**Draft**

70425

# INDIA

# JHARKHAND

## PUBLIC FINANCIAL MANAGEMENT AND ACCOUNTABILITY STUDY

**September, 2007**

Financial Management Unit
India Country Management Unit
South Asia Region

**Document of the World Bank**

## Table of Contents

## Report Team and Acknowledgements

This study has been conducted by the SARFM task team led by Papia Bhattacharya under the overall guidance of Robert J. Saum and P.K. Subramanian. The core team comprised Vinod Sahgal (Consultant SARFM), Subhash Mittal (Consultant SARFM), R. Ramanathan (Consultant SARFM), Joel Turkewitz (SARPS), Mahesh Purohit (Consultant Taxation), Sarabjeet Singh (Consultant SARPS), Peter Trepte (Consultant SARPS), Rajni Khanna (SASPR), Aditi Nayar (SASPR) and Sona Thakur (SAREX).

The study benefited from a range of discussions with several officials of the Government of Jharkhand. In particular, the team thanks Mr. Mukhtyar Singh, Principal Secretary, Finance; Mr. S. Mukhopadhyay, Officer on Special Duty, Finance; Mr. Mukesh P.Singh and Mr. R.K.Verma, Accountants General at the Office of the C&AG of India in Jharkhand; Ms. Alka Tiwari, Commissioner, Commercial Taxes; Mr. Chugh, Development Commissioner; Mr. Burji, Secretary, Planning; Mr. Pandey, Secretary, Health; Ms. Nidhi Khare, Special Secretary, Health; Mr A.K. Singh, Secretary, Rural Development; Mr. Arun Singh, Secretary, Roads Construction; Mr. R.K. Shrivastava, Secretary, Urban Development.

The team thanks peer reviewers, Rahul Sarin (Ex-Principal Secretary, Finance, Jharkhand), B.B. Lal (USAID), Frans Erik Kolls Ronsholt (PEFA Secretariat), Marius Koen (OPCFM), Ismaila B. Ceesay (SARFM), Mohan Nagarajan (SASPR), Yolanda Tayler (SARPS) and Rajiv Sondhi (EAPCO).

Thanks are also due to Justina Parambaloth, Srilatha Shankar Iyer, Girija Sawkar and Vinaya V. Vemuri for providing valuable administrative support, coordination and logistics on an ongoing basis.

The study also draws on the Annual Audit Reports of the CAG of India on Jharkhand and the World Bank report, *Jharkhand: Addressing the Challenges of Inclusive Development* by Rajni Khanna and Binayak Sen. The study is based on a request from the Department of Economic Affairs, Ministry of Finance, Government of India.

For further information on the study, contact Papia Bhattacharya at: pbhattacharya@worldbank.org.

| | | |
|---|---|---|
| Vice President | : | Praful C. Patel |
| Country Director | : | Isabel M. Guerrero |
| Senior Manager, India Program | : | Fayez S. Omar |
| Sector Manager | : | Robert J. Saum |
| Task Team Leader | : | Papia Bhattacharya |

## Abbreviations and Acronyms

| | |
|---|---|
| **AG** | **Accountant General** |
| **AG (A&E)** | **Accountant General (Accounts and Entitlement)** |
| **AP** | **Andhra Pradesh** |
| **BCO** | **Budget Control Officer** |
| **CAG** | **Comptroller and Auditor General** |
| **CAS** | **Country Strategy** |
| **CHC** | **Community Health Centre** |
| **CO** | **Controlling Officer** |
| **CPS** | **Central Plan Schemes** |
| **CPW** | **Central Public Works** |
| **CSS** | **Centrally Sponsored Schemes** |
| **DDO** | **Drawing and Disbursing Officer** |
| **DMIC** | **Debt Management and Investment Cell** |
| **DRDA** | **District Rural Development Agency** |
| **FY** | **Financial Year** |
| **FRBM Act** | **Fiscal Responsibility and Budget Management Act** |
| **GFS** | **Government Finance Statistics** |
| **GoI** | **Government of India** |
| **GoJ** | **Government of Jharkhand** |
| **GSDP** | **Gross Domestic Product** |
| **HoD** | **Head of Department** |
| **IFS** | **Internal Financial Advisor System** |
| **JCCT** | **Joint Commissioner Commercial Taxes** |
| **JSEB** | **Jharkhand State Electricity Board** |
| **MIS** | **Management Information Systems** |
| **MTFRP** | **Medium Term Fiscal Reform Program** |
| **PAC** | **Public Accounts Committees** |
| **PUC** | **Public Undertakings Committee** |
| **PAN** | **Permanent Account Number** |
| **PFM** | **Public Financial Management** |
| **PFMA** | **Public Financial Management and Accountability** |
| **PHC** | **Primary Health Centre** |
| **PPB** | **Program and Performance Budgeting** |
| **PRI** | **Panchayati Raj Institution** |
| **RTI** | **Right to Information** |
| **TIN** | **Tax Identification Number** |
| **USAID** | **United States Agency for International Development** |
| **UC** | **Utilisation Certificate** |
| **VAT** | **Value Added Tax** |

# I. SUMMARY ASSESSMENT

1. The Bank's September 2004 Country Strategy (CAS) puts special emphasis on engagement with four poor States of India where poverty is increasingly concentrated and public institutions are considered to be the weakest. Jharkhand is one of these four States. With one of the highest poverty rates in India and a sharp divide between rural and urban poverty, the Government's biggest challenge is to ensure equitable growth through effective delivery of social benefits. Another key challenge for the Government is providing appropriate infrastructural set-up for attracting private investments. In other words, accelerating growth in this lagging State is likely to be tied to increasing the volume and effectiveness of public spending in social development and creation of infrastructure. With expanding capital budgets, the functioning of systems for spending money in the State acquires extraordinary significance. Infusion of more resources in a weak PFM environment fraught with weaknesses in budgeting, budget execution and oversight procedures, may lead to leakages and inefficient service delivery. It is therefore essential that the State's public financial management (PFM) system is geared up to prevent program leakages and enhance the effectiveness of public spending. Enlarging the absorptive capacity of the State systems will be the key challenge which will require extensive capacity building support.

2. Jharkhand, India's youngest and 28th state came into existence on November 15, 2000. It was carved out of the tribal dominated areas of Bihar. Jharkhand's governance and accountability is marked by a particularly challenging political and administrative environment. The complexities of caste and ideology are further compounded by the interplay between tribal and non-tribal political interests in this resource-rich state. The deeply fractured political reality has manifested itself in repeated fragmented election results where no party gets a clear majority. Many of the institutions of public financial accountability are understandably fragile and only just becoming operational. Panchayati Raj Institutions (PRIs) or rural local governments are not in operation, posing a serious challenge to improving the quality of governance at the rural level. Elections of PRIs announced in 2005, slated to be held after a gap of 27 years, were put on hold by a Court Order because of legal challenges over the state's reservation policy.

3. There are large numbers of job vacancies across the State Government – as much as 40 percent by one estimate. Investment in capacity building of public administration has been modest during these first six years of Jharkhand's existence.

4. The preliminary Public Financial Management and Accountability (PFMA)[1] assessment conducted by the Bank in 2005 alongside the preparation of the Bank's report, *Jharkhand: Addressing the Challenges of Inclusive Development*, acknowledges some areas of improvement in financial management such as the development of performance-based budgets in a few departments, creation of the Centre for Fiscal Studies for conducting analytical studies relating to revenues and expenditure in conjunction with debt management, computerization of treasuries across the state, etc. The preliminary assessment nevertheless suggested that there are several challenges ahead and significant areas of governance and accountability that remain ripe for institutional reforms and capacity building. It emphasized the need to improve internal controls, reporting and oversight arrangements.

This Study uses the PEFA[2] PFM Performance Measurement Framework as a tool for analyzing the effectiveness of the existing PFM system at the State level. The PEFA Framework includes a set of high-level indicators which assesses the performance of PFM systems, processes and institutions over time. The study aims to do an objective analysis based on relevant indicators without assigning any scores against those indicators.

**Overall Findings**

5. The study's overall findings are that both fiduciary and development risks are high. The prevalent PFM environment in the State could be attributed to both lack of capacities as well as absence of demand from the legislature including the government machinery and the wider population to enforce accountability. Under the circumstances, the State Government urgently needs to adopt a two fold strategy – (i) enforce the existing rules and regulations through incentive/disincentive mechanism to improve financial discipline and (ii) undertake capacity building initiatives at all levels of the government including the legislature. Both these initiatives need to move in tandem.

6. Consistent with other States, the Government of Jharkhand (GoJ) has a reasonable framework comprising financial rules, treasury codes, procurement rules and other rules of procedures and related regulations governing PFM. While the overall framework is comprehensive, many of these rules are quite antiquated and need to be revamped.

---

[1] The key elements of a government PFMA system comprises budget preparation and approval; implementation including revenue administration; fund management; expenditure management including procurement; internal controls; accounting and financial reporting; and audit and legislative oversight.

[2] The PEFA is a multi-agency partnership program sponsored by the World Bank, IMF, European Commission, DFID, French Ministry of Foreign Affairs, Swiss State Secretariat of Economic Affairs and Strategic Partnership with Africa. PEFA aims to support integrated and harmonized approaches to assessment and reform in the fields of public expenditure, procurement and financial accountability.

7. The budget formulation process needs to be strengthened. The credibility of the budget is hampered with over-optimistic projections. There is limited capacity at the field level to implement the budget as intended. Non-availability of timely information on progress of expenditure on schemes at the departmental/field level, lack of feedback from the field functionaries and lack of technical expertise for prudent planning results in formulation of unrealistic budget. Similarly revenue estimates lack precision as departments do not employ any quantitative methods of estimation other than percentage growth from earlier periods.

8. Although accounts are prepared on a monthly basis, information is neither adequate nor timely to meet decision making and control purposes. The main challenge in Jharkhand is to improve compliance with rules and regulations and strengthen transparency and accountability. There is an urgent need to improve controls over budget execution, both, in terms of expenditure management including procurement, as well as revenue administration. The internal control framework is weak. Internal audit, as elsewhere in India, is a minor player in the overall system of PFM. Although there is an independent public audit set-up the single biggest problem affecting the impact of the external audit is lack of responsiveness from the executive to audit observations. The situation is compounded by the relative inexperience of the legislative system, particularly with regard to its oversight responsibilities. The system of legislative scrutiny in Jharkhand in very rudimentary, be it scrutiny of the annual budget or post-budget oversight.

9. During the last couple of years, the state has taken some initiatives to enhance fiscal discipline under the United States Agency for International Development (USAID)-assisted REFORM Project. Some of these initiatives include the setting up of the Centre for Fiscal Studies to enhance the capacity of the Finance Department for fiscal planning and analysis, studies on a variety of topics including revenue estimates, tax expenditures, buoyancy and elasticity of sales tax, etc. The State has also enacted the Fiscal Responsibility and Budget Management (FRBM) Act earlier this year. But, the reforms program has so far focused on fiscal management as distinct from financial management of public resources. Under this background the need for substantive improvements in GoJ's PFMA system cannot be overemphasized.

**Key Findings**

10. ***Enhance the demand for accountability through strengthened legislative oversight and greater impact of external audit***

10.1. **Respond to External Audit:** One of the most serious concerns is that despite widespread knowledge of control weaknesses there is limited response from the executive by way of timely remedial actions on the findings of the Comptroller and Auditor General (CAG). The CAG's findings tend to be repetitive year after year as no corrective actions are undertaken to resolve the underlying causes. The

situation is further compounded by the lack of timely follow-up action by the Public Accounts Committee (PAC) and the Public Undertakings Committee (PUC)[3]. There were over 3,700 observations awaiting a response as on March 31, 2006. Audit committees have been set up in 16 departments to assist with the settlement of outstanding observations. But they too have neither been successful in materially reducing the long list of outstanding concerns, nor in taking timely action to recover the detected losses, inordinate outstanding advances and unnecessary over-payments. Greater ongoing personal interaction between senior auditors and senior departmental officers may reduce the communication gap on the seriousness of the audit issues being raised and what is recommended by way of remedial actions. Such interaction could also help in making more constructive recommendations. This apart, an effective system needs to be put in place to establish individual accountability for serious lapses pointed out by the CAG and failure to take remedial measures on a timely basis.

10.2. **Provide more time for effective pre-budget legislative scrutiny:** Legislative scrutiny of the budget before its approval is minimal. The Estimates Committee is not functional; for example, the budget for FY 2007-08 was passed by the Assembly without any debate. There is an immediate need for considering a system of Standing Committees in the Assembly for scrutiny of demand for grants including supplementaries of various departments like the one prevalent in the Government of India (GoI).

10.3. **Enhance post-budget scrutiny:** The oversight committees of the Assembly are ineffective. The PUC is not fully functional. It has held only one meeting since inception. The PAC exists and has been holding meetings since 2004-05. However its impact too has been minimal partly because of the reportedly poor attendance of its members and lack of interest taken by departmental secretaries and partly because of limited research capacity of the committees for study and follow-up. The hearings are held in camera; there is no public or media interface.

10.4. The capacity of this institution of legislative oversight to exact the accountability of the executive is inadequate. Capacity building of the oversight committees, through exposure to best practices and training of members and staff, in research and follow-up methodologies will be beneficial. The most recent reports of the CAG should be given priority and the executive called to account for failure to take remedial measures on a timely basis. Such steps could have a salutary impact on the performance of the PFMA system of Jharkhand. Recognising that enhancing demand for accountability will take time and is a long term option, improving efficiency of service delivery by tightening controls through better enforcement of the existing rules and regulations as indicated below, possibly through various incentive/disincentive mechanisms, may be a possible way forward in the short to medium term.

---

[3] The PUC is the equivalent of the PAC which is responsible for legislative oversight of the Public Sector Undertakings based on CAG's audit report.

11. ***Improve the efficiency of service delivery and impact of development programs through more effective budget execution and monitoring by tightening internal controls***

11.1. **Strengthen departmental MIS for in-year monitoring of budget execution:** A review of the departments of health and rural development revealed that in-year budget reports maintained at the spending unit level are not aggregated to prepare departmental reports for performance monitoring purposes. The situation may be the same in most other departments. The department of finance neither receives monthly statements of expenditure from the departments to facilitate in-year budgetary correction nor do they have the capacity, in terms of staff strength, to undertake such monitoring.

11.2. **Improve controls over budget execution and improve compliance with financial rules:** Budgetary control over spending units is weakened by a lack of regular in-year monitoring of expenditure by Controlling Officers (CO).[4] Control over the system of procurement is also weak. Financial controls are not operated as intended and incidences of non-compliance with established rules are pervasive. For example, an immediate concern of the state is with regard to numerous bank accounts reportedly opened by several departments at various levels (district, block, etc) without necessary permissions, and funds withdrawn from the Consolidated Fund parked in such accounts. The Government does not have a reliable estimate of the magnitude of this irregularity. The Accountant General, Accounts & Entitlement, (AG,A&E) is in the process of assessing the amount involved. Also there is a very large incidence of withdrawal of advances through Abstract Contingency Bills (AC Bills)[5] that remain un-cleared for extended periods of time. During 2005-06 Rs. 10.7 billion was drawn as advances against which no settlement had been submitted till October 2006. In addition Rs. 11.7 billion is outstanding from 2004-05 and Rs. 3.6 billion pending for 2003-04. Such weaknesses enhance the risk of sub-optimal program outputs at the point of delivery in the implementation of programs.

11.3. **Reconcile monthly accounts regularly:** Reconciliation of accounts between the records of the AG (A&E) and those of the line departments are not undertaken regularly. According to the external auditors out of approximately 10, 000 Drawing and Disbursing Officers (DDOs),[6] an average of 1500 do not reconcile their accounts every year. The cumulative amount involved amounts to Rs. 230.8 billion as on March 31, 2006. At stake is the reliability of the State's accounts –

---

[4] Controlling Officers are budget control officers in respect of the budget placed at their disposal.

[5] AC Bills (Abstract Contingency Bills) represent payments drawn from the treasury without any details/supporting vouchers. These are accounted for as expenditure.

[6] Officers nominated by the head of office to discharge the functions of drawing cheques/cash from the treasury and make disbursements.

monthly and annual -- as well as the accuracy and completeness of internal departmental records.

11.4. **Introduce systems-based independent internal audit:** Internal audit activities are being conducted by the staff of the department of finance. Audits are mostly transaction based with focus on routine compliance with financial rules. The main objective is to recover funds where irregularities can be attributed to individuals. There is no systems based auditing of the state's delivery mechanisms. Internal auditors lack professional skills to assess the effectiveness of controls and make recommendations to senior management for improving the effectiveness of financial management systems. The function is not independent of the finance function. As elsewhere in India, internal audit is a minor player in the overall system of Jharkhand's PFM.

12. ***Provide greater transparency through more access to information on budget preparation and execution process across the Government, Public Sector Agencies and Autonomous Bodies***

12.1. **Provide public access to information *suo moto*:** Existing disclosure practices have not been sufficiently conducive to greater openness. The procedures for providing public access to essential information are being established in line with the requirements of the Right to Information (RTI) Act (2005) and training of staff in this relatively new area is under consideration.

12.2. The State needs to ensure timely disclosure of *suo moto* information as required under the RTI Act in a user friendly manner. Transparency would enhance the Government's own monitoring of the implementation of development activities undertaken by public bodies across the state. This would also concurrently help reduce the administrative burden relating to the supply of information on individual request-by-request basis. Specific areas where greater transparency would be helpful include: a) resources budgeted for and made available to primary service units; b) in-year budget execution reports prepared by departments and agencies of the state including timely publication of departmental monthly accounts; c) major contracts awarded; and d) minutes of proceedings of the PAC and the PUC respectively.

12.3. **Disclose the reasons for the repeated high level of "savings" and "excesses" in voted expenditures:** There is a large number of grants persistently experiencing significant "savings" of expenditure relative to the budget. The reasons for most of these are not disclosed in the annual accounts. Even more serious, approximately Rs. 58.76 billion of "excess" expenditure incurred on various grants since 2002/03 have not so far been regularized by the State Assembly. A very significant portion of recent "excess" relates to the power sector.

12.4. **Disclose response to audit paragraphs:** The Government's response to audit observations made by the CAG of India are not provided in time for publication in the annual audit reports of the CAG. This omission on the part of the executive

undermines the efforts of the CAG to contribute more effectively to the accountability of the use of funds and the state's overall operating performance.

13. ***Improve fiscal management and formalize a multi- year perspective to planning and priority setting***

13.1. **Draw up a Mid-Term Fiscal Program to move towards FRBM Act Targets:** A multi-year perspective in fiscal planning, expenditure policy and budgeting is on the anvil. The Jharkhand FRBM Act passed in April 2007 is a call for introducing a medium-term fiscal framework which requires forward estimates of fiscal aggregates on a rolling basis and targets for reducing the state's deficits quite substantially by March 31, 2009. There is an opportunity here for bringing together budgeting for investment and recurrent expenditures with more rigorous cost estimates factored into the decision making processes

13.2. **Improve tax administration**: There is an urgent need for improving resource mobilization. The GoJ has taken the first step in this direction through implementation of the Value Added Tax (VAT) from April 2006 onwards. While this is expected to lead to an increase in tax revenues, a lot will depend on how well it is administered. Effectiveness in collection of tax payments needs improvement by strict compliance and enforcement procedures. The incidence of repeated irregularities relating to sales tax, land revenue, excise, tax on vehicles, etc appears to be excessive. Shortages of Rs. 14.23 billion in 24,000 cases were detected by audit in 2005-06. Departmental audit committees need to meet more regularly, address the systemic cause(s) for such large numbers of irregularities and suggest ways to prevent leakages in revenue receipts.

13.3. **Add credibility to the budget:** Variations range from 0.3% to 21% between budgets and actuals relating to fiscal deficits during the last three fiscal years. Budget estimates of line departments for expenditure are often overstated because of incomplete information from the field on actual expenditure and the forecasts of revenue are not always backed with sufficient analytical support. Besides, as elsewhere, the budget is seen to be a document that needs to meet political imperatives.

13.4. There are a large number of cases where funds have not been spent as provided: 49 out of 52 grants have shown "savings" in FY 2005-06. Both capital and revenue expenditure are often below the target. In a large number of grants, supplementary demands were sought although there was no need for seeking such additional funds.

13.5. These weaknesses raise a more fundamental question regarding not only the capacity of the state for prudent financial management but also the adequacy of human and technical resources for program implementation. There are perennial shortages of technical skills that need to be addressed.

13.6. The state's initiative in introducing Program and Performance Budgeting (PPB) under the USAID- assisted REFORM[7] Project is a step in the right direction. Currently 10-12 departments are implementing the same. This needs to be integrated with the main budget-making/reporting procedures of the GoJ.

14. ***Strengthen the department of finance and create a finance and accounts cadre for the state***

14.1. The department of finance does not have the strength in either numbers or professional skills to lead the financial management and control function. There is at present no dedicated cadre for supporting the professional development of financial officers in the departments and agencies of the Government. The State does not have an established finance and accounts service.

14.2. The State has an Internal Financial Advisor System (IFS) under which every line department has a Financial Advisor (IFA) generally drawn from the state/central civil service. No specific training is provided to them to handle this specialized job. The officers therefore do not have the right orientation to help the heads of department (HoDs) in taking appropriate financial decisions. This situation is compounded by the comparative inexperience of the state's legislative system particularly in the context of oversight responsibilities associated with budget approval and execution.

14.3. The state also needs to build up a faculty with technical expertise either in-house or outsourced for imparting training and upgrading skills of officers/staff posted in the treasury, internal audit and commercial taxes functions, or as IFAs, etc.

[7] USAID- aided Technical Assistance Project for reforms in PFM.

# II. MAIN REPORT

## Background

1. Jharkhand, India's youngest and 28th State came into existence in November 2000 pursuant to the reorganization of the erstwhile State of Bihar by the Bihar State Reorganization Act, 2000. More than 77 percent of the population of the state resides in rural areas and depends on agriculture for sustenance. Jharkhand is one of the richest states in the country in terms of mineral resources. Close to half of the gross domestic product (GSDP) of the state emanates from industry which includes mining, quarrying and registered manufacturing. But the high degree of industrialization has not resulted in a high level of income for the state. While the structure of the output indicates a high level of industrialization, the structure of employment reveals the predominance of agriculture.

2. Jharkhand was plagued by adverse initial conditions -- low average income, very high incidence of poverty, and inadequate social development. Although the state has made considerable progress in reducing poverty since the early nineties, it still remains a state with one of the highest poverty rates in India, with a sharp contrast between rural and urban poverty. More than half of Jharkhand's land area is designated as tribal land and is protected under the 5th schedule of the Constitution. The state's key social indicators such as literacy, school enrolment, infant mortality and child nutrition are well below the all-India average.

3. The financial position of the state has been progressively under strain. Although the state's revenues are rising steadily, the fiscal deficit of the state has been increasing at an alarming rate, from Rs. 22.2 billion in FY 2005 to Rs. 56 billion in FY 2006. While revenue expenditure and capital outlay are growing at a steady pace, loans and advances, mainly loans to the power sector, have jumped drastically in 2005-06 leading to a spike in the fiscal deficit. The debt stock is continuing to rise and has grown from Rs. 129.2 billion in FY 2005 to Rs. 163.5 billion in FY 2006 – an increase of 27 percent over the previous year. The passage of the FRBM Act in April 2007 will provide an institutional framework and bind the Government to prudent fiscal policies. This legislation is aimed at institutionalizing a medium-term fiscal framework and encourages the imposition of a defined time-frame for a gradual reduction in the Government's fiscal and revenue deficits.

## PFMA Legal and Institutional Framework

4. As in other states of India, the legal and institutional framework for PFM in Jharkhand is laid down by the Indian Constitution. The Constitution provides for an oversight role of the legislature over public finances and a broad mandate for the CAG. The legislative procedure to be followed in financial matters in the

State Legislature (Legislative Assembly) is laid down in Articles 196 to 207 of the Indian Constitution. These are, *inter alia*, definition of money bill, presentation of annual financial statement (budget) showing estimates of receipts and expenditure of the state separately on revenue account and other expenditure (capital expenditure) to be further bifurcated into voted and charged portions, submission of demands for grants, passing of the Appropriation Bill including supplementaries,[8] excess grants and vote on account. The Appropriation Bill, when assented to by the Governor, becomes the Appropriation Act and authorizes the executive to draw money from the Consolidated Fund of the state. Similarly, the Finance Bill (i.e. the bill containing only provisions for taxation/modification additions/alterations to the existing taxation laws), when assented to by the Governor, becomes the Finance Act and authorizes the executive to levy the taxes. These provisions are to be followed in letter and spirit by every State Government in India and form part of "legislative oversight".

5. Being a part of the erstwhile State of Bihar, the state has adopted the Bihar Budget Manual, Treasury Rules and Financial Rules of the composite State of Bihar. In-year budget execution reports or monthly accounts are compiled by the AG (A&E). Annual finance and appropriation accounts are audited and certified by the CAG and placed in the Assembly. Jharkhand has a uni-cameral legislature. Article 208 of the Indian Constitution provides that a House of the Legislature of a State may make rules for regulating its procedure and the conduct of its business, subject to the provisions of the Constitution.

6. The Jharkhand State Legislature has adopted "The Jharkhand Legislative Assembly Rules" effective from September 2001 that lays down the rules of business proceedings of the Legislative Assembly. These rules provide for the composition of the Estimate Committee and the PAC, the former for deciding the format and contents of the budget documents and the latter for examining the reports of the CAG of India on the accounts of the state and the appropriation and finance accounts as certified by the CAG of India. A PUC has also been constituted to consider the reports of the CAG of India on the accounts of the Government companies (five), State corporations (one) and State autonomous body (one). The State Legislature has not so far enacted any law to constitute "Departmentally Related Standing Committees" to enable examination of the demands for grants of departments by the elected representatives and offer suggestions on the programs, modification in the allocation of funds and on the functioning of the departments. The line departments do not prepare and place before the legislature the "annual reports" containing information on their functions and activities/achievements on the lines prevalent in the GoI. Therefore, legislative oversight is restricted to discussion of the budget proposals and supplementaries by the "House Business Committee".

[8] In-year budget requests.

7. In 2005 the Bank conducted a preliminary assessment of the PFM system of the state as part of the preparation of the Bank's Report *Jharkhand: Addressing the Challenges of Inclusive Development.* The main findings of this preliminary assessment were:

- Being a newly formed state, though its initial financial position compared favourably with other Indian states, there were already some disturbing trends in its fiscal balances. Moreover, the distribution of assets and liabilities of the composite state of Bihar between the successor states of Bihar and Jharkhand was not completed and the impact thereof on Jharkhand's financial position was not clear.
- The GoJ has inherited from Bihar a standard set of general financial rules, treasury codes, budget manual, and other rules/manuals/codes of procedures and related regulations governing the PFMA system. However many of these documents date back to the late forties or fifties. There is an urgent need for a comprehensive examination and revision of these rules/manuals/codes/instructions.
- The state does not have an established finance and accounts service. The State has an Internal Financial Advisor System (IFS) under which, every line department has an IFA generally drawn from the state/central civil service. No specific training is provided to them to handle this specialized job. The officers therefore do not have the right orientation to help the HoDs in taking appropriate financial decisions.
- There was no directorate of treasuries in Jharkhand and the administrative as well as the functional control of treasuries lay with the district officers. An officer from the department of finance was nominated to take charge of the important function of control of treasuries amongst his numerous other responsibilities. The GoJ had made some progress in introducing direct credit of employees' salary (all groups) to their bank accounts. There was some effort to computerize the treasuries. A pilot was being initiated by the National Informatics Center in one treasury in Dhanbad district and there was a plan to extend it to seven other treasuries.
- A scrutiny of the appropriation accounts revealed that year after year utilization of budgetary allocations in many cases was less than 50 percent which was probably due to allocations being made without linking them to requirements. The budget document provided little information on the deliverables of the budget outlays. Other disclosures such as large outstanding liabilities (like pension liabilities, statement of contingent liabilities such as committed contracts and guarantees issued by the State Government and their risk ratings, bad/doubtful debts) were missing in the budget document.
- The annual accounts were usually ready for publication about a year later. There were delays in submission of monthly accounts to the AG, both by the treasuries, and line departments using the LOC system, which prepare their own monthly accounts.
- There was an urgent need to strengthen the internal audit function of the state. Regarding external audit, responses to audit observations were very poor and this undermined the effectiveness of audit. At the time of the review, the GoJ

had just formed a PAC cell in all line departments to expedite response to the auditor and the PAC.

- The state was yet to discharge its constitutional mandate of devolution of powers and duties to the local bodies, that is, Urban Local Bodies (ULBs). Panchayati Raj Institutions were not in operation in the state, posing a serious challenge to improving the quality of governance at the local level. Elections of PRIs announced in 2005, to be held after a gap of 27 years, was put on hold by a Court Order because of legal challenges over the state's reservation policy.
- The position with regard to PSEs was not clear as the bifurcation of assets and liabilities of these companies was pending.

8. The preliminary assessment which was essentially based on a desk review and discussion with the officials of GoJ suggested that there were several areas in need of a thorough review of systems and procedures. No action plan was agreed with GoJ based on the findings of the preliminary review. The intent was to get an overview of the PFM system to feed into the Bank's report, "*Jharkhand: Addressing the Challenges of Inclusive Development"* and also provide preliminary information for a more detailed study. Against this backdrop, a greater in-depth analysis of GoJ's PFM performance, including the procurement system, has been undertaken through this study to assess the present position and identify weak areas of performance requiring focus for improvement.

**Purpose**

9. The purpose of this study is to make an objective assessment of the PFMA system of the State, identify its strengths and weaknesses and areas that may be in need of reforms and related capacity building. This study is a prerequisite to determining the precise nature and extent of any capacity building initiatives in Jharkhand. The study provides the Government a diagnostic tool for establishing priorities and to develop a baseline for monitoring future PFM performance of the State.

**Scope, Methodology and Approach**

10. The study uses the PFM performance measurement framework (refer Annexure I) as a tool for assessing and analyzing the effectiveness of the existing system at the aggregate level. The PFM performance measurement framework has been developed by the PEFA[9] partners in collaboration with the OECD/DAC joint venture. It is an integrated monitoring framework that allows monitoring of Country/Sub-national Government PFM performance over time. It includes a set of high-level indicators which measures and monitors the performance of PFM

[9] The PEFA is a multi-agency partnership program sponsored by the World Bank, IMF, European Commission, DFID, French Ministry of Foreign Affairs, Swiss State Secretariat of Economic Affairs and Strategic Partnership with Africa. PEFA aims to support integrated and harmonized approaches to assessment and reform in the fields of public expenditure, procurement and financial accountability.

systems, processes and institutions. The study aims to do an objective analysis based on relevant indicators provided in the framework without assigning any scores against those indicators.

11. Since the PEFA indicator framework is primarily designed for assessing PFM performance at the national level, for the purpose of this study some of the indicators namely PI-3, PI-7, PI-8 have been adapted, where necessary, for assessment at the sub-national level and/or to suit the Indian context. The study also does not cover the indicators on donor practices namely D1, D2 and D3 because currently the state is not directly implementing any donor funded project. There are certain Centrally Sponsored Schemes (CSS) of GoI borne under the Central Government's budget and funded by donors which are being implemented using the state machinery. All these schemes are implemented following GoI guidelines.

12. The study was executed through a combination of desk analysis and fieldwork. Discussions were held with the stakeholders including the Secretaries of the line departments and the Accountants General of Jharkhand. The published records, including State Government documents and reports of the CAG of India, have been drawn upon where necessary. USAID is the only donor working in the area of PFM in Jharkhand. Consultations were also held with the team members of the USAID-assisted REFORM Project who provided information on request.

13. The study comprises an assessment of the PFMA system of the state at the aggregate level. This was complemented with a drill down exercise in three departments – rural development, health and roads construction. The findings from the detailed review of the three departments were remarkably similar and support our conclusions drawn on the PFMA performance of the state at the aggregate level. Therefore the findings from these departments were not repeated in separate chapters and have been used as illustrations as relevant in this report.

14. The study is based on financial information up to March 31, 2006 as the state's accounts have been finalized up to FY 2005-06.

## A. PFM Out-Turns: Credibility of the Budget (PI 1-4)

### PI- 1: Aggregate expenditure out-turn compared to original budget

15. A PFM system's ability to deliver public services as included in the Government's policy statements is an important indicator that measures the ability of the system to deliver these policies as translated in the budget documents. The PEFA framework suggests that to meet the highest standards of credibility, variance between budgeted primary expenditure and actual primary expenditure should not exceed 5 percent of the budgeted expenditure in any of the previous three years.

16. **Primary fiscal expenditure variance**

16.1. Table1 indicates that variance in primary fiscal expenditure has been quite significant from year to year except in FY 2005-06 when the variance was 1.5 percent which is within the recommended level of 5 percent. The variance was way beyond the recommended level in the previous two years.

**Table 1: Variance in primary fiscal expenditure**

| **Fiscal Years** | **2005-06** | | **2004-05** | | **2003-04** | |
|---|---|---|---|---|---|---|
| **(Figures in Rs. million)** | **B.E (a)** | **Actual (b)** | **B.E (a)** | **Actual (b)** | **B.E (a)** | **Actual (b)** |
| Primary Fiscal Expenditure | 128,505 | 126,570 | 108,360 | 77,450 | 82,030 | 53,340 |
| Variance (a-b/a) | | 1.5% | | 28.5% | | 35% |
| Primary Fiscal Deficit | Amount | % of Budgeted Expenditure | Amount | % of Budgeted Expenditure | Amount | % of Budgeted Expenditure |
| Budgeted | **-46,378** | **-36%** | **-38,772** | **-36%** | **-6,358** | **-7.7%** |
| Actual | **-41,833** | **-32.5%** | **-10,760** | **-10%** | **3,091** | **3.8%** |
| Difference | **4,545** | **3.5%** | **28,012** | **26%** | **9,438** | **11.5%** |

16.2. The variance in primary fiscal expenditure in FY 2005-06 had narrowed down drastically. Although in FY 2005-06 there was noticeable under-spending on the expenditure side at the aggregate level, the decreasing variance was mainly on account of disbursements under loans and advances of Rs. 37,470 million, which is more than 5½ times the budget estimate of Rs. 6,604 million. This meteoric rise was on account of repayment of central dues of Rs. 28,560 million of the Jharkhand State Electricity Board (JSEB) by GoJ. The amount repaid was not provided for in the budget estimate and has been shown in the appropriation accounts as capital expenditure[10] of the energy department.

16.3. The high level of variance in the aggregate expenditure out-turn is due to low level of spending across departments. Twenty-five departments representing 48 percent of the total number of grants have shown persistent under-utilization by more than Rs. 20 million and 10 percent of the original allocation every year over the last years three years (FY 2004 to FY 2006). Average savings over the last three years (2003-04 to 2005-06) excluding the extraordinary transaction of repayment of dues of JSEB in 2005-06) is about 20 percent of the total budgetary provision including supplementaries.

[10] Since accounting is on a cash basis, loans and advances are treated as expenditures.

16.4. There are several reasons for the under-utilization across departments, one being that demands from the line departments are often not based on proper projections or well constructed detailed estimates furnished by field units. This raises questions regarding the quality of budgetary demands and consequently budget realism.

**Box 1: Under-utilization of budget**

**Health:**

- Under the revenue head, average savings against budget estimate over three years (FY 2003-04 to 2005-06) was 34%.
- In five schemes under the revenue section entire budget provision remained unutilized for all three years.
- Savings under capital section dropped from 68% in FY 2003-04 to 9% in 2005-06.

**RD:**

- Average savings under revenue head over last three years is 60%.
- Under the capital head, savings have tapered down from 37% to 15%
- In five schemes under the revenue section the entire budget provision remained unutilized for all three years.

**Roads Construction:**

- Average budget utilization over three years is 84%; better than the overall average for the state.
- Variance in 2006-07 likely to be much higher based on departmental expenditure reports up to February 2007.

16.5. At times supplementaries voted during the year are also found to be unrealistic. For example, during FY 2005-06 supplementary provisions in 36 grants of Rs. 6085 million proved unnecessary, as savings amounting to Rs. 23,220 million against these very grants were made. This is largely the result of non-availability of departmental in-year expenditure reports which should form the basis of projection of supplementary provisions.

**Box 2: A few cases where supplementaries voted though the original grant not fully utilized**

**Health:**

- In FY 2005-06 supplementary provision of Rs.511 million under revenue expenditure heads proved unnecessary; huge savings of Rs. 3,090 million against the original budget.
- Situation similar in FY 2003-04.

**RD:**

- Supplementary provisions of Rs. 787 million in the revenue section and Rs. 911 million in the capital section proved unnecessary (FY2005-06).

16.6. The major reason for under-utilization of funds is over-optimistic expenditure forecasts coupled with limited capacity in terms of staff strength and skills for execution.

**Box 3: Limited capacity for budget execution**

**Health:** A number of posts of medical officers, para-medics, nurses, ayahs and other field workers are lying vacant; while a veterinary doctor is available in each block, no physician is posted at the block level; there are huge savings in the budget, especially on prevention and control of diseases, primary health centers, etc.

**RD:** In the engineering wing nearly 50 percent of the posts are vacant. In the panchayat raj wing, about 32 percent of the sanctioned positions are lying vacant.

**Roads Construction:** In line with the government's policy to scale up investments in infrastructure, in FY 2006-07 budget allocation went up by 75 percent (from Rs. 3,000 million to Rs. 5,260 million), without consideration of implementation capacity. Against this overall allocation, only around 25 % was allocated to service delivery units till February (end of 11th month of the financial year).

16.7. In terms of deficits, during FY 2005-06, the ratio of primary fiscal deficit to primary expenditure was budgeted at around 36 percent, however the ratio as per the actual results was 33 percent. While the actual revenue receipts were close to budget estimate (see PI-3), there was noticeable under spending on the expenditure side across departments. However, this was negated by high disbursements of loans and advances as mentioned above.

16.8. During FY 2004-05, there was a variance (26 percent) with the actual ratio being 10 percent vis-à-vis 36 percent budgeted. The main reason for this variance is that the expenditure incurred by GoJ has been much less (71 percent) compared to what was budgeted, while the revenue receipts were 96 percent of the budget. The impact of the under-expenditure was to some extent negated by the fact that the state had disbursed almost 1.25 times the loans and advances (shown as capital expenditure) than what was budgeted.

16.9. In FY 2003-04, there was a primary surplus vis-à-vis budgeted deficit. The variation from the budgeted ratio was of 11.5 percent, resulting from low levels of spending (65 percent) with a corresponding reduction in the revenue collection (75 percent) compared to what was budgeted.

## 17. Increase in interest cost compared to the budgeted amounts

17.1. The reason for examining variations in ratios based on primary fiscal deficit and not fiscal deficit is that debt service payments during the year may change due to interest rate movements. However, a comparison of budgeted interest costs with actuals indicates significant variations (20 percent in 2003/04 to 53 percent in 2005/06) which go beyond fluctuations in interest rates (see Table 2).

**Table 2: Increase in interest cost compared to the budgeted amounts**

| Million rupees | | | | | | |
|---|---|---|---|---|---|---|
| | 2005-06 | | 2004-05 | | 2003-04 | |
| Interest Cost | Amount | % increase in interest cost compared to budget | Amount | % of budgeted expenditure | Amount | % of budgeted expenditure |
| Budgeted | **9270** | **-53.1%** | **7,755** | **-47 %** | **9,904** | **-19.4 %** |
| Actual | **14,195** | | **11,413** | | **11,823** | |
| Increase compared to Budget | **-4925** | | **-3,658** | | **-1,919** | |

17.2. While interest rates are not within the control of the State Government, considering that the stock of debt and consequently interest costs are steadily increasing and forming a significant part of the state's expenditure, the state should enhance its capacities for debt planning, and forecast its interest costs realistically so that they do not adversely impact the state's fiscal position. A Debt Management and Investment Cell (DMIC) have been set up under the USAID-assisted REFORM Project. This initiative needs to be made fully effective with proactive ownership of the department of finance.

## 18. Fiscal deficit

18.1. In view of the increasing importance of interest costs of the State (both from the angle of quantum and volatility), the aggregate expenditure out-turn indicator has also been examined in terms of the ratio of fiscal deficit to total expenditure (Table 3).

**Table 3: Ratio of fiscal deficit to total expenditure**

| **Million rupees** | | | | | | |
|---|---|---|---|---|---|---|
| | **2005-06** | | **2004-05** | | **2003-04** | |
| | **B.E** | **Actual** | **B.E** | **Actual** | **B.E** | **Actual** |
| **Total Expenditure** | 137,775 | 140,770 | 116,115 | 88,860 | 91,940 | 65,160 |
| **Gross Fiscal Deficit** | **Amount** | **% of Budgeted Expenditure** | **Amount** | **% of Budgeted Expenditure** | **Amount** | **% of Budgeted Expenditure** |
| **Budgeted** | -55,647 | -40.4% | -46,526 | -40% | -16,267 | -17.7% |
| **Actual** | -56,033 | -40.7% | -22,170 | -19% | -8,740 | -9.5% |
| **Difference** | -386 | -0.3% | -24,354 | -21% | -7,535 | -8.2% |

18.2. The variation in the ratios during the three years is lowest for 2005-06, as explained earlier, due to the disbursement under loans and advances.

18.3. ***In conclusion, although the degree of variation in aggregate expenditure out-turn between budget and actuals in 2005-06 was within the recommended level of 5 percent, this was mainly achieved due to repayment of dues of JSEB by the State Government. If this extraordinary transaction is not considered, the variance (around 24 percent) will be in line with the earlier years and way***

***beyond the recommended level of 5 percent This raises questions regarding the State's capacity for development and implementation of the budget.***

**PI -2: Composition of expenditure out-turn compared to original approved budget**

19. Where the composition of expenditure varies considerably from the original budget, the budget will not be a useful statement of policy intent. Changes in the overall level of expenditure (assessed in PI-1) will translate into changes in spending for administrative budget lines. This indicator measures the extent to which reallocation between budget lines have contributed to variance in expenditure composition beyond the variance resulting from changes in the overall level of expenditure. As the budget is usually adopted and managed at individual department levels, this indicator measures the credibility of budget preparation and execution process as practised at the departmental level.

20. The PEFA framework recommends that to meet the highest standards of credibility, the variance between expenditure composition and overall deviation in primary expenditure should not exceed more than 5 percent in any of the previous three years.

21. Three years' department-wise variation between budget estimates and expenditure out-turns have been tabulated to arrive at average variance in expenditure out-turn.

22. Table 4 shows that the variance in expenditure composition vis-à-vis overall deviation in primary expenditure is much less than the recommended level of 5 percent in 2004-05 and 2003-04. With almost all departments showing savings and unable to spend the allocated budget, there was no need for reallocation between the departments. However in 2005-06, a very large over-utilization was recorded against the energy department. This, as mentioned earlier, was due to the one-time disbursements to repay arrears of the JSEB. Since this was not provided for in the budget estimate, savings from other departments have been utilized to accommodate this excess expenditure of the energy department (Table 4).

**Table 4: Variance in expenditure composition vis-à-vis overall deviation in primary expenditure**

*(Rs in millions)*

| **Administrative classification** (Major Grants) | 2005-06 | | 2004-05 | | 2003-04 | | 3 years |
|---|---|---|---|---|---|---|---|
| | Variance | | Variance | | Variance | | Average |
| | Rs | % | Rs | % | Rs | % | |
| Rural Dev. Dept. | 6660.7 | **38.5%** | 9803.4 | **48.7%** | 8406.9 | **55.6%** | **47.6%** |
| School & Public Education | 1480.1 | **9.8%** | 2308.4 | **16.3%** | 2729.0 | **23.8%** | **16.6%** |
| Pension | 1174.8 | **15.2%** | 3077.1 | **33.2%** | 3446.8 | **38.1%** | **28.8%** |
| Home Dept. | 2784.5 | **22.9%** | 1607.1 | **20.2%** | 1407.7 | **22.5%** | **21.8%** |
| Welfare Dept. | 1030.8 | **16.0%** | 1451.6 | **27.3%** | 1610.4 | **35.9%** | **26.4%** |
| Health, Medical Education & Family Welfare | 3645.5 | **40.9%** | 935.9 | **18.1%** | 1610.3 | **40.8%** | **33.3%** |
| Energy Dept. (see note 1 below) | -25412.5 | **-159.7%** | 874.8 | **8.8%** | 1315.8 | **39.6%** | **-37.1%-** |
| Water Resources | 1030.9 | **21.0%** | 1443.3 | **37.0%** | 239.0 | **7.4%** | **21.8%** |
| Public Health Eng. Dept. | 757.2 | **20.7%** | 1080.6 | **34.4%** | 1638.2 | **50.8%** | **35.3%** |
| Road Construction Dept. | 710.2 | **16.9%** | 381.9 | **10.6%** | 603.2 | **21.3%** | **16.3%** |
| Forest & Environment | 336.4 | **17.1%** | 233.3 | **12.1%** | 967.8 | **39.2%** | **22.8%** |
| Higher education | 451.6 | **18.4%** | 418.4 | **24.3%** | 131.5 | **9.0%** | **17.2%** |
| Urban Dev. & Housing | 260.6 | **12.9%** | 717.5 | **43.3%** | 873.8 | **60.2%** | **38.8%** |
| Finance Dept. | 1726.3 | **82.8%** | 32.9 | **10.1%** | 1145.1 | **79.9%** | **57.6%** |
| Agriculture Dept. | 355.2 | **20.0%** | 539.2 | **35.0%** | 405.8 | **28.4%** | **27.8%** |
| Revenue & Land Reforms | 196.9 | **16.4%** | 276.2 | **22.6%** | 315.2 | **26.7%** | **21.9%** |
| Industries Dept. | 800.1 | **41.9%** | 889.8 | **46.2%** | 548.1 | **47.2%** | **45.1%** |
| Building Construction Dept. | 392.6 | **24.1%** | 560.2 | **44.3%** | 260.9 | **24.5%** | **30.9%** |
| Labor Employment | 171.0 | **11.4%** | 330.4 | **26%** | 238.2 | **26.7%** | **21.4%** |
| Science and Technology | 49.0 | **28.6%** | 1006.0 | **61.2%** | 297.3 | **49.5%** | **46.4%** |
| Others (30 Depts'.allocation) | 288.57 | **20.7%** | 2943.4 | **26%** | 1505.7 | **21.5%** | **22.7%** |
| Total (a) | 52757.6 | **636.0 %** | 30911.6 | **570.9%** | 29696.7 | **720.1%** | **642.3%** |
| Average Variance (exc. debt servicing)(a/21) | | **30.3%** | | **27.2%** | | **34.3%** | **30.6%** |
| Aggt. Primary Exp Variance (see PI-1)(B) | | **1.5** | | **28.5%** | | **35%** | |
| (A)-(B) | | **28.8** | | **1.3%** | | **0.7%** | |

Note: 1. All variances denote under-utilization of budgets allocated, except for the Energy Dept. .in FY 2005-06.

23. ***In conclusion, it is seen that variance in expenditure composition vis-à-vis the overall deviation in primary expenditure is well within the recommended level of 5 percent, the only exception being FY 2005-06 due to an extraordinary item of expenditure. This shows that reallocation between budget lines have not contributed to variance in expenditure composition beyond the variance resulting from changes in the overall level of expenditure***.

**PI - 3. Composition of revenue out-turn compared to original approved budget**

24. Revenue forecast is the basis on which annual plans for a state are prepared; hence the importance of this estimation cannot be over-emphasized. This indicator provides the result of comparison of budgeted and actual revenues and an overall indication of the quality of revenue forecasting and revenue administration.

25. A comparison of the last three years' revenue forecasts and actual achievements indicate under-forecasting during 2005-06 and over-forecasting in other two years (Table 5).

**Table 5: Revenue forecasts and actual achievements**

| *Million rupees* | | | | | | |
|---|---|---|---|---|---|---|
| | *2005-06* | | *2004-05* | | *2003-04* | |
| | Amount | % of Budgeted Revenue | Amount | % of Budgeted Revenue | Amount | % of Budgeted Revenue |
| Budgeted | **82,027.8** | | **69,501.1** | | **75,562.4** | |
| Actual | **84,638.8** | 103% | **66,605.1** | 96% | **56,377.7** | 75% |
| Difference | -2,611.0 | -3% | 2,896.0 | 4% | 19,184.7 | 25.% |

26. Forecasts of revenue receipts of GoJ were within 3 percent for FY 2005-06 and 4 percent for FY 2004-05. Budget estimates for FY 2003-04 were higher than realizations by 25 percent.

27. While this may be so at the aggregate level, when the variation is disaggregated under individual resources, the analysis reveals wide variations both for the state's share of central taxes and grants-in-aid and for the state's own resources. While the forecast of state tax revenues for FY 2004-05 was almost exact, for the two other years forecasts were higher by almost 20 percent. The state's share in central tax revenues however has been significantly underestimated consistently for FY 2005/06 and FY 2004/05. The FY 2005-06 forecast was underestimated by as much as 79 percent, FY 2004/05 by 13 percent and FY 2003/04 overestimated by 7 percent. In FY 2003-04 the aggregate revenue was largely affected by a lower turnout in central grants–in- aid (30 percent of the forecast).

28. As regards non-tax revenues the record is much better. Only in one year, FY 2004/05, was the variation more than 3 percent (Table 6).

**Table 6: Variations compared to budget**

| Revenues | | | | |
|---|---|---|---|---|
| Variations : Actual compared to Budget | | | | |
| | Weightage | 2005-06 | 2004-05 | 2003-04 |
| At Aggregate Level | | 103% | 96% | 75% |
| Tax Revenues | | 116% | 105% | 87% |
| - state | 32% | 82% | 99% | 82% |
| - state's share in central tax revenues | 36% | 179% | 113% | 93% |
| Non-Tax Revenues | 17% | 103% | 86% | 97% |
| Central Grants | 12% | 65% | 109% | 30% |

Note: Weightage depends upon last three years' average share in the total revenues that the state has raised under each of these categories.

29. Central grants-in-aid to the state budget under Centrally Sponsored Schemes (CSS) and Central Plan Schemes (CPS) are allocated by the concerned ministry of the Union Government against specific projects. Release of funds under these grants depends on several factors including implementation progress, issuance of utilization certificates (UCs) as well as the efficiency of the central process.

30. An important factor is the relative weights of the different categories of revenue. For example, while state taxes and the state's share of taxes from GoI is the largest, being 35 percent and 36 percent of total revenue respectively, non-tax revenue is around 17 percent of total receipts and grants from GoI is around 12 percent. Since GoJ has little information on amount of the Central Government's likely revenue receipts, and GoI's tax revenues have been rising sharply, the share of central tax revenues have been underestimated to a large extent.[11] However, the state should be able to forecast its own revenue, both tax and non-tax , with greater accuracy. The departments do not employ any quantitative method other than percentage growth or percentage change from earlier periods. As a result, the estimates lack precision.

31. ***In conclusion, it is seen that the actual revenue receipts in the aggregate were within 5 percent in two out of the three years. However, revenue forecasts at the disaggregate level show wider variations vis-à-vis actuals. There is enormous scope in improving the quality of revenue forecasting.***

[11] Share of revenue generated by GoI from central taxes and duties is decided on the basis of a transparent formula recommended by the Finance Commission. The Twelfth Finance Commission evolved a formula of sharing these funds which harmonizes equity with fiscal balances. Criteria (and weights) used for allocation are income distance (50%), population (25%), area (10%), tax effort (7.5%) and fiscal discipline (7.5%).

**PI-4: Stock and monitoring of expenditure payment arrears**

32. This indicator is concerned with measuring the extent to which there is a stock of arrears, and the extent to which the systemic problem of overdue arrears, if any, is being brought under control and addressed.

33. Jharkhand does not have a system of recognizing arrears at the aggregate level. The present public financial reporting system across Indian states recognizes expenditure only after payments have been made. The Bihar Financial Rules as applicable in Jharkhand require that the CO keep a record of all financial commitments and liabilities.[12] While the spending units of certain line departments which adhere to the Central Public Works (CPW) Accounts Code maintain records of arrears pertaining to procurement of stores, there is no system to capture these arrears at the departmental level.

34. ***In conclusion, in the absence of a system for capturing the stock of expenditure payment arrears, the impact of arrears on the fiscal position of the state is not being monitored. There is so far no plan for addressing this issue.***

## B. Key Cross Cutting Issues: Comprehensiveness and Transparency

**PI-5: Classification of the budget**

35. GoJ's overall accounting classification is in line with the uniform countrywide system of classification of accounts prescribed by the President on the advice of the CAG of India. The existing system has a uni-dimensional coding structure which flows in one direction from funds to sector/sub-sector to functions/ programs to schemes/economic classification. The system meets the requirements of the international standard for the classification system of Government Finance Statistics (GFS).

36. Although the present system was devised three decades ago, it was designed to allow compilation of accounts through computerized systems. However, the present system does not provide mapping of linkages between functions, programs and schemes at different levels to assist decision makers in policy formulation and effective monitoring.[13]

37. The CGA of India is currently considering a new system of accounts classification for GoI in line with international best practice. The proposed multi-dimensional

---

[12] Rule 11 of Bihar Financial Rules: A CO must see not only that the total expenditure is kept within the limits of the authorized appropriation but also that the funds allotted to spending units are expended in the public interest and upon objects for which the money was provided. In order to maintain a proper control, the CO should arrange to be kept informed, not only of what has actually been spent from an appropriation but also what commitments and liabilities have been and will be incurred against it.

[13] Ministry of Finance (GoI), Expert Group Report on Classification of Government Transactions (July 2004).

account classification system will have distinct segments representing funds, economic categories, functions, programs, and other data attributes. The new system under consideration will be multi-tiered with a simpler chart of accounts than the existing one. It is expected to allow for fund-based accounting and facilitate transition to accrual accounting, and assist in preparing reports consistent with GFS.

38. ***It may therefore be concluded that the present classification system being followed can produce consistent documentation in accordance with the national standards which are consistent with GFS standards.***

**P1-6: Comprehensiveness of information included in budget documentation**

39. This indicator measures the comprehensiveness of information included in the budget documentation, the purpose being to assess whether adequate disclosures are made in the annual budget documents (the annual budget and supporting documents).

40. The PEFA framework recommends that budget documentation should fulfill nine information benchmarks in order to be considered complete. These include information on the following elements in addition to detailed information on revenue and expenditure: (i) macro-economic assumptions including at least estimates of aggregate growth; (ii) inflation and exchange rate; (iii) fiscal deficit; (iv) details of debt stock at the beginning of the current year; (v) financial assets including details at least for the beginning of the current year; (vi) prior year's budget out-turn; (vii) current year's budget (either the revised budget or estimated out-turn; (viii) summarized budget data for revenue and expenditure according to the main heads of classification; and (ix) explanation of budget implications of major policy initiatives, both in revenue and expenditure with estimates of budgetary impact.

41. The institutional framework for disclosure through budget documentation is set under Article 202 of the Indian Constitution.

42. In Jharkhand a number of documents are placed in the Assembly as part of the budget documentation. These are given in Table 7, along with brief particulars that the documents contain.

**Table 7: Budget documents**

| Document Title | Particulars given in the document |
|---|---|
| Non-Plan (detailed) | - Major head-wise summary of budget provisions.<br>- Detailed budget provisions (giving minor heads and object heads) under each major head.<br>- Budget provisions include "budget estimates" for the financial year under proposal.<br>- Budget estimates and revised estimates for the current financial year.<br>Unaudited actuals for the previous financial year. This information is not generally incomplete. |

| | |
|---|---|
| Plan (detailed) | Same as above |
| CSS &CPS (detailed) | Same as above |
| Public Account (detailed) | Same as above |
| Revenues & Receipts (detailed) | Same as above |
| **Document Title** | **Particulars given in the document** |
| Budget Summary | - Overall summary of budget receipts and budgeted expenditures – apart from the budget year, it also provides BE and RE for current year.<br>- Functional details of receipts and expenditure for budget year, current year and previous year (actual).<br>- Department-wise details of allocations under major heads. |
| Explanatory Memorandum on the Budget | The document more or less repeats information earlier provided under budget summary. |
| Demands for Grants | Details of budget provisions (separately under revenue & capital) for each grant provided for budget year and current year. |
| Annual Financial Statement | Budget provisions for budget year, current year and unaudited actual for previous year given major head-wise. |
| Budget at a Glance | Overall fiscal indicators, pictorial presentation of where a rupee comes from and where it goes, etc. |
| Budget Speech | Budget speech as delivered by the Finance Minister in the Assembly. The speech provides narratives about major programs proposed in the budget in various sectors including tax proposals. |

43. As can be seen from the above, at present there is no information provided on macro-economic assumptions, such as inflation, aggregate growth of the economy, etc. Many states prepare an Economic Survey Report providing analysis, trends, etc. This is a useful exercise which helps give direction to the state for its future economic path.

**Box 4: Innovation in Karnataka**

Recent innovation introduced in Karnataka is the Action Taken Reports (ATR) on promises made in the previous year's budget.

*Source: Orissa SFAA*

44. While the budget documents provide details of the state's likely receipts/ payments, both revenue and capital during the year, it does not provide the opening debt position, which is however covered quite comprehensively in the finance accounts.

45. Although an explanatory memorandum to the budget provisions is prepared, it repeats information already contained in the other budget documents. It does not provide an explanation of budget implications of the new initiatives, or the likely impact of major revenue/expenditure policy on budgetary estimates. Generally the budget speech delivered by the Finance Minister makes references of this nature in the form of major policy initiatives.

46. The state has developed a website on which its annual budget documents are put up. The annual budget document for FY 2007-08, which was approved by the Legislative Assembly on March 21, 2007, is yet to be posted.

47. Disclosure in the budget document needs to be improved in three out of the nine information benchmarks recommended by PEFA. These include the following:

- Statement of deficit financing describing anticipated composition;
- Macro-economic assumptions including estimates of aggregate growth, and inflation ; and
- Explanation of budget implications of new policy initiatives, with estimates of the budgetary impact of all major policy changes and/or some major changes to expenditure programs.

48. As regards the statement on debt stock and the statement on financial assets, these two are part of annual finance accounts. Since there is no fixed time-table for presentation of audited finance accounts to the legislature, the accounts may not be always available for discussion at the time of the budget. The accounts in the case of 2005/06 were tabled *after* the budget for FY 2007-08 were approved by the Assembly.

49. ***It can hence be concluded that currently the budget documentation fulfils six out of nine information benchmarks recommended by the PEFA Framework. Presently a lot of information is repetitive. The state may consider simplification of the budget document in line with the budget documents of GoI and some other states like Andhra Pradesh and Karnataka. The Reserve Bank of India's (RBI) core group had come out with a Voluntary Disclosure Norm for the State Governments under Detailed Summary of the Budget in 2001, which GoJ may consider. The recently enacted FRBM Act requires disclosures in the budget document on policy analysis, information on level of debt and financial assets, new policies introduced, etc.***

**PI-7: Extent of unreported Government operations**

50. The purpose of this indicator is to assess the significance of Government operations which are not reported through the state budget. The PEFA framework recommends that annual budget estimates, in-year execution reports and year-end financial statements should cover all budgetary and extra-budgetary operations of the Government. This will ensure a complete picture of Government revenues and expenditure across all categories and financing.

51. GoI provides a large amount of additional central assistance to all states including Jharkhand by way of CSS and CPS for development purposes based on the priorities established by the Central Government in consultation with State Governments. While a number of these schemes are funded through the budget process as grants-in-aid from Central Government (A/c 1601) (refer PI--3), the increasing trend is to directly transfer funds to special purpose vehicles –

registered societies operating as autonomous bodies. The state does not have a ready mechanism to determine the total amount of extra budgetary funds that the state is receiving under such schemes. It is quite likely that the funds received under CSS and CPS are on the increase[14] from year to year. It would be safe to assume that a significant amount of such "extra budgetary funds" are being spent in the state on this account.

**Box 5: Central schemes**

**RD:** The entire central assistance under CSS and CPS flows directly to the DRDAs. In 2005-06, the grant of Rs. 9764 million went as central assistance to DRDAs vis-a-vis Rs. 10,622 million incurred through the state budget.

**Health:** The major portion of central assistance is routed through the state budget. Central assistance for three schemes (Aids Control, RCH and NRHM) flow directly to implementing agencies (autonomous societies). Eight percent of the total central assistance in FY 2005-06 was transferred to such societies.

52. ***The conclusion therefore remains that in the absence of a suitable tracking mechanism, it is not possible to quantify the level of extra budgetary operations under the CSS as a percentage of the total expenditure of the State. However, it would be safe to assume that a significant amount of such "extra budgetary funds" are being spent in the State on this account. Separate disclosures in the budget documents of estimated receipts for budget year and actuals for previous year for these schemes would enhance transparency. Currently the State is not directly implementing any donor funded project, although the prevalent practice in India is that they are usually within the budgetary systems of State Governments.***

**PI-8: Transparency of inter-governmental fiscal relations**

53. This indicator concerns transparency and allocation of funds by a national government to sub-national governments. As the PEFA framework has been basically formulated in the context of the national government, this indicator is not directly applicable for this study. However, this indicator may be relevant in the context of the third tier of governance. The 73rd and 74th amendment to the Constitution provided an effective framework of local self-governance in the country through ULBs (the third tier). In Jharkhand, PRIs are not in operation, posing a serious challenge to improving the quality of governance at the rural level. Elections of PRIs announced in 2005, slated to be held after a gap of 27 years, were put on hold by a Court Order because of legal challenges over the

[14] As per an estimate of a World Bank study on CSS, GoI's outlay for FY 2005-06 for such schemes to all states was close to Rs. 500,000 million.

state's reservation policy. Under similar grounds, elections for ULBs have also not been held in the state. The state had to suffer a loss of central grants amounting to Rs. 3 billion for not holding elections for local bodies.

54. Although PRIs are not in operation, most of the villages have a village pradhan (head) under the traditional "hereditary" system who selects 10-15 members to the village sabha. Till March, 2006, the Directorate of Panchayati Raj allocated Rs. 50,000 per annum to all village sabhas for undertaking development work in the village like digging of wells, tube-wells, drainage pipes, etc. The gram sabhas furnish UCs to the Directorate of Panchayati Raj. The Directorate also ensures monitoring of the execution of works through the office of the block development officers. With effect from April 1, 2007, this scheme has been discontinued.

55. In Jharkhand there are in all 39 ULBs (2 municipal corporations, 18 municipalities and 19 notified area committees). In the absence of institutional mechanisms for devolution of funds to local bodies, including ULBs, presently the Department for Urban Development makes allocation of funds to individual ULBs. For FY 2004-05 and FY 2005-06, this was Rs. 849 million and Rs. 1180 million respectively. Even though UCs are required to be submitted by ULBs, the department does not have a mechanism to identify pending UCs.

56. Apart from the UCs, there is no financial reporting by the Rural and Urban Local Bodies to the parent departments. No audit is conducted for these local bodies.

57. Although the State Finance Commission[15] of Jharkhand was formed on January 28, 2004, it has not yet submitted its report. The state is yet to discharge its constitutional mandate of devolution of powers and duties to the ULBs.

58. ***Hence, in conclusion, in the absence of duly elected local bodies, both urban and rural, there is actually no inter-governmental fiscal relationship. The Government releases funds to these local bodies as grants-in-aid through the departmental budgets. Although in case of PRIs, fixed amounts (Rs. 50,000 for every PRI) were being released till recently, releases to ULBs are not based on any transparent rule-based system. There is no financial reporting by these Rural and Urban Local Bodies to the parent departments.***

**PI-9: Oversight of aggregate fiscal risk from other public sector entities**

59. The purpose of this indicator is to assess the quality of the oversight role of the state government in the context of fiscal risk associated with the financial position of state owned and/or controlled entities.

---

[15] In terms of articles 243(I) and 243(Y) of the Constitution, the State Finance Commissions are to recommend: (i) the principles that should govern the distribution of the net proceeds of taxes leviable by the state between the state on one hand and the local bodies on the other and the inter-se allocation between different panchayats and municipalities; (ii) determination of taxes, duties, tolls and fees assigned to or appropriated by the local bodies; (iii) grants- in-aid from the Consolidated Fund to the local bodies.

60. Since the state government has a formal oversight role in relation to all public sector entities and even local governments, it should monitor and manage fiscal risks arising from the activities of such entities. There may be occasions, when although the state government may not have a formal oversight role, it has to assume responsibility for financial default of autonomous entities.

61. There were five government companies, one statutory corporation and one autonomous body under the control of the state government as on March 31, 2006. Total investment in PSUs at face value is estimated at Rs. 24,739 million. The annual accounts of *all* these entities are behind schedule (Table 8).

**Table 8: Status of Annual Accounts of Government Companies and Statutory Corporation as on March 2006**

| S. No. | Name of the Company/Statutory Corporation/Autonomous Body | Date of Incorporation | Period of Accounts | Year in Which Accounts Finalized |
|---|---|---|---|---|
| 1 | Jharkhand Hill Area Lift Irrigation Corporation | 22.3.2002 | 2003-04 | 2005-06 |
| 2 | Jharkhand Police Housing Corporation Limited | 13.3.2002 | 2004-05 | 2005-06 |
| 3 | Jharkhand Tourism Development Corporation Limited | 22.3.2002 | - | - |
| 4 | Jharkhand State Forest Development Corporation Limited | 27.3.2002 | 2002-03 | 2004-05 |
| 5 | Jharkhand State Mineral Development Corporation Limited | 7.5.2002 | - | - |
| 6 | Jharkhand State Electricity Board | 20.3.2001 | 2001-02 | 2005-06 |
| 7 | Jharkhand Electricity Regulatory Commission | 24.4.2003 | - | - |

62. The task of overseeing the operations of state owned/controlled entities has been entrusted to the line departments through which the funding of these organizations is undertaken. Although the governing bodies of such organizations have a certain level of autonomy, they cannot raise loans or create major public liabilities without taking necessary approvals from the state government.

63. There is no visible system of monitoring of fiscal risk associated with these entities in the department of finance,[16] and therefore there is no system of consolidation of fiscal risk issues into an annual report. Moreover, given that annual financial statements of these entities are in arrears, the net worth of public sector undertakings cannot be assessed on a timely basis. Since any major financial losses on the part of these entities could enhance the fiscal risk to the state, it is important that the department of finance does at least an annual review of the financial position of such entities.

[16] No such subject has been enlisted in the Office Order (dated February 12, 2007) allocating work among different officials of the department of finance.

64. Another issue is the lack of sufficient legislative scrutiny. For instance, the PUC has met only once since the formation of Jharkhand (refer PI 28).

65. While the Annual Finance Accounts of the state have provision (under Statement 6) to provide details of guarantees issued by the state government on behalf of various statutory corporations, boards, etc, it was observed that the FY2005-06 Finance Accounts do not include this information. The best estimate of outstanding guarantees issued after the formation of Jharkhand as on March 31, 2006 and as provided by the department of finance was Rs. 5.4 billion.

66. The issue is accentuated by the fact that the distribution of assets and liabilities (including guarantees) of a number of state public units of the composite state of Bihar between the successor states of Bihar and Jharkhand has still not been completed. Many of these entities may have had large outstanding liabilities at the time of bifurcation of Bihar.

67. Autonomous government agencies which are established through separate legislation are not empowered to raise any loans or issue guarantees.

68. ***In conclusion, given the paucity of up to date information with GoJ on the financial position of a large majority of the public sector entities, and insufficient monitoring by the department of finance, the aggregate fiscal risk on account of all these entities is not being assessed. So far there is no attempt by the department of finance to prepare a consolidated overview.***

**PI-10: Public access to key fiscal information**

69. The purpose of this indicator is to assess how easily accessible is the information on fiscal plans, positions and performance of the state government to the public. The PEFA framework lays down a benchmark of six elements of information to which public access is essential – annual budget documentation, in-year budget execution reports, year-end financial statements, external audit reports and contract awards above the value of USD 10,000.

70. The RTI Act passed by the Central Government in 2005 provides for the availability of complete information on all aspects of the workings of all public bodies to the country's citizens on request. Jharkhand, like all other states, is required to comply with this legislation including the provision for making available on "suo moto" basis, information specified in Section 4 of the Act. According to a study of RTI compliance by the departments of education in states across India, conducted by the Centre for Civil Society (a Delhi-based NGO), Jharkhand was amongst the states with the poorest performance.

71. The state is in the process of setting up the infrastructure required for complying with the requirements of the RTI. This includes dissemination of information to the public on their rights, appointment of public information officers in each public body, training of staff, etc.

72. **Annual budget documentation**

72.1. The annual budget documentation is available in printed format and on GoJ's website. Printed information is available once these are presented in the Legislative Assembly. Information on the website is available thereafter. It is a fairly voluminous set of papers.

72.2. Thus the budget documents are accessible to the media and public at large almost immediately after these are tabled. The documents are however not easy to understand for a lay man. Attempts are being made through documents like "Budget at a Glance" to simplify the presentation and improve its understandability. However, "Budget at a Glance" is not available on the GoJ website.

73. **In-year budget execution reports**

73.1. In-year budget execution reports or monthly accounts compiled by the AG (A&E) are not made public suo moto. CAG publishes on its website monthly accounts of states where there is concurrence of the state. Jharkhand so far has remained an exception.

74. **Year-end financial statements**

74.1. Annual Finance and Appropriation Accounts are audited and "certified" by the CAG normally within 9-10 months of the close of the financial year. These are required to be placed in the Assembly at the next available opportunity. However there have been delays in the past three years. The audited accounts for 2005/06 were provided to the State Government in November 2006 but tabled only on April 4, 2007 after the budget was presented and approved. Immediately after the accounts are laid in the Assembly they are available to the public on request. The format of the accounts has been prescribed by the CAG of India. The publication of the document, "Accounts at a Glance" is an attempt to improve the understandability of the accounts.

75. **External audit reports**

75.1. External audit reports are normally submitted by the CAG to the Governor, as per Article 151 of the Constitution, who causes them to be laid on the floor of the state legislature. They are generally tabled within six months of the completed audit. They are released as public documents only after they are laid on the table of the state legislature.

75.2. Normally the audit reports are expected to be placed before the legislature at the earliest opportunity that is in the next session of the legislature after receipt from the auditor. They should ideally be available for legislators before the budget debate takes place. However there is no legal requirement for this. The audit

reports for FY 2005-06 were tabled on April 4, 2007, soon after the budget was approved for FY 2007-08. The AG of Jharkhand also gave a press briefing after the audit report for FY 2005-06 was tabled. The audit reports are available on the website of the CAG of India.

76. **Major contracts awarded**

76.1. Presently Jharkhand does not publish such information suo moto. Only the bidders who have participated in the bid process are generally informed about the bidder who is selected.

77. **Resources available to primary service units**

77.1. Another important aspect of public access that the PEFA framework refers to is the level of access to information on resources available to primary service units in at least two sectors, such as schools and primary health centres (PHCs). Information of this nature is not presently being published.

77.2. ***In conclusion, it is seen that currently three out of the six information benchmarks recommended by PEFA are made available to the public. There is immense opportunity to improve public access in the areas of in-year budget execution, both financial and physical, progress of development projects, major contracts awarded and resources, physical and financial, made available to primary service units. The RTI Act provides for sufficient public access to information on the state's development activities. The State is in the process of building its capacity to comply with the requirements of the Act***.

## C. Budget Cycle

### C (i) Policy Based Budgeting

### PI-11: Orderliness and participation in the annual budget process

78. The purpose of this indicator is to assess the budget formulation process, effective participation by other line departments as well as political leadership.

79. The Bihar Budget Manual as adopted by Jharkhand provides the institutional framework for preparation of the budget. This manual lays down the detailed processes of budget formulation, including the calendar for different events. While the department of finance finalizes the non-plan[17] part of the budget based on departmental requests, it is aided and advised by the planning department in

[17] The non-plan budget mainly consists of salary, establishment costs and maintenance costs of schemes and programs.

finalization of the plan budget.[18] Budget circulars issued by the department of finance contain detailed instructions such as budget calendar and budget formats, etc. for formulating the budget by various line departments. Indicative budgetary ceiling for line departments are not specified in the budget circular.

80. The department of finance and the department of planning undertake the lead to finalize the annual plan size. The department of finance first undertakes an assessment of resource availability. Overall plan size and priorities are firmed up on the basis of consultations with senior bureaucracy and political leadership. However there is a need to ensure that the ground realities of the department's ability to implement are considered, while preparing estimates. Thus, although detailed budgetary reviews are undertaken as per prescribed procedures by the departments of finance and planning, it emerges that there is a need for greater technical expertise in this area in the departments of finance, planning and implementation or finding alternate ways and means of accessing such technical expertise. Another major constraint is non-availability of up-to-date actual expenditure figures for the year prior to the budget year at the departmental level.

**Box 6: Reference to last year's actuals**

**Heath:** Budget document for FY 2004-05 does not give actuals for the preceding year under ANY head. In FY 2005-06, actuals given only under few heads in the revenue section (establishment exp & some grantee institutions). Budget document for FY 2006-07 contains no actuals in revenue section; but, only for a few items in the capital section (non-plan). During discussion, the Principal Special Secretary agreed that no monthly or annual expenditure statements are received from the DDO/CO and that the budget is prepared based on verbal discussions with the heads of departments/ institutions.

**RD:** Budget documents for FY 2004-05 and FY 2005-06 do not give actuals for the preceding year under ANY head. In the plan budget for FY 2006-07, actuals given only in a few cases relating to staff salaries.

81. As indicated under PI-2 above, most departments have not been able to utilize funds allocated to them. The CAG in their audit report have over the years regularly identified a number of instances where funds had to be surrendered, because the budget estimates were the result of ad hoc estimates rather than detailed estimates furnished by the field units.[19]

82. Before the budget document is finalized, there are consultations with representatives of various stakeholders, like the business and industrial community, agriculturists, etc. The budget document once finalized is approved by the cabinet before being presented to the legislature in the budget session. The budget document has generally been passed by the legislature before the beginning of the next financial year, although during 2005-06 a vote on account had to be taken for the budget year 2006/07, and the budget was finally approved only in July 2006. The budget for 2007-08 was approved in March 2007 before

[18] All schemes and programs included in the current Five Year Plan comprise the plan budget.
[19] For details on savings, refer para 17.4 under PI-1.

the year end. However there was no debate in the Assembly before the passage of the related legislation.

83. The budget calendar generally allows three to four weeks for the departments to prepare their detailed estimates. But there are significant delays in submission of detailed estimates by most departments. In the context of Jharkhand, the issue of the budget circular is more of a formality as it does not specify any ceilings and is just a repetitive standard guideline issued every year. All departments are aware of the budget schedule and nothing prevents them from starting the process earlier.

**Box 7: Budget calendar**

**Health:** Budget circular issued by the department of finance stipulates that estimates for plan and non-plan should be submitted by September 13 and 20, respectively. Estimates for 2007-08 were submitted on February 21, 2007 (plan) and on March 10, 2007 (non-plan).

**RD:** In FY 2006-07 the budget estimates for both plan and non-plan were submitted on February 28, 2006.

84. The process of preparing estimates using the bottom-up approach is very weak.

**Box 8: Input from line departments**

**Health:** No input from the field offices in the budget process. Review of the last three years' budget preparation reveals routine process of incremental budgeting for non-plan. For plan sector, it is either one-fifth of annual plan allocation or an approximation/ repetition of amount proposed in BE and RE of the current year.

**RD:** No input from most of the field units.

**Roads Construction:** The scenario is comparatively better. Budget estimates are prepared based on specific proposals from field units reviewed at higher levels.

85. ***In conclusion, standard guidance on the preparation of budget estimates is made available through budget circulars every year. Indicative ceilings for departments are not provided in the budget circulars. The budget calendar does not allow sufficient time considering the best practice recommended by the PEFA framework (at least six weeks from receipt of the circular) to the departments for preparing detailed budget estimates. Input from field units are often not received. The situation is further worsened by non-availability of up-to-date actual expenditure figures for the year prior to the budget year at the departmental level. The budget is approved before the start of the fiscal year by the legislature on an annual basis.***

**PI-12: Multi-year perspective in fiscal planning, expenditure policy and budgeting**

86. The purpose of this indicator is to assess the extent to which the priority setting, planning and budgeting process is based on a rolling multi-year plan basis with a medium-term perspective.

87. A multi-year perspective is an important ingredient of fiscal planning. Expenditure policy decisions having multi-year implications should be aligned with availability of resources in the medium-term perspective to achieve aggregate fiscal targets.

88. The state has prepared a Vision 2010 which provides long-term sectoral strategy for the state's development. However, these are not costed in terms of estimates of forward expenditures. As in the central and State Governments in India, a process for preparing Five Year Plans is also established. While preparing the Five Year Plan, forecasts of revenues, estimates of expenditure and projections of deficits are prepared. Currently GoJ is in the process of finalizing its Eleventh Five Year Plan which is expected to cover detailed estimates of the next five financial years' (2007-2012) revenues, expenditures and deficits. Projections prepared by the department of finance for the Eleventh Five Year Plan provide sectoral plan and non-plan allocations**.** The Five Year Plans are not being adjusted annually on a rolling basis. The state does not have a process for annual adjustments to the plan with the result that it becomes outdated within a year or two and, further, is of limited value in the context of the changing fiscal scenario. The process adopted so far also does not provide for integration of investment and recurrent expenditure.

89. The state has passed the Twelfth Finance Commission recommended FRBM Act. The Act requires that the state adopt a Medium-Term Fiscal Framework and targets for reducing the state's deficits quite substantially by March 31, 2009.

90. The state is in the process of strengthening its debt and investment management capacities. A Debt Management and Investment Cell (DMIC) has been recently established.[20]

91. ***In conclusion, there are no forward estimates of fiscal aggregates on a rolling basis. Nor has adequate debt sustainability analysis been undertaken so far. Costing of sector-wise strategies are done only for plan expenditure in the form***

---

[20] A DMIC has been established to study the institutions and organizational set-up, gaps in debts and investment management, extent of contingent liabilities, risk factors and parameters necessary to scrutinize the risks, level of financing, devolution of powers in the form of taxation and revenue empowerment of local bodies. This was proposed to be studied in depth. It is also proposed to study the system of accounting and keeping of records in the AG's office.

***of Five Year Plan. Budgeting for investment and recurrent expenditures are separate processes.***

***C (ii) Budget Cycle***

92. While the performance indicators PI 13-16 are generally employed at the national level, in a federal structure, it is equally important to analyze efficiency of the overall tax system at the sub-national level.

93. Currently the state's major tax revenues are from VAT comprising about 80 percent of its overall tax revenues. This study is therefore confined to VAT while assessing the system against indicators PI 13, 14 and 15.

**PI-13: Transparency of taxpayers' obligations and liabilities**

94. The purpose of this indicator is to assess clarity and comprehensiveness of tax legislation and administrative procedures, level of awareness among taxpayers of their obligations and liabilities and existence of an effective appeal mechanism.

95. The state implemented VAT on goods with effect from April 1, 2006, replacing the existing first-point sales tax. The VAT covers all goods except a few items, like petroleum and liquor.

96. The enactments relating to VAT and the rules (procedures) made there under are clear and easy to comprehend. There is no ambiguity in assessing tax liability. Tax officials have no discretion in fixing tax liability. The only discretion available is in imposing penalty for various offences. This needs to be prescribed in the law so that the officers are not able to favour taxpayers by using their discretion. The enactment and the rules are easily available to the taxpayers. The Government has brought out publications showing the Act and Rules. The information is also available on the website. Some brochures have also been published and distributed for VAT.

97. There exists a well-structured system of appeal, revision and reference. A formal process of appeals has been established at three levels. The initial appeal is to the Joint Commissioner Commercial Taxes (JCCT). A revision petition against the orders of the JCCT (appeals) can be filed before the Commercial Taxes Tribunal, which basically consists of members drawn from the judicial, accounts and taxation services. The Commissioner Commercial Taxes also has powers of revision either on his own motion or on the basis of petitions filed before him. In cases involving points of law, reference can be made to the High Court, otherwise the findings of the Tribunal are final.

98. A large volume of information also gets collected during assessment, searches and seizures, and survey operations. However, it seems that their collection is

neither systematic nor thorough. For this purpose, a thorough reorganization of the department with greater use of information technology is needed for a suitable Management Information System (MIS) to utilize the information in an appropriate way. Online systems of gathering market intelligence and sharing of databases could prove to be a great driver towards openness and transparency in the system, helping in stepping up revenue collections.

99. ***In conclusion, legislations and procedures relating to VAT are comprehensive and clear. The enactment and the rules are easily available to the taxpayers. Tax officials have no discretion in fixing tax liability. The only discretion available is in imposing penalty for various offences. There exists a well-structured system of appeal, revision and reference***

**PI-14: Effectiveness of measures for taxpayers' registration and tax assessment**

100. **Registration process**

100.1. Since registered dealers are the most important aspect of tax administration, the Jharkhand VAT Act requires that all taxpaying dealers with turnover exceeding Rs. 5 lakh must be registered with the tax department.

100.2. The procedure of registration includes submission of a prescribed application form, which calls for details of the business of the dealer. The form must accompany a certain amount of initial security along with some surety or bank guarantee. The officer, in turn, verifies the credentials of the dealer and issues a registration certificate to the dealer in a prescribed form.

100.3. The overall procedure of registration is complicated and calls for information which is of no great relevance for the department and inconvenient for the taxpayer. The procedure should be simplified. However, post-registration enquiries and fixing of input credit under VAT is extremely essential.

100.4. In addition to registering those who come forward, the process of tax enforcement begins with the identification of taxpayers who are not yet registered with the department. Departmental efforts in identification of taxpayers who are not yet registered with the department are not up to the mark. This is an extremely formidable task particularly in a state like Jharkhand, where the unorganized sector predominates. An effective taxpayer information system and monitoring alone can help achieve this task. The establishment of an effective taxpayer information system is crucially dependent upon a unique identification numbering system such that the information relating to various indicators can be collected and collated.

100.5. As a first step, as suggested by the Empowered Committee of State Finance Ministers, the department has given a ten-digit tax identification number (TIN) to

all taxpayers. The TIN for dealers under VAT should ideally be integrated with the identification numbers for other taxes such as the permanent account number (PAN) of income tax and TIN for Cen VAT (central tax on manufacturing units).

*100.6.* ***In conclusion, although there is a system of registration of all the tax paying dealers having turnover exceeding Rs. 5 lakh under the Jharkhand Value Added Tax Act, the system is not linked to other government tax registration systems.***

101. **Planning and monitoring of tax audit programmes**

101.1. Planning and monitoring of tax audit programmes do not exist. This is primarily due to the fact that VAT is a new tax. The department has yet to start receiving annual returns. The work should start after that. Under state excise no such work has been attempted. The assessment procedure commences when all returns are received. In the event of all returns being correct, the assessing authority accepts them without calling the dealer; the dealers are treated as self-assessed. However, if returns are not filed or are not found to be in proper order, then a notice is issued to the dealer to present himself before the assessing authority to explain the issues involved.

101.2. Only those dealers who are selected for assessment during a particular year based on risk assessment are to be assessed. It is, therefore, customary to make a selection of cases for audit (departmental scrutiny). It is this process of selective verification of the volume of information received by the tax administration which establishes deterrence. Under the VAT regime, it is proposed to cull only those dealers for assessment who are selected on the basis of risk assessment. However, during our visit to the tax department it was revealed that so far no work has been undertaken in the direction of "risk management" or towards developing a methodology for selection of cases for audit. It is, therefore, extremely important that the department develops a mechanism for risk assessment, which forms a scientific and, therefore, objective basis for identifying cases of potential tax evasion and, therefore also, for selected in-depth audit (assessment).

101.3. ***In conclusion tax audit and fraud investigation programs do not exist. The department does internal assessment based on samples selected on the basis of risk assessment.***

102. **Effectiveness of penalties**

102.1. Penalties under the current system are lesser than warranted. These could be enhanced to make them effective deterrents. Also, these must be fixed as per the offence, leaving no discretion with the officers concerned.

102.2. Effectiveness of the assessment and penalties process may also be examined from the CAG's audit report, which indicates that almost 98-99.9 percent of total tax collection is through pre-assessment processes.

102.3. The existing organization for administration of VAT is based on case specialization where each official deals with most functions relating to the taxpayer. Under the VAT regime this needs to be changed to functional specialization, where one official deals with a specific function.

102.4. Another aspect requiring attention relates to training of departmental personnel. In the past, the officers of the sales tax department were generally drawn from the administrative service. At no stage of recruitment or promotions, however, were these officers sent for appropriate training in the assessment of taxes. It is, therefore, of paramount importance that under the new tax regime the officers posted in the tax department are imparted right training. The training should aim at enabling the officers to understand the intricacies of assessment procedures laid down, and legal problems that have arisen or are likely to arise in relation to VAT.

102.5. ***In conclusion, penalties are not set sufficiently high to act as deterrence. The process of assessment of penalties also needs to be reviewed.***

**PI-15: Effectiveness in collection of tax payments**

103. The purpose of this indicator is to assess the effectiveness of collection of tax payments, including arrears.

104. The information on collection of arrears relating to FY 2003-04, FY 2004-05 and FY 2005-06 was not available with the department. The arrears of revenue pending collection during FY 2000-01 to 2002-03 as furnished by the department, are given in Table 9.

**Table 9: Arrears of revenue pending collection** *(In Rs. Million)*

| Year | Opening Balance | Addition | Total | Amount recovered | Closing Balance | Percentage of col. 5 to 4 |
|---|---|---|---|---|---|---|
| *1* | *2* | *3* | *4* | *5* | *6* | *7* |
| 2000-01 | 10,881.8 | 1,639.5 | 12,521.3 | 628.6 | 11,892.7 | 5.02 |
| 2001-02 | 11,892.7 | 1,810.1 | 13,702.8 | 623.9 | 13,078.9 | 4.55 |
| 2002-03 | 13,078.9 | 1,696.0 | 14,774.9 | 581.6 | 14,193.3 | 3.93 |
| 2003-04 | NA | NA | NA | NA | 12,860.8 | NA |
| 2004-05 | NA | NA | NA | NA | 13,410.2 | NA |

Table 9 indicates that while the amount of arrears increased from Rs. 10.88 billion on April 1, 2001 to Rs. 14.19 billion on March 31, 2003, thereby registering an overall increase of 31 percent, the rate of recovery was low and ranged from 3.93 percent to 5.02 per cent. The percentage of recovery of arrears of revenue decreased during 2001-02 (4.55 percent) and in 2002-03 (3.93 percent), that is, after bifurcation of the state, when compared to 2000-01 (5.02 percent).

105. All registered dealers above the threshold limit are taxpayers on the basis of the provisions of the law and, therefore, pay tax every month. The taxpayer pays tax directly to the treasury. However, the procedure for payment of tax is complicated. It requires filling in the challan form in quadruplicate of which the treasury returns the third and fourth copies duly endorsed for payment. The "original" copy is sent to the respective assessing authority, while the treasury retains the duplicate copies. The dealer submits the copy marked "quadruplicate" along with the return to the assessing authority.

106. The above procedures for payment of VAT are elaborate and cause considerable inconvenience to the dealer. The existing system of filing lengthy forms for return and collection of detailed information about the dealer through annual "information return" needs to be simplified. Also, it is important that the dealers are allowed to pay tax in all the nationalized banks by cheque.

107. Further, in regard to penalty for fiscal offences in the present law there is some discretion given to the officers. It is important that not much discretion should be given to the tax officials. The penalty should be prescribed in law.

108. As regards procedures of tax administration, standards of accountability at the level of officers is considerably diluted since, *inter alia*, the performance targets, particularly those related to revenue collection, were unrealistic and thrust upon them. The officers in the field resort to questionable practices to meet revenue targets, divorced from underlying economic trends. It is, therefore, important that the revenue targets should be based on underlying economic trends. According to CAG audit reports there is a shortfall in tax collection with a number of irregularities being repeated. There is no system of reconciliation between tax assessments, collections and arrears in the department.

109. Adequate client services play an important role in the VAT regime. These services not only help increase voluntary compliance but also reduce interaction of the dealers with the department. The department should lay special emphasis on providing requisite client services to all the dealers. In fact, the departmental effort should be to provide printed brochures and leaflets, including return forms, well in advance of the due date of submission of the return. Also, requisite information should be made available electronically, mostly online.

110. It must be appreciated that the ultimate accountability of the tax administration is to the citizens in general and to the taxpayers in particular. With a view to enhancing accountability and transparency in tax administration, the tax department must publish an annual report of its own and put it on its website. The annual report must separately provide for performance indicators of each circle. In addition, the quarterly progress of achievement must be displayed on the website, so that taxpayers have an opportunity to respond.

111. ***In conclusion, the rate of increase in arrears is more than the rate of recovery resulting in mounting of arrears. The system of reconciliation between tax***

***assessments, collections and arrears does not exist. This indicates lack of internal control mechanism in the department.***

**PI-16: Predictability in the availability of funds for commitment of expenditure**

112. The purpose of this indicator is to assess the extent to which reliable information is available to line departments on availability of funds for budget execution.

113. In GoJ the budget allocations are available to line departments from the beginning of the financial year. The current situation is that there is no need for cash rationing and no restrictions are imposed on departments in making payments for committed expenditures or incurring new commitments

114. The cash position is being monitored daily by the department of finance. The state has sufficient access to loans and advances as may become necessary. The state has not resorted to ways and means advances[21] or overdraft even for a single day during the last two financial years (2004-05 and 2005-06). However, the department of finance does not prepare any formal monthly cash flow forecasts and therefore in theory runs the risk of unforeseen cash shortages and surpluses.

115. ***In conclusion, while modern cash forecasting techniques have not been introduced, cash balance with the RBI is regularly monitored along with treasury operations. No cash flow forecasts are prepared for the fiscal year or on a monthly basis. In the last two years there is no visible shortage of funds for commitment of expenditure.***

**PI-17: Recording and management of cash balances, debt and guarantees**

116. The purpose of this indicator is to assess financial management capacity of GoJ in debt management, covering issues such as contracting, servicing and repayment, management of cash, debt and government issued guarantees.

117. As with all other states, the RBI maintains the single treasury account of Jharkhand. The recording of all withdrawals and receipts by the state's 24 district treasuries and six sub-treasuries is well established and information flows from the district treasuries to the department of finance and the RBI on a daily basis. This helps the RBI to ascertain the state's consolidated closing cash balance on a daily basis.

118. The treasury operations in Jharkhand have been computerized. However the system is not on real time. Unlike most Indian states, the department of finance

[21] Source: Finance accounts for FY 2005-06. Ways and means advance is given by RBI to bridge any gap that might arise for short periods due to mismatch between the receipts and expenditure of the state governments.

does not have an adequately staffed dedicated cell for managing treasury functions. The State has invariably ended with huge cash balances as is evident from the successive annual finance accounts.

119. Also, funds are reportedly lying in the accounts of commercial banks maintained by the line departments in contravention of the financial rules of the state (see PI 20). The Government does not have any estimate of the magnitude of this irregularity. The AG (A&E) is in the process of assessing the amount involved. The GoJ has issued instructions to all line departments to close such accounts and have the funds re-deposited in the Consolidated Fund.

120. The state's outstanding debt as on March 31, 2006 was Rs.163.5 billion. This includes all public debt including small savings and provident funds. These records are maintained by the AG and are reported with complete details in the annual accounts. Considering that a large quantum of market loans and other Central Government loans appear in the state's accounts, it is important that the state develops mechanisms to manage these loans proactively. The procedure for contracting are elaborate and loans have to be approved by the Cabinet. As stated earlier, the state has already constituted a DMIC. This is a progressive step. Opportunities for debt restructuring and reducing interest costs are to be further explored.

121. Approval of the Cabinet is required before issuing guarantees. As indicated under PI-9, there is inconsistency between disclosure on guarantees made in the state finance accounts for FY2005-06 and the information provided by the department of finance. This indicates that the system of maintenance of records on guarantees needs to be strengthened.

122. There is no standard framework laying down transparent criteria and fiscal targets for approval of debts and guarantees. However the newly enacted FRBM Act lays down that the total debt stock of the state will be limited to 300 percent of the total revenue receipts by the end of 2007-08 coupled with interest payment limited to 18-25 percent of revenue receipts.

123. Given the delay in finalization of the division of assets and liabilities between Jharkhand and Bihar, the records of debt and guarantees remain incomplete from this perspective.

124. ***In conclusion, there is enormous scope for improvement in this area. Debt records are maintained by the Accountant General and reported with complete details annually. The RBI maintains the single treasury account of the State and ascertain the State's consolidated closing cash balances of all treasuries and sub-treasuries on a daily basis. However, funds lying in commercial bank accounts opened by line departments are not consolidated. There is no standard framework laying down transparent criteria and fiscal targets for approval of debts and guarantees. Thus there is an urgent need for putting in place systems which bring forth professional expertise in management of cash,***

***debt investments and guarantees. The initiative taken under the REFORM Project, if advanced with stronger ownership of GoJ, can have a beneficial effect in this area***.

**PI-18: Effectiveness of payroll controls**

125. The purpose of this indicator is to examine the financial management processes which are in place to ensure that salaries are paid and charged in the accounts for government employees on the basis of an authentic payroll.

126. The Bihar Financial Rules form the framework that provides detailed procedures for system of controls over payroll payments. Similarly, the Bihar Service Code provides the framework for detailed procedures regarding creation and maintenance of service books. A service book is maintained for all employees except Group A employees and those employed on a casual/contract basis. The service book is a complete and comprehensive record of service details, entitlements, claims, posts served, etc. about an employee. Service books of Group C & D employees are kept by the Head of Office (HoO) of the respective line departments. The DDOs under the supervision of the HoO are charged with the responsibility of keeping control of the payroll of employees under their jurisdiction. This ensures that salaries are drawn only for employees actually working and in accordance with the entitlements. For Group A employees, the service book (called History of Services) is maintained by the AG. Entitlements for Group A employees are worked out and authorized for payment by issue of payslips at the treasury by the AG. These employees draw their salaries from the treasury. For Group B, the service book is maintained by the department of finance which authorizes withdrawal of salary by the concerned departmental DDO. Thus overall, an adequate manual system exists for ensuring consistency between the personnel database and payroll. Required changes to the personnel records and payroll are updated monthly and generally in time for the following month's payments. Retroactive adjustments are rare. However, it may be worthwhile to mention that in GoI and many other states, a uniform system of maintenance of service book by the HoO and withdrawal of salaries by the departmental DDO is in place. This facilitates simplification and also reduction in the number of DDOs.

127. There is no state wide aggregate database of all government employees. The treasury also maintains the database of sanctioned strength under each DDO. It ensures that salaries drawn overall by a DDO are not in excess of the sanctioned strength. The treasury only ensures that salaries drawn each month are not in excess of the sanctioned strength under each cadre.

128. The GoJ has introduced direct credit of the employee's salary for all groups to their bank accounts to reduce the flow of cash in the system.

129. The AG's audit includes verification of service books as does the audit wing of the finance department. Audit reports do not include any major irregularities on this front.

130. ***In conclusion, the payroll of all regular employees is verified with personnel records on a monthly basis before payments are effected. Records are updated on a regular basis and all changes are authorized with a satisfactory audit trail. Record keeping and documentation controls are well supervised. Annual AG audit includes verification of service books.***

**PI-19: Competition, value for money and controls in procurement**

131. The purpose of this indicator is to assess the quality and transparency of the public procurement system including the extent to which open and fair competition is used for getting value for money.

132. So far as the state procurement system is concerned, there is currently a lack of sufficient data to clearly set out how widespread is the reliance on the use of open competitive tendering. Whatever data there is suggests that the open procedure is used regularly. Indeed, as explained in the next paragraph, one of the main problems in Jharkhand appears to be automatic recourse to open competitive tendering whether or not that is the appropriate method of procurement. Moreover, this is not an exercise in judgment, but the result of strict application of the rules.

133. As with other states, the purchasing authorities of GoJ, at all levels of spending, are required to comply with a series of procurement rules inspired by the General Financial Rules of GoI, in the case of supplies contracts, and the Public Works Department (PWD) code in respect of works. For historical reasons, in Jharkhand, these were taken directly from the rules applicable in Bihar.

134. There is no specific procedure for the procurement of consultancy services. It seems clear that these rules are in need of updating and reform but there are additional impediments to good procurement in Jharkhand. The political situation is such that the various departments lack the manpower, skills and momentum to apply the rules appropriately or fail to apply them at all. In order to overcome their practical difficulties, they are obliged to address their procurement needs through different methods not identified in the rules. Many of the methods adopted are incompatible with the existing rules,[22] suggesting that at least some reform of those rules is necessary. The response of executing agencies to the extreme pressures created by a lack of capacity and human resources represent

[22] For example, PWD road construction is currently pursuing PPPs in roads although the regulatory structure for PPPs in Jharkhand has not yet been developed. The health department has experimented with signing sole source contracts with large PSUs for the construction of works in order to ease their procurement burden, although this approach is not sanctioned by applicable regulations.

practical ways to expedite procurement but come at the high cost of reducing transparency and competition.

135. The common feature in all departments interviewed was the lack of a consistent approach. This is also exacerbated by the lack of oversight and control. There is no collection and synthesis of procurement data and no entity responsible for overseeing procurement policy or execution in the state. Whilst there are some expenditure approval mechanisms, there is no direct internal or external control of the procurement function and no systematic audit. Procurement failures are identified, if at all, by chance or as a result of political intervention. Whilst the data collected, therefore, suggests that the open procedure is the preferred method of procurement and is used regularly, this does not provide an accurate measure of the system. Besides, the system is based on outdated and inappropriate rules, applied haphazardly, undermined by a lack of capacity and bedevilled by the current political uncertainty in the state. The quality and transparency of the system is thus open to question.

136. With respect to applicable regulations regarding the use of different procurement methods, Jharkhand's public procurement system is excessively rigid. Procedures other than open competitive tendering are provided for but the rules applying to the proper use of these exceptional methods are so stringent and/or unrealistic that the rules force procurement entities to apply the open procedure even where that is not the most appropriate.

137. The cost of applying such a procedure will often far outweigh any financial or substantive benefit so that any pretence of seeking to achieve "value for money" or efficiency is lost. Thus, the open procedure must be used for all contracts whose value exceeds INR 200; there is no procedure for seeking quotations, no limited bidding and no pre-qualification. These problems are compounded by the lack of competence, the absence of sufficient standard forms for bidding and contract documents and the over-reliance placed on often outdated schedules of rates in the evaluation process as a means to avoid exercising judgment. Thus the problem is neither that the regulations do not provide for conditional use of exceptional procedures nor that the regulations are not complied with. The real issue is that the regulations are themselves flawed and compliance with them is likely to lead to a loss of efficiency and value for money.

138. There is no objective and independent complaints mechanism[23] which would enable aggrieved bidders to effectively challenge any breaches in the recognized procurement process. If there are any complaints - and the evidence is that such

---

[23] It is important to distinguish between the role of an independent complaint mechanism and the CVC. Independent complaint mechanisms are designed to ensure that bidders and/or potential bidders have the ability to raise complaints against a procurement process and ensure that the process happens in accordance with the rules. The objective of this is to have a proper process, not to identify and punish wrong-doing on the part of officials. Processes that are run by the CVC or state vigilance committees operate in order to identify wrong-doers within the government and punish them.

complaints are rare - these are generally dealt with at a departmental level. This is a type of internal and hierarchical administrative control which implies that the complaint will be heard by the same government department which is responsible for the procurement. Given the involvement of senior officials in various tender committees, this will, in some cases at least, result in the same persons hearing a complaint against a procedure in which they are implicated. Modern procurement systems make efforts to provide complainants with confidence in a complaints mechanism which provides impartial and independent review.

139. ***In conclusion, the procurement function is rather poorly executed. The combination of a severe lack of capacity and human resources with a set of outdated rules constrains the ability of executing agencies to comply with the law and execute procurement effectively. In response, agencies are developing new practices which while pragmatic continue to widen the divide between the formal rules and actual practices. There is a severe institutional failure to guide, support and ensure value for money.***

**PI-20: Effectiveness of internal controls for non-salary expenditure**

140. The purpose of this indicator is to assess the comprehensiveness, relevance and understanding of the internal control framework and compliance with controls in budget execution.

141. Apart from the Bihar Financial Rules (Volumes I & II), a number of other rules and codes have been adopted by Jharkhand. These include the Bihar Budget Manual, the Bihar Treasury Code, the PWD Code, the Public Accounts Code, etc.

142. While the overall framework is undoubtedly comprehensive, many of the rules are antiquated and need to be reviewed. GoJ has issued a number of orders/circulars impacting many of these rules but without amending them. There is a need to revamp these in line with more modern results-based management techniques, taking advantage of present-day technology solutions.

143. The treasury ensures that no excess withdrawal takes place against allocations under any budgetary head. In Jharkhand there are large savings in almost every demand for grant. Therefore the question of non-availability of cash/budget to meet commitments does not arise. However, there is no system of tracking commitments at the departmental level.

144. Athough in the present scenario, budget overrun against any demand for grant is a very rare phenomenon in Jharkhand, our study in three departments has revealed several instances of non-compliance with the other internal control rules and procedures as laid down in the State Financial Rules (See Box). A perusal of

Chapter V[24] of the CAG's Annual Audit Report of successive years indicates several lapses in internal control.

**Box 9: Monitoring and control of expenditure**

**Health & RD**: As per Rule 475 of BFR, all COs/HoDs are required to maintain a broadsheet in the prescribed format to watch receipts of the monthly and progressive totals of expenditure up to sub-head level from all DDOs to monitor expenditure vis-a-vis physical achievements. COs/ HoDs neither maintain broadsheets nor insist on getting the expenditure figures from the DDO. There is no expenditure monitoring by COs.

**Roads Construction**: Monthly accounts are maintained by field units and consolidated and monitored at the level of CO. Since the department functions under the PWD model, where monthly accounts are required to be compiled by district level units and not by AG (A&E), accounting is regular. A person from the divisional accountant cadre is positioned in every district level unit to undertake the accounting function.

**Health**: Rule 306A of the Jharkhand Treasury Code requires inspection once a year of the office of DDO by the CO with special emphasis on accounting records. No such inspection has been conducted.

**RD**: Although inspection was conducted in four districts in FY 2005-06, no inspection reports were issued.

**RD**: Rs. 240 million drawn from Contingency Fund in February 2004 was not recouped till close of the year. Finance accounts for FY 2004-05 shows that this advance was utilized under the head- 4515-103 – Rural Development and withdrawal was due to "non-availability of provision". But, the AA/s 2003-04 shows that Rs. 87.19 lakhs and Rs. 1314.47 lakhs were re-appropriated from this minor head reflecting lack of budgetary control.

**RD**: Contracts for construction of rural roads contain provision for recovery of liquidated damages in case of delay in completion of works. Recoveries although made were refunded in all cases after a few years on the ground that delay was due to law and order situation. In no case since the formation of the state were liquidated damages forfeited.

145. Timely clearance of advance accounts is another important aspect of internal control. The Jharkhand Treasury Code[25] provides that advances drawn on AC bills are required to be settled within one month by providing supporting invoices, failing which the treasury should decline further withdrawal of the AC Bill by the same DDO. However, there is widespread non-compliance. Unadjusted advances are an endemic problem in the state. Overall, an amount of Rs. 10.73 billion was drawn during 2005-06 as advances against which no settlements had been submitted till October 2006. The corresponding amounts outstanding for adjustment as on October 2006 for 2004-05 was Rs. 11.67 billion and for 2003-04 was Rs. 3.63 billion.

146. In 2004 the department of finance issued instructions for opening of commercial bank accounts, one each at the level of deputy commissioner, circle officer, block development officer and sub-divisional officer to overcome certain practical

[24] AG Jharkhand does a review of the internal control system of one line department every year. This is reported in Chapter V of the Civil and Commercial Audit Report.
[25] Rule 320 of Jharkhand Treasury Rules (Vol I).

difficulties after taking necessary permission from GoJ as required by the treasury code. The circular was ambiguous about the purpose for which these accounts could be opened. Taking advantage of this ambiguity, numerous bank accounts were reportedly opened by several departments at various levels (district blocks, etc) without necessary permissions, and funds withdrawn from the Consolidated Fund were parked in such accounts. GoJ does not have a reliable estimate of the magnitude of this irregularity. AG (A&E) is in the process of assessing the amount involved. GoJ has issued instructions to all line departments to close such accounts and have the funds re-deposited in the Consolidated Fund.

147. Unlike other States like Karnataka, Tamil Nadu, Rajasthan, GoJ faces a major capacity constraint as it does not have an established Finance and Accounts cadre. Although the state has IFS under which every line department has an IFA, the IFAs are generally drawn from the state/central civil service. No specific training is provided to them to handle this specialized job. The officers therefore do not have the right orientation to help the HoDs in taking appropriate financial decisions. Weak capacity in enforcing internal controls is evident from the recurrent and large number of audit objections.

148. ***In conclusion, essential financial controls have not been operating as intended. The CAG audit reports point to frequent and repeated financial irregularities involving very large sums of money. The most serious of all concerns is that despite widespread knowledge of control weaknesses there is limited response from the executive by way of timely remedial actions. CAG's findings tend to be repetitive year after year due to continued non-compliance with the established controls. Incentives to promote adherence to internal control systems as adopted in Andhra Pradesh merits consideration.***

**Box 10: Incentivizing Compliance with Financial Management Rules: Andhra Pradesh**

In April 2002, the Government of Andhra Pradesh issued a Government Order (GO 507), which restated some basic financial management rules of the state, and also attempted to set up an incentive structure for compliance with these rules. The basic move was to link fund releases to prior adherence with financial management requirements, using self-certification. GO 507 includes the following provisions:

- No amounts can be drawn for a particular scheme until the responsible DDO indicates that at least 50 percent of pending audit paragraphs for the years up to 2000/02 have been replied to.
- No further Abstract Contingent (AC) Bills (advances for expenditures) will be paid until detailed contingent bills (expenditure statements) are provided for earlier AC bills, indicating how the funds will be released against the AC bill were actually utilized.
- No funds will be released after the tenth of the month to a DDO unless she/he certifies that she/he has undertaken a reconciliation of accounts for the previous month (this refers to the reconciliation between departmental and treasury figures).
- Funds will not be released to Personal Deposit Accounts or bank accounts unless UCs show that at least 75 percent of the funds released earlier has been spent.
- Prior to the release of funds, local bodies and other government entities need to have completed their statutory audit for 1999/00, and have cleared their audit objection.

*Source: Karnataka PFMA Study, World Bank, April 2004.*

**PI-21: Effectiveness of internal audit**

149. The purpose of this indicator is to assess whether there is a regular and adequate feedback on the performance of the internal control systems through an internal audit function, which is independent of the internal financial control systems and whether it is operating to professional standards.

**Box 11: Internal audit**

**Health and RD**: Although audit has been conducted in some of the field units, no internal audit report has been submitted to the secretariat of the department in the last five years.

150. There is no independent internal audit function in the state. There are however "internal audits" in the nature of a internal checking activity conducted periodically by approximately 125 dedicated staff of the department of finance to monitor the functioning of certain financial controls based on requests received from line departments/district collectors or areas deemed as having high risk by the department of finance. These "internal audits" of transactions are focused mainly towards identifying major defalcations with a view to undertake recoveries. There are individual audit reports of their activities but no summation of the results of their activities or overall impact of the function. These internal checks are transaction-based and not systems-based. They do not make recommendations for improvements of systems. Internal audit staff is drawn from the commercial tax cadre. No specialized training is imparted to the internal audit staff.

151. ***In conclusion, the internal audit function mainly focuses on recoveries in cases of defalcations and does not meet professional standards. Internal audit, as elsewhere in India, is a minor player in the overall system of Jharkhand's public financial management.***

***C (iii) Accounting, Recording and Reporting***

**PI-22: Timeliness and regularity of accounts reconciliations**

152. The purpose of this indicator is to assess the regularity and timeliness of reconciliations of critical accounts data.

153. Since primary data from which AG (A&E) compiles Jharkhand's accounts are provided by the treasuries, the information so compiled needs to be reconciled with the information kept by the DDOs of the concerned line departments which are the spending units. Normally AG (A&E) reconciles the information on a monthly basis. However in Jharkhand a huge backlog of these reconciliations, widespread across departments, has been piling up (Table 10). This raises questions regarding the reliability of financial information in the primary records of GoJ.

**Table 10: Unreconciled Expenditure [26]**

| | | | *Rs. million* |
|---|---|---|---|
| **Year** | **Number of COs who did not reconcile their figures** | **No. of units** | **Amounts not reconciled** |
| 2000-01 | 24 | 1259 | 902.37 |
| 2001-02 | 27 | 1736 | 3324.83 |
| 2002-03 | 29 | 2453 | 3939.93 |
| 2003-04 | 95 | 1120 | 4067.89 |
| 2004-05 | 95 | 1615 | 5544.76 |
| 2005-06 | 96 | 1636 | 5307.52 |
| Total: | 366 | 9818 | 23088.30 |

154. Jharkhand has approximately 10,000 DDOs out of which about 8,000 are in the education sector. Therefore reconciliation is a huge task by itself. Reduction in the number of DDOs merit consideration.

**Box 12: Rationalising number of DDOs**
UP which had more than 30,000 DDOs at one time, rationalized the number of DDOs by applying the principle of "one DDO per department per district" and successfully reduced the number of DDOs to less than 10,000.

155. As on date, the unreconciled difference in the closing cash balance according to the GoJ's books and that intimated by RBI up to March 2006 is Rs. 25 million. However, the entire unreconciled balance relates to the period prior to the formation of the state.

156. ***In conclusion, the analysis above indicates that the accounts are not reconciled regularly and delays extend into several years.***

**PI-23: Availability of information on resources received by service delivery units**

157. The purpose of this indicator is to assess whether appropriate systems exist to capture information which can clearly demonstrate that resources, in cash and kind, that are intended for use by front line service delivery units such as schools and health clinics as per plan, are actually received. Tracking of such information is crucial in order to determine if the PFM systems effectively support frontline service delivery.

158. Although the budget documents do not make it explicit, allocations for primary

[26] C&AG''s Civil and Commercial Audit Report 2006.

service units are basically embedded within the budget of the concerned departments. The accounting system as maintained by the AG (A&E) is capable of capturing actual expenditures up to the DDO level. However, this is not being done currently. Expenditures incurred are being captured only up to the level of the Budget Control Officer (BCO).

159. In the education sector, the headmasters of schools are generally the DDOs. In the health sector, the Chief Medical Officers (CMOs) are the BCOs for the entire district. The medical officers are the DDOs at the primary service delivery units. There is no formal reporting arrangement for feedback on either physical or financial resources utilized at the primary service delivery units.

160. So far as distribution of materials is concerned, the same is recorded at the level of the primary service delivery units. GoJ does not undertake tracking surveys to collect such data.

161. Although expenditures incurred are being captured up to the level of the budget control officer by the AG, the same is not available to the implementing department. Thus at the level of the line department there is no arrangement for reporting or aggregation of data for monitoring purposes.

162. ***In conclusion, the accounting system does not provide information to demonstrate resources actually received by the primary service delivery units.***

**PI 24: Quality and timeliness of in-year budget reports**

163. In-year budget reports allow comparison of the actual financial performance with the budgets to make corrective actions as needed. The purpose of this indicator is to assess GoJ's ability to produce comprehensive timely in-year budget execution reports from the accounting system.

164. According to the Bihar Financial Rules, every department is expected to maintain a register for recording all expenditure in the prescribed format at the spending unit level. A copy of this is required to be sent to the CO every month. A monthly abstract is also expected to be prepared in the budget format for all spending units and submitted to the CO.[27] The abstract allows for comparison between budget and actuals on a monthly basis.

165. However, our reviews in the three departments reveal that the above system is not being adhered to. Thus there is no aggregation of in-year budget reports to prepare a departmental report for monitoring purposes in most departments. The only exceptions are the few departments[28] rendering accounts to the AG (A&E) directly. The department of finance does not receive monthly statements of

[27] Rule 475 of Bihar Financial Rules.
[28] RD, Health and Roads Construction Departments.

expenditure from the departments to facilitate in-year budgetary correction at its level.

166. Monthly accounts received by the department of finance from the AG (A&E) provide expenditure data by major heads for functional levels and not department-wise for administrative levels. It therefore does not facilitate in-year budgetary corrections.

167. In the absence of regular reconciliation between the accounts compiled by AG (A&E) and the in-year budget reports maintained at the level of the spending unit or DDO, accuracy of data cannot be ascertained.

168. Presently there is no mechanism for periodic review of budget execution reports by the cabinet.

169. ***In conclusion there is no effective in-year monitoring due to lack of availability of timely accurate monthly scheme-wise / departmental accounts.***

**PI-25: Quality and timeliness of annual financial statements**

170. The purpose of this indicator is to assess the completeness, accuracy and timeliness of annual financial statements submitted for audit.

171. The framework of year-end financial statements is common across all states and GoI and is determined by Article 151 of the Indian Constitution. These statements basically consist of two major documents, the Finance Accounts and the Appropriation Accounts.

172. Finance Accounts present the accounts of receipts and outgoings of the Consolidated Fund for the year, under revenue and capital heads, the accounts of the public debt, contingencies fund and financial assets as worked out from the balances recorded in the accounts. However no comparison is made with the budgetary allocations. Corresponding figures for previous years are given. Major variations compared to previous year are explained, but the explanations are generally brief without always going into the details. The Finance Accounts have a total of 19 individual statements with annexes covering a number of details. A few important ones can be identified as Capital Outlay, State's Debt Position, Loans & Advances, Guarantees given by the State Government, Cash Balances, Capital Expenditures, Commitments for Incomplete Capital Works, etc.

173. Appropriation Accounts provide the comparison of the charged/voted grants with actual expenditure. These analyze each individual grant, minor head-wise, providing details of grants under the revenue and capital head with actual expenditure. The comments also consider the status of supplementary grants. However, as in other states, the reasons for variations between the budget grant and actuals are not provided for most of the grants. As a result the utility of the Appropriation Accounts is diminished.

174. An additional statement called 'Accounts at a Glance' is prepared. This provides an overview of government revenues and expenditure and the financial performance of the state. The information is presented through tables and brief explanations. The overall purpose appears to be to help a non-expert understand the salient features of the State Finance and Appropriation Accounts.

175. These year-end financial statements are prepared on cash-basis accounting by the AG (A&E) on behalf of the CAG, who certifies the "correctness" of the presentations. Normally, the financial statements are certified within 9-10 months of year-end, but they are not made available to the public till these are placed on the floor of the house. In the case of Jharkhand this takes place generally after 12 months.

176. Till now there are no accounting standards codified for presentation of Government Accounts. In 2002 the CAG took the initiative to formulate a Government Accounting Standards Advisory Board (GASAB) which has issued five Exposure Drafts, including Exposure Draft 4 on Presentation of Financial Reports. The draft recognizes cash-based accounting with certain established exceptions. It makes several suggestions on how to make the financial statements more presentable and simpler to understand. It also recommends disclosure of all major accounting policies.

177. ***In conclusion, consolidated financial statements are being prepared annually with sufficient information on revenues, expenditure, financial assets and debt. The statements are prepared on a consistent basis and format over time. These are prepared in line with prevailing national rules for government accounts. These rules do not comply with international public sector accounting standards for cash-based financial reporting. The statements are submitted for external audit within six months of the year's end. Tax expenditures, pension and other liabilities, contingent liabilities etc are not disclosed.[29] Any significant improvements in these areas are recognized as being in the domain of central institutions.***

[29] Under the recently enacted FRBM Act, this information is required to be disclosed in the annual budget document.

### *C (iv) - External Scrutiny and Audit*

**PI-26: Scope, nature and follow-up of external audit**

178. The purpose of this indicator is to assess the adequacy, independence and quality of audit, timeliness of submission of audit reports to the legislature and effectiveness in follow-up of audit observations.

179. Articles 148 to 151 of the Indian Constitution deal with the CAG, which is an authority created by the Constitution. The head of the CAG's audit organization at Ranchi is called the AG-Audit.

180. The Constitution prescribes adequate safeguards for the free and independent functioning of the CAG who is appointed by the President and holds office for a fixed non-renewable tenure of six years.

181. 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 matters contained in the said list, to the exclusion of the state legislatures.

182. The state audit reports of the CAG are submitted to the Governor who must have them laid before the legislature.

183. The CAG has responsibility to audit all receipts and expenditure of the State Governments including substantially government funded bodies or authorities.[30]

184. The statutory auditors for the audit of government companies are appointed by the CAG who has the right to issue directions to such auditors and to also conduct any further audit deemed necessary. The scope of audit is also decided by the CAG.

185. The CAG's annual audit report of Jharkhand consist of two parts, a Civil and Commercial Report which covers audits of government departments and state public sector entities, while the Audit Report of Revenue Receipts cover the revenue part of the state government. These reports provide an overall critique of state finances, comments on efficiency of budgetary allocations, both original and supplementary, performance review of 2-3 departments, results of transaction audits undertaken in the state, results on review of internal controls in one department every year and report on audit of PSUs. Transaction audit is

[30] 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 percent 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.

conducted annually in all the line departments and major field units. The CAG follows a system of biennial and triennial audit of small field units. The reports are written with clarity and cover a variety of issues. The CAG also publishes annually an epitome of the main contents of their audit reports.

186. The CAG has promulgated their own auditing standards in line with international standards. In practice, however, the majority of audit work is focused on compliance with financial rules and regulations. The emphasis on performance auditing is increasing. Of late the CAG has introduced the practice of hiring private consultants for doing field surveys of beneficiaries and other stakeholders.

187. A gap analysis identifying variations between CAG's auditing standards and actual practices has not been undertaken. One concern is reporting on the fair presentation of financial statements of the government. The report is focused on "correctness" of the statements as distinct from "fair presentation" of the financial position of the state. The audit issues that are of the highest significance need to be prioritized. Also, the impact of audit qualifications is not provided on the face of the "audit certificate".

188. The CAG's audit reports become public after these have been placed in the legislature. Audit report for FY 2005-06 was tabled in April 2007. In the earlier years these were tabled after about 18-21 months after the end of the financial year.

189. The single biggest problem affecting the impact of external audit is a lack of responsiveness from the executive to audit observations. While the state has been regular in presenting the CAG's report to the legislature, the response to audit findings at the department level, as is common in most Indian states, is rather tardy. A large number of issues remain pending. For example, over the years, 760 inspection reports ranging from 1986-87[31] to 2005-06 still remain unresolved. GoJ could benefit by following the effort made in Karnataka where a computerized tracking system has been introduced to follow up on audit observations and in Andhra Pradesh where release of funds to departments are linked to timely audit response.

**Box 13: Unresolved inspection paras**
*(outstanding since FY 2000-01)*

| | |
|---|---|
| Health | 236 |
| RD | 790 |

**Box 14: Improvement in audit responsiveness**

In Karnataka Departmental Committees and an Apex Audit Committee (at chief secretary level) have been established to institutionalize and facilitate the audit responsiveness process. Interim audit findings and final audit reports are put up to these committees for appropriate response. Controller (Accounts Management) has established a web-enabled audit tracking and monitoring system (a first in India) linking the entire government and the State AG's office, which has assisted in improving the responsiveness to audit reports, with overall 82% audit responses in 2004/5 (Base - October, 2002 for CAG audit reports) as compared to 38% in 2002-03.

[31] These pertain to areas now falling under Jharkahnd which were earlier part of undivided Bihar.

190. The seemingly indifferent attitude of government and the legislature to 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. Audit observations are frequently repeated year after year. The Government may consider initiating steps taken by States like Andhra Pradesh and Karnataka (see box nos. 10 & 14 respectively) to improve audit responsiveness.

191. ***In conclusion, there exists a fairly robust constitutionally guaranteed independent public audit set-up. All major entities are subject to audit covering revenue, expenditure and financial assets/liabilities. A full range of regularity audits and performance audit in select departments are performed generally adhering to their auditing standards, focusing on significant and systemic issues. Audit reports are generally submitted to the Assembly after one year of the end of the period covered. There is no clear evidence of effective and timely follow-up by the executive. Thus the elaborate system of public audit is not having the desired impact on the state's performance.***

**P1-27: Legislative scrutiny of the annual budget law**

192. The purpose of this indicator is to assess the nature and extent of legislative scrutiny of the budget *before* the budget law is passed.

193. The PEFA framework assesses whether the legislature undertakes detailed scrutiny of budget proposals, whether internal procedures of the legislature for budget review are firmly established and complied with, whether the legislature is allowed adequate time of at least two months to review budget proposals and whether clear rules exist for supplementaries.

194. Jharkhand has established rules for the functioning of the Legislative Assembly. Keeping in line with the rules, the Jharkhand assembly has, on paper, an Estimates Committee. But it is not functional. Although the legislative assembly rules lay down procedures for presentation, discussion and passage of the budget,[32] there is insufficient debate on the budget document before it is passed by the legislature. The 2007/08 budget proposals were enacted reportedly without any discussion on the floor of the assembly. Supplementaries are passed during the fiscal year but again without sufficient debate in the assembly.

[32] The state legislative assembly rules lay down that there shall be no general discussion of the budget till after five days from the day on which it is presented to the assembly and the voting on demand for grants shall not commence till after 17 days from the day the budget is so presented. However, the speaker of the house has the power to suspend these rules.

195. ***In conclusion, the established procedures for conducting review of budget proposals are not followed. The time allotted for review by the Legislature is clearly insufficient for any meaningful debate in the House.***

**PI-28: Legislative scrutiny of external audit reports**

196. The purpose of this indicator is to assess the nature and extent of legislative scrutiny after the budget execution has been completed. The focus in this indicator is on state government departments and related entities, including autonomous agencies to the extent that either: (a) they are required by law to submit audit reports to the legislature; or (b) their parent or controlling department must answer questions and take action on the agencies' behalf.

197. The framework and system of ex-post legislative oversight of public financial management is prescribed in the Indian Constitution. Each state assembly operates in a manner that respects the centrally driven framework.

198. Jharkhand has framed its Rules of Procedure and Conduct of Business of the state assembly. These rules provide for the establishment of the PAC and the Committee on Public Undertakings (PUC) to which the Audit Reports of the CAG stand automatically remitted for follow-up action. In some states, departmental standing committees monitor the timely presentation of reports and papers to the legislature. Jharkhand does not have any such committee.

199. The PAC and the PUC consist of up to four members and have a term of one year. A minister cannot be a member of either of the committees. One of the committee chairmen (PUC) is at present from the opposition and the other (PAC) from the supporting party. Both committees are assisted by the CAG office in Jharkhand in the examination of their audit reports.

200. The PAC is expected to examine the audit reports of the CAG on the accounts of the state government. It is also expected to examine cases of excess expenditure beyond the amount of grants authorized by the legislature and make suitable recommendations before the excess amount can be regularized by the legislature. But the record so far is that the meetings are few and far between and they do not regularize any excess expenditure.

201. The system of legislative scrutiny in Jharkhand is very rudimentary. Examination of audit reports is at a bare minimum and there is a huge backlog (Table 11). The reports are discussed on a first in first out basis – thus the recent reports of the CAG will not be dealt with for a long time. Hearings that do take place reportedly are not in-depth. And very few, if any, recommendations have been made by the oversight committees so far.

**Table 11: Backlog in legislative scrutiny**

| Year of audit report | No. of paras | | | No. of reviews | | No. discussed | | | No. settled para/rev | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | *Civ.* | *Com* | *RR* | *Civ.* | *RR* | *Civ.* | *Com* | *RR* | *Civ.* | *Com* | *RR* |
| 1999 - 2000 | 30 | -- | 36 | 7 | 1 | 21 | -- | 36 | -- | -- | 3/0 |
| 2000 - 2001 | 19 | -- | 32 | 6 | 2 | 19 | -- | 22 | 1/3 | -- | 1/0 |
| 2001 - 2002 | 13 | 1 | 25 | 3 | 2 | 12 | -- | 25 | -- | -- | -- |
| 2002 - 2003 | 26 | 1 | 39 | 5 | 3 | 19 | -- | 32 | 1/0 | -- | -- |
| 2003 - 2004 | 17 | 2 | 29 | 6 | 2 | -- | -- | 2 | -- | -- | -- |
| 2004 - 2005 | 23 | 4 | 27 | 5 | 2 | -- | -- | -- | -- | -- | -- |
| 2005 - 2006 | Not yet placed before the legislature | | | | | | | | | | |

202. The PAC held 14 meetings in 2004-05, 10 meetings in 2005/06 and 24 meetings in 2006/07 up to January 31, 2007. Seven "Action Taken Notes" have been issued so far. A major disability is the lack of a sufficient number of meetings, poor attendance by members, and an inadequate response to the committees' reports. These are closed hearings where the engagement of the public and the media is absent. Even secretaries of departments do not personally appear before the committee. There is very limited transparency of the committee process or results.

203. The PUC is expected to examine the accounts and the audit reports of the public sector undertakings, and the reports of the CAG, if any, on these undertakings. Here again the system is not working as intended. There are extremely few hearings. The PUC had held only one meeting in 2005/06, since the formation of the state, but has so far not submitted any report.

204. The relative inexperience of the legislative system in Jharkhand is one of the reasons for lack of rigorous legislative scrutiny. Capacity building in this area will help in strengthening legislative oversight. Exposure to best practices and training of members and staff in research and follow-up methodologies will be beneficial.

205. ***In conclusion, while the machineries for oversight exist, the main issue is lack of any impact of legislative scrutiny – the oversight committees have not been able to place sufficient pressure on the executive to improve Jharkhand's public expenditure management system. And this has detrimental effect not only on the performance of the legislature but also on the impact of the external audit function on which it feeds.***

**Government reforms**

206. Jharkhand has recently passed the FRBM Bill recommended by the Twelfth Finance Commission. This legislation is aimed at institutionalizing a medium-term fiscal framework and encourages the imposition of a defined timeframe for a gradual reduction in the government's fiscal and revenue deficits. A Center for Fiscal Studies comprising a Fiscal Policy and Analysis Cell and a Debt and Investment Cell has been set up in the department of finance under the USAID-assisted REFORM Project to augment the capacity of Jharkhand's department of finance in the areas of revenue and expenditure, planning, forecasting and analysis and for developing a medium-term fiscal framework. USAID has also recommended a software for debt and investment management which is under consideration by the state. Under this project, technical assistance has been provided for preparing departmental performance budgets in 12 major departments. Manuals are being written for improved debt management, performance budgeting, disclosure of contingent liabilities, etc. A number of studies and evaluations are also being completed on a variety of topics including revenue estimates, tax expenditures, buoyancy and elasticity of sales tax, and cost benefit analyses of program activities, such as irrigation schemes and primary education. Training has been imparted on project appraisal techniques to officers in the planning and line departments

207. The reforms program has so far focused on *fiscal* management as distinct from financial management of public resources. It would now be opportune to expand the scope of the existing reforms beyond macro economics. This should ideally encompass budget execution and monitoring arrangements, including human resource requirements and technical capacity for better financial management, reporting and external scrutiny arrangements. Without these, the targets set in the fiscal responsibility legislation recently passed would be difficult to achieve.