rajasthan, Jaipur
18. The Centre for Good Governance, Government of Andhra Pradesh, Hyderabad
19. The National Institute of Rural Development Hyderabad
20. The Institute of Public Enterprise Hyderabad
21. The Centre for Economic and Social Studies Hyderabad
22. The World Bank, India, New Delhi
23. Parliament Library, New Delhi
24. India International Centre, New Delhi

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6. Report of the Constitution Review Commission.
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13. Comptroller and Auditor General of India: Auditing Standards.
14. Fiscal Policy Strategy Statement 2005.
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