Impact Study of implementation of recommendations of

State Financial Accountability Assessment

Government of Andhra Pradesh

CENTRE FOR GOOD GOVERNANCE
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About CGG

The Centre for Good Governance (CGG) was established by the Government of Andhra Pradesh (GOAP) in October 2001 to help it achieve the goal of 'Transforming Governance'. Besides supporting the design and implementation of GOAP's Governance Reform Programme, CGG undertakes action research, renders professional advice, and conducts Change Management and Management Development Programmes for Government departments and public agencies to help them implement their reform agenda.

The Finance Department, GOAP entrusted the project *'Post State Financial Accountability Assessment Impact Study'* to CGG under DFID supported Delivery of Improved Services in Administration (DISA) programme.

The Team

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Abbreviations

AC	Abstract Contingent
AFF	Annual Fiscal Framework
AG	Accountant General
AO	Accounts Officer
BRO	Budget Release Order
CAG	Comptroller & Auditor General
CAO	Chief Accounts Officer
CCO	Chief Controlling Officer
CO	Controlling Officer
CSS	Centrally Sponsored Schemes
DC	Detailed Contingent
DDO	Drawing and Disbursing Officer
DR	Development Report (of SFAA Report)
DTO	District Treasury Officer
EAP	Externally Aided Project
FD	Finance Department
FR	Fiduciary Report (of SFAA Report)
FRBM	Fiscal Responsibility and Budget Management
GASAB	Government Accounts Standards Advisory Board
GO	Government Order
GOAP	Government of Andhra Pradesh
GOI	Government of India
GSDP	Gross State Domestic product
IFIS	Integrated Financial Information System
MEO	Mandal Education Officer
MTEF	Mid Term Expenditure Framework
MTFF	Medium Term Fiscal Framework
NIC	National Informatics Centre
PAC	Public Accounts Committee
PAO	Pay & Accounts Office
PD	Public Deposit
PFM	Public Financial Management
PHC	Primary Health Centre
REINS	Resource & Expenditure Information Systems
SCO	Subordinate Controlling Officer
SFAA	State Financial Accountability Assessment
SSA	Sarva Siksha Abhiyan
STO	Sub Treasury Office

Executive Summary

1 The State Financial Accountability Assessment conducted in 2003 was an important milestone in that it provided the government a sense of where it stood with respect to public financial management and what needed to be done in order to further strengthen it. The SFAA Report listed as many as 193 action points at the end of its report. While many were within the state government's ambit, there were a few which required GoI and CAG to take action. There was no concerted action on part of the government to implement the recommendations. There was no steering committee or a similar mechanism to review the implementation from time to time. Recommendations that required cooperation of other agencies were not referred to them. The report nor its findings / recommendations were disseminated within the government to all the stakeholders.

2. There are 12 PFM parameters which were subject of assessment. GOAP has done extremely well in respect of two - debt management and contingent liabilities. There has been substantial progress in achieving budget transparency. There has been very little movement in PFM legal framework, asset management, internal controls, monitoring and evaluation. Increasing use of societies to implement government schemes has increased not only the fiduciary risk that the amounts may be misspent but also of misappropriation.

3. There has been very little progress in improving the PFM legal and institutional framework since SFAA Report except issue of a few detailed government orders (some like GO 507 were already issued by then). The codes and manuals remain to be updated. Accountability of CCO, CO and DDO remains to be codified. Accessibility of codes and manuals could be improved with the official distribution of their hard copies or their availability on website. Institutionally, finance and accounting is yet to be recognized as an important function to deserve sufficient number of posts, an organized cadre and continuous upgrading of competence through training.

4. Unpredictability of receipts from central government, under provisioning of non-salary O&M expenses, limited flexibility in budgeting owing to debt servicing and salary commitments, lack of ownership of budget at departmental / district level, and poor capacity of district level offices to prepare budgets etc. remain the challenges to effective budget formulation. There is a need to build on the MTEF attempted in health department to make its application state wide, and also link it to actual yearly budgetary process. There has been consolidation and also improvement as far as budget comprehensiveness and transparency are concerned. GOAP is moving towards the medium term objective laid down by the Core Committee appointed by the GOI on fiscal transparency, according to which states are to be encouraged to move towards publishing Budget Summary in the format prescribed by the Planning Commission. Many of the requirements of this format are either already provided in

the Budget in Brief or in the process of being added to the various documents on the basis of the recommendations of SFAA study .

5. As for budget execution, predictability of flow of funds remains a source of concern. While compliance with Treasury controls is adequate, in the area of departmental controls compliance is generally weak. Control over re-appropriations and releases from Contingency Fund need much improvement. The practice of opening bank accounts to deposit scheme funds / grants has assumed alarming proportion and unless remedied on priority poses a big risk of defalcation and misappropriation. Recording and monitoring of loans requires urgent attention. There is need for financial MIS to guide the government on with in the year commitments and identify shortfalls and savings so that there are more real time adjustments rather than once a year exercise of revised estimates.

6. Reliability of accounts is ensured by the government and the AG as (unlike in private firms) the responsibility for maintenance and preparation of accounts is divided between the two. Timeliness of reconciliation and control over public account continue to pose significant fiduciary risks which can be addressed by the government; whereas there are accounting issues such as accounting standards and policies that require changes at the Government of India level requiring active engagement of CAG and GOI.

7. While GOAP has made some effort in improving timeliness and reliability of monitoring reports, there is scope for further improvement notwithstanding the constraints placed by India wide formats laid down by CAG of India.

8 On all counts, asset management and internal audit in GOAP are weak and they need urgent attention. The GOAP has commissioned CGG to prepare an asset register framework and an internal manual. A framework only provides a starting point, the actual test lies in ensuring that a) the departments are persuaded to prepare and maintain asset registers and b) the state is able to prepare a state wide register of valuable assets. Internal Audit Manual is useful provided there is an internal audit department with sufficient staff to use it. The government should consider setting up an internal audit department with a proper mandate and resources.

9. As pointed out above, debt management and management of contingent liabilities made good progress. On the whole, GOAP has taken significant steps to contain, mitigate and handle the risk of contingent liabilities. It has also ensured greater transparency in reporting on guarantees. Some action is still needed in respect of meeting future pension liabilities, particularly under the new pension scheme.

10. As for external audit, all the recommendations (except Government's response to audit observations) in this chapter are such that they require action to be taken by the CAG of India. There is a need for GOAP to communicate its concerns to CAG of India to

his representative in the state viz. Principal Accountant General (Civil Audit) so that there is some movement in this.

11 Legislative scrutiny could be made more effective if the government ensures prompt dispatch of explanatory notes in respect of all paragraphs included in the Audit report; and ATR in respect of all PAC recommendations. Providing PAC Secretariat with staff competent in PFM functions will help it discharge its responsibilities better.

Summary of Recommendations

PFM Legal and institutional framework

1. Undertake modernizing and updating the Treasury Code, Financial Rules and Budget Manual without further delay and, once updated, place them on government web site in downloadable format for easy accessibility;
2. After updating the codes and manuals, the Government should consider bringing out a short guide (a digest) of key fiduciary responsibilities of CCOs and COs;
3. Encourage preparation of manuals of (standard operating) procedures for departments;
4. Create sufficient number of posts for discharge of finance and accounting functions in the line departments at all levels; and
5. Create an organized finance and accounts cadre to discharge the PFM function in the government.

Budget Formulation

6. Take action on the Revenue Reforms Committee recommendations, particularly on setting up a TRU;
7. Build capacity to scientifically forecast revenue by econometric modeling in order to achieve budget realism;
8. Guide lower formations to prepare realistic budgets by organizing seminars and workshops as part of budgetary exercise;
9. Strengthen practices relating to medium term fiscal and expenditure frameworks. Specifically, persuade as many departments as possible to prepare MTEF, build their capacity to do so by conducting training programmes for them, etc.
10. Similarly, build capacity of departments to prepare outcome budgets by providing them training and guidance. Achieve some standardization and minimum quality in the outcome budget document.

Budget Execution

11. Predictability of expenditure allocation may be improved by adopting an IT solution as has been done by some states (e.g. Khazane in Karnataka and Koshavahini in Maharashtra);
12. Opening of bank accounts for depositing scheme funds be regulated very stringently by adopting some strict measures;
13. There is an urgent need to develop financial MIS that would give the departments and FD a clear picture of actual expenditure versus budget estimates. Again, adoption of IT would address this problem quite effectively. Availability of information in real

time would strengthen monitoring of budget execution and make the processes of within the year expenditure changes transparent.

14. Record keeping of loans and advances and control over them needs to be improved by suitable measures.
15. Assess the risk involved in unreconciled balances between the closing ledger balances of the Public Account shown in the AG's main /control accounts and detailed accounts; and take suitable steps to clear them.

Accounting

16. The reconciliation of expenditure between DDO and treasury / PAO should be reviewed and further improved;
17. Government should enhance the capacity of departments to prepare their own accounts which are complete and accurate;
18. Government should immediately take measures to review functioning of APGLI, AP State Government Employees Insurance Scheme and Class IV G.S. GPF account.
19. Government should engage CAG of India, GoI and GASAB in bringing about necessary changes in accounting systems.

Monitoring and Evaluation

20. The government should consider strengthening capacity of departments in accounting so that they are able to prepare departmental accounts independently from their own record. This would help the departments monitor within the year expenditure better as also ensure accuracy of accounts compiled by AG through regular reconciliation.
21. Two other reforms might be necessary to bring about a credible system of financial MIS in the government. They are:
    a. The number of DDOs is simply too huge (about 60,000) for any system to work in practice. The motivation to create more DDOs was to basically increase convenience in drawing the pay and allowances without too many hassles. The downside of course is that now every primary school and PHC is a DDO. There is an urgent need to rationalize their number; and
    b. Application of IT (particularly web based) so that the data is captured in real time. The NIC developed system in Maharashtra is a good example of how IT can enable not only budgetary control but also monitoring commitments against the budget and requirements of cash.
22. It is recommended that payroll must be centralized at the district level and payment of salaries to all government servants should be made through electronic transfer or by advice to bank to credit their accounts. Secondly, a web based application that

captures transactions from DDO and Treasury should be put in place so that financial data is available in real time.

Asset Management

23. Once the Asset register framework is ready, the government should expeditiously prepare a statewide asset register of valuable assets and ensure that all government offices maintain asset register of other (less valuable or ordinary) assets held by them.

Contingent Liabilities

24. Expedite its examination of the report submitted by Darshaw & Co. the firm of actuaries and start accurately providing for pension liability and create a fund to serve as corpus for future liability of pensions; and

25. Take suitable action in maintaining proper account of deductions made from employees towards contributory pension scheme and investing the funds as per GoI guidelines as and when available.

Internal Controls

26. Recently, FD has commissioned CGG to prepare an Internal Audit Manual. Important as a manual is, it is also required that the GOAP takes suitable action in creating a credible IA department with a) well thought out mandate, b) reporting structure that would ensure its independence, and c) competent staff in reasonably sufficient numbers for the IAD to be viable.

External Audit

27. The government should try and get the overall sense of deficiency in the working of its offices from the myriad audit reports and deal with them systematically. For this purpose, it could have software developed that would enable grouping all audit observations under some standard terms so that they can be consolidated and considered for suitable action.

28. As the GOAP's internal audit is strengthened, automatically external audit would withdraw from extensive transaction audit by relying on the work of IA. The external audit would then be able to concentrate more on value for money and performance audits that help the government more.

Legislative Scrutiny

29. Ensure prompt dispatch of explanatory notes in respect of all paragraphs included in the Audit report;

30. Ensure prompt filing of ATNs in respect of all PAC recommendations;

31. Provide PAC Secretariat with staff competent in PFM functions so that they can provide able support to PAC in discharge of its responsibilities; and

32. Request AG and PAC to prioritize the items for discussions so that PAC's oversight in improving systems as much as ensuring accountability of executive.

Chapter 1

Introduction

1.1 State Financial Accountability Assessment (SFAA) was undertaken as part of ongoing fiscal reform process in 2002-03 by CGG with assistance from Atos KPMG Consultants for Government of Andhra Pradesh (GOAP). SFAA had two broad objectives viz.

- fiduciary objective - to assess and manage the risk that the government and donor funds might not be spent on authorized or intended purposes and thus support the exercise of donor's fiduciary responsibilities.
- developmental objective - facilitating understanding of GOAP's PFM arrangements and assessing its strengths and weaknesses and thus contributing to the design and implementation of capacity building programmes; and

1.2 Accordingly, SFAA study report consisted of two reports on the two objectives above. Both the reports were structured around the key aspects of PFM as below:

- legal and Institutional framework;
- budget formulation;
- budget execution;
- accounting;
- monitoring and reporting;
- asset management;
- debt management;
- contingent liabilities;
- internal controls;
- external auditing;
- legislative scrutiny of public finances; and
- Public access to information on public finances.

1.3 The SFAA study made several recommendations at the end of its report. There were in all 193 action points. Some of the salient recommendations were:

- Codify key fiduciary responsibilities of Chief Controlling Officers and Controlling Officers and disseminate as short and simple guides, along with DDO manual;
- Place all PFM texts and guides (i.e. manuals, rules, etc.) on the website allowing download for easy access by all;

- Set up discrete functions with Finance Department to take responsibility for key components of PFM e.g. asset management, budgeting and accounting, internal controls, liaison with audit/PAC;
- Prioritize the pilot Medium Term Expenditure Framework (MTEF) in primary health and education.
- Simplify classification system by continuing to reduce the classification levels below minor head and standardizing the sub-heads;
- Produce full accounts and balance sheet for the Contingency Fund;
- Devise GOAP wide expenditure monitoring report format that provides a stronger basis on which to manage with-in year expenditure;
- Implement reporting mechanism by DDO to CO on fiduciary performance indicators such as assets within their department, all bank accounts in the public account and outside government account, reconciliation with bank and treasury, response to external audit observations, and so on;
- Similar report as above from CO to CCO and CCO to Secretary of the department;
- Strengthen controls over schemes not using the treasury system;
- Set up a pension fund and keep actuarial projections of future pension costs updated to ensure adequate funding of these future liabilities; and
- Set up an internal audit wing in Finance Department;

1.4 Some of the measures that GOAP had initiated following the SFAA study were:

- Prepared and distributed a Handbook on Financial Accountability among all Chief Controlling officers/ Sub controlling officers and Drawing and Disbursing officers in the State;
- Issued instructions to place all public financial management texts and guides and government orders on the official website allowing download;
- Issued a comprehensive budget timetable;
- Simplified classification system by reducing the classification levels of sub heads below minor heads;
- Prepared and submitted an Annual Fiscal Framework;
- Introduced an Integrated Financial Information System (IFIS) connecting all Treasuries, PAOs and PAOs (Works) to monitor the day to day expenditure and receipts;
- Issued instructions to all CCOs/DDOs on reconciliation, furnishing of Utilization Certificates, Audit Paras, AC/DC bills and monthly expenditure statements;
- Set up a pension fund;

- Established an internal audit wing in Finance Department;
- Issued orders to re-activate state level audit committees and sub-committees to resolve CAG's audit objections;

1.5 Certain other measures under implementation include:

- Institutional strengthening of Finance Department;
- Strengthening of forecasting of state revenue; and
- Publication of report on financial liability with outline of Government policy for addressing the issue.

Terms of reference of Impact Study

1.6 SFAA had used a diagnostic framework, drawing upon sources of international good practices (largely from the guidelines given for Country Financial Accountability Assessments by the World Bank). Applying this frame work, SFAA identified the divergence between the best practices and the PFM practices existing in GOAP. Based on this data, SFAA made recommendations to bring the prevailing PFM practices in GOAP to expected standards. The present study intends to ascertain the effect of the new policies and procedures put in place by the GOAP on basis of the recommendations. The Terms of Reference for the study have the following as the objectives:

a. The Study will assess the procedures, arrangements, flow, effectiveness, merits, bottlenecks and deficiencies of the scheme and its implementation across GOAP; and

b. The area of the study shall include:

   - Government orders and framework of SFAA;
   - Status of implementation and coverage till date;
   - Procedural issues;
   - Issues in implementation;
   - Field level issues and feedback from administrators and employees;
   - Issues of concern; and
   - Other issues which would significantly influence the success of the SFAA implementation.

Methodology

1.7 The TOR suggests the following methodology:

- Review of related studies and analysis will be done. The study will be organized in three parts.

   a. Desk review of available data on SFAA;
   b. Data collection from the field; and

c. Analysis of data and preparation of report.

1.8 As pointed above there were 193 action points based on SFAA study report. A majority of them were expected to be implemented in short / medium term (6 months to 2 years) and some in the long term (5 to 7 years). A large number of recommendations were within the competence and jurisdiction of the state government (meaning the Finance Department), while some required to be taken up with outside authorities / bodies such as the CAG of India, Public Accounts Committee, etc.

1.9 There are a few problems dealing with the recommendations as they have been given in the SFAA report:

a. While the SFAA study report was organized along the 12 PFM key aspects, when it came to the recommendations these were organized differently. Sometimes the recommendations were grouped under a different heading altogether. Recommendations relating to one key PFM aspect were scattered over several places. It would have been helpful if the recommendations were given chapter-wise and PFM key principle-wise.

b. Although cross reference to the main report was given against each action point, the report itself did not contain the recommendation. In that sense, the recommendations were not extracted from the report but were broadly based on the report. Sometimes, there was no discussion even on the subject of recommendation. To illustrate, under 'Strengthen Treasury System' a recommendation is give that 'each DDO (should be allowed) to draw (money) from only one Treasury / PAO' and reference is given to paragraph 5.8 of Fiduciary Report. However, there is no discussion about this at all in the said paragraph. Under the circumstances, it is difficult to infer the rationale for the recommendation.

c. The recommendations have not been prioritized in terms of significance. As some recommendations were definitely 'do-able' while others were more 'aspirational', some distinction should have been made while listing the recommendations along the above lines.

1.10. Under the circumstances, the study team's first exercise was to analyze the recommended action points by chapter and by PFM key aspect and prioritize them. For the latter, it had used its judgment. Further, the study team identified the institution responsible for taking action and the timetable for doing so for each action point.

1.11 To assess the impact, it was necessary to first identify *indicators* which would provide the status of implementation; and for each indicator, to determine the *sources of data* that would provide information whether or not the implementation has taken place. Detailed questionnaires were prepared to collect information / data for each level viz. the secretariat department, the Head of Department (Chief Controlling Officer), district office (Controlling Officer) and the Drawing and Disbursing Officer (DDO). In addition, separate questionnaires were prepared for collecting information from the Finance Department, the Director of Treasury and Accounts, Director of Works Accounts, etc. The questionnaires were mailed to 78 offices out of which only one office (DTO, Nellore) sent the response. The study team collected information / data from 33 offices personally during field visits.

1.12 For the purpose of the impact study, the School Education and Primary Health (Director of Health Services) were selected as these were the focus department for SFAA study as well. The field visits included the following offices of district and below district offices (DDOs) in the three districts of Guntur, Warangal and Ranga Reddy.

Ranga Reddy District

▪ DM & HO, DEO, DTO	Ranga Reddy
▪ PHC, STO, MEO Primary Schools, Sarva Siksha Abhiyan	Sivarampally, Moinabad and Sankarpally Chevalla and Rajendra Nagar. Hayath Nagar Koheda, Malkajgiri and Nagaram

Guntur District

▪ DM &HO, DEO and DTO	Guntur
▪ STO, MEO, Primary Schools, PHC, Sub-centres, PAO (W&P), Sarva Siksha Abhiyan	Nutakki, Mangalagiri, Medikondur, Prathipadu,and Pedanandipadu

Warangal District

▪ DM &HO, DEO and DTO	Warangal
▪ STO, MEO, Primary Schools, PHC, Sub-centres, PAO (W&P), Sarva Siksha Abhiyan	Station Ghanpur, Hasanparty, Chintakattu, Jangaon, Raiparty, Abadighanpur and Thorrur

1.13 The data so collected was further analyzed and validated through stakeholder consultation. The study team held consultations with:

- Officials of the FD [the budget and expenditure wings and debt servicing cell], the Treasuries and PAOs.
- Heads of Departments of commercial taxes, primary education and primary health, etc.
- The Accountant-General [A&E], PAG Civil and AG (CRA).
- Officials of Legislative Secretariat.

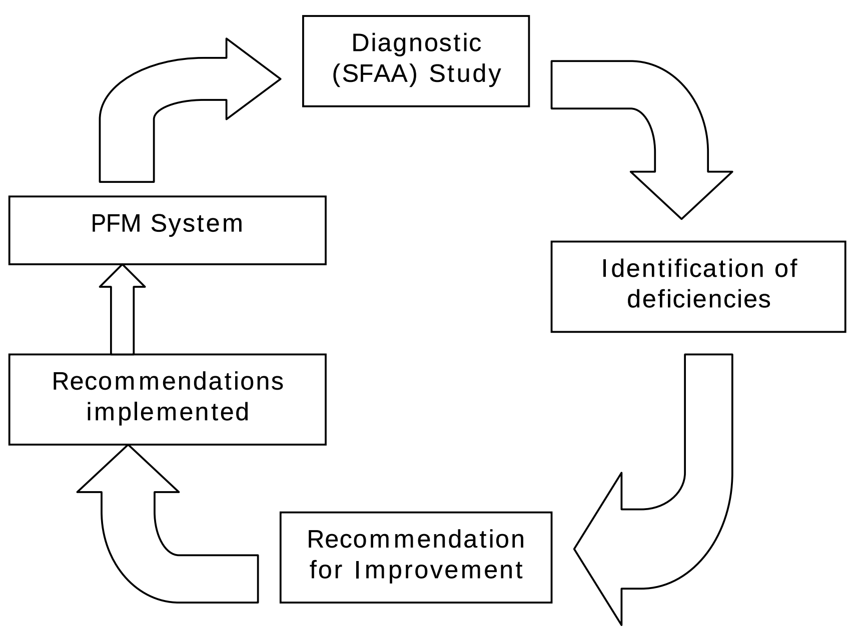
Despite the efforts of Finance Department, the study team found it difficult to meet some key officials. (List of the official the study team met is enclosed at Annexure A.)

Evaluation of Impact

1.14 Finally, for each action point the impact study provides the extent of implementation of the action point and the related impact or lack of it. Wherever, possible, it analyzes the underlying reasons for lack of implementation / impact.

1.15 Although the study has been termed as an 'impact' study, it is more a quick assessment of the status of implementation of the recommendations at one level. Impact implies a study of outcome of implementation, which is of a different qualitative dimension. As shown in the diagram below, the underlying assumption is that there is a direct correlation between the recommendations (which are based on deficiencies identified through diagnostic study) and implementation of recommendations resulting in removal of deficiency and finally to improved PFM System. The inference, therefore, is that effective implementation of recommendations would result in the outcome of improved PFM system, and assessing implementation would give one a fair idea of the impact.

Figure 1 - Cycle of improving PFM System



Lack of concerted and organized approach to implement recommendations

1.16 It is expected that the state government on receiving the SFAA Study Report would have adopted a suitable approach to implement the recommendations. The study team could not find any evidence of the government having formally considered the report and its recommendations. The government did not prioritize the recommendations nor did it prepare any plan for implementing them. There was no steering committee or a similar mechanism to monitor the implementation of recommendations. There was a Financial Reforms Implementation Committee (FRIC) when SFAA study was in progress. Ideally, this committee could have overseen the implementation of SFAA report recommendations. However, there is no information on the work of this committee beyond 2004. The report itself was not disseminated among the important stakeholders. Many senior officers whom the study team met were not aware of the SFAA Report or its recommendations. Some recommendations which required the state government to take up the issues with other bodies remained dormant. As a result, the efforts to implement the recommendations remained unplanned, informal and sporadic rather than being concerted and organized.

1.17 That much of the PFM reform work preceded or happened concurrently with the SFAA study is evident from the SFAA report which captures many of them. The state government had initiated significant reforms in the area of budget making. In the post SFAA period, major reforms and accomplishments have been in the areas of debt management and contingent liabilities. There is again a discernible movement in PFM reforms lately. GOAP has commissioned preparation of an internal audit manual and a framework for asset management in government. Similarly, it plans to undertake training personnel at different levels in budgetary process, for which a training module is under preparation. Other initiatives include a medium term expenditure framework (MTEF) and outcome budget for school education department and internal audit of Department of Health and Family Welfare. If these initiatives are properly followed up it would result in strengthening PFM practices in these areas.

Chapter 2

PFM Legal and Institutional framework

2.1 The legal framework provides authorised and standard practices that guide PFM processes. These are generally contained in codes, rule books and operating manuals. The key requirements of a good legal framework are that they:

a) Are prepared the first time with due care and are reviewed from time to time and updated periodically through an established procedure;

b) Clearly establish accountability framework over the institutions and individuals; and

c) Are accessible to all staff working in / supervising PFM function both in terms of their physical availability and more importantly their availability in a language and format that is easily understood.

2.2 From the institutional framework point of view, it is expected that a) the responsibility for PFM rests unambiguously at one point in the organization say, in the Finance Department and b) the roles of different players are clearly defined and understood.

2.3 The SFAA made several recommendations on legal and institutional framework as below (☒ indicates not yet implemented / partially implemented and ☑ means implemented):

	SFAA Recommendations
☒	Review and selectively revise all codes and manuals on an ongoing basis (FR 3.4)
☒	Produce short and simple guide for each key area of PFM (with covering GO to lend authority) (FR 3.7.1). Codify key fiduciary responsibilities of CCOs and COs (FR 3.7.1) and disseminate as short and simple guide, along with DDO manual (FR 3.7.2)
☑	Establish discrete functions within Finance Dept. to take responsibility for key components of PFM e.g. asset management, PFM legal framework, internal controls, PFM budgeting/accounting techniques, liaison with audit/PAC (FR 3.2)
☒	Place all PFM texts and guides, and GOs, on the website allowing download (FR 3.5); Send GOs directly to the District Collector for them to pass down the chain of district officials of all departments (FR 3.4)
☒	Review provisions for training, both to finance function staff and to DDOs, COs, CCOs and other key officials (FR 3.8)

2.4 The field testing and consultation with the stakeholders showed that there has been very little change on the ground since SFAA Report was submitted to the government.

Modernization of codes and manuals

2.5 It was informed that the Finance department has created a cell for updating AP Treasury Code, AP Financial Code and AP Account Code Volume I. In reply to a query by the study team, it was stated by the Finance Department that a short and simple guide codifying key fiduciary responsibilities of CCO and CO is under preparation and would be completed soon after the updating of departmental codes and manuals (which are under revision) is completed. *As on date these manuals remain to be revised and modernized as recommended by SFAA Study*. Government Orders on various PFM issues continue to be issued. Such piecemeal amendments to rules is not a good practice as a) over a period they might result in inconsistencies and b) departments find it difficult to keep track of them and there is likelihood of some orders being missed by some departments.

2.6 GOAP through Dr MCR HRD Institute has developed a series of departmental and functionary manuals in an attempt to provide more a user friendly source of guidance for officials. It is seen that the departmental manuals generally describe in detail the evolution of the department and about the organizational structure, while the functionary manuals list the 'functions' of different functionaries in the department. These manuals do not provide either the accountability structure nor do they give any guidance regarding the procedures to be followed or checks to be exercised in the course of day to day work.

2.7 The CGG at the instance of GOAP prepared and circulated a Hand Book on Financial Accountability. This is a compilation of rules, procedures, etc. contained in various codes. It includes formats of registers to be maintained and checks to be exercised by different authorities. In addition, it contains extract of some important Government Orders. Although this Handbook comes closest to what might be considered a guidance book for CCO/CO/DDO, it is a poor substitute for modernized manuals. As a matter of fact there is a danger that the hand book might displace the codes as basic PFM text. This is at best a stop gap arrangement till the codes and manuals are updated. The unfortunate aspect is that during control tests it was observed that even this Handbook was available with only two of the 12 offices test checked.

2.8 An important requirement for maintenance of any manual is that the procedure for amending any part of the manual should be clearly laid down / provided either in the manual itself or outside the manual. SFAA recommendation that discrete functions within Finance Department be established to take responsibility for key components of PFM assumes importance in this context. While overall responsibility and authority to amend any portion of the PFM codes and manuals would rest with Finance Department, officials dealing key components of PFM would in turn have the responsibility to constantly review the changes in the PFM environment and propose required changes. Ideally, all manuals and codes must be updated at least once every five years when all amendments made in between should be incorporated in the manuals.

2.9 The present practice is, however, to issue a government order which normally cites a number of previously issued government orders on the same subject. The GO might make a few changes to the earlier orders or sometimes, very rarely though, consolidates the earlier ones. With this the problems are that a) the guidelines tend to be scattered over a number of government orders; and b) they escape detailed and comprehensive scrutiny that an amendment to rule (requiring gazette notification) would require and therefore may carry the risk of conflicting with the principles laid in the codes. The Government has not fully implemented the SFAA recommendation to establish discrete PFM functions within Finance Department. Presently, they have all been added to the functions of an officer of the rank of Deputy Secretary.

Easy accessibility of PFM rules

2.10 With a view to provide accessibility the GOAP is placing important orders on website but the Codes and Manuals are not made available on the website. To access the website, computers were supplied to most of the DDOs. Control tests in three selected districts revealed that many computers are not put to use at all or made use of partially, due to a) lack of knowledge of computer operation, b) non-deployment of qualified computer operators, c) non-availability of un-interrupted power supply or d) want of internet connection. In one of the DDOs (MEO, Rayaparthi, Warangal District), the computer which was supplied four years ago has been lying in packed condition as of November 2007.

2.11 It was noticed that the DDOs and the employees in the field offices are generally not conversant with the Budget Manual as a copy of Manual has not been supplied to them. None of the 12 field offices test checked by had a copy of the budget manual. Though the priced (private) publication of the Budget Manual is available, a copy has not been officially supplied to offices.

2.12 Control tests revealed that all GOs are being sent to District Collectors to be passed down to district level officials. Further, as GOs are kept on Website facilitating downloading by the user officials, the Collectors are not being asked to pass them on to the other offices in the district.

PFM staff

2.13 A critical requirement for adequately controlling fiduciary risk is to have sufficient number of competent staff to handle finance and accounting functions in the government. This is the weakest link in the chain of accountability. The SFAA report has dealt with this only perfunctorily and that also from the stand point of building

PFM competence. It had not checked the prevailing levels of competence or number of staff discharging finance and accounting function in the government.

2.14 Although there are some organized accounting services such the Treasury Accounts Service, Pay and Accounts Officers Service, Works Accounts Service, etc. they mostly work in the Treasuries and Pay & Accounts Offices. They are also seconded to the urban local bodies and government departments as accounts officers. The accounting functions in most departments particularly at the lower levels are discharged by persons belonging to clerical cadre whose knowledge of accounts is extremely limited. There are no finance professional to assist CCO either in preparing the budget or monitoring its implementation or otherwise to render any financial advise.

2.15 Although Dr MCR HRD Institute, the various departmental training institutes and the district training centres impart training, there is no focused training in PFM aspects systematically given to officers at different levels. Thus, there is a deficiency both in terms of numbers as well as competence as far as PFM function is concerned.

Conclusion

2.16 A Strategic Performance Innovation Unit (SPIU) was set up in Finance Department under Delivery of Improved Services in Administration (DISA) programme. The SPIU is manned by officers seconded from RBI and NABARD. This and the Project Monitoring Unit assist the Principal Secretary, Finance (IF) in initiating reforms. A lot of work has been done in respect of debt management and contingent liabilities by the SPIU. The PMU is also pursuing many reforms under the World Bank IDF grant for PFM strengthening in GOAP.

2.17 There has been otherwise little progress in improving the PFM legal and institutional framework since SFAA Report except issue of a few detailed government orders (some like GO 507 were already issued by then). The codes and manuals remain to be updated. Accountability of CCO, CO and DDO remains to be codified. Accessibility of codes and manuals is poor as there is no official distribution of their hard copies or their availability on website. Institutionally, finance and accounting is yet to be recognized as an important function to deserve sufficient number of posts, an organized cadre and continuous upgrading of competence through training.

Recommendations

2.17 It is recommended that the government:

a. Undertake modernizing and updating the Treasury Code, Financial Rules and Budget Manual without further delay and, once updated, place them on government web site in downloadable format for easy accessibility;

b. After updating the codes and manuals, the Government should consider bringing out a short guide (a digest) of key fiduciary responsibilities of CCOs and COs;

c. Encourage preparation of manuals of (standard operating) procedures for departments;

d. Create sufficient number of posts for discharge of finance and accounting functions in the line departments at all levels; and

e. Create an organized finance and accounts cadre to discharge the PFM function in the government.

Chapter 3
Budget Formulation

3.1 Budget formulation is the first stage in the process of operationalizing government's programmes and plans for a year. The budget links resources with what is proposed to be achieved during the year. Ideally the process should involve participation of the executive departments of the government and the general public, involve discussions at the political level and finally receive legislative review and acceptance. The annual budget should not be a mere compendium of numbers but should contain narration regarding programmes and targets in a language intelligible to the uninitiated and it needs to be disseminated in cooperation with free media.

3.2 Annual budget is not an isolated exercise. A carefully crafted economic frame work is critical to budget formulation. The annual fiscal frame work should be derived from medium term fiscal frame work (MTFF) which in turn is built out of long term perspective plans for each sector of economy. These long / medium term plans and the fiscal strategy framework have to be an exercise carried out by the heads of major departments and desirably with assistance from some experts in the fields of economics and accounts. Planning and budgeting are two complementary operations. Thus the budget for any fiscal year is an expression both part of a programme and also parts of programmes for several years in future.

Key Principles

3.3 The following are the key principles of an effective budget formulation:

- Budget realism;
- Participation of the spending departments;
- Comprehensiveness and transparency; and
- Accessibility and timely presentation.

3.4 The SFAA study identified several weaknesses in the budget formulation in GOAP and recommended certain measures, which have been regrouped and prioritized. The recommendations fall broadly under the above principles. Some recommendations are such that they require intervention by the Union Government as the form of accounts is decided by the President on the advice of the Comptroller and Auditor General of India. (☒ indicates not yet implemented / partially implemented; ☑ means implemented; and ?? the recommendation needs further examination)

SFAA Recommendations	
	Budget Realism **(Revenue Forecast)**
☒	Review recommendations of Dr. Sarma Committee on revenue forecasting and develop a plan for implementation as appropriate (FR 4.2.1)
☒	Distinguish between conservative revenue forecasts, to be included in the Budget, and more challenging revenue targets to be provided to revenue departments (DR 3.3)
	(Expenditure Framework)
☑	Include the medium term objectives in the AFF, and updated AFF, with an explicit discussion of the consistency of the budget indicators with these medium-term objectives. (DR 3.7.1)
☒	Integrate the MTFF and MTEF processes as a framework for developing multi-year departmental baselines (i.e. moving to medium term budgeting) (DR 3.4)
☒	Prioritize the pilot MTEF work in primary health and education. Ensure consistency between MTEF approaches in primary health and education to create a framework that can be rolled out to other departments (FR 4.3.1) Use MTEF pilot projects as an opportunity to achieve greater integration between the plan and non-plan budget process within line departments (DR 3.5)
☒	Adopt a rolling term MTFF rather than being co-terminus with the plan period, so that the MTFF will always cover 5 years (DR 3.2)
☒	Develop training programme to build the capacity of departments to develop MTEFs and undertake activity-based costing (FR 4.3.1)
	Consultation and participation in budgetary process
☑	Investigate scope to / benefits from setting up official committee of Principal Secretaries from “central” departments (Finance, Planning, GAD etc) to support Cabinet Budget Committee in reviewing draft performance budgets (DR 3.2).
☒	Develop a plan to build the capacity of district offices to participate in budget formulation (FR 4.3.2)
☑	Issue a comprehensive annual budget timetable by October of each year and hold seminars to outline process to line departments and provide opportunities for queries (DR 3.1)
	Comprehensiveness
☑	Include debt liabilities under the Public Account in the debt stock figures in Budget in Brief (FR 4.4.2)
☑	Provide a summary table of budgetary aid or schemes and projects financed by donor assistance in the Budget and Accounts (FR 4.4.3, FR 7.3)

☑ Include a summary of major subsidies provided by GOAP in Budget in Brief and Accounts (FR 7.3)

☑ Disclose details of gross transactions of Contingency Fund, loans and advances by institution (FR 11.3)

Transparency

☒ Simplify classification system by continuing to reduce the classification levels below minor head and standardizing the sub-heads (FR 4.5.2.2 and DR 3.7);

☑ Maintain consistency in the preparation of summary tables across budget documentation and years (if changes are required, explain these changes)

☒ Provide summary tables of revenue and expenditure on GFS consistent basis (FR 4.5.2.2)

☑ Include details of the amounts devolved to districts and local bodies in the Annual Financial Statement

☒ Show Budget Estimate, Revised Estimate and Actual for previous year in the Annual Fiscal Framework and Budget in Brief summary tables.

☒ Disclosure of cash flow in more useful cash flow statement form.

Accessibility

☒ Publish all financial reports in Telugu and place them on website

Revenue Forecast - State's own revenues

3.5 Budget realism consists in accurately forecasting the revenues that can be mobilized and estimating the expenditure that would be incurred by the state government during the ensuing year to realize the goals set for the year. Unrealistic budget estimates erode the credibility of the whole budgetary process. Good revenue marksmanship ensures affordability of the schemes and programmes to be executed during the year.

3.6 During the years 2002-03 to 2004-05 the actual receipts of state owned revenues continued to be less than the forecasts by over 5 percent and this position improved substantially in 2005-06, when the actual receipts of its own revenues were 99.67 per cent of the budget estimates. The position was even better in 2006-07 when the actual revenue receipts (pre account) were 99.79 per cent of the budget estimates. The improved revenue forecast even though no sophisticated revenue forecasting techniques were employed was partly due to buoyancy in state's own revenues which showed a raising trend from 2005-06.

Fig: 3.1 - State's own revenues as per cent of GSDP

Year	Percentage
2002-03	9.88
2003-04	9.44
2004-05	9.61
2005-06	10.46
2006-07 (Pre-account)	11.66
2007-08 (B.E.)	13.34

(Source: AFF for 2007-08)

3.7 Revenue Reforms (Dr. EAS Sarma) Committee (RRC) appointed by GOAP in January 2002 suggested (August, 2004) that an annual economic survey be conducted in the state as is done at the national level and data gathered used by the revenue earning departments. It has also recommended setting up a Tax Research Unit (TRU) which can help the government in assessing the impact of changes in revenue laws, tax rates, etc. The RRC report is under examination in the revenue department. *GOAP is yet to set up a TRU and devise sophisticated techniques for revenue forecasting in major revenue earning departments.*

3.8 It is a recognized principle that departmental ownership of the budget is a key to better implementation of the budget. However, there has been little change in the manner in which revenue estimates are prepared. The revenue earning departments still project revenue estimates by marking up over the current year's receipts. These being considered conservative are further revised by the Finance Department and these estimates are set as targets to the heads of revenue earning departments. *Thus, GOAP is yet to implement the SFAA recommendation that while the targets for departments are ambitiously fixed, the budget estimates should be prepared more realistically on the basis of sophisticated techniques.*

Central transfers

3.9 Central inflows include transfer of state share of central taxes and contribution (loans and grants) to plan schemes. SFAA found that 83 percent of variance between budget and actual revenue in 2001-02 was on account of shortfall in central transfers. The actual inflows have been persistently lower than the estimates in the pre-SFAA period and continue to be lower in the later years as well**.** The percentage of the shortfall being as high as 21 per cent in 2002-03, which decreased to 19.92 per cent in 2004-05 and to 9.01 per cent in 2005-06. In view of this the actual of total revenues continue to be marginally lower than the budget estimates.

Figure 3.2 (Rs in crores)

	2003-04	2004-05	2005-06	2006-07
Central Taxes Budget Estimates	5273	6056	6688	8039
Actual	5069	6059	6951	8866
Shortfall	204	(3)	(253)	(827)
Grants-in-Aid Budget Estimates	5538	4858	4904	7184
Actual	4389	2681	3597	4965
Shortfall	1149	2177	1301	2219
Percentage total shortfall	*12.51*	*19.92*	*9.01*	*9.14*

Source: Annual Fiscal Framework 2007-08 and Budget in Brief

3.10 Although SFAA has identified uncertainty of central inflows as a major weakness in revenue forecasting but did not make any recommendation to overcome this problem. Estimate of central inflows is made on the basis of discussions with the Planning Commission. The actual inflows may vary depending upon any changes made by the Union Government in volume and distribution of central transfers. As the state budget is presented to the legislative assembly earlier than the central budget this situation is bound to continue. As lower central funds flow would affect the expenditure side of the budget also and consequently affect execution of schemes planned, it is imperative that a solution is found to this problem. It may be worth while to consider whether the state budget presentation to the legislature could be suitably deferred to overcome the weakness in forecasting central inflows.

3.11 On the recommendation of the Twelfth Finance Commission (TFC) the union government have changed 30:70 (grant - loan) method of funding the CSS in respect of non- special category states and it has been releasing the grant portion without insisting that the state government take the corresponding loan portion. It is now left to the state government to determine the quantum of loan they need. Further the state government’s access to market borrowing has also been made easier as recommended by TFC. This is expected to improve the assessment of in-flows of central funds and also give the state government greater freedom to choose a type of loan they would take.

Expenditure estimation

3.12 A high correlation between actual expenditure and budget estimates is critical to budget formulation. Unrealistic estimates undermine the credibility of the budget process. In GOAP revenue expenditure has been consistently less than the estimates for over decades. This position slightly improved during 2003-04 when the actual expenditure was less than the budget estimates by 5.08 per cent. There was deterioration in 2004-05 when the actual was less than budget estimates by 8.32 per cent. It was less by 6.5 per cent in 2005-06. This was attributed partly to lower releases of funds for centrally sponsored schemes (CSS).

Figure 3.3 (Rs in crore)

		2003-04	2004-05	2005-06	2006-07
Revenue Expenditure	BE	31427	34152	27378	45327
	Actual	29830	31307	34915	41438
Revenue Expenditure excluding debt servicing	BE	24503	26681	29455	37130
	Actual	22974	24215	27907	33945
Capital Expenditure	BE	4793	6189	7509	10065
	Actual	4251	5414	7662	9904
Loans and Advances	BE	1182	944	1227	1308
	Actual	1494	1593	756	907

Source: Budget in Brief and Annual Fiscal Framework

Fiscal and Expenditure Framework

3.13 The GOAP had prepared a Medium term Fiscal Framework and has been preparing an Annual Fiscal Framework as part of the budgetary exercise. However, in the AFF, only financial indicators are being given and there is no explicit discussion of consistency of the budget indicators with the medium term objectives as recommended by SFAA Study. As for Medium Term Expenditure Framework (MTEF), there has been only one attempt in Department of Health and Family Welfare. There has been no further progress in this respect. Training programmes have not been organized to build capacity of the departments to prepare the MTEF. Other recommendations regarding MTEF such as preparing a rolling MTEF, integrating MTFF with MTEF, etc. remain unrealized.

3.14 The disturbing feature of decreasing non-salary O & M expenditure as a percentage of total expenditure continues. It was a little over 5 per cent of total expenditure during 2003-04 to 2006-07 as against 4 per cent from 2000-01 to 2002-03. As in the past non-salary O&M expenditure has been getting squeezed by expenditure demands of salaries and debt servicing which account for 76.27 per cent of non-plan expenditure for 2006-07 (RE) and 75.55 per cent during 2005-06 (actual). This low provision for O & M expenditure is despite of the declared strategy of the state government to improve efficiency in government expenditure and provide more for such expenditure. As identified by SFAA, this failure to provide sufficient funds to adequately service development spending in terms of operation and maintenance is a result of dividing funds between plan and non-plan. *There is as yet no decision at the GOI level to dispense with plan non-plan distinction as recommended by the EFC.*

Under the circumstances, the tendency to spread resources thinly across plan schemes at the expense of non-salary O&M continues.

Building capacity for developing realistic expenditure estimates

3.15 For 2007-08 Budget Estimates, a comprehensive circular (G.O.Ms.No. 275, dated 21-9-2006) was issued to all Heads of Departments and the HODs were asked to submit their estimates to the line departments concerned by 15 October 2006 and the line departments were instructed to scrutinize the estimates received from the HODs under their control and submit the same with their comments to the Finance Department by 31 October. Each department was also asked to give a 'Statement of Assets', 'Tax Revenues raised but not realized' and 'Statement of miscellaneous liabilities'. If it is assumed that the circulated letter would take at least a week to reach the officers concerned there is only two weeks for the HODs to respond. That cannot be considered as adequate time. Further the full time-table up to the date of presentation of the budget in legislative assembly is not included in the circular. The dates on which the Finance Minister would discuss the Budget proposals with the Ministers and Secretaries of the individual departments were given in a separate U .O. note issued on 20 December for the budget of 2007-08, the dates of discussion being between 4 and 9 of Jan. 2007. Such discussions ensure political commitment to the budget process. Departments (the minister concerned and his officers) were allowed 30 minutes to one hour to present their case for any changes in the allocations proposed. As there no minutes kept, it could not be ascertained how useful these meetings were, and what changes were made for what reason. It is seen that the line departments do not submit any liability statements with the budget estimates. SFAA recommended that an official committee of Principal Secretaries from central departments (Finance, Planning, GAD etc.) may be set up to support Cabinet Budget committee in reviewing draft performance budget. Such a committee was set up for assisting the cabinet budget committee in reviewing draft performance budgets. However, performance budgets have already been replaced by outcome budgets as discussed earlier in this chapter

3.16 Seminars at district & State level, as suggested in SFAA study were conducted during 2003 both for guiding the officials to prepare budget estimates as well as for preparation of 'Performance Budgets'. *But this practice of conducting seminars and workshops was not followed for 2004-05 budgets and thereafter.*

3.17 The district offices generally respond to the circular calling for budget estimates by sending 'number statements' and information on the amount required for pay and allowances of staff employed, for contingent expenditure and for traveling and other allowances to the HOD. *As a large number of schemes are centrally sponsored schemes and as the district officers have no idea of the targets under each scheme for the ensuing year, they do not send any estimates of expenditure for execution of* *schemes. This work is done at the HOD's level only. The position is more or less similar in respect of state schemes as well. The departments work on the schemes based on the amount available.*

3.18 Though field data is available before start of the year about each scheme, allocations for schemes are made not by their costs but by distribution of available amounts. That is, schemes are executed to the extent money is available.

Performance / Outcome Budget

3.19 Performance Budget introduced in 1969 was replaced by 'outcome budget' from the year 2007-08 to address the 'growing concern about the need to track not the mere intermediate physical outputs that are more readily measurable but also the 'outcomes' which are end objectives of state intervention. Finance Department circulated detailed guidelines and formats for preparing outcome budget to all Administrative Departments vide U.O. Note of the F.D. No.779-B/36/DMC/2007 dated 6-02-2007. Only a few departments prepared outcome budget. The outcome budget of Department of School Education for 2007-08 shows that it has not been prepared in accordance with the guidelines issued by the FD. Given the complexities involved in preparation of outcome budget, it remains largely an exercise by the secretariat department. Although, FD circulated the format of outcome budget and it has been advising departments on the preparation of outcome budgets *but no seminars were organized at any level for providing training to the line departments in the preparation of outcome budget.*

Budget comprehensiveness and transparency

3.20 Comprehensiveness of budget consists in providing in the budget documents adequate information to enable observers be it the public, the market operators, donors or the legislature to make an accurate assessment of the underlying fiscal position. Comprehensiveness and transparency are complementary to each other. GOAP has been the front runner among the Indian states in budget comprehensiveness. SFAA study recommended that inclusion of information on the following items would make GOAP budget even more comprehensive.

- Guarantees and Special purpose vehicles;
- Borrowings from the Public Account;
- Donor Funding and directly funded centrally sponsored schemes.

Transparency consists in making 'open and visible' how the revenues of the government are realized and spent as also all processes of decision making. According to the standards prescribed in the IMF code 'the public should be provided with full information, on the past, current and projected fiscal activity of the government'.

3.21 *Guarantees and Special Purpose Vehicles:* The special purpose vehicle loans have been used as a mechanism to increase borrowing of the state government, over levels agreed with the GOI. *Now that these are also shown included in total debt, there is no further action on this issue.*

3.22 *Borrowings from the Public Account:* Small savings, provident fund, etc. which are included in the public account also constitute debt liabilities of state government. Government makes appropriate annual contribution for amortization of open market loans and these are called sinking funds. These and other funds and deposit balances also constitute liabilities of the state Government. To arrive at total liabilities of the State Government all these have also to be added.

3.23 From 2004-05, in Table 11 of Budget in Brief debt liabilities under Public Account are included. But, as balances under reserve funds and deposit balances are not included, the figure shown by the CAG as total liabilities of the state in the Audit Reports differs from the figure of total public debt shown as outstanding in Table 11 of Budget in Brief. For example in the year 2005-06, the CAG report had shown the fiscal liabilities as Rs.79,549 crores where as the figure in the Budget in Brief was Rs.70,408 crores.

3.24 The report of the working group on state government liabilities[1] included deposits and reserve funds/sinking funds in the total liabilities of the state government in addition to contingent liabilities. The CAG gives the total liabilities figure in the Finance accounts as per the recommendation of the working group. This information has to be added to Budget in Brief.

3.25 *Donor Funding:* A statement showing a list of externally aided projects is detailed at serial no.38 in Vol. VII of the budget documents. *Such a summary can also be added to Budget in Brief.*

3.26 Other recommendations relating to comprehensiveness and transparency are dealt with below.

- **Include a summary of major subsidies provided by GOAP in Budget in Brief and Accounts**

  As provision of large scale subsidies has more or less come to be accepted as inevitable political reality, subsidies should find a place in Budget Documentation. *Major subsides provided by GOAP are shown distinctly in the Annual Fiscal Framework (AFF) for 2006-07 onwards but not included in the Budget in Brief. This recommendation is yet to be implemented.*

[1] Constituted in the state finance ministers conference held at the RBI in August 2004

- **Disclose details of gross transactions of the contingency fund and loans and advances by institution**

  This information is available in the Finance Accounts but is not being disclosed in budget documents as yet.

- **Include details of the amounts devolved to district and local bodies in the Annual Financial Statement**

  Loans and grants given to and amounts devolved to the local bodies is included in one of the Appendices to the budget but not given in a summary form in the Budget in Brief.

- **Disclosure of cash flow in more useful cash flow statement form**

  Cash flow statement is included in the Finance Account of A.P presented to the Legislature. As this is prepared by the AG in the format approved by the CAG this can be changed with the approval of the CAG only. *So far no request was made by the Finance department to the CAG in this connection*

- **Include and narrative with key fiscal indicators and expenditure priorities in Budget in Brief / on website**

  Budget in Brief is available on the GOAP website and can be downloaded. Though all the important fiscal indicators are given on the first page, expenditure priorities are not explained in a narrative form. Expenditure priorities are discussed in the Budget Speech of the Finance Minister which is also available at the same site on the internet.

- **Show BE, RE and Actual for previous year in the AFF and Budget in Brief summary tables.**

  This recommendation is in tune with the standard prescribed by IMF code that it should be possible to find out how good the budget forecasts were by perusing one set of budget documents for a year. However, in budget papers of 2007-08, for instance, the actual of 2005-06, B.E. and R.E. of 2006-07, and B.E. of 2007-08 are given. Only by referring to budget of 2006-07 also can one get the BE, RE, and Actual of 2005-06. So if an additional column showing B.E. of 2005-06 is also added in the Budget Documents of 2007-08, it would be possible to compare the B.E. & Actual of the previous year at a glance. The advisory group on fiscal transparency appointed by the GOI recommended that B.E. & R.E. of the previous year be given in the Budget n Brief. *This recommendation is yet to be implemented*.

- **Maintain consistency in the preparation of summary table across budget documentation and years (if changes are required, explain these changes)**

  All the tables are prepared by the GOAP are consistent during the last four or five years. Only additional information is added to make it more comprehensive and to meet the internationally accepted transparency norms.

- **Provide summary tables of revenue and expenditure on GFS consistent basis**

  Such a presentation is possible when the accounts classification which is decided on an all India basis by GoI on the advice of CAG is consistent with GFS format.

- **Simplify classification system by continuing to reduce the classification levels below minor head and standardizing the sub heads**

  The concerted effort to simplify classification made during pre SFAA period has not been repeated. As in the past, a review of accounting heads takes place at the time of budget preparation and a few heads may be clubbed or eliminated.

Conclusion

3.27 Many of the earlier weaknesses in budget formulation such as a) informal methods of revenue forecast, b) unpredictability of central inflows, c) lack of ownership of budget at departmental / district level, d) poor capacity of district level offices to prepare budgets, etc. continue. On the other hand, the state has not further progressed on the improvements made in the processes of budget formulation. MTEF in health department has not been followed up. Even in department of health it has been an isolated exercise not linked with actual budget making. Practice of wider consultation on draft budget by holding seminars has been given up. There has been no further review of budget head classification below minor head level.

3.28 There has been consolidation and also improvement as far as budget comprehensiveness and transparency are concerned. GOAP is moving towards the medium term objective laid down by the Core Committee appointed by the GOI on fiscal transparency, according to which states are to be encouraged to move towards publishing Budget Summary in the format prescribed by the Planning Commission. Many of the requirements of this format are either already provided in the Budget in Brief or in the process of being added to the various documents on the basis of the recommendations of SFAA study .

Recommendations

3.29 It is recommended that the government

a. Take action on the Revenue Reforms Committee recommendations, particularly on setting up a TRU;

b. Build capacity to scientifically forecast revenue by econometric modeling in order to achieve budget realism;

c. Guide lower formations to prepare realistic budgets by organizing seminars and workshops as part of budgetary exercise;

d. Strengthen practices relating to medium term fiscal and expenditure frameworks. Specifically, persuade as many departments as possible to prepare MTEF, build their capacity to do so by conducting training programmes for them, etc.

e. Similarly, build capacity of departments to prepare outcome budgets by providing them training and guidance. Achieve some standardization and minimum quality in the outcome budget document.

Chapter 4
Budget Execution

4.1 Once the budget for the year is approved and the demands for grants for the year are voted by the Legislative Assembly, the next stage in the budget process is the budget execution, which is releasing resources and spending them for implementation of the policies of the government. In this chapter we examine the impact of implementing the SFAA recommendations that were intended to bring about changes in the current practices to conform to the principles listed below.

a. A high correlation between budget and actual expenditure achieved through predictability in expenditure allocation;

b. Transparent and clear process for within year expenditure changes;

c. Departmental controls over approval and recording of transactions submitted for payment;

d. Clear processes for moneys granted or advanced to be promptly and accurately recorded, vouched and recovered by departments; and

e. Control commitments and arrears.

4.2 The SFAA had made a detailed analysis of budget execution and concluded that a) predictability of flow of funds was still a source of concern; b) at grant level actual expenditure had varied (savings / excess) compared to the budget. However, these did not pose a significant fiduciary risk of funds being spent on unauthorized purposes as excess expenditure is generally very low; c) there were instances of diversion pointed by CAG of India which is a matter for concern; and d) while compliance with Treasury controls is adequate, in the area of departmental controls compliance is generally weak. SFAA Report has made the following recommendations which have been suitably grouped under the above key principles. (☒ indicates not yet implemented / partially implemented; ☑ means implemented; and ?? the recommendation needs further examination)

SFAA Recommendations	
☒	**Strengthen predictability of expenditure allocation.**
	Given that Finance Department now provides three-quarter releases to CCO, the latter may be required to also provide one distribution statement for first three-quarters as early as possible.
	Transparent and clear process for within year expenditure changes
☒	Prepare consolidated monthly monitoring statement that highlights implications of within-year patterns in revenue and expenditure for end-year deficit and debt figures (FR 7.2.2)
☒	Departments to provide explanations for actual expenditure relative to budget (as well as total appropriations including Supplementary Estimates) in Appropriation Accounts (FR 5.3.4)
☒	Clearly define the criteria for 'urgent expenditure' for use of the Contingency Fund and for Supplementary Estimates
☒	Move to ex ante rather than the ex post authorisation of Supplementary Grants (this will require introduction of Supplementary Estimates to the Assembly earlier in the budget year and may require more than one Supplementary Estimates per year) (FR 5.3.3)
☒	Develop a process to ensure that if revenue monitoring identifies a shortfall that is likely to be sustained for the year before Revised Estimates, a revised expenditure and cash plan is developed and communicated to departments as soon as possible, rather than waiting for Revised Estimates (DR 6.1)
	Strengthen key accounting controls in departments and treasuries
☒	Strengthen controls over schemes not using the Treasury system e.g. DPEP and seek to bring them into Treasury system (FR 5.8.4); No bank accounts to be maintained other than authorised accounts (FR 5.6.5.1)
??	Each DDO to draw only at one Treasury/PAO (FR 5.8)
	Monies advanced are promptly and accurately recorded and recovered
☒	Ensure AG has sufficient information about institutional loans and advances to enable proper reporting (FR 5.7.3)
☒	Improve record keeping of loans and advances (FR 5.7.3)
☒	Strengthen controls over issue and recovery of loans and advances (FR 5.7.3)
☒	Undertake exercise to review all loans and advances, review their recoverability and classification, writing off where necessary (FR 5.7.3)

Strengthen reporting on budget vs. actual expenditure

☒ Include summary of main reasons for excess expenditure in Appropriation Accounts; i.e. over-run in non-control items, authorised relaxation of Treasury controls and items of relaxation not covered by Supplementary Estimates (FR 5.3.5)

?? Publish a list of all re-appropriations with the Appropriation Accounts (FR 5.3.1)

☑ Produce full accounts and balance sheet for the Contingency Fund (DR 4.2.1)

☑ Provide summary of funds recouped for the Contingency Fund in Supplementary Estimates (DR 4.2.1)

☒ Provide table in Supplementary Estimates summarising these releases for which ex post authorization is sought from the Legislative Assembly (DR 4.2.2)

☒ Investigate scope for within-year monitoring of commitments (FR 5.9 and 7.2.2)

Review and clear un-reconciled balances between the closing ledger balances of the Public Account shown in the AG's main/control accounts and the detailed accounts (FR 5.7.3, FR 6.7)

General scheme of budget execution

4.3 As soon as the demands for grants are voted by the Legislature, the Finance Department releases fifty per cent of the allocations made to all Administrative Departments. The administrative department then redistributes the allocation and intimates the Chief Controlling Officers (CCO) of their respective allocation. The CCO similarly intimates the Controlling Officers or District Officers of their allotments and so on down the line. In parallel, Director of Treasuries, who is endorsed copies of allocation and its redistribution passes on this information to the district and sub-treasury officers. The DDO draws funds from the (sub) treasury for making various payments (towards salaries, to suppliers and contractors for works executed and for contingent expenditure) based on the allocation and budget release. There above process is applicable to withdrawal of monies from government account with one exception that is, the salary expenditure which is a 'non-control' item of expenditure.

4.4 The release of funds for centrally sponsored schemes or for schemes funded by other agencies, however, is subject to release of funds by the union government or the funding agency and funds for such schemes are released as separate orders for each scheme. The basic documents to record these transactions (bills/challans) are prepared by the DDO who also maintains some rudimentary accounting records such as the cash book, Treasury Bill Register, etc. The District Treasury Officer compiles the account of these transactions and sends it to the Accountant General with supporting vouchers, schedules, challans, etc. The AG, who is the representative of the CAG in the state, compiles the accounts for the entire state and sends it to Finance Department by 25th day of the month following the month of accounts.

Strengthen predictability of expenditure allocation

4.5 Predictability of allocation of funds is essential for proper and orderly execution of the projects or programmes as per the budget as the departmental officers at all levels can plan their work without any uncertainty about the funds that would be available for their work. Budget releases are made through Budget Release Orders issued by the Finance Department to the Administrative Departments and the CCO. Later the CCOs communicate releases to the COs and DDOs as explained above.

4.6 In 2003-04 the Finance Department started to intimate all heads of departments about allocation for the first three quarters of the year immediately after the demands for grants were voted by the Legislature. *This practice does not obtain anymore.* The Finance Department now releases only 50 per cent of the budget allocations as the first installment for expenditure during the first two quarters of the financial year. The second installment is released only in October after a review of the expenditure incurred during the first quarter. The third and the final installment of allocation are released in the month of January. But in practice, there is no free flow of release orders to enable execution of work unhindered without any doubts about availability of funds. The COs, it was noticed, receive their allocation for the first time in the year in July and August. In the various Government Orders issued on this subject no definite dates have been prescribed for the CCO and the CO to intimate further allocations to lower formations. *However, it appears that there are delays in communication of allocations by the CCO and CO as well, as explained below.*

4.7 It was observed during control testing, that the Controlling Officers get their first allotment letter as late as August. They are informed about their allotments only quarterly. Tests conducted in the districts revealed significant delays in communication of allotments as shown in the Figure 4.1 below. It can be seen that allotment orders were sometimes conveyed on the last working day of the month of March.

Figure 4.1 Delays in expenditure authorization at District / Unit Level for 2006-07

	Primary Health				Primary Education			
Qtr end	**Jun**	**Sept**	**Dec**	**Mar**	**Jun**	**Sept**	**Dec**	**Mar**
CCO to CO	22-4-06 to 12-7-06	28-7-06 to 16-8-06	7-10-06 to 18-12-06	29-1-07 to 13-2-07	6-5-06 to 26-5-06	18-7-06 to 3-8-06	21-9-06 to 16-12-06	5-1-07 to 13-3-07
CO to DDO	8-6-06 to 11-9-06	16-8-06 to 5-10-06	7-10-06 to 15-12-06	24-2-07 to 23-3-07	24-6-06 to 17-3-07	22-9-06 to 17-3-07	4-2-07 to 17-3-07	4-2-07 to 31-3-07

4.8 In the case of a DDO of Primary Education Department in Guntur allotment of contingent grant for the first three quarters of 2006-07 was received on 17-3-07 and that of the fourth quarter on 24-3-07. In order to avoid lapse of grant, the officer drew the amount and deposited the same in his PD account. Such delays in release of allotments usually result in March rush, which is commented on, year after year, by the CAG in his Audit Report as 'Rush of Expenditure' in March. The expenditure during the quarter ended March during the last three years is shown in Figure 4.2.

Figure 4.2 - Expenditure in last quarter and the month of March (Rs. in Crores)

Quarter ended	Expenditure	Percent of total expenditure	Expenditure during March	Percent of total expenditure
31 March 2003	8068.91	24		
31 March 2004	13836.95	41	7425.48	22
31 March 2005	14730.30	40	1758.44	5
31 March 2006	17592.28	41	11330.47	27
31 March 2007	20,480.85	40	13,129.74	26

4.9 Despite the rules and instructions for prompt issue of allocation orders being clear and reiterated almost every year, there is invariably a delay in issue of allocations that makes predictability of funds flow uncertain. Some more effort in streamlining the procedures in this area is necessary. Unless predictability is improved it would affect the pace as well as efficiency in execution of projects. Lack of predictability is the principal reason for surrender of grants at the very end of the year. Predictability of flow of funds to officers at service delivery level (District Officers and DDOs), who in fact control the pace of operations, has to be improved. A time table should be prescribed laying down clearly the dates within which the allocations should reach the COs and DDOs. Some states (Karnataka and Maharashtra, for instance) already follow practices that provide for budget allotments to be recorded in a central database which then becomes available to lower levels and the counterparts in Treasury and Accounts department instantaneously. It is understood that GOAP is also considering implementing such a system in the state.

Transparent and clear process for within the year expenditure changes

4.10 In 2005-06 against the budget estimate of Rs 55,331.30 crore and total grants (including supplementary estimates) of Rs.58,605.51 crore, the actual expenditure was Rs 49,305.81 crore (89.11 percent BE and 84.13 per cent of the total grants). In 2006-07 against budget estimate of Rs.63,527.74 and total grant (including supplementary estimates) of Rs.63,683.36, the actual for the year was Rs.57,387.05 (90.33 per cent of BE and 90.10 per cent of the total grants).

4.12 The huge saving of Rs.9300 crores (in 2005-06) is the total of Rs.9886 crores saved in 38 grants and Rs.586 crores excess spent in 11 grants. The savings varied from 1.09 per cent in grant number XXXVIII to 57.69 per cent in grant number XL. In only 5 grants the expenditure exceeded the budget estimates. The government did not furnish any reasons for savings in many cases to the Accountant General and in the cases where reasons were given they were of the following categories:

- Slow start of the scheme;
- Want of administrative sanction;
- Observance of economy;
- Non-filling of vacant posts;
- Non-receipt of government sanction and;
- Discontinuance of the scheme.

4.13 Very high savings have occurred in grants numbers

- XL, Public Enterprises (57.69 per cent) due to non-payment of government pleaders fees and non-payment of loan to an undertaking
- II, Governor and Council of Ministers (38.89 per cent) due to non-functioning of the council and observance of economy, and
- XXX, Cooperation (46.41 per cent) the reasons for the savings were not intimated.

4.14 Out of the total grant of Rs. 4510 crores for School Education, Rs.66.82 was surrendered on 31 March under various sub-heads. Supplementary grants were obtained in March 2006 for Rs.5.47 crores under Capital and Loans under this grant. (Please see table below) In all 33 re-appropriation orders were issued amending the grants in this demand, the last being in June 2006. Explanations for variations were sent to the AG by middle of October 2006. A small number of explanations were not incorporated in the Appropriation Accounts as they were received late. In 34 cases (amount Rs.368.43crores) under different heads, the appropriation was reduced and in 12 cases (amount Rs.92.32 crores) the appropriation was increased. Appropriation was reduced to the extent of Rs.96.88 crores under SSA and no specific reason was given for this reduction. Reasons were generally similar to those given for scheme in paragraph above. For reduction in 18 cases (amount Rs.29.71crores) the reason given was 'non-receipt of sanction orders from the government'. Another Rs.6.48 cores was re-appropriated due to discontinuance of the scheme.

Table 4.3- Grant Number XII - School Education

Revenue	Appropriation.	Expenditure	Savings	per cent
Voted	4504.61	4060.59	444.02	9.86
Capital	3.47	2.66	0.81	23.34
Loans	2.00	2.00	Nil	Nil
Total	4510.09	4065.26	444.83	9.86

4.15 Entire appropriation (in Rs crores) under the following heads was surrendered for similar reasons

• Assistance to Hindi Pundits	1.50
• Supply of Science kits to U.P. schools	0.23
• Environmental orientation of school education	0.22
• Improvement of Urdu education	0.42
• Tribal sub-plan: PMGY Programme	23.80
• Education Technology Programme	0.50
• Direction &Administration under SSA	5.05

4.16 How many of these changes are due to reduction in central inflows could not be ascertained. Under existing laws only excess expenditure over what is approved for the grant are required to be reported to the Legislative Assembly but not surrenders in total.

4.17 A saving of Rs.9300 crores (15.86 per cent) out of total grant of Rs.58,606 crores in the year 2005-06 and results of analysis of expenditure against grant number XII (School Education) above points to the need for improving the process of within the year changes in budget execution and the related expenditure.

- ***Strengthen measures to ensure departments submit monthly expenditure statements to CCO who should ensure suitable and timely follow-up action***

4.18 Generally reports to the CCO are sent by the CO, who gets the statements from the DDOs. The CCO send the expenditure statements to the concerned administrative departments who forward the same to the FD. It is only on the basis of these statements that the HOD sanctions re-appropriations. Control tests have revealed that there are some DDOs and COs who do not send the expenditure statements regularly and that makes the control of budget at the level of the Heads of Departments weak. An analysis of the re-appropriations made by the HOD during the last four years is discussed below. Control tests have revealed the following position as regards re-appropriation made by the CCO.

2003-2004

a. Out of anticipated savings of Rs.1848.78 crores, fewer than 25 grants, savings of Rs.571.46crores (31 per cent) were not surrendered. In 14 of these the savings were Re. 1crore and above.

b. In 14 cases surrenders were made even though expenditure was in excess of the grant.

c. In 51 grants/appropriations, Rs.3396 crores (93 per cent of the total saving) were surrendered on the last day of March

2004-2005

a. Out of the savings of Rs.7371.02 crores as much as 67 percent occurred in 5 grants out of total 40 grants. In the Demand no. XII School Education the saving was Rs.755.51 crores against a total demand of Rs.4244.20 crores and no reason was given for the saving by the department. Similarly in Demand no. XVI Medical and Health the saving was Rs.239.84 crores against a total demand of Rs.1672.18 crores. Interestingly for these two demands supplementary grants were obtained for Rs 5.81 crores for school Education and Rs.72.77 crores for Medical and Health.

b. In 35 grants and appropriations, Rs.6220.22 (84 per cent of the total savings) was surrendered on the last day of March 2005.

c. In 61 heads of account, injudicious re-appropriation of funds proved excessive or resulted in savings.

d. Overall, for the 17 grants and appropriations, while the savings were Rs.1790.28 crores the amount surrendered was Rs.2062.83crores.

2005-06

a. Out of the savings of Rs. 9885.52 crores, Rs.7119.24 crores (72.02 per cent) occurred in 5 grants. In Demand no. XII School Education, the savings were Rs. 444.02 crores and the reasons given by the department was non-receipt of sanction orders and non-payment of salaries to State Institute of Education Technology and discontinuance of some schemes; and

b. In 35 grants and appropriations Rs. 8568.52 crores (86.68 percent of the total savings) were surrendered on the last day of March 2006.

2006-07

a. In 56 heads of accounts, injudicious re-appropriations of funds proved excessive or resulted in savings, by over Rs. 5 core in each case.

b. In 38 grants and appropriations, Rs. 7455.01 (67 per cent of the total saving) was surrendered on the last working day of the financial year.

4.19 HOD should have the power to shift funds across the schemes when such changes are absolutely necessary; such flexibility is considered essential to pin the HOD to be responsible for outcomes. However, there should not be any unnecessary changes made in the grants. Injudicious re-appropriations show a lack of proper control pointing to need for improving the reporting and monitoring systems and tightening financial control.

- ***Improved explanations for actual expenditure relative to budget (as well as total appropriations including Supplementary Estimates)***

4.20 The reasons given by the departments for variations are very general and do not appear to have been given after close scrutiny and analysis in each case by the Heads of Departments. The CAG in his report for the year 2005-06 mentioned that the reasons for variances were called for from the controlling officers and that they were either not received or received incomplete in 70 per cent of the cases. In the Audit Report for the year 2006-07 this percentage was recorded as 75. This work of providing explanations for the variances is given very low importance and is left to be attended by some subordinate staff.

4.21 SFAA has recommended that Internal Audit should analyze reasons for variation and report the same to the external audit. As IA is practically non-existent in most departments, this work cannot be left to be looked into by the Internal Audit wing but should be done by the Controlling Officers of the spending departments. At the present the quality of analysis for the variances remains poor and has to be improved.

- ***Clearly define the criteria for 'urgent expenditure' for use of the Contingency Fund and Supplementary Estimates***

4.22 The A.P. Contingency Fund Rules made under the A.P.C.F. Act, 1957 clearly define the circumstances under which the departments can draw an advance from the Fund. The scheme or the purpose of the request for an advance from the contingency fund should be extremely urgent that cannot be postponed. *The Finance Department has not issued any further orders supplementing these instructions following the SFAA recommendation.* As regards supplementary estimates, clear instructions are available in the Budget Manual. As per the provisions of the Manual it is the responsibility of the Chief Controlling Officer who is expected to not only explain clearly why a supplementary appropriation is required but also why the need for funds was not foreseen at the time when original estimates were framed. It is emphasized that the government will not accept any proposal for a supplementary appropriation unless they are convinced that if the supplementary appropriation is not sanctioned serious inconvenience would be caused to public service.

4.23 Control tests revealed that about 114 orders for release of advances from the Contingency Fund were issued in 2005-06 right from April onwards. Out of these, 27 withdrawals from the Fund were for amounts less than a lakh of rupees and the smallest amount was Rs. 10,000. *Many of these releases from Contingency Fund were not included in the supplementary estimates though the Rules stipulate that it is the responsibility of the Administrative Departments to send to the FD the proposals for supplementary estimates.*

4.24 During the year 2004-05 it was noticed that in 29 grants/appropriations, the supplementary grant of Rs.709.66 crores was proved unnecessary as the expenditure did not exceed even the original grant and similarly in 2005-06 in 24 grants, supplementary estimates of Rs.256.43 crores proved to be unnecessary as the expenditure did not exceed even the original provision. Some of the supplementary estimates are for purposes like 'purchase of cars, CT Scanners, etc'. Excessive recourse to supplementary estimates would detract the importance and the effort that should be brought to bear on budget formulation as well as undermine financial control. There is needed to stay in tune with the provisions of the budget manual.

- ***Ensure more timely regularization of excess expenditure***

4.25 A large amount of excess expenditure amounting toRs.13,052.89 crore for the years 1997-98 to 2006-07 is yet to be regularized. The FD stated that meetings are held at the level of Principal Secretaries to the government to discuss and get proposals. Despite such action, the results are not as expected as can be seen from Figure 3 which shows excess expenditure yet to be regularized by supplementary estimates. One difficulty is tracing the old records for study and providing necessary explanations for the excess expenditure to the PAC. This has to be considered at a high level to provide a solution to the problem as otherwise the list would go on increasing. It may be good to tackle those relating to the immediately preceding years first and then tackle the back-log. The excess relating to the year 2003-04 is quite high and has to be taken up for regularization immediately.

Fig 4.4 Excess expenditure pending regularization (Rs. in Cores)

Year	No. of grants/ appropriations	Amount of Excess	Amount for which Explanation not furnished to PAC
1997-98	32	405.12	405.12
1998-99	35	310.63	310.63
1999-00	27	846.31	846.31
2000-01	21	414.29	414.29
2001-02	22	427.69	427.69
2002-03	15	546.25	546.25
2003-04	36	9303.24	9303.24
2004-05	6	14.83	14.83
2005-06	13	585.82	585.82
2006-07	8	198.71	198.71
Total	215	13,052.89	13,052.89

- ***Move to ex-ante rather ex-post authorization of supplementary estimates***

4.26 Article 205 of the Indian Constitution enables the state government to approach the Legislature for grants of supplementary estimates if the amount authorized by any law made in accordance with the provisions of Article 204 of the Constitution of India to be expended for a particular service for the current financial year is found to be insufficient for the purposes of that year or when a need has arisen during the current financial year for supplementary or additional expenditure upon a new service not contemplated in the annual financial statement for that year. As per the provisions in the budget manual only such proposals, which if not considered would cause ' serious inconvenience to public service' should only be included in the supplementary estimates.

4.27 If monitoring is done by HOD during the year, he can make re-appropriations within the grant by shuffling funds from the heads where saving is expected to heads where additional funds are needed. If the grant is found to be insufficient, he can request the Finance Department for a supplementary grant for additional funds. If such requests are made as and when the need is felt it would be possible for the FD to obtain a supplementary grant. But as a measure of abundant precaution the FD waits till March to finalize the supplementary demand for presentation to the LA.

4.28 *In all the three years after the SFAA study no effort was made to implement this recommendation.* In the year 2003-04 no supplementary grant for further expenditure was submitted to the Legislature as the Assembly was dissolved. During 2004-05 to 2006-07 only one Supplementary demand for further expenditure was submitted and that too in March.

Figure 4.5 (Rs in crores)

1	2	3	4	5	6	7
Year	Total Expenditure during the year	Interest payments	Net expenditure	Supply. estimates	(5/2)%	(5/4)%
2003-04	48,855	6,856	41,999	No S.E.	-	-
2004-05	45,747	7,091	38,656	2,421	5.29	6.26
2005-06	48,628	7,008	41,620	3,164	6.51	7.60
2006-07	61,552 (RE)	7,983	53,569	4,666	7.58	8.71

4.29 The percentage of charged expenditure in the amount of supplementary estimates shown in column 5 is negligible, that in the year 2005-06 being 0.33 per cent of the supplementary estimate. That dependence on supplementary estimates has been growing is clear from the fact that the percentage (shown in column 7) has grown from 6.26 in 2004-05 to 8.71 in 2006-07.

Strengthen key accounting controls in Treasuries

4.30 GOAP has a very well established treasury system which has been functioning efficiently, a fact recognized by the study. Treasuries in A.P. till recently were of two kinds: one where cash transactions are handled by the bank (these are called Banking Treasuries) and the second category which handles and disburses cash (these are non-banking treasuries). Recently all non-banking treasuries have been converted to banking treasuries. This is a major step taken by the government.

4.31 In addition to the treasuries there are 31 Pay and Account Offices (Works & Projects) through out the state under the Director, Works and Accounts and PAO (Hyderabad city). The PAO (Hyderabad) deals with 1200 DDOs located in the twin-cities of Hyderabad and Secunderabad. The suggestions as regards PAO (W& P) are dealt with in the chapter on accounts. The other recommendations to strengthen the treasury system are considered below:

Strengthen and control over schemes not using the treasury system

4.32 Financial rules prohibit operation of unauthorized bank accounts but the system of drawing huge funds on sanctions issued by GOAP on AC bills and keeping them in scheduled or other banks has been noticed to be common in many offices. This practice has many other risks in addition to fiduciary risk. GOAP issued detailed instructions in GO Ms No 113 dated 10-5-2007 regarding streamlining of fund flow from GOI. Some of the important points in the guidelines issued are as follows.

a. Funds received from GOI should be routed through one bank only both at the state and the district level.

b. The bank account should be opened in the designation of HOD at the State head quarters and in the designation of District Officers at District level.

c. All accounts should be operated with joint signatures.

d. Funds should not be drawn to be kept in Fixed Deposits.

e. Reconciliation, of balances as per the officer's books with those of the bank, on a monthly basis shall be done. Heads of department should be personally responsible for reconciliation.

f. No self cheque should be drawn except for salaries and petty office expenses

4.33 These orders were circulated by the Government to all the Heads of Department, all District Treasury Offices, Sub Treasury Offices and all District Collectors for implementation. Despite such clear instructions, multiple bank accounts continue to be operated by field officers.

4.34 Control tests revealed that bank accounts, one for each scheme, are being maintained to hold funds of different schemes. As some of the offices administer many schemes, they have as many bank accounts as the number of schemes handled by them. Some of these accounts were neither mandated nor authorized by the competent authority. During the scrutiny of records with the DDOs in test checked districts, the following, which involve fiduciary and other risks, were noticed

a. Multiple Bank accounts are maintained by DDOs and COs.

b. Reconciliation of cash book balances with the bank balances has been in arrears in respect of many DDOs/COs for many months.

c. Non-maintenance of cash books by certain DDOs/COs viz. DM&HOs, Medical officers, Mandal Education Officers and Headmasters of Primacy Schools was also noticed.

d. Funds of one scheme were mixed up with other schemes viz. funds drawn on AC bills towards Family Welfare compensation with funds of RCH scheme.

e. Rules prescribe that bank account should be operated as joint accounts with another medical officer. In respect of Reproductive Child Health Programme (RCH/NRHM) certain Medical Officers have bank accounts which can be operated by a single officer only in respect of RCH funds.

f. Non-remittance of unspent balances to the scheme account at Headquarters i.e. HOD account viz. OBB, Midday Meals Scheme and SSA.

g. Non-utilisation of Hospital Development Funds by the Medical Officers of PHCs for long periods.

h. Non-closure of cash books for long periods.

i. Keeping huge scheme funds with Urban Cooperative Banks.

j. Non-maintenance of cash books in respect of RCH scheme. Cheques received from DMHO are encashed and kept in the office for distribution among ANMs in cash instead of issuing cheques by the medical officers.

k. Non-furnishing of Statement of Expenditure by COs in respect RCH-Untied Funds for the years 2005-06 and 2006-07, leading to the non-release of Untied Funds for the year 2007-08. Some instances are quoted below

Additional Project Coordinator -SSA-Guntur

4.35 Ten bank accounts are maintained with Nationalised Banks including with Urban Cooperative Bank with huge amounts deposited under the scheme resulting in parking of scheme funds without prompt utilization for the intended purposes. The balances available with various banks as at September, 2007 ranged from Rs.27.19 lakh to Rs.598.67 lakh. The following amounts have been lying un-utilized since long time.

Table 4.6

S. B. Account number/Scheme	*Amount in Rupees Balance available As on 30-9-07*	*Lying unutilized since*
32583 – Canara Bank K. G.B.Vidyalaya	71,24,730..00	May 2006
11003214894-S.B.I. 11th Finance Commission for civil works	7,50569.75	2002-03
904-NTR Urban Coop. Bank /Completion of incomplete buildings	16,77,246.00	Nov. 2004

4.36 Further, refunds made by MEOs / Schools during February 2006 to September 2007 of unspent balances of grants aggregating to Rs 31.30 lakh have not been remitted to State Project Director till October 2007. In addition to the above this officer holds Rs.828.19 lakh for use on the on-going schemes in 7 bank accounts. Such huge funds that is not necessary for immediate use involves many risks.

A.P.C.SSA-Warangal

4.37 Rupees 15,86,298 given under DPEP during 2002-03 has been lying unutilized since November 2007 in S.B. account no. 7656 with Canara Bank, Hanumakonda and this amount includes mainly refunds made by the MEOs of the unspent portion of the grant given to them and the interest credited by the bank on these balances. In addition to this amount, the officer holds Rs.1248.38 lakh under different on-going schemes in three accounts with the same bank.

SSA-Rangareddy

4.38 An expenditure of Rs.28,03,500 towards cost of library books was booked in the cash book dated 31-12-2005 of DPEP. However, cheques for Rs.14,01,750 only were issued vide cheques nos. 012989, and 012991 dated 31-12-2005 for Rs.3,75,200 and for Rs.10,26,550 respectively, but in the monthly expenditure statement sent to State Project Director, the entire amount of Rs.28,03,500 was included. The error was not rectified and an amount of Rs.14,01,750 is lying un-utilized till June 2007, though the scheme was closed long ago.

SSA - State Project Director

4.39 Control tests revealed that the directorate maintained 32 Savings Bank Accounts in various branches of 6 Nationalised Banks spread throughout twin cities of Hyderabad and Secunderabad. Out of the above 32 accounts, 14 accounts have been closed and the remaining 18 bank accounts are being operated as of December, 2007 to account for the amounts received from Government of India and A P State Government under various interventions of the SSA scheme. Control tests also showed that the full information regarding the dates from which the closed accounts were operated is not available with the Directorate as the information could also not be furnished by the banks due to lack of data in the system. It was also seen during study that huge amounts of scheme fund are lying un-utilized since long as detailed below:

Table 4.7

Name of scheme	Savings Bank Account Number	Amount (Rs Lakh)	Date from which lying in the account
SSA	85001 [SBH]	32.53	January, 2007
NPEGEL	57227 [Canara Bank]	922.48	April, 2007
XI FinCom	01/00371985 [AB}	78.73	December, 2006
PMGY	01170085010 [SBH]	19.64	September, 2006
EGS	01/00372308 [AB[]	84.73	October, 2006

4.40 Further it was seen during the study that:

a. The reconciliation of cash book balances with that of Bank balances has not been done regularly;

b. The entries made in the cash books are sometimes incorrect and incomplete. The entries made in the cash book [DPEP.I] were not supported with details and balance arrived at deducting huge amounts relating to earlier years. For example,

- a) DPEP-I cash book for 2005-06 showed that Rs.46,46,347 was debited in the cash book on 28-6-2005 being the difference during 2004-05. The opening balance on 28-6-2005 was Rs.98,49,734. After deducting Rs.46,46,347 the closing balance on that date was shown as Rs.52,43,987.00 instead of Rs 52,03,387; and
- The closing balance ofRs.3,69,95,539 as on 31-3-2003 was taken as Rs.3,65,89,807 as opening balance for the year 2003-04 in DPEP-II Cash Book. Similarly the closing balance of Rs.3,63,88,940/- was taken as Rs.3,63,58,940/- resulting short account of cash balance.

c. There is no proper monitoring system to ascertain information regarding the balances available with the District offices under each scheme, to regulate the releases of funds whenever the grants are received by the Director.

d. Internal Audit was poor with only two posts of Asst. Accounts Officers and One Junior Accounts Officer sanctioned to cover all the District offices under the Directorate. As against the sanctioned posts as above the post of Junior Accounts Officer was vacant since long. The services of the existing staff are utilized elsewhere other than Internal Audit Functions.

DEO Warangal

4.41 A huge balance of Rs.3,34,26,297 was available under various schemes as on 31 March 2007. This amount includes unutilized funds under different schemes as detailed below.

Table 4.8

Name of the Scheme	Amount in Rupees	Date from which lying unutilized
Unspent balance of Mid-meal scheme out of Rs. 11,33,60,957/- drawn on 4 AC bills during 2003-04	99,79,937	2003-04 Remitted to Govt. Account on19-09-2007
Special Vidya Volunteers	11,77,127	25-07-2005
Vidya Volunteers	7,31,623	September 2005
Operation Black Board	6,94,875	6-3-2007
Construction of Kitchen Sheds Under Mid- meal Scheme	1,24,20,000	March 2007

DEO Guntur

4.42 Seven bank accounts are maintained to hold funds under different schemes. The unspent balance under OBB, which is a closed scheme, is being utilized even during 2007-08 without its surrender.

DEO Rangareddy

4.43 Seven bank accounts are maintained in all, but the cash books in respect of a) SSC Examinations, b) 7th class examinations, and c) Vidya Volunteers were not made available to the study team. Huge unspent balances are lying unutilized as indicated below.

Table 4.9

Name of the scheme	Amount	Unutilized since
	[Rs.]	
Midday meals scheme [AC bills drawn during 2003 under the scheme]	3,15,527	2003
OBB	11,58,000	2003

The payments for midday meals scheme are made through Treasury since 2006 onwards, and therefore the retention of amounts received for that scheme in bank accounts should have been discontinued.

DM&HO Guntur

4.44 Four bank accounts are maintained under RCH [NRHM scheme] out of which two bank accounts remained in-operative as indicated below:

Table 4.10

Bank	Amount	Inoperative since
SBI main Branch	3,28,127	July-2006
Syndicate Bank	4,07,335	February-2006

The bank passes book and the cash book in respect of ‘Urban Health Centres’ was not made available as it was stated to have been held up with Chartered Accountant. The balance available under the account was Rs.26, 88,583.00 as on 14-6-07.

DMHO, Warangal

4.45 Nine bank accounts are maintained under different components of RCH and under non-RCH schemes. The bank accounts under RCH are under the joint account with the District Collector. However, the cash books maintained under the scheme are not up-to-date requiring special attention for updating. The backlog (as on 11/07) in posting the entries in the cash book is detailed below.

Table 4.11

Bank A/c No. [SBI Nayeemnagar]	Balance as per bank pass book [Rs]	Date from which cash book has to be updated
1048634186	1,02,882	March, 2007
30017423469	73,85,765	December, 2006
30017422217-1	82,19,738	October, 2006
10486364153	86,921	Since 2004-05*
30021482135	22,074	March, 2007
10486364277	38,913	August, 2007

*An amount of Rs.1.15 lakh was diverted towards Family Welfare compensation during February, 2007 has not been refunded]

4.46 Control testing also revealed that the following huge funds are lying unutilized with DM&HO. Reasons for such huge accumulation in bank accounts was stated to be the release of funds by the CFW through 'on line credit' without the knowledge of the district office.

Table 4.12

SB A/c. No	Amount [Rs.]	Date from which lying unutilized
3001742217-1	82,19,738	October, 2006
10486364459	25,00,000	March, 2007

4.47 The above position shows how the GOAP's instructions on maintenance of bank accounts have been largely ignored exposing the government to major risk of misappropriation and misuse of scheme funds.

- **Each DDO to draw from one treasury/PAO**

4.48 At present, a large number of DDOs draw money from more than one treasury. Control tests show that some officers have jurisdiction covering an area of more than sometimes one district and in those cases the officers draw from more than one treasury. In respect of 12 districts it was noticed that 167 DDOs draw money from more than one treasury. Information about such officers in other districts is not available. In the district of Nalgonda as many as 52 officers draw money from more than one treasury. This facility is to prevent frequent transfer of cash from one place to another which would become compulsory in case the officer has to draw from only one treasury. The risks involved in the current practice have to be analysed in consultation with the AG and controls provided to prevent misuse.

4.49 As pointed out in paragraph 1.9(b) of Chapter 1, there is no discussion on this point in paragraph 5.8 of Fiduciary Report of SFAA referred against recommendation. As a result, it is not known what prompted the SFAA team in making the above recommendation as also whether they considered the compulsions that DDOs have which requires their drawing funds from more than one treasury.

Promptly and accurately record monies advanced

4.50 It is expected that in respect of loans given to various organizations and government servants the following practices are followed.

- A proper record is kept of loans and advances;
- There are adequate controls over issue and recovery of loans and advances; and
- All loans and advances are periodically reviewed as to their recoverability, classification and writing off where necessary

4.51 Presently, the loan position is reviewed by the AG only. All the loans are sanctioned by the departments with the concurrence of the FD. Demand, Collection and Balance statements are not received from any department in the FD and as such no review is conducted by the FD. The FD does not receive any periodical reports on the status of loans from the administrative departments. There is no information on overdue loans in the FD.

4.52 The CAG in the annual audit report for the year 2005-06, mentioned that the total outstanding loans as on 31 March 2006 were of the order of Rs. 10,213 core. Interest received on such loans varied from 0.18 per cent to 4.5 per cent during 2001-06. The position is shown in the table given below.

Table 4.13- Loan position of GOAP (Rs. in crores)

Details	**2001-02**	**2002-03**	**2003-04**	**2004-05**	**20005-06**
Opening balance	7654	8405	9180	*9419	9639
Amount advanced during the year	1698	1235	1494	1593	756
Amount repaid during the year	947	460	1256	1373	182
Closing balance	8405	9180	9418	9639	10,213
Net addition	751	775	238	220	574
Interest received	341	282	422	68	18
Interest received as per cent total loans advanced	4.3	3.2	4.5	0.71	0.18
Average interest paid by the State (per cent)	10.4	12.00	11.5	10.2	9.11
Diff. between int. paid and received (per cent)	6.2	8.8	7.00	9.5	8.93

* *Differs by Rs, 1.00 crore (increased) due to lower rounding of closing balance in 2003-04*

4.53 The position of recovery has shown some improvement during 2003-04 and 2004-05 but fell sharply during 2005-06. According to the information given by the FD no fresh loans were sanctioned during last four to five years except to institutions such as A.P. Police Housing Corporation, A.P. Housing Corporation, and A.P.H.M.H.I.D.C., etc. When assets are created with expenditure met from the loans given to companies, they are converted as equity capital of the company.

4.54 There are standing instructions of the government that the information about the overdue amounts as on 31 March every year together with steps taken for the recovery of the arrears etc. in respect of the loans for which detailed accounts are maintained by the departmental officers should be sent by the heads of departments to the AG by 30 June every year for the previous financial year. Information about the overdue amounts as on 31 March 2006 has not been received from any of the officers, as reported by the AG. The CAG report mentioned that the apportionment of assets and liabilities, after the split of the APSEB into two companies with effect from 1 February 1999 has not so far been done.

Strengthen accountability of DDOs, COs, and CCOs in respect of GIA and AC/DC bills

4.55 No reports are received from the DDOs to the COs nor are the COs report to the CCOs on these two items. It was not also being insisted on by the senior officers of the departments. The position as regards the utilization certificates and AC/DC bills is discussed below.

4.56 Grants–in–aid given to various bodies in the last three years is as follows. 3002 utilisation certificates are outstanding as on 31-3-05 for a total amount of Rs.597.07 crore. The outstanding position as at the end of the financial year 2004-05 is shown in table 4.14 below.

Table 4.14

Department	UC pending as at 31-3-05	Value of the UC pending (Rs. in crores)	Earliest year from which pending
Revenue Relief on account of Natural calamities	2447	474.71	1993-94
Panchayat Raj and Rural Development	410	61.39	1991-92
Municipal Administration and Urban Development	99	23.86	1998-99
Social Welfare	42	37.67	1992-93
Education	4	1.44	1992-93
Total	3002	597.07	

Abstract Contingent Bills

4.57 After a sanction is received for execution of a scheme, money may be drawn in anticipation of expenditure on Abstract Contingent bills. The officer so drawing the money has to submit a detailed bill viz. the Detailed Contingent bill with all the vouchers in support of expenditure made out of the advance. Many times the submission of DC bills is delayed very badly and this is a high risk area. The position of submission of DC bills in GOAP as at the end of the financial year 2006 is given in table 4.15 below.

Table 4.15 (Rs. in crores)

Name of the Department	No. of AC bills pending	Total amount of AC bills as on 31-3-06	2003-04	2004-05	2005-06
Revenue	5,319	275.83	140.09	44.46	82.28
Education	24,996	109.67	96.62	5.86	7.19
Medical, Health & Family Welfare	83,752	109.65	88.77	12.79	8.09
Social Welfare	96	103.06	0.89	2.55	99.62
Home	2,097	98..27	73.64	18.61	6.02
General Administration	4,374	31.12	28.19	0.73	2.20
Others	3,864	76.63	32.74	16.04	27.85
Total	1,24,498	804.23	469.94	101.04	233.25

Number of AC bills for which the departments have to submit have increased despite the G.O.507 issued in 2002. During the field testing it was seen that out of 12 offices only five offices maintained AC Bill register.

Increase transparency of the Public Account

4.58 The only action point under this recommendation is that it should be ensured that the AG has sufficient information about institutional loans and advances to enable proper reporting. It was found in field study that neither the AG nor the FD receives any information from the administrative departments. In the Finance Accounts for the year 2005-06, the AG reported that acceptances of balances were due in 4955 cases from the various departments for loans amounting to Rs.1689.60 crore. AG reports that there are unreconciled differences between the closing balances shown in the Finance Accounts and those shown in separate registers or other records maintained in the accounts /departmental officers for the purpose. In many cases the full details and documents required are awaited from the Treasury and departmental officers. So far the FD has not taken any initiative to ensure that the AG is given the necessary details and documents.

Strengthen reporting on budget vs. actual expenditure

4.59 The report of actual expenditure against the budget is available in only one document fully and that is, the 'Appropriation Accounts' prepared by the CAG. This document is generally available in public domain nearly six months after the financial year is over; it could take longer if there is a delay in placing the Appropriation Accounts before the Assembly for some reason. For example, Appropriation Accounts for 2005-06 was available in October 2006. In this document the original grant, surrenders made out of this grant, the re-appropriation made during the year, and the final amount of grant against each demand are given along with the actual expenditure for the year.

- **Include summary of main reasons for excess expenditure in Appropriation Accounts**

4.60 Appropriation Accounts are prepared by the Accountant General and they are drawn up as per the format approved by the CAG. If these items i.e. over-run in non-control items, authorized relaxation of Treasury controls and items of relaxation not covered by supplementary estimates are given as a summary in the Appropriation Accounts, it would definitely show clearly the extent to which the government had to resort to these facilities to meet the expenditure needs not contemplated at the time of budget formulation. *No suggestion has so far been sent to the CAG to include a table as recommended and the Appropriation Accounts are published in the same format as before.*

- **Publish a list of all re-appropriations with the Appropriation Accounts**

4.61 There are 40 grants and the re-appropriations made during the year in each grant are not only numerous but also many times involve very small amounts. For all the demands the number is very huge and it is felt that this would make the Appropriation Accounts very bulky and that information may not serve any purpose.

- **Produce full accounts and balance sheet for the Contingency Fund**.

4.62 Full account of the contingency fund is available in the Finance Accounts (in Statement No.16 in Part II-Contingency Fund) compiled by the CAG. The said statement gives the opening balance, advances drawn and recouping made during the year, and the closing balance under each head of account. This is adequate disclosure and adding a similar statement in the Appropriation Accounts is unnecessary.

- **Provide summary of funds recouped for the contingency fund in the supplementary estimates**

4.63 No such summary is provided in the supplementary estimates prepared by the Government but in the summary portion of the supplementary demand against each grant for further expenditure, notes are added at the end to provide information as to why further demand for funds is being made. If the amount is for the purpose of recouping the advance drawn from the Contingency Fund it is mentioned in the notes. As an account of the Contingency Fund is available in the Finance Accounts and Government Orders are issued ordering recouping to the Contingency Fund, a summary as recommended is not considered necessary. The transactions under Contingency Fund are not very large and they are generally recouped in the same year by obtaining the supplementary grant.

- **Provide table in Supplementary Estimates summarizing the releases for which ex-post authorization is sought from the Legislative Assembly**

4.64 No such table is provided at present in the supplementary estimates. G.Os are issued to indicate the recouping to the Contingency Fund, and total amount of withdrawals not recouped during the year is also given in a separate GO. The intention is to have at one place the information as to how often this facility of Contingency Fund is used during the year and how fast the recouping is done. It would be desirable to give a table as suggested.

- **Devise GOAP-wide expenditure monitoring report format that provides a stronger basis on which to manage within-year expenditure**

4.65 The Finance Department has not so far devised such a comprehensive format to manage within-year changes. This remains to be done to improve the management of within year changes.

- **Prepare consolidated monthly monitoring statement that highlights implications of within year patterns in revenue and expenditure for end-year deficit and debt figures and develop a process to ensure that if revenue monitoring identifies a short fall that is likely to be sustained for the year before the revised estimates, a revised cash plan is developed and communicated to the departments estimates, as soon as possible, rather than waiting for the Revised Estimates**

4.66 This work is largely done by regular meetings held at the Principal Secretary level. The revenue collections are regularly intimated to the FD. And there is a monitoring cell in the FD which does this work. *If a comprehensive format is devised for this monitoring as suggested in another action point it would be more purposeful.*

The FD issues orders in urgent cases relaxation treasury control in anticipation of supplementary estimates. These orders of the FD are with the specific instruction to the head of the department that they should move for supplementary grant well in advance. Tests showed that such relaxation of treasury control, in 2004-05 was accorded in 133 orders for withdrawal of additional funds aggregating Rs 1107.03 crore and CAG report points out the following.

a. 21 sanctions were issued in the last two weeks of March

b. 23 sanctions aggregating to Rs.24.24 crore were covered neither by supplementary grant nor by re-appropriation

c. In 2 sanctions for Rs.8.35 crore, no expenditure was booked even though sanctions were covered by supplementary grant/re-appropriation

d. In 6 cases though additional funds were provided in relaxation of treasury control, the expenditure did not exceed the original provision.

4.67 There is a need to scrutinize the proposals for relaxation of treasury control more thoroughly to avoid cases of the sort mentioned above. The Treasury control relaxation orders given during 2005-06 and 2006-07 are as follows:

Table 4.16

Year	No. of Departments	No. of orders	Amount in Rs. crores
2005-06	24	303	1896.81
2006-07	27	409	2562.01
2007-08	24	234	889.99

That so many relaxation orders have to be issued calls for more attention to detail in estimating the requirements at the budget formulation stage.

Within year monitoring of commitments

4.68 Though no system has been developed to monitor commitments and to meet commitments relating to a financial year in the same year it has been possible according to the FD to do so in the last two to three years.

- **Departments to be trained in using monitoring reports as a management tool in variance analysis and strategies for mid-term correction wherever necessary**

4.69 In none of the Training Institutes courses have been organized for this purpose but this work of monitoring is done by the Heads of departments regularly on the basis of expenditure statements they get from the DDOs and COs . At the secretariat level, in the administrative departments, meetings are held with the Heads of departments to continuously monitor the progress of expenditure. Similarly the Revenue earning departments send progress reports of revenue collection to the FD. The Heads of Revenue earning departments monitor the revenue collections on monthly basis against targets fixed for the month on the basis of the annual target fixed for the department.

Conclusion

4.70 It is seen from the control tests that predictability of expenditure allocation is still poor. Control over re-appropriations and releases from Contingency Fund need much improvement. The practice of opening bank accounts to deposit scheme funds / grants has assumed alarming proportion and unless remedied on priority poses a big risk of defalcation and misappropriation. Recording and monitoring of loans requires urgent attention. There is no reliable and timely financial MIS to guide the government departments on 'within the year commitments' and identify shortfalls and savings so that adjustments are made in real time rather than once a year exercise of revised estimates.

Recommendations

4.71 It is recommended that:

a. Predictability of expenditure allocation be improved by adopting an IT solution as has been done by some states (e.g. Khazane in Karnataka and Koshavahini in Maharashtra);

b. Opening of bank accounts for depositing scheme funds be regulated very stringently by adopting some strict measures;

c. There is an urgent need to develop financial MIS that would give the departments and FD a clear picture of actual expenditure versus budget estimates. Again, adoption of IT would address this problem quite effectively. Availability of information in real time would strengthen monitoring of budget execution and make the processes of within the year expenditure changes transparent.

d. Record keeping of loans and advances and control over them needs to be improved by suitable measures.

e. Assess the risk involved in unreconciled balances between the closing ledger balances of the Public Account shown in the AG's main /control accounts and detailed accounts; and take suitable steps to clear them.

Chapter 5
Accounting

5.1 Accounting involves recording financial transactions in a precise manner in a prescribed format. Accounting plays a vital role in financial management of any entity not only in minimizing fiduciary risk but also in ensuring accountability. GOAP like other State Governments in India follow cash basis accounting. This method is simple, clear and easily understood and promotes financial control.

Principles of good practice

5.2 The key principles of good practice in accounting as identified by SFAA are as follows.

- Clear and optimal roles and responsibilities in accounting process.
- Clearly defined accounting concepts, policies and procedures.
- Accounting policies support the needs of the user of the accounts.
- Timely rendering, compilation and production of accounts.
- Systems and Controls support relevant and reliable accounting.
- Complete and reliable accounting for funds held outside the Consolidated Fund.

Timeliness of reconciliation and control over public account pose significant fiduciary risks which could be addressed by the government; whereas there are accounting issues such as accounting standards and policies that require changes at the Government of India level requiring active engagement of CAG and GOI. The SFAA study has made the following recommendations. (☒ indicates not yet implemented / partially implemented; ☑ means implemented; and ?? the recommendation needs further examination)

SFAA Recommendations	
	Strengthen GOAP accountability for accounting and financial reporting
??	Transfer increasing responsibility for payment and accounting to line departments.
??	Increase the involvement of line departments by requiring each CCO to produce his department-wise accounts and submit to the AG, along with reconciliation certificate.
??	GOAP should assume responsibility for compilation of the accounts by signing and presenting the accounts (FR 6.2.2).

Clarify accounting concepts, policies and procedures

☒ Produce a summary of GOAP accounting concepts and policies, publishing in Accounts (FR 6.3)

☒ Conclude discussions with AG / GASAB about accounting treatment of subsidies and grants in order to ensure that 2002-03 accounts are drawn up on consistent and agreed basis (FR 6.3)

?? Support and contribute to GASAB initiative to develop national accounting standards; seeking voluntary compliance as soon as possible (FR 6.3). Ensure GASAB accounting standards are promptly disseminated in AP through integration into PFM legal framework and training (FR 6.3)

Strengthen accountability of DDOs, COs and CCOs for PFM

☒ Complete reconciliation a) with Treasuries / PAO (FR 6.6.4.1) and b) with AG (FR 6.6.4.1). Clear backlog of PAO (Hyderabad) cheque reconciliations with bank and devise system to ensure monthly reconciliations henceforth (FR 6.6.4.2). Clear the arrears in reconciliation of paid cheques by PAO (Works and Projects)/PWD (FR 6.6.4.2) While clearing the backlog, the focus should be on fully reconciling current balances and work backwards.

Increase transparency of the Public Account

☒ Analyze each suspense and remittance account, clear backlog, and strengthen systems of control over each suspense account to ensure that items posted are promptly cleared (FR 6.7.4)

☒ Thorough review of APGLI and AP State Government Employees Group Insurance Scheme to be undertaken (FR 6.7.1)

☒ Thorough clearing of unposted items in APGLI and Class IV employees' Provident Fund (FR 6.7.1 and 6.7.2)

5.3 The implementation of the above mentioned recommendations and impact of the recommendations is discussed in this chapter.

Strengthen GOAP accountability for accounting and financial reporting

- **Transfer increasing responsibility for payment and accounting to line departments.**
- **Increase the involvement of line departments by requiring each CCO to produce his department-wise accounts and submit to the AG, along with reconciliation certificate. Initially, produce monthly accounts moving to six monthly and Annual Accounts.**

5.4 The system obtaining now is that the treasuries and the PAOs make payments and render accounts to the AG for consolidation. Treasury and PAO are in the nature of a common service agency. On the other hand, the role of the departmental drawing and disbursing officers is to reconcile their accounts with figures intimated by Treasury/PAO offices. The HOD is expected to prepare consolidated account for the department on the basis of returns received from the lower formations, verify the same with the amounts booked by the AG, and suggest corrections, wherever necessary.

5.5 Thus, the departmental officers do have a responsibility to generate their departmental accounts. However, having an independent agency such as the AG to compile the accounts for the state as a whole incorporating the inter-governmental transactions and transactions with RBI, has many advantages. The important thing is that they are not mutually exclusive options. The departments can and should produce accounts for their internal purposes of monitoring, while AG prepares the accounts for the state as a whole for statutory purposes.

5.6 As for the suggestion that the departments assume responsibility for payments (please refer paragraph 6.2.1 of SFAA Report), it assumes that the each department would have its own 'payment office' or all its DDOs are permitted to operate bank accounts. Since accounting goes hand in hand with payment function, the payment office would have to be pay and accounts office. Such a practice does exist in Union Government where after departmentalization of accounts in 1976, each Ministry has it own PAO. However, the important difference is that unlike GoI, each department in the state has field level offices in each district and below. This would require each department to maintain a PAO in each district. As there are about hundred departments, there would be around 2300 PAOs in the state! Such dispersal of payment across some so many PAOs would make consolidation and compilation of accounts a near impossibility. Thus, it is imperative that there is a common service agency such as Treasury to pay and partly compile accounts and AG to further consolidate accounts for the state. The departments should no doubt maintain their accounts for internal monitoring purpose, which is not happening. Also, reconciliation of departmental accounts with the accounts compiled by AG is not happening.

5.7 The problem is that Heads of Departments do not receive regularly monthly reconciled expenditure statements from all the COs. Control tests in the office of the Director of School Education revealed that he reported completions of reconciliation with AG up to June, 2007, although reconciled figures were not received from all COs. The Director School Education simply accepted the figures of the Accountant General and reported those figures as reconciled figures. The Director of School Education did not have the departmental figures from all COs and other units.

5.8 The moot point is whether reconciliation serves any purpose. Admittedly there are two sets of records - one which the department maintains (of the payments authorized by it) and the payments that have actually taken place at the Treasury. There is theoretical possibility that the actual payment may vary from the one authorized by the department. This is a matter of having adequate internal controls built into the process to prevent such a thing from happening; and, one such control could be reconciliation of the two. This is best tackled at the point where both the transactions take place - DDO and the Treasury much like the way bank reconciliation is done. It should be squarely the responsibility of the DDO to reconcile his account with the Treasury after the latter supplies him with the statement of receipts and payments. Reconciliation between CCO and AG is not only impractical but also other inaccuracies that creep into compilation on both sides complicate the process. This is a matter on which the state government needs to engage the AG for finding a suitable via media.

- **GOAP to assume responsibility for compilation of the Accounts and sign and present the Accounts**

5.9 If the GOAP assumes responsibility for compilation of accounts, the Principal Secretary to Government, Finance Department would sign and present the accounts. According to Section 10[1] of the DPC Act 1971 the CAG is responsible for compilation of State Accounts from initial and subsidiary accounts rendered to the AG by Treasury Officers or Departments responsible for keeping such accounts. The second proviso to the section empowers the State Governor with the approval of the President and in consultation with the CAG to relieve the CAG of the responsibility to compile State Accounts. So far GOAP has not considered this option.

5.10 The spirit of this suggestion appears to be that the government and its departments should assume greater constructive responsibility for the accounts. That is, while AG continues to compile the accounts for the entire state, the heads of department should be able to prepare the accounts for their departments independently (based on their records). This is necessary for two reasons: a) Departments generally have no idea of actual expenditure versus their budget allotment and as a result are unable to monitor the progress of expenditure; and b) Reconciliation of accounts with AG, which is indeed an important control measure, is practically inoperative because there are no departmental accounts with which to reconcile. In most cases, the departments accept the accounts as compiled by AG making the exercise of reconciliation entirely meaningless.

- **Quarterly meetings of Finance Department and the A.G. to resolve the issues**

5.11 So far no timetable for regular quarterly meetings of the Accountant General with the officials of Finance Department has been drawn up. It is reported that such meetings are fixed whenever key issues arise. Such meetings were held in April, 2005, November, 2005, April, 2006 and December, 2006. As the record of discussions was not available, what transpired in such meetings is not known. This is a very important recommendation on which Finance Department could take action to draw up an agreed timetable for the year and each meeting held with an agreed agenda so that both parties could participate in the discussions actively.

Clarify accounting concepts, policies and procedures and supporting GASAB

5.12 Accounting concepts are laid down in the various codes and manuals of the Government. In India it is the CAG who determines the accounting policies and the format of Accounts. The Accounts Code, General Financial Rules and Treasury Code provide the elaborate structure of the existing accounting and public finance management systems. The CAG who compiles the Finance Accounts summarizes the broad system of classification and divisions of Accounts and adds notes wherever necessary for better understanding of the concepts on which the accounts are based. Although the generally voiced criticism that financial accounts of government are quite abstruse and incomprehensible to the common man and they are not user friendly is true, there is very little that the state can do to bring about a change in this as this matter is to be decided by GoI in consultation with CAG. As Government Accounts Standards Advisory Board (GASAB) is tasked with this responsibility, it is to be hoped that there would be some positive change in near future.

Strengthen accountability of DDOs, COs and CCOs for PFM.

- **Implement reporting mechanism by DDO to CO, CO to CCO and CCO to the Secretary of the Department concerned, copied to Finance Department on reconciliation of accounts figures**

5.13 Control tests conducted in treasuries / DDOs / COs revealed the following position. Prior to January, 2004 the work of reconciliation of departmental figures with those of Treasuries was done by the DDOs and COs who used to get their statements certified by Treasury Officers. Since all Treasuries and Pay and Accounts Offices have been provided with computers, it was decided (vide G.O.Ms.No.12 Finance [TFR.II] Department dated 13-1-2004) that the Treasury Offices would generate the Receipt and Payment Statement monthly in respect of each DDO and send it to the DDO on 11^{th} of every month asking him to reconcile and send back the statement by 20^{th} of every month. If the DDO fails to submit reconciled statement, the Treasury Officer was directed not to admit the bills of such defaulter DDOs thereafter.

5.14 It was noticed that while furnishing the computer generated statement of monthly Receipts and Payments to the DDOs for confirmation it was stipulated by the Treasury Officers that *if the confirmation is not received from the DDOs, the figures in the statement sent would be deemed to have been accepted by the DDOs.* Such a stipulation was unauthorized and in practice confirmation is not received from the DDOs; the Treasury Officers presume that the statement sent as verified one. The DDOs also accept the statement sent by the Treasury Officer and send the same to the superior officer as statement of expenditure. It was noticed that DM & HO Guntur has not verified the statements from Treasury Officer since January, 2004, and has submitted un-reconciled statements up to March, 2006. Thereafter, no monthly statements were submitted to the CCO by the DM & HO, Guntur.

5.15 GOAP has issued vide G.O.Ms.No.285 Finance [TFR.II] Department dated 15-10-2005 that all DDOs, COs and CCOs should report to their superiors monthly on reconciliation with treasuries and send monthly expenditure statements regularly. In the districts visited, the following officers have not sent reports as required from the dates indicated against them.

Office	*Report not sent from*
DM & HO, Guntur	April 2006
M.E.O., Prathipadu	February 2006
M.E.O, Malkajgiri	January 2004
M.E.O, Hayatnagar	April 2005
P.H.C, Station Ghanpur	November 2006

5.16 It is obvious that some of the Heads of Departments do not receive regularly expenditure statements from the DDOs and COs. Without those statements, consolidated account cannot be prepared by the HOD. This is the reason why many HODs accept the AG's figures without any reconciliation. One of such HOD is the Director of School Education.

5.17 Control tests also showed that the CCOs were not sending any reports to the Secretaries of the administrative departments on reconciliation between DDOs in Twin Cities and Pay and Accounts Office, Hyderabad. As reported by the Pay and Accounts Officer Hyderabad, out of 1200 DDOs in Twin Cities only 1060 have completed reconciliation up to August 2007. The work of reconciliation is poor though the importance of this work is continuously emphasized, by the Government. There is need to enforce strict compliance of the orders of the Government as regards reconciliation.

5.18 In his Audit Report for 2006-07 the CAG reported that the reconciliation of departmental figures of expenditure with those booked by the Accountant General was not done by 27 departments for the year 2006-07. Similar position was reported in the Audit Reports for the last four years. The major defaulting departments are Home, Irrigation and Command Area Development, Revenue, Registration and Relief, Finance and Planning and Transport, Roads and Buildings.

- **Clear backlog of PAO [Hyderabad] cheque reconciliations with Bank and devise system to ensure monthly reconciliations henceforth**.

5.19 SFAA study found that the work of reconciliation of cheques cashed by the bank was in arrears and this is reflected as a credit balance of Rs 317.37 crores under suspense account as on 31-3-2002 (Finance Accounts 2001-02). For clearing the huge backlog, GOAP issued orders to entrust the work of bank reconciliation to a private agency and the work relating to the period from 1-1-2001 to 31-3-2003 was completed by the private agency. The Pay and Accounts Officer reported [November, 2007] that the reconciliation was completed up to June, 2007. No further efforts were made to clear the backlog relating to the period prior to 1-1-2001. The unreconciled balances as reported in the Finance Accounts 2005-06 is Rs.459.53 crore, which shows that un-cashed pre audit cheques is huge. Bank reconciliations should always be up to date. Current reconciliation may become difficult unless there is information about cheques issued in the earlier period. Action to clear the backlog should be taken up immediately.

- **Clear the arrears in reconciliation of Paid Cheques by PAO [Works and Projects/PWD]**

5.20 There are 31 Pay and Accounts Offices and Asst. Pay and Accounts Offices under the control of Director of Works Accounts and the tests revealed that reconciliation is in arrears ranging from 4 to 14 months. The Director holds meeting with Joint Directors of Works Accounts and in these meetings the progress of reconciliation and issue of Schedules of Suspense with Treasuries (SSTs) by PAOs/APAOs is also discussed. The last such meeting was held in September, 2007. The progress is slow.

- **Seek to supplement Cash Accounts with memoranda and management process (e.g. for assets) to produce some of the benefits which would be achieved by moving to Accruals Accounting**

5.21 There is no evidence of any initiative to collect data to supplement cash accounts with information to produce the benefit that would be achieved by moving to accruals accounting. But in pursuance of the recommendations of SFFA, the Finance Department had issued instructions to all departments in GOAP to maintain Assets Registers and send six monthly reports to the concerned superior officers. The Heads of Departments after compilation of all assets of all subordinate offices and agencies, including State level offices shall report to their administrative departments of secretariat, the asset inventory information by 31st December every year to begin with from 31st December, 2004. The administrative departments in turn shall furnish the same asset information to the Finance Department by 15th January every year. No reports in compliance to these orders have been received by FD except a few.

5.22 Similarly the FD has been asking the departments to send along with Budget papers three statements as indicated below.

a. Statement of Assets (both financial and physical)

b. Tax revenues raised but not realized

c. Statement of miscellaneous liabilities outstanding

But none of these statements are being received along with Budget proposals from the departments. The FRBM Act and rules made there under enjoin submission along with the Budget documents these statements. On an enquiry it is learnt that GOAP plan to submit these documents from 2009-10 Budget onwards.

Enhance the accuracy of the Accounts.

- **AG to ensure that supporting documentation for variation of budget is verified.**

5.23 This obviously refers to the variation statements prepared by Heads of Departments after reconciliation of their accounts figures with those booked by the AG and sent to the AG for carrying corrections in the accounts of the AG. As large number congregate at one time for reconciliation and submit large number variation statements, the AG's office checks to ensure only whether there is provision under the Head to which the amount is proposed to be transferred and correctness of the classification with reference to the transaction. AG's office may not have time to verify the vouchers based on which the transfer is proposed and therefore might be unwittingly assisting in classifying the expenditure where there is a provision even though the expenditure might relate to another head. (please see a discussion on this in paragraph 5.8 above)

5.24 This is a matter that requires AG to exercise additional vigilance while allowing transfer of expenditure from one head to another. It is not known whether this along with other recommendations that concern AG have been communicated to them for their consideration.

- **AG to submit RBI deposit discrepancy statement with accounts to Finance Department**

5.25 Reconciliation between AG's and RBI's figure is undertaken on a monthly basis and a report is submitted to the Government in the first week of second succeeding month. The monthly account of the State Government is also sent in the first week of second succeeding month along with the RBI deposit discrepancy statement.

Increase transparency of the Public Account

5.26 In Public Account, transactions relating to Debt, Deposit, Advances, Remittances and Suspense are recorded. The transactions under Debt, Deposit and Advances in Public Account are those in respect of which government incurs a liability to repay the monies received or has a claim to recover the amounts paid together with the repayments of the former (Debt and Deposits) and recoveries of the later (Advances). The transactions relating to Remittances and Suspense involve merely adjusting heads. The initial debits or credits to these heads are cleared by corresponding receipts and payments either within the same circle of account or in another circle.

- **Review and clear un-reconciled balances between closing ledger balances of Public Account shown in AG's Main/Control Accounts and the Detailed Accounts.**

- **In the case of reconciliation the focus should be on fully reconciling the current balances and work backwards**

5.27 The un-reconciled balances between the closing ledger balances of Public Account shown in AG's Main Account and Detailed Accounts maintained by the Accountant General still persist in spite of steps taken by the AG to reconcile the discrepancies. In Finance Accounts for the year 2005-06 some of the differences have been detailed as shown below.

Table 5.1

Head of Account	Earliest year to which differences relate	Amount of difference (Rs. in '000)
6202-Loans for Education, Arts, Sports and culture	1992-93	71.18
6215-Loans for water supply and Sanitation	1992-93	**12,647.29?**
6401-Loans for Crop Husbandry.	1992-93	[-] 1,76,57
6408-Loans for Food Storage and Warehousing.	1994-95	[-] 2,81,14
8443-Civil Deposits.	1995-96	[-] 2,81,14
8658-Suspense Account.	1989-90	71,49,13
8782-Cash Remittance and Adjustment officers rendering accounts to the same Accounts Office.	1981-82	362,90,22

5.28 The Finance Department could discuss the reasons for slow process of reconciliation during the periodical meetings held with AG, obtain the list of officers from whom information is wanted and pursue with the officers concerned to ensure early reconciliation.

- **Analyze each Suspense and Remittance Account, clear backlog and strengthen systems of control over each Suspense Account to ensure that items posted are promptly cleared**

5.29 Though no initiative has been taken by Finance Department to discuss this question of clearance of Suspense balances with the Accountant General to devise procedures for obtaining information necessary for clearance there has been considerable reduction in the Suspense Account as shown below.

Analysis of larger Suspense Account balances

Account:	Balance as on 31st March, 2006:
PAO Suspense	Debit balance of Rs.64.07 crore which is considerably reduced from Rs.145.08 crore as of 31st March, 2003
Suspense Account [Civil]	Debit balance of Rs.14.59 crore. There was a credit balance of Rs.115.28 crore as at 31st March, 2003.

Cash Settlement Suspense Account [CSS]	This Head of Account is no longer in operation. It exists only to clear the outstanding balances. There is a debit Balance of Rs.64.33 crore as against Rs.65.29 crore as at March, 2003.
RBI Suspense Central Accounts Office	This account has been substantially reduced from debit balance ofRs.258.19 Crore as at 31st March, 2003 to Rs.22.08 crore.

- **Thorough review of APGLI and AP State Government Employees Group Insurance Scheme to be undertaken.**
- **Reform management of APGLI and AP State Government Employees Group Insurance Scheme.**

5.30 Under APGLI, monthly subscriptions are collected from government employees towards endowment insurance. The total subscription together with interest is paid back to the employee at the time of retirement or death. Detailed accounts of APGLI are maintained by the Director of Insurance. Control tests made revealed that the Management of the Fund still is not in good shape due to,

a. Accounts of the Fund have been compiled up to 1998-99 only and got certified by the Accountant General [Audit].

b. Accounts for the subsequent years i.e. from 1999-2000 to 2006-07 have to be compiled and submitted to the A.G, for certification.

c. There is heavy suspense balance of Rs.229.71 crore as on 30th September, 2007 which represents the amount of credits not posted to individual accounts due to absence of the details. No effort is being made to obtain the details and the clearance is very slow.

d. The Account Slips notifying the policy-holders, the balances in their Accounts, though issued up to 2005-06 do not represent correct amounts in view of huge suspense balances; and

e. There is no Internal Audit system in the department to monitor the affairs of the Fund.

5.31 The present state of accounts, particularly delay in compilation of Annual Accounts and non-clearance of huge suspense balances, may lead to possible manipulation of Fund Account. The Director of Insurance informed that the post of ‘programmer’s vacant since 2005 and cited this as the main reason for non-clearance of suspense balances.

Andhra Pradesh State Government Employees Group Insurance Scheme

5.32 The AP State Government Employees Group Insurance Scheme is a compulsory for all the State Government Employees. The Director of Insurance is the Administrator of the Scheme. The director is responsible for maintenance of accounts of scheme and for sending report to the Government periodically. Accounts have not been prepared for the Scheme right from the inception of the scheme in 1984. Government has not so far undertaken a review of the above two schemes much less taken any steps to reform their management as recommended by SFAA.

- **Thorough clearing of un-posted items in Class-IV Employees Provident Fund.**
- **Class-IV Employees Provident Fund to be restructured as single accounting Unit with unified control.**

5.33 Class-IV Employees PF Accounts are maintained by the District Treasury Offices. During field visits the following deficiencies are noticed. There are very large amounts under un-posted items to the individual subscriber's accounts. Exact number is not available with the Director of Treasuries and Accounts. The amount un-posted as at 31st March, 2007 was Rs.5.52 crore for the entire State except the districts of Visakhapatnam, Kurnool and Nellore for which information is not available with the Directorate. The following reasons were reported for such huge amounts of un-posted items.

a. Recording of incorrect account numbers and Head of Account in the schedules enclosed to the monthly Pay Bills, by the DDOs.

b. Non-furnishing of schedules in support of deductions made towards the PF.

c. Non-pursuance by the Treasury officers with the DDOs for the clearance of un-posted items.

5.34 With an amount of Rs.5.52 crore still to be posted in the individual subscriber accounts, the state Class-IV PF Accounts should be considered as bad. The DDOs obviously, do not exercise even the minimum checks, to ensure that all schedules are attached to salary bill before signing the bill. The State Government has not taken any initiative to bring the Class-IV employees PF Account under unified control.

Conclusion

5.35 The accounting as a PFM issue can be seen in three components viz. a) reliability of accounts, b) departmental ownership and c) problems with public account. Item b) and a) are interrelated. As far as the reliability of accounts is concerned, it is generally ensured (typically in a private firm) by the firm assuming responsibility for correct maintenance of its initial accounts and preparation of the financial statements according to Generally Accepted Accounting Principles (GAAP). The accounts so maintained and compiled (signed by the CEO and CFO) are audited according to auditing standards by an independent auditor who attests them to be true and fair. The situation is, however, different when it comes to government accounts. The GOAP accounts are compiled by the CAG on the basis of accounts rendered by treasuries and the PAOs and also audited by CAG. There is no ownership of accounts by the government as it does not compile them. This is as per the arrangement that exists now. Unless there is a change, it would be best to leave the question of reliability of accounts to CAG as also the accounting standards. The GOAP should build capacity to assume greater responsibility for its accounts by strengthening control over DDOs reconciliation with the treasuries and by compiling the departmental accounts through proper checks and balances and application of an appropriate web based IT tool.

5.36 Although not a PFM issue because it is an isolated issue, management and accounting of APGLI, AP State Government Employees Group Insurance Scheme, Class IV Government Servants G.P.F account needs urgent attention and reform. There is substantial exposure in these and risk of misappropriation, defalcation, etc. is quite high and imminent.

Recommendations

5.37 It is recommended that:

a. The reconciliation of expenditure between DDO and treasury / PAO should be reviewed and further improved;

b. Government should enhance the capacity of departments to prepare their own accounts which are complete and accurate;

c. Government should immediately take measures to review functioning of APGLI, AP State Government Employees Insurance Scheme and Class IV G.S. GPF account.

d. Government should engage CAG of India, GoI and GASAB in bringing about necessary changes in accounting systems.

Chapter 6

Monitoring and reporting

6.1 The provision of timely and accessible financial information for monitoring and reporting enables the government to make appropriate within year changes in the allocation of budget grants as well to exercise financial control to ensure that the funds necessary are expended fully and for intended purposes.

Principles of good practice

6.2 The following are the key principles of good practice in monitoring and reporting that are key to minimizing fiduciary risks.

a. Timely, relevant and reliable monitoring of budget execution enables line departments, finance department and other stake holders to exercise financial control and undertake corrective action as necessary; and

b. Timely, relevant understandable and comparable financial reporting enables prompt scrutiny at the year end and highlighting the extent to which funds were used for the intended and authorized purposes.

6.3 The SFAA study after examining the system obtaining for monitoring and reporting by GOAP at various levels made certain recommendation and suggested some action points for improvement. (☒ indicates not yet implemented / partially implemented; ☑ means implemented; and ?? the recommendation needs further examination)

SFAA Recommendations	
☒	Strengthen measures to ensure timely submission of monthly expenditure statements to CCO who should ensure suitable and timely follow-up action (FR 7.2.2.1)
☒	Devise GOAP-wide expenditure monitoring report format that provides a stronger basis on which to manage within-year expenditure (FR 7.2.2.2)
☒	Publish a quarterly or six monthly expenditure reports that reveals key trends in within year revenue and expenditure (DR 6.1)
☒	Departments to be trained in using monitoring reports as a management tool, in variance analysis and strategies for mid-term correction wherever necessary (FR 7.2.3.1)

Enhance pro-active within year expenditure management.

1. **Strengthen measures to ensure departments submit monthly expenditure statements to CCO who should ensure suitable and timely follow up action (FR 7.2.2.1)**

6.4 It was noted during field visit that the DM & HO, Guntur has been submitting expenditure statements (i.e. D.O.R. statements) to the CCO without reconciling them with the treasury figures for the last four years. This irregularity has not been checked by the CCO at any point of time, nor has the DTO insisted on compliance with GO 507. The control tests in the three selected districts revealed that five Controlling Officers and 6 DDOs have furnished the expenditure statements up to date, six DDOs (listed below) have not sent any expenditure statements during the years 2005-06, 2006-07 and 2007-08 as shown below.

a. MEO - Thorrur - Warangal
b. MEO - Raiparthy - Warangal
c. PHC - Stn Ghanpur - Warangal
d. MEO - Malkajgiri - R.R District
e. MEO - Prathipadu – Guntur District
f. MEO - Pedanandipadu - Guntur District

6.5 The non-submission of expenditure reports affects the monitoring system and makes the HODs to rely on budget release data rather than information on actual expenditure for monitoring. There can be significant differences between budget releases and actual expenditure as the district agencies may not have spent the allotted amounts in full and expenditure on the non-control items may be lower or higher than budget, therefore the reliance on budget releases due to incomplete information undermines the usefulness of monitoring reports to departmental officers attempting to manage within year expenditure. There is therefore need to further strengthening the monitoring and reporting mechanism to help improve levels of compliance by the DDOs, COs and DTOs.

2. **Devise GOAP wide expenditure monitoring report format that provides a stronger basis on which to manage within year expenditure (FR 7.2.2)**

6.6 SFAA suggested that GOAP prescribe a suitable format for departmental monitoring reports to contain the following information.

a. Within year monitoring of overall commitments and arrears.
b. To exhibit information on monitoring of components of non-plan expenditure; for example, monthly expenditure statements do not provide an object head wise break down or distinguish between control and non-control items. Given that non-control expenditure is not subject to treasury checks against

appropriation, the later distinction serves as key in understanding the causes at divergences between budget and actual expenditure.

c. Provision for analysis as to the reasons for divergence between budgets and actual.

d. Actual expenditure for the year to date is compared with the budget for the year as a whole.

e. Information on the expenditure that was budgeted for the month compared with actual expenditure for the month.

6.7 The GOAP has yet to examine the recommendation and devise a suitable format to serve the intended purpose.

3. Strengthen aggregate monitoring by preparing consolidated monthly monitoring statement that highlights implications of within the year patterns in revenue and expenditure for end year deficit and debt figures (FR 7.2.2)

6.8 The Revised Estimates are prepared on the basis of monitoring done within year and presented to the Assembly for approval in January/February every year. These revised estimates represent an updated version of the original approved estimates, which are revised to reflect changes to spending and revenue patterns which have occurred during first six to ten months of the year. The revised estimates also take into account changes in forecasting revenue yields. Consolidated monthly monitoring reports would enhance scope to consider approaches to using within year monitoring more proactively to enable GOAP early identification of the need for cuts or reductions in departmental appropriations. They would consistently highlights implication of with in year pattern in revenue and expenditure for accurate assessment of end-year deficit and debt figures.

6.9 In practice in GOAP monitoring is done during periodical meetings held with all the HODs level and the secretariat level. The expenditure statements are obtained and consolidated for discussion and decisions at these meetings. There is no systematic collection of financial data as yet in the government. The data from treasury is consolidated in the Finance Department through the Resource & Expenditure Information Systems (REINS), but it is not on line and consequently there is a time lag in its availability. Accountant General's financial figures for a month are generally available by 25th day of the following month. There is definitely a need for generating financial MIS either by the government on its own with its data (from Treasuries and PAOs) or in collaboration with the AG.

4. Disclosure of Loans and Advances by institution (FR 7.3)

6.12 The Finance Accounts do not provide complete picture of arrears in recovery of loans and advances such as institution wise details of outstanding amount and recoveries made during the year and so on. It would improve transparency if institution wise details with the amount outstanding against is given in the Finance Accounts.

6.13 At present the disclosures in Finance Accounts are Head of Account wise and not institution wise. Although, the formats are prescribed for the country as a whole and any change in them would require approval by CAG, such additional information can be provided by GOAP on its web site or some internal document. It is also as much a matter of availability of such information as its disclosure. GOAP should firstly examine whether or not it has the required information in its records.

5. Disclosure of cash flow in more useful statement form (FR 7.3)

6.14 The cash flow statement is included as an explanatory note to statement Number I summary of transactions rather than as a separate cash flow statements. In this case also approval of CAG is needed, as the format designed for whole of India. GOAP has not initiated any action on the suggestion of SFAA to move CAG.

6. Provide more high frequency financial information of general interest to stake holders in interim accounts. [F.R 7.2.2]

6.15 Accounts are compiled by the AG and no accounts are published by the GOAP other than what the AG presents 10 months after the closure of the financial year. However, GOAP has yet to initiate action on this recommendation

7. Investigate scope for within year monitoring of commitments (FR 7.2.2)

6.16 All the treasury controls are devised for application before making payments only. Neither the Heads of Departments nor the District Officers maintain any Commitment Register for recording before making commitments on behalf of Government. If each payment made is routed through such a Commitment Register, it would be possible to know at any time, the balance of commitments to be honored. The Finance Department could devise a suitable format for the “Commitment Register” and train people to record commitments and pass on reports for consolidation at the level of Head of the Department. The Finance Department is yet to take any action in this regard.

8. Departments to be trained in using monitoring reports as a management tool in various analysis and strategies for mid term correction wherever necessary. (FR 7.2.3.1)

6.17 The Finance Department is yet to take action in this regard.

9. Provide a summary table of budgetary aid for schemes and projects financed by donor assistance in the budget and accounts. (FR 7.3)

6.18 Donor aided projects are detailed in an annexure in Vol. VII of the budget but this information is not included in the Budget in Brief. It would be in the interest of transparency to include this is Budget in Brief. This information is not included in the

Finance Accounts compiled by the AG and GOAP has not so far taken any initiative to get this information added to the accounts

10. Include a summary of major subsidies provided by GOAP in Budget In Brief and Accounts (FR 7.3)

6.19 In the AFF published by the Finance Department the subsidies given by GOAP are included but not in Budget in Brief or Accounts. No action to implement this recommendation has been taken so far.

Conclusion

6.20 The SFAA reports stresses unduly, we feel, on India-wide formats prescribed in consultation with CAG of India. They do affect how the information is presented periodically and at the year-end by AG. They affect the other stakeholders (public at large, the legislative assembly and other users of the financial statements) However, when the concern is about information required for monitoring, all-India formats are irrelevant. The government is free to collate and present data in whatever manner it chooses. The issues are whether: a) the required data is being captured in its records (such as institutions which owe moneys to government); b) such data is available in digitized form for easy consolidation and presentation; and c) data is available preferably in real time or with least amount of delay.

6.21 Treasuries and PAOs being the source of payments and receipts originate by and large all the financial data. They also capture the data on computers and thus all financial data that they generate is available in digitized form. The third source of data is the departments which initiate the process of payment and receipt. Consolidation of financial data for the state as a whole happens at two places: a) the Accountant General (A&E) who has the responsibility to compile the state's accounts (unless the State takes over this responsibility); and b) the finance department which receives the data from treasuries in a batch mode and uploads it into system i.e. Resource and Expenditure Information System (REINS). AG's data is complete but misses the granularity as it does not capture the DDO particulars. The FD's data is incomplete as it does not contain data relating GOI and RBI transactions. Both are off-line processed in batch mode. While AG data is available after almost a month REINS data is available a little earlier. Most importantly, both do not capture accounts related to societies as they operate their funds through their own bank accounts. The third source of data i.e. the departmental data is mostly in manual returns and partially consolidated.

Recommendations

6.22 It is recommended that:

a. The government should consider strengthening capacity of departments in accounting so that they are able to prepare departmental accounts independently from their own record. This would help the departments monitor their within the year expenditure better as also ensure accuracy of accounts compiled by AG through regular reconciliation.

b. Two other reforms might be necessary to bring about a credible system of financial MIS in the government. They are:

   (i) The number of DDOs is simply too huge (about 60,000) for any system to work in practice. The motivation to create more DDOs was to basically increase convenience in drawing the pay and allowances without too many hassles. The downside of course is that now every primary school and PHC is a DDO. There is an urgent need to rationalize their number; and

   (ii) Application of IT (particularly web based) so that the data is captured in real time. The NIC developed system in Maharashtra is a good example of how IT can enable not only budgetary control but also monitoring commitments against the budget and requirements of cash.

c. It is recommended that payroll must be centralized at the district level and payment of salaries to all government servants should be made through electronic transfer or by advice to bank to credit their accounts. Secondly, a web based application that captures transactions from DDO and Treasury should be put in place so that financial data is available in real time.

Chapter 7
Asset Management

7.1 The Government has been spending large sums of money on creation of assets over the years under different schemes. These assets are scattered all over the state and are acquired by various departments and institutions keeping in view their functions. Assets held by departments include land, buildings, vehicles, furniture, equipment and stores and stock. There should be adequate control over the assets to prevent their misuse and theft. Since GOAP wants to create a climate in which switch over from cash system of accounts to accrual system can be made easy, measures to ensure effective asset management assume urgency.

7.2 Another related issue is about maintenance of assets that are acquired at considerable cost. There is a tendency not to provide enough resources for maintenance of assets as such expenditure comes from non-plan expenditure which is seen generally as unproductive.

Principles of Good Practice

7.3 The key principles of good practice in asset management to minimize fiduciary risk are:

- Clear and appropriate asset management rules to safe guard all types of assets.
- Adequate provisions for safe guarding assets viz. stock and asset registers and internal controls.
- Independent and regular scrutiny of assets to verify enforcement controls.
- Disclosure and transparency of assets owned enables accountability.

7.4 The SFAA study after examining the asset management in GOAP at various levels made certain recommendation and suggested some action points for improvement. (☒ indicates not yet implemented / partially implemented; ☑ means implemented; and ?? the recommendation needs further examination)

SFAA Recommendations	
☒	Assign named individual in each district office to be responsible for providing training, ongoing guidance and enforcing compliance by, for example, undertaking regular and surprise checks to all field offices under control of the CO. Also to be responsible for maintaining district-wide stock accounts, asset registers etc by compiling results of field office returns (FR 8.2)

- ☒ Undertake a GOAP-wide stock take of government owned and held assets, in order to facilitate proper recording, monitoring, security and control of these assets (FR 8.3)
- ☒ Develop and establish a GOAP-wide system of stock records and asset registers, with information required and timing to be clearly defined (FR 8.3)
- ☒ Develop asset management computerized module, and link to e-khazana, to enable consolidation of records and reconciliation of expenditure on stocks and stores, assets etc. For larger offices where appropriate, install computerized inventory systems (FR 8.3)
- ☒ Implement reporting mechanism, by CO to CCO, from CCO to Secretary of Administrative Department of assets within their department (six monthly) (FR 8.5);
- ☒ Include assets as memorandum item in annual accounts, with GOAP being required to report on acquisitions, disposals, assets held of which type, both in number and value (FR 8.5)

7.4 The above recommendations to improve the quality of asset management may be grouped as under:

a. Strengthen asset management

b. Strengthen accountability of DDOs, COs and CCOs for PFM (including reporting mechanism on assets with in the department)

c. Increase comprehensiveness, accessibility and transparency of budgetary and financial reporting by including a statement on assets acquired and disposed during the year in the accounts.

Strengthen asset management

- **Under take GOAP wide stock take of Government owned and held assets in order to facilitate proper recording, monitoring, security and control of these assets.**
- **Develop and establish a GOAP wide system of stock records and asset registers with information required and timing to be clearly defined.**

7.5 The key requirements to ensure that assets are retained in proper custody and used as per prescribed norm are - physical controls, maintenance of stock and asset registers, physical verification and controls over disposal of assets.

7.6 GOAP has issued guide lines on asset management and maintenance of registers and records (GOMS No 667 Finance (TFR II) Department dated 10.10.2004). The instructions were very comprehensive covering all aspects of asset management and prescribed 14 formats for various registers such as register of lands, register of buildings, register of roads etc. Government directed all the Heads of Departments to prepare lists of all assets of all subordinate offices and agencies including state level offices, and to report to their administrative departments of secretariat the asset inventory information by 31 December of every year. The administrative department of secretariat in turn shall furnish the same asset information to finance department by 15th of January each year.

7.7 However, majority of departments including Roads & Buildings, Irrigation, Revenue, Education, Medical & Health, etc. have not furnished the information on assets. Only 13 departments (Anti Corruption Bureau, Lok Ayukta, Gray Hounds, Director of State Audit, Industrial Tribunal, Intelligence, etc.) have furnished the information to the Finance Department (January 2005). No information has been received from even these departments subsequently. The information received in January 2005 was not consolidated in Finance Department due to non-receipt of information from majority of major asset owning departments and also due to lack of man power. No further action was taken by Finance Department in this regard.

7.8 Control testing in the 12 offices in 3 districts revealed that assets registers were not maintained in any of the offices. Directorate of Health and Directorate of Education also did not maintain any asset register. Only stock registers of furniture, equipment and consumables like medicines / stationery were maintained. In none of these offices were assets verified during 2004 to 2007; nor did any of them send half yearly statements on assets to Controlling Officer as required.

- **Develop asset management computerized module and link it to e-khajana, to enable consolidation of records and reconciliation of expenditure on stocks and stores, assets etc. For larger offices where appropriate, install computerized inventory systems**

7.9 No action has been taken by GOAP to develop computerized module for asset management linking it to e-Khajana.

- **Introduce system of asset valuation**

7.10 Valuation of assets is very important in case of change in the system of accounting from cash basis to accrual basis in future. Departments should first be asked to send lists of assets created during the previous financial year with the budget proposals and statement of assets for previous years. For valuation of assets created earlier detailed guidelines should be given and training courses organized for the same. So far a system of asset valuation has not been undertaken by Government.

- **Assign named individual in each District Office to be responsible for providing ongoing guidance, enforcing compliance by, for example undertaking regular and surprise checks to all field offices under the control of the CO. Also to be responsible for maintenance district wide stock accounts, asset register etc by compiling results of field office returns.**

7.11 GOAP has not issued any orders on the above suggestion. Control tests in the offices of controlling offices in PH & PE departments revealed that no such arrangement exists, and that in respect of stores and stock, physical verification was not done in the offices.

Strengthen accountability of DDOs, COs and CCO for PFM

- **Implement reporting mechanism by DDO to CO, CO to CCO and CCO to Secretary to concerned Department under intimation of Finance Department about assets with their department for every six months**

7.12 Prompt, accurate and reliable information on assets created would help containing fiduciary risk. Increasing transparency in reporting could be a strong systemic incentive for Heads of Departments to improve discipline and accountability for assets and their management. GOAP in October 2005 issued instructions on reporting mechanism by DDOs to COs, COs to CCO and by CCO to secretaries of the concerned administrative departments under intimation to finance department on several fiduciary performance indicators including a six monthly report on assets within their departments. During the control tests in the selected offices it was noticed that none of the offices has sent half yearly report on assets under their control to their superiors. The Finance department received asset information only from 13 departments as indicated earlier in this chapter. A lot remains to be done in this area.

Increase comprehensiveness, accessibility and transparency of budgetary and financial reporting.

- **Include assets as memorandum item in annual accounts**

7.13 Assets would form part of accounts when the system of accounting is switched over to accrual basis from cash basis. The Annual Accounts which are published are those compiled by the CAG and the present format does not include details of assets. Before making suggestion to CAG to include a memorandum of assets in the Annual Accounts, it is necessary that the Finance Department to equip itself with complete and accurate information of assets in the state as the CAG would depend on the state Government for such a list.

7.14 According to Rule 5 of the FRBM Rules 2006, the State Government at the time of presenting the budget for the year should include a statement of assets (form D.7) in the format prescribed. This is required to be implemented not later than three years after coming into force of the Act. GOAP plans to implement this requirement from 2009-10 onwards. Training of the District offices in preparation of assets statements is necessary to achieve the purpose.

Conclusion

7.15 GOAP have issued guidelines on maintenance of records in respect of assets and reporting to government periodically but compliance has been poor and the Finance Department has not been active in pursuing the matter. Finance Department has recently entrusted CGG to prepare a framework for preparing and maintaining a government wide asset register.

Recommendations

7.16 Once the Asset register framework is ready, the government should expeditiously prepare a statewide asset register of valuable assets and ensure that all government offices maintain asset register of other (less valuable or ordinary) assets held by them.

Chapter 8

Debt Management

8.1 The A.P. Fiscal Responsibility and Budget Management Act 2005 was promulgated to ensure prudence in Fiscal Management and Fiscal Stability. As per section 8(1) of the Act the outstanding total liabilities of the State Government should not exceed 35 per cent of the estimated Gross State Domestic Product of that year. The conference of State Finance ministers held at the Reserve Bank in August 2004 appointed a Working Group on compilation of liabilities of the State Governments. The Working Group submitted its report in December 2005. According to the report, debt and liabilities are considered synonymous and accordingly all borrowing which are repayable and on which interest accrues were recommended to be considered as debt. Contingent liabilities were recommended to be excluded from debt/liabilities. According to the working group the following should be included in the total liabilities of the State Government.

I Consolidated Fund

Public Debt

a. Open market Borrowings
b. Borrowings from the Banks and Financial Institutions / Negotiated loans
c. Special Securities issued to NSSF
d. Bonds / Debentures which are issued by the State Government
e. Loans from the Centre (i) Plan (ii) Non Plan of others (specify)

Ways and Means Advances [WMA] and overdrafts from the RBI or any other Banks

a. Ways and Means Advances[WMA]
b. Overdrafts [OD]

II Public Account

a. State Provident Funds
b. Small Savings, Insurance and Pension Funds, Trust and Endowments etc.
c. Other items in Public Accounts of which deposits i). Bearing interest and ii). not bearing interest

a. Reserve Funds / Sinking Funds i). Bearing interest and ii). not bearing interest

III Contingency Fund

Total liabilities (I+II+II)

Outstanding debt

8.2 In Figure 8.1 below is shown the outstanding debt of GOAP as at the end of each financial year for the last six years.

Figure 8.1

Year	Open Market Loans	Loans from Central Government	Loan from autonomous bodies etc	Special Securities (Small Savings & Provident Fund)	Total	% increase over previous year
2002 - 03	14,259.07	19,288.93	5,632.25	10,903.07	50,083.32	17.86
2003 - 04	17,085.95	17,988.57	7,318.45	10,903.07	53,296.03	6.41
2004 - 05	19,965.53	16,129.15	10,187.79	20,110.71	66,393.18	24.58
2005 - 06	21,348.05	16,044.75	7,565.65	25,449.07	70,407.52	6.05
2006 - 07	23,543.81	16,388.24	8,074.44	29,945.57	77,952.06	10.72
2007 - 08	27,464.09	17,051.98	7,998.85	33,949.09	86,464.01	10.92

[Source: BIB 2007-08: Figures do not include sinking, other reserve funds]

8.3 The liabilities have increased in 2004-05 by nearly 25 per cent over the previous year and have been increasing on an average by over 9 per cent every year thereafter. During the last two years increase was over 10 per cent. The figures of total liabilities given above do not conform to the definition given by the Reserve Bank as they do not include amounts under sinking funds and contingency fund. As per the CAG report for the year 2006-07 the total outstanding liabilities are as follows.

Figure 8.2

Years	Rs in crores	% of GSDP
2003 - 04	64,545	33.81
2004 - 05	74,288	35.69
2005 - 06	79,549	34.24
2006 - 07	86,622	33.22

8.4 The total liabilities have gone up by 34.20 per cent from Rs. 64,545 crore in 2003-04 to Rs 86,622 crore in 2006-07. Though in the year 2004-05, the total liabilities exceeded the limit prescribed under section 8(1) of the FRBM Act 2005, the debt / GSDP ratio was brought down 2006 - 07.

Key principles of good practice.

8.5 SFAA study identified the following as principles of good practice to minimize fiduciary risk.

a. Proactive approach to developing a debt policy and debt management

b. Effective forecasting and monitoring debt levels and maturity profiles.

c. Comprehensive and transparent reporting of debt.

d. Effective scrutiny of debt policy and performance.

8.6 The SFAA study after examining the debt management in GOAP made certain recommendation and suggested some action points for improvement. (☒ indicates not yet implemented / partially implemented; ☑ means implemented; and ?? the recommendation needs further examination)

SFAA Recommendations	
	Provide supporting mechanisms to achievement of debt objectives
☑	Continue to petition GoI to transfer funding for CSS direct to state governments, rather than requiring GOAP to take loan from GoI in order to get the grant funding (FR 9.2)
☒	Allow dedicated time in Legislative Assembly for a debate of GOAP's debt strategy for the budget and the medium term (both with the publication of the AFF and the Budget) and/or Estimates Committee report to Assembly on strategy(DR 8.4)
	Build debt policy and management capacity
☑	Develop modeling skills of Debt Management Unit to model alternative fiscal scenarios and assess their consistency with medium term objectives (FR 9.4)
☑	Ensure that the revenue and expenditure policies to achieve GOAP's medium term debt objectives are well developed and internally consistent (FR 9.2)
☑	Within the limited scope for treasury management given the structure of debt, continue efforts to minimise the cost of debt and align maturity profiles and servicing of debt with projected flows of revenue
☒	Commission a study to assess whether it would be appropriate for GOAP to entrench fiscal principles or objectives for debt in legislation (FR 9.2)
	Provide supporting mechanisms to achievement of debt objectives:

8.7 The action recommended by SFAA after a study of the debt situation in A.P. with reference to the good principles mentioned is considered below.

- **Within the limited scope for treasury management given the structure of debt, continue efforts to minimize cost of debt and align maturity profiles and servicing of debt with projected flows of revenue**.

8.8 The main components of debt of the State Government are:

- Loans from Government of India;
- Internal debt, comprising market borrowings and loans from Central Financial Institutions;
- Net accretion to the Public Account; and
- Off budget borrowings.

8.9 There have been a number of initiatives taken by the union government to provide debt relief to the States on the basis of recommendations of the Twelfth Finance Commission. Block loans given to States up to 31-3-2004 and outstanding as on March 31-2005 have been consolidated and interest rate fixed at 7.5 percent along with uniform tenure of 20 years. In the case of GOAP the consolidation was effected in the accounts of 2006-07 and the relief obtained was Rs. 706.09 crores (Finance Accounts 2006-07). In addition, GOAP had utilized the call option to close some high cost PFC bonds.

8.10 Formerly loans and grants for extending plan assistance to the State was in the ratio of 70:30. The State Government did not have the choice to take only the grant portion of assistance and chose the quantum of loan they need. This system of extending plan assistance was changed on the recommendation of the Twelfth Finance Commission (TFC) according to which the centre had to confine itself to extending plan grants leaving it to States to decide how much they wish to borrow and from whom. Further, the Union Government in 2003-04 budget had announced a Debt Swap Scheme (DSS) that would enable the States to pre-pay their high cost debt to the centre through additional market borrowings and proceeds of small savings (up to specified limits) at the prevailing interest rates over a period of three years ending 2004-05. GOAP had utilized this facility to swap Rs. 7,321 crore of high cost debt by the end of 2004 - 05 (RBI Report December 2005-S-32 at Page S-73).

8.11 Further GOI reduced the interest on loans from the Centre from 10.5 per cent to 9 per cent with effect from April 1st 2004 (RBI Report December 2004 Page 7). The GOI had extended the Debt swap scheme by allowing states to raise fresh loans and repay their old high cost loans to NABARD and some other agencies. The facility was used by the GOAP but the quantum of advantage gained is not available. As this facility of Debt swap scheme was not extended to loans given for financing centrally sponsored scheme high cost loans bearing interest @ 13 per cent as shown below are still outstanding. NABARD loan of Rs 1616.19 crore is also outstanding.

Figure 8.3

Year	**Amount (Rs. in crores)**	**Rate of Interest (%)**
1995 - 96	273.56	13
1996 – 97	2774.55	3
1997 - 98	735.54	13
1998 - 99	1129.75	12.5/13
1999 - 00	975.92	13

8.12 Due to these changes the debt servicing cost of GOAP has come down from 30.3 per cent during 2005-06 to 30 percent during 2006-07 (A.F.F 2007-08). Thus, a lot has happened on debt position and the GOAP is free to decide how much to borrow and from whom. Debt sustainability is the ability of the State to maintain a constant debt-

GSDP ratio over a period of time and also includes the states ability to service its debt. The GOAP has been working according to its policy that the debt should be kept at sustainable level.

8.13 The break-up of the total debt of GOAP show a trend towards reducing dependence on GOI and increase debt from low-cost sources. The proportion of loans from GOI have come down from 40 per cent of total debt in 2003-04 to 29 per cent in 2006-07 is significant.

Fig 8.4

Net borrowing of GOAP (Total borrowing less the cash balance at year end)

Borrowings	Balance at end 2004 (Rs in crore)	% of gross borrow-ings	Balance at end 2005 (Rs in crores)	% of gross borrow-ings	Balance at end 2006 (Rs in crore)	% of gross borrow-ings
Loans and advances from GOI	17989	40	16,129	31	16,045	29
Market Loans	17086	38	19,965	38	21,348	39
Loans from other institutions	3029	7	4567	9	2888	5
Total internal debt	20115	45	24532	47	24236	44
Off budget borrowings	4289	9	5621	11	4678	9
Net public Account	2749	6	5792	11	9624	18
Gross Borrowings	45142	100	52074	100	54583	100
Closing balance (cash)	(-) 171		286		(-)89	
Net Borrowings	45313		51788		57672	

8.14 Though off budget borrowings are not permissible under article 293(3) of the Constitution the State continues to undertake off budget borrowings. The present position is indicated below.

(Rupees in Crore)

Off Budget Borrowings			
Year	Source through which borrowed	Amount Borrowed	Amount outstanding as on 31 March 2007
2001-02	AP TRANSCO	876	7
2002-03	AP TRANSCO Bonds	850	850
2003-04	AP TRANSCO Bonds	380	380
	AP Water Resources Development Corporation (APWRDC)	568	568
2004-05	APWRDC	737	737
2005-06	APWRDC	455	455
2006-07	APWRDC	600	600
Total		4466	3597

[Source: CAG Audit Report 31.March 2007]

- **Commission a study to assess whether it would be appropriate for GOAP to entrench fiscal principles or objectives for debt in legislation**

8.15 The AP FRBM Act 2005 is one step in the direction of entrenching debt policies in legislation. But this Act does not specifically stipulate why and when the State should resort to borrowing and how the State should utilize its borrowings. This suggestion is still to be fully implemented.

- **Ensure that the revenue and expenditure policies to achieve GOAPs medium term debt objectives are well developed and internally consistent**

8.16 GOAP has taken major policy initiatives in the last three years focusing on Agriculture and Irrigation with equal emphasis on Social sector (weaker sections). With the budget for the year 2006-07 GOAP laid before the Legislative Assembly the following Statements

a. Macroeconomic frame work statement giving an overview of state economy;

b. Medium Term Fiscal Policy Statement prescribing fiscal targets and assumptions for achieving them; and

c. Fiscal Policy of the State for the ensuing year relating to taxation, expenditure, borrowings etc.

8.17 According to the State's own Fiscal Correction Path the State expects to achieve 'Revenue Surplus' position by 2008-09 taking the tax revenue collections to 9.94 per cent of the GSDP with non-tax revenue going up to Rs 6,038 crore by 2009-10. The outstanding debt by the 2010 is projected as Rs. 1,12,186 crore which would be 32.03 per cent of G.S.D.P. and this is well within the limit prescribed by the FRBM Act. 2005.

- **Continue to petition GOI to transfer funding for CSS direct to the State Governments rather than requiring GOAP to take loan from GOI in order to get the grant funding**.

8.18 The Procedure of funding CSS has been changed and GOAP can now decide the quantum of loan they need. GOI has been giving the grant portion without insisting on GOAP taking compulsory the loan portion.

- **Allow dedicated time in LA for a debate of GOAP debt strategy for the budget and the medium term (both with the publication of AFF and the budget) and / or Estimates committee report to the Assembly on strategy**

8.19 So far no action has been taken by the GOAP on this recommendation.

- **Develop modeling skills of Debt Management Unit to model alternate fiscal scenarios and assess their consistency with medium term objectives**

8.20 Debt Management cell has been created in the Finance Department. The duties of the cell have not been laid down in any order and the cell at present is engaged in the work relating to processing of (a) the cases relating to giving guarantees by GOAP and (b) Loans to Public Sector Units. The cell has to be strengthened and trained to deal with debt strategy matters.

Conclusion

8.21 The enactment of FRBM legislation in 2005 laying down limit to outstanding liabilities of the State Government is a very important milestone in debt management. GOAP's commitment to transparency is evident in full disclosure of the debt position in its budget documents (vol. V / 2) and all the budget documents are placed on the GOAP website. The fact that the GOAP did not resort to overdraft / Ways and Means advances facilities from the RBI at any time during the last three years is ample evidence of prudent cash management. That GOAP has been successfully pursuing a policy of keeping debt at sustainable levels is supported by the comments in the audit report 2006-07 that 'trends indicate the state is moving towards debt stabilization which in turn improve debt sustainability position in the State'.

Recommendations

8.22 The government may further strengthen debt management cell by inducting professionals trained in treasury / portfolio management.

Chapter 9

Contingent Liabilities

9.1 Contingent liability 'is an obligation relating to a past transaction or other event or condition that may arise in consequence of a future event now deemed possible and not probable'. In government, guarantees constitute contingent liabilities on the consolidated fund of the state. Guarantees are extended by the state government with respect to loans raised by statutory corporations, government companies, local bodies and other institutions under the State's control.

9.2 The negative net worth of State public enterprises could also be considered as a contingent liability as ultimately it is the state's responsibility. The following are the key principles of good practice in the management of contingent liabilities.

a. Guarantees extended subject to risk assessment and proper approval

b. Contingent liabilities estimated and adequately provided for.

c. Transparent reporting of contingent liabilities

9.3 The SFAA study after examining the management of contingent liabilities in GOAP made certain recommendation and suggested some action points for improvement. (☒ indicates not yet implemented / partially implemented; ☑ means implemented; and ?? the recommendation needs further examination)

SFAA Recommendations	
☑	Clarify procedures for issuing of guarantees; Finance Department to strictly enforce the requirement for adequate scrutiny of guarantee proposals, including an assessment of risk (FR 10.2)
☒	Continue with policy to estimate and provide for pensions. However, once consultancy report on pension liability is received, publish it (or a summary) with outline of Government policy for addressing the issue (FR 10.4) and set up proposed Pension Fund (FR 10.3)
☑	Consider the relevance of a statutory limit on guarantees (FR 10.2)
	Assign responsibility within Finance Department for keeping actuarial projections of future pension costs updated to ensure adequate funding of these future liabilities (FR 10.3)
☑	Establish an annual procedure to assess the mix of guarantees and the continued relevance of the flat guarantee fee policy (FR 10.2)

Current position of guarantees

9.4 GOAP extended guarantees to statutory corporations, government companies, and cooperative institutions and to local bodies for the due discharge of certain liabilities like loans, repayment of share capital etc. of those entities. The F.R.B.M. Act 2005 enjoins that the state government should limit the annual incremental risk weighted guarantees to 90 per cent of the total revenue receipts (TRR) in the year preceding the current year. Ceiling imposed by the Government of India prior to promulgation of the FRBM Act was that the total outstanding contingent liabilities should not exceed 9 per cent of gross state domestic product. Figure below shows the position of guarantees during the last four years

Figure 9.1

Year	Total revenue receipts (TRR)	Outstanding guarantees	As percentage of GSDP	As percentage of TRR
2003-04	26,869	**17,232**	8.61	74.91
2004-05	28,749	17,707	8.51	65.90
2005-06	34,851	17,262	7.49	60.04
2006-07	44,240	17,512	6.72	50.25

9.5 The total amount of guarantees outstanding in all the four years is well within the limit prescribed under the FRBM Act as well as the limit prescribed by the GOI. While the TRR grew at a rapid pace the amount of outstanding guarantees has more or less remained static. The recommendations of SFAA report to improve management of contingent liabilities are discussed below.

Guarantees extended subject to risk assessment and proper approval

- **Finance Department to strictly enforce the requirement for adequate scrutiny of guarantee proposals, including assessment of risk**.

9.6 GOAP has taken a number of measures to streamline the process of examining and issuing of guarantees. In the G.O. dated 20-9-2003 the government issued detailed guidelines for examining the proposals for issue of guarantees by the heads of departments and the administrative departments of the government for immediate compliance. The salient features of those orders are as follows.

a. No guarantees should be extended to cover loans given by the Financial Institutions of the central government;

b. Guarantee will cover only the principal portion of the loan and not interest thereon;

c. Borrowing entity shall set apart from its profits an adequate debt redemption reserve that shall be invested in government securities;

d. The state government may not guarantee the entire borrowing programme of the borrowing entity. The extent would vary from case to case so that the risks are not borne by the state government alone and would be shared between the state government and the lender;

e. In the case of loans from the market or from financial institutions guarantees should be given following the RBI instructions;

f. The administrative department has to undertake a financial appraisal as to the viability and '*bankability*' of the proposed investment;

g. Insist on a second mortgage of the assets in favour of the government as a pre-requisite for the guarantee and ensure that adequate security and margin is available;

h. Government shall not give guarantees, except in special cases, to cover cash credit accommodation for working capital purposes;

i. A detailed method of fiscal risk evaluation was also included in this order;

j. The administrative departments of the government are required to monitor the performance of the borrowing entity;

k. The administrative departments are required to send quarterly reports on the status and the fiscal risk of guarantees to the Finance Department;

Consider the relevance of a statutory limit on guarantees

9.7 Following the lead given by the central government, the state governments have promulgated the Fiscal Responsibility and Budget Management Act in 2005 according to which the total outstanding guarantees should not exceed 90 per cent of TRR of preceding year.

Estimate and adequately provide for contingent liabilities

- **Establish an annual procedure to assess the guarantees and the continued relevance of the flat guarantee fee policy**.

9.8 GOAP decided that the administrative departments should do a quarterly evaluation of the fiscal risk and send reports to the Finance Department. Government has created a Guarantee Reserve Fund and the fund is being credited with the amounts as indicated below.

- 1.1 per cent of the guarantee(s) outstanding against guaranteed entities whose liability is not taken over directly or indirectly by government as on 31st. December every year would be contributed to the fund account;

- In addition to the income accrued to the fund, the accretions by way of guarantee commission realized during the preceding year from the institutions to whom guarantees have been issued would also be transferred to the fund account during the succeeding year;

- Further guarantee commission rates have been revised to 1/2 per cent per annum or 2 per cent consolidated for the entire guarantee period;
- The total accumulation in the fund as on 31-3 2006 was Rs.331.63 crores, the investment of which is being done by the Reserve Bank of India. An amount of Rs.35.43 crores of guarantee commission is due for recovery from the borrowing entities as on 31 March 2006. The total amount of outstanding guarantees stood at Rs.17,712 crores as on 31-3-06 and analysis as to how much of it is in respect of closed entities and entities whose net-worth has become negative is not available. The adequacy or otherwise of the accumulations in the fund has to be judged with reference to a detailed fiscal risk analysis done by the administrative departments

Set up proposed Pension Fund

9.9 Creation of a fund was suggested with a view to create a corpus to make it self sustaining to meet pension pay out in future. During 2006-07 the pension bill was Rs 3934 crores and it was 35.26 per cent of the salary bill and likely to increase in future because of a possible upward revision as a result of the Sixth Pay Commission recommendations. The government has to take decision in this regard soon.

9.10 Further, with effect from 1 September 2004 the State Government has changed the method of giving retirement benefits to the government servants. Those recruited on or after that date come under a new contributory pension scheme according to which both the government servant and the government contribute to build a fund from which future retirement benefits would be paid. Though the government has been recovering from the government servants their part of the contribution the government so far has not decided about their part. In the year 2005-06 and 2006-07, an amount of Rs. 100 crores was provided in the budget for creating the pension fund for this purpose but as fund was not created the amount was allowed to lapse during those years. The government has also not so far decided as to who would maintain this account and who would administer the fund and the amounts collected from the government employees is kept in a suspense account for adjustment later. On enquiry about this uncertainty it was stated that the state government is awaiting the decisions of the Government of India in respect the scheme they implemented for their servants with effect from 1 April 2004

- **Assign responsibility in the Finance Department for keeping actuarial projections of future pension costs updated to ensure adequate funding of these future liabilities**

9.11 A cell has been created in Finance department for this purpose as already mentioned above the Report of the Darshaw & Co. is under study.

Transparent reporting of contingent liabilities

9.12 The Advisory Group appointed by the RBI to report on matters relating to fiscal transparency in the central and the state governments has recommended that states should be encouraged 'to increase the extent of reporting on contingent liabilities and major tax expenditures and Quasi Financial Activities (especially the losses of SEBs)'. The GOAP publishes information on guarantees given by the government in the Budget in Brief and this is available on the Government web site for all to see. The orders relating to the procedure of scrutinizing the proposals for guarantees and their follow up are also put on the same web site.

9.13 The losses made by the government corporations, Public Sector Enterprises and other entities also constitute contingent liabilities. The accumulated losses of one statutory corporation were Rs.1243.69 crores as against paid up capital of Rs.201.27 crores. It would be desirable to include a statement of the net worth of all government companies and statutory Corporations in the budget documents.

Conclusion

9.14 GOAP has made significant strides in making provision for the contingent liabilities and the monitoring and reporting mechanism set up will help contain the risk of a surprise demand for realization of guarantees by the lenders. Instructions issued for assessment of the proposals for guarantees are so exhaustive and cover all aspects of fiscal risk evaluation that they can serve as a model for all state governments. Quarterly monitoring by the Finance Department would ensure prompt detection of weaknesses for early remedial action. In putting both the instructions issued for evaluation of proposals and the detailed information about guarantees given by the government on the web-site of GOAP and also in the budget documents proves the government's commitment to transparency.

9.15 That the total outstanding guarantees during the last four years have remained static at almost the same figure reflects the caution that government has been exercising in giving guarantees

Recommendations

9.16 It is recommended that the government should:

a. Expedite its examination of the report submitted by Darshaw & Co. the firm of actuaries and start accurately providing for pension liability and create a fund to serve as corpus for future liability of pensions; and

b. Take suitable action in maintaining proper account of deductions made from employees towards contributory pension scheme and investing the funds as per GoI guidelines as and when available.

Chapter 10

Internal controls

10.1 Internal control[2] is an integral process that is effected by an entity's management and personnel and is designed to address risks and to provide reasonable assurance that in pursuit of entity's mission the following general objectives are achieved:

a. Executing orderly, ethical and economical efficient operations

b. Fulfilling accountability obligations

c. Complying with applicable laws and regulations

d. Safeguarding resources against loss misuse and damage.

10.2 The key principles of good practice for minimizing fiduciary risk are:

a. Clear accountability for internal controls;

b. Effective internal controls designed, installed and operated; and

c. Monitoring and evaluation of risks, controls and compliance.

10.3 The SFAA study after test checking internal controls in some departments of GOAP made certain recommendation and suggested some action points for improvement. (☒ indicates not yet implemented / partially implemented; ☑ means implemented; and ?? the recommendation needs further examination)

	SFAA Recommendations
	Enhance accountability for internal controls
☒	Assign specific roles and responsibility for developing and promulgating the government-wide framework;
☒	Ensure that the internal control system are installed, operated and complied throughout government and within each institution;
	Increase understanding and appreciation for internal controls
☒	Establish formal system of risk and self assessments throughout GOAP (FR 11.4.1)
☒	Increase training of officials in internal controls (DR 10.2) and

[2] *INTOSAI (International Organization of Supreme Audit Institutions) Guidelines for Internal Control Standards for Public Sector*

- ☒ Enforce responsiveness to internal audit observations by laying down timeframe required for response and link non-response to non-release of payments (FR 11.4.2)

Create government wide internal audit functions

- ☒ Develop internal audit expertise to guide the long term development of internal audit by establishing a specialist internal audit cell in Finance Dept (FR 11.4.2);
- ☒ Create exclusive internal audit cadres with individuals of proven honesty and integrity and impeccable record (FR 11.4.2)

Increase understanding and appreciation of internal controls

- **Establish formal system of risk and self assessment through out GOAP**

10.4 No initiative has been taken by the Finance Department to instruct Heads of Departments to assess and identify risks in achievements of objectives of the Departments, and install controls based on risk perception

- **Increase training of officials in internal controls**

10.5 Training programs are arranged for officials in MCR HRDI, Hyderabad and other institutions in office procedures rules and regulations. No specialized training, aimed at preparing people for conducting IA, was arranged in any institute.

- **Issue policies regarding maintenance, back up movement of data, hard ware and Software and implement in each department**. **Ensure back up and disaster recovery plan /arrangements for alternative activity continuity made in each IT site**.

10.6 While no initiative has been taken by the Finance Department to frame polices to strengthen record management in each Electronic Data environment, it is seen that back up arrangements exist in many departments.

10.7 CAG from the year 2003 has been reporting on the internal control mechanism obtaining in one department each year. The main findings are summarized below. They reflect poor internal control mechanism across departments of GOAP.

2002-2003

Commercial Taxes Department

a. Staff meant for I A was used for other work. In Commercial Taxes department. 13 posts of Assistant Commissioners (Audit) and Commercial taxes Officers (Audit) were vacant.

b. The coverage of IA was poor and there were large number of IA Reports out standing.

c. Departmental manuals and functional manuals did not contain provisions regarding IA and there is no separate IA manual.

d. In conclusion the Audit report mentioned that the Government failed to recognize the importance of internal Audit.

2003-2004

Animal Husbandry, Dairy Development and Fisheries Department

a. Budget Control - actual expenditure was 83.86 per cent of BE and the department did not have adequate controls in preparation of budget estimates, utilization and surrenders;

b. Budget estimates were submitted to HOD in the last 4 years with a delay of over 100 to 150 days.

c. Treasury control relaxation orders were obtained for Rs .4.16 cores but they were regularized by obtaining supplementary grant re-appropriation;

d. Submission of expenditure statements was delayed by COs. The Director did not carry out reconciliation of expenditure figures with those of the A.G.;

e. Lack of organizational control resulted in inaccurate reporting of achievements;

f. Procurement controls were lax;

g. Administrative inspections done were few and far between the shortfall ranging from 40 per cent in 2000-01 to 90 per cent in 2001-02;

h. Insufficient arrangement for IA and huge number of IA reports outstanding.

2004-05

Family Welfare Department

a. Internal controls were weak;

b. Because of weak budgeting discipline, 36 percent of the funds in 2003-04 and 23 percent of the funds in 2004-05 remained unspent leading to huge surrenders even after re-appropriations;

c. The Commissioner did not send Budget Estimates to Administrative Department for the years 2000-01, 2001-02 and 2002-03, consequently the FD finalized the Budget Estimates for the Commissioner without inputs from him. For the years 2003-04 and 2004-05 the Commissioner submitted estimates without inputs from subordinate officers. For 2003-04 the B E were sent late by 90 days;

d. There was no proper control over administrative inspections; and

e. The department did not have IA manual. No training was imparted to the IA staff. There were huge arrears in Internal Audit and large number of pending IA reports.

2005-06

Women and Child Welfare Department

a. Lack of proper controls resulted in non-submission / belated submission of budget estimates, persistent savings, non-remittance of unspent balances, advances remaining pending without adjustment for years and diversion of funds.

b. Improper operational controls resulting in poor implementation of both Central and State schemes.

c. No record was maintained to show whether department inspections were conducted;

d. The department did not have a manual for IA. Lack of response to IA observations.

2006-07

Medical Education Department:

a. Budget Estimates finalized without inputs from estimating officers;

b. Lack of budgetary control resulted in huge surrenders and un-necessary re-appropriations;

c. Lack of controls resulted in non-realization/non-remittance of demand drafts worth Rs.67.21 lakh for several years;

d. Appropriation of department receipts for department expenditure by Medical Institutions;

e. Lack of importance for IA rendered it ineffective;

f. Diversion of funds relating to tuition fees of NRI students aggregating Rs.14.40 lakh by A.P. Health & Medical Housing Infrastructure Development Corporation and Kurnool Medical College for other purposes.

Create government wide internal audit function

- **Establish Internal Audit Wing in Finance Department, with reports copied to HOD.**

10.8 No attempt has so far been made to bring Internal Audit under one umbrella to have unified control. In 2003 GOAP created an Internal Audit (IA) wing in the Finance Department to monitor the progress of Internal Audit work with the following specific responsibilities:

a. Allocation of Budgets to the districts;

b. Receiving Audit Reports from the district level Internal Audit Committees and communication of the same to the concerned department, monitoring the action taken on the reports;

c. Follow up actions on the decisions taken by the State level Internal Audit Committees; and

d. Formulation of various rules, forms, etc. for conducting Internal Audit and reporting.

10.9 GOAP has entrusted the work of internal audit of the Department of Collegiate Education and Intermediate Education to the Director of State Audit in June 2005. A firm of Chartered Accountants was entrusted the job of preparing a check list and an Internal Audit Report Format. The report format prepared by the firm was considered unsuitable and was revised in the Finance Department. The revised format was given to the Director State Audit in August, 2006. The Director State Audit started the IA work in October 2006 and completed Internal Audit of 79 institutions (8 Degree Colleges and 71 Junior Colleges). The Finance Department in July, 2007 entrusted the IA of School Education Department to the Director State Audit. Control tests of IA reports of some of the colleges showed that coverage in Internal Audit was not exhaustive and the staff has to be trained to make it more effective.

10.10 There are I.A. sections in fourteen departments GOAP and the staff in position as on 31-8-2007 is as below:

Name of the Post	No. of Posts Sectioned	No of posts filled	Vacant
AOs	4	4	Nil
Superintendent /JAO	40	40	Nil
Senior Accountant	54	1	53
Jr Accountant	6	1	5

10.11 As can be seen, Internal Audit Cells have been functioning in fourteen departments with inadequate manpower. Many times staff is diverted to other functions. In practice effective Internal Audit does not exist in many departments. In the format approved and circulated by the Finance Department, though reporting on the position of outstanding AC/DC bills and utilization certificates in respect of grants are included, all other aspects suggested in the action points are not included. Comments on the budget execution are required to be reported on as per instructions contained in G.O. 166 issued on 10-11-2003. The instructions contained have still to be incorporated in the relevant codes and manuals. Control testing of some of the reports, revealed that none of the reports contained comments on the aspects of Budget Execution. This was presumably because the Internal Audit parties are not aware of this requirement. Majority of the departments neither have I.A. Manual nor chapters regarding IA in their Departmental Manuals. This position is also reflected in Chapter V of the Audit

Reports of the CAG for the years from 2003 to 2007. Internal Audit Manuals have to be prepared for all the departments.

Conclusion

10.12 Proper internal controls are essential to improve efficiency and to ensure compliance with prescribed rules and procedures and to avoid wasteful expenditure. Lack of trained staff and inadequate number of staff have been the major constraints in setting up a credible IA function in the government. Generally, there is a lack of appreciation about the need for strong internal control framework.

Recommendations

10.13 Recently, FD has commissioned CGG to prepare an Internal Audit Manual. Important as a manual is, it is also required that the GOAP takes suitable action in creating a credible IA department with a) well thought out mandate, b) reporting structure that would ensure its independence, and c) competent staff in reasonably sufficient numbers for the IAD to be viable.

Chapter 11

External Auditing

11.1 Government mobilizes large revenues in the form of tax and non-tax revenue and it is the responsibility of the state government to raise resources properly and ensure economy in utilizing those resources and to avoid wasteful expenditure. External Audit assists the legislature in exercising its oversight role over public expenditure as well as in collection of taxes. It is the responsibility of external audit to bring to light examples of deviation from accepted standards of financial propriety, rules, regulations, etc., and weaknesses in the systems leading to uneconomical or wasteful expenditure.

11.2 The CAG is the supreme audit authority whose duties and powers are laid down in the Constitution of India and the laws made there under. In addition to audit the CAG is in charge of compiling the accounts of the state governments. He has two of his officers in the state capital: one called the Principal Accountant General for audit and the other called the Accountant General (Accounts & Entitlements) for compilation of accounts.

Principles of good practice

- Clearly established, sufficient and enforced independence, duties, jurisdiction and powers;
- An effective audit approach;
- Objective and competent auditors;
- *Timely and appropriate responses to audit observations;*
- *Follow up procedures to ensure implementation of audit observations;* and
- Timely and accessible audit opinion and reporting.

11.3 The SFAA study made the following recommendation and action points for improvement in external audit. (☒ indicates not yet implemented / partially implemented; ☑ means implemented; and ?? the recommendation needs further examination)

SFAA Recommendations	
☑	Increase timeliness/quality of responses to AG audit observations by re-activating State level audit committees in pilot departments. Audit committees to meet frequently to resolve Inspection Reports and audit paragraphs issues to avoid them being escalated to the Audit Reports
??	Enhance audit approach by Finance Department / GOAP requesting CAG to: a. Petition CAG to complement audit observations with more positive and constructive comments/recommendations as to how to strengthen systems and procedures (FR 12.5) b. Include physical verification of assets as a core part of audit methodology (FR 12.3.2); c. Place a greater emphasis on the performance audit of social sector expenditure, as this is expected to be a growth area and where outputs and outcomes of expenditure are less amenable to physical verification (FR 12.3.2); d. Integrate the evaluation of, and liaison with, internal audit into its audit methodology and regular practice (DR 11.1); e. Contract experts in specific technical fields as required in order to enhance the quality of audit of, for example, construction of roads or irrigation schemes (DR 12.4.2); f. Issue department-wise audit opinions once department-wise accounts are issued (FR 12.7.2); g. Report directly to the Legislative Assembly when a major issue arises. Specifically, the CAG should report to the Assembly as soon as the amount of excess expenditure has been confirmed (DR 11.2) h. Adopt risk-based audit methodologies and undertake more special risk based audits (FR 12.3.2)
	Increase accessibility of audit opinion and reporting by petition CAG to issue an audit opinion on the government accounts, and one which clearly distinguishes between the role of the AG as accountant, and that of the CAG as auditor. The opinion should also clarify the scope of the audit (FR 12.7.2)

11.4 A number of SFAA recommendations on external audit related to audit approach or quality of audit, which are not within the influence of the state government. Some of them do not even concern the state directly; for example, the suggestion that on some matters CAG should report directly to Legislative Assembly. A view on such a matter has to be taken by the legislative assembly and the CAG. Some suggestions such as contracting experts the CAG already does so where considered necessary. As for the suggestion that external audit should liaise with internal audit, the moot point is does the state have credible internal audit system. It would have been thus inappropriate to raise all the SFAA recommendations directly with the CAG of India. However, the state could have taken action on recommendations which were within its ambit.

Timely and appropriate responses for audit observations:

- **Revive Audit Committees and Audit Committees to meet frequently to clear outstanding Inspection Reports and Paragraphs**
- **GOAP to issue deadlines for responsiveness to Audit observations**

11.5 The state government in June 2004 issued instructions reconstituting Audit Committees for expeditious settlement of audit objections and paras in inspection reports. The State level committee has the chief secretary as the chairman and the finance secretary concerned with the PAC as the convener of the committee. The Departmental committees have the secretary of the department as the chairman. The district committees have the district collector as the chairman and convener. The duties of all the committee are specified in the order. The AG or his representative has been included as members in all the committees. The orders contained in the GO no. 507 are being strictly enforced and that has a salutary effect on settlement of the outstanding observations, implementation of Audit.

11.6 Due to the efforts made by Finance Department in issuing necessary orders to the departments concerned, and also the constant pursuance by the Principal Accountant General (Audit) with the departments, for arranging district level Audit Committees, the level of pending reports /paragraphs has come down considerably as at the end of June, 2007. The Panchayati Raj and Rural Development Department have done well in bringing down the pending level from 1633 Reports and 10180 paragraphs as at the end of June 2004 to 213 Reports and 1413 paragraphs at the end of June, 2007. The following are the departments with high outstanding Reports and paragraphs as per the CAG's Audit Report for 2006-07.

Department	Outstanding as at the end of June 2007	
	Reports	Paragraphs
Education	2247	9807
Health	977	4733
Revenue	1432	3694
Finance	1214	3821
Social Welfare Including Tribal Welfare	500	3034
Irrigation and CAD (Irrigation Wing)	860	2281
Agriculture and Cooperation	573	2029

Irrigation and CAD [Project Wing]	897	1782
Women and Child Development and Disabled Welfare	567	1567
	9267	32748

11.7 The above nine departments out of the 32 had contributed to the bulk of the pending Reports (73.27 percent) and paragraphs (75.31 per cent) of the total pending Reports (12647) and paragraphs (43,482). While the Panchayat Raj and Rural Development Department did well in minimizing the outstanding reports and paragraphs, the Departments of Health, Revenue and Social Welfare hardly responded to the efforts made by the Finance Department and the Principal Accountant General (Audit).

11.8 Thus, after the Audit Committees have been revived there has been considerable progress in the clearance of old Inspections Reports. During last four years from June 2004 to June 2007 there was reduction of 31 per cent and 36 per cent in Inspection Reports and Paragraphs respectively as shown in Fig.

	Pending IR /Paragraphs at the end of				**Percentage reduction**
	Jun.'04	**Jun, 05**	**Jun, 06**	**June, 07**	
Inspection Reports	18317	17771	16489	12647	31
Paragraphs	67459	62763	54676	43482	36

11.9 Of the 18317 inspection reports pending as at the end of June 2004, 10981 relate to the year 1999-00 and earlier years. The reason for this delay in clearing of the old reports could be the frequent change of personnel in the concerned offices and the difficulty in tracing the old records necessary for answering the audit observations. The Departments listed below have not held any Audit Committee meetings so far.

a. Irrigation and Command Area Development.

b. Planning.

c. Revenue.

d. Transport, Roads and Buildings.

e. Backward Classes Welfare.

f. Environment, Forest, Science and Technology.

g. Health, Medical and Family Welfare.

h. Housing.

i. Industries and Commerce.

j. Youth Advancement, Tourism and Culture.

11.10 As these are major departments, revival Audit Committees and holding the meetings frequently would hasten the progress of clearance. Though there is considerable clearance of the pending reports / paras, the response still is slow and has to be improved as seen from the delay in furnishing even the first replies to the reports as shown below. Some drive for prompt responses to audit observations is called for.

Reports for which even the first replies are not received

Year	Inspection Reports	Paras
2001-02 & earlier years	nil	nil
2002-03	1	3
2003-04	72	379
2004-05	58	249
2005-06	1001	4933
2006-07	1365	6583

11.11 According to the instructions issued by the Finance Department as far back in 1993, the administrative departments are required to submit explanatory notes on paragraphs and reviews included in the Audit Reports within three months of presentation of the Audit Reports to the legislature, without waiting for any notice or call from the Public Accounts Committee duly indicating the action taken or proposed to be taken in respect of the paras. The Report of the CAG for the year 2007 reported the following position.

Year of the CAG Report	*Number of paras for which ATNs have not been received as at the end of July, 2007.*
2002-03 & earlier	48
2003-04	19
2004-05	19
2005-06	34
Total	120

11.12 Though there has been considerable improvement in furnishing the action-taken–notes in the last four years, there is still a backlog relating to the audit report for the year 2002-03 and earlier years for which action taken notes are still to be submitted.

Other issues

11.13 CAG has no powers to enforce his audit finings or impose penalties on officers who are held responsible for misuse or wastage of funds and set time limit for submission of documents which are required for his audit work or for responding to his preliminary audit enquiries. The last one is critical to his ability to complete the work according to his set schedule and to finalize the reports. It is possible, by delaying production of documents for his scrutiny, to frustrate his attempt to do a thorough audit examination fast. While the RTI Act gives the citizen the power to enforce a 30 day limit for submission of information/documents he wants, the CAG has no such power. He can only appeal to the executive in case of delays in furnishing information required by him and if records are denied by abnormal delay, his only weapon is to include this fact in his audit report. This point is best illustrated by the fact, that, CAG reports year after year savings and excess expenditure vis-à-vis grants in the Appropriation Accounts which remain unexplained by the departments concerned.

Conclusion

11.14 While there is some progress in the area of response to audit observations, there has been no attempt by external audit to high light systemic deficiencies in a consolidated report based on its transaction audits. They continue to be reported in a large number of inspection reports with a great deal of duplication of points noted. Both the external audit and the government deal with them piecemeal rather than look at the bigger picture that should naturally emerge from these reports. To illustrate, weakness in DDO reconciliation with Treasury might have been pointed out in twenty five offices; they are dealt with individually and not as a control issue across government. This manner of reporting and dealing with audit observations causes system overload as the number of objects becomes unwieldy and unmanageable.

Recommendations

11.15 The government should try and get the overall sense of deficiency in the working of its offices from the myriad audit reports and deal with them systematically. For this purpose, it could have software developed that would enable grouping all audit observations under some standard terms so that they can be consolidated and considered for suitable action.

11.16 As the GOAP's internal audit is strengthened, automatically external audit would withdraw from extensive transaction audit by relying on the work of IA. The external audit would then be able to concentrate more on value for money and performance audits that help the government more.

Chapter 12
Legislative Scrutiny

12.1 An effective legislative scrutiny is essential to secure accountability of the executive for proper utilization of public resources. Also active involvement of legislative committees can make depth scrutiny of executive performance possible.

Principles of good practice

a. Clear roles, responsibilities and process for the approval of budgets and legislative scrutiny;

b. Timely and effective scrutiny of budget execution by the assembly and its committees to ensure that the funds are being, or have been spent on authorized and intended purposes, as expressed in the budget; and

c. Transparency of legislative approval and scrutiny which increases the accountability of the executive.

12.2 The SFAA study made the following recommendation and action points for improvement in legislative scrutiny. (☒ indicates not yet implemented / partially implemented; ☑ means implemented; and ?? the recommendation needs further examination)

	SFAA Recommendations
☒	Strengthen support to Assembly and Committees by providing PFM and technical/sector policy support for Assembly and Committees (DR 12.1); Train legislators in PFM issues (DR 12.1)
☒	Make the life of the Committees co-extensive with the life of the Assembly, with a proportion (say, one third) of the members rotating each year (FR 13.2, FR 13.3.2)
☒	Enhance Assembly monitoring of budget estimates and budget execution by expanding the role of Estimates Committee to scrutinise estimates and budget execution or by establishing standing committees for key sectors (FR 13.2)
☒	Request PAC to issue an annual plan / timetable to discuss CAG's audit report and make this plan widely available and released to the media in summary form (FR 13.3.2.1); and issue an annual report on its performance against plan including its main achievements. Again, this report should be made widely available and released to the media in summary form (FR 13.3.2.1);

- ☒ Consider establishing sub-committees, possibly specialising in key sectors to undertake the speedy clearing of outstanding audit paras (FR 13.3.2.1); and
- ☒ To focus its immediate attention on the numerous cases of excess and un-regularized expenditure in recent years, seeking explanation for the excesses, recommending regularization where appropriate, and taking appropriate action in other cases (FR 13.3.2.1)

12.3 As with the recommendations relating to CAG of India, the above recommendations in respect of legislative committees are also not within the influence of the state government. The issue of legislative scrutiny can also be seen from the stand point of how the government could support it. To illustrate, strengthening of PAC secretariat by providing officers with PFM expertise is something on which the government could have taken action. The Legislative Assembly has only administrative support staff and has no access to technical assistance, either in general budgetary or specific sector policy issues.

12.4 The important issue in this context is to what extent have government departments been responsive in furnishing their explanatory notes and action taken notes to PAC. The Finance and Planning Department issued (May 1995) instructions to all administrative departments and the Heads of Departments to submit the Action taken Reports (ATRs) on the recommendations of the Public Accounts Committee (PAC) within six months from the date of receipt of recommendation. As of July, 2007, about 1220 recommendations of PAC made between1962-63 to 2005-06 in regard to 24 departments remained outstanding. Of these, the PAC had discussed ATRs in respect of 299 recommendations relating to 15 departments. Of the remaining 921 recommendations, the concerned administrative departments are yet to submit ATRs for 451 recommendations. Of these 210 ATRs (47 percent) were due from Irrigation and Command area Department alone.

12.5 One difficulty as regards regularization of excess expenditure relating to earlier period would be progressive loss of information due to loss of records, and with efflux of time it would be increasingly more difficult to trace records and to provide valid explanations for the excesses of expenditure over grants. Immediate action is necessary at least in respect of items relating to the latest period. According to the latest report of the CAG, excess expenditure amounting to Rs.12,854.18 crore for the years 1997-98 to 2005-06 have yet to be regularized.

Conclusion

12.6 As can be seen, GOAP did not take up any of SFAA recommendations with the legislative secretariat, Speaker of the Assembly or the Chairman, PAC. As a result, none of the recommendations have been acted upon.

Recommendations

12.7 It is recommended that the legislative scrutiny be made more effective by

a. ensuring prompt dispatch of explanatory notes in respect of all paragraphs included in the Audit report;

b. ensuring prompt filing of ATRs in respect of all PAC recommendations;

c. providing PAC Secretariat with staff competent in PFM functions so that they can provide able support to PAC in discharge of its responsibilities; and

d. requesting AG and PAC to prioritize the items for discussions so that PAC's oversight results in improving systems as much as ensuring accountability of executive.

Chapter 13

Public access to information on public finances

13.1 Easy accessibility of all financial information including, budget, schemes and programmes of the government is the essential need to support and supplement legislative and audit oversight. All information should be intelligible to the lay man and should be user friendly. Such access empowers the Civil Society and helps holding the government of the day to account.

13.2 The Key Principles of Public Accessibility are:

- Increase transparency of and accessibility to information by public;
- Provide opportunities for public consultation and participation; and
- Provide avenues for filing, following up and redressing public complaints.

13.3 The SFAA study made the following recommendation and action points for improvement in respect of public access. (☒ indicates not yet implemented / partially implemented; ☑ means implemented; and ?? the recommendation needs further examination)

	SFAA Recommendations
☒	Announce approximate release dates for the AFF and for the public consultation process at least one month in advance (FR 14.2)
☑	Include a narrative with key fiscal indicators and expenditure priorities in Budget in Brief (FR 14.2);
☒	Accounts should contain statement by HoD, which sets out parameters of responsibility and how they have fulfilled these (DR 10.1), with specific reference to internal control (FR 11.2)
☑	Sittings of the Legislative Assembly to be broadcast on the radio/Television (FR 13.4)
??	Develop longer-term plan for strengthening consultation over time (moving from current emphasis on transparency to greater focus on consultation over time) (FR 14.13)
☒	Investigate reasons for low participation of NGOs and other civil society organisations in AFF consultative process (DR 13.2)

13.4 GOAP has made significant strides to enhance transparency and public access to financial information such as:

- Published a draft 2002-03 budget and subsequently draft budget of 2003-04 to facilitate public consultation
- Making available all the budget documents in addition to Budget in Brief which provides very useful summaries on state receipts, payments and liabilities and the Finance Minister's speech on GOAP's website (www.aponline.gov.in);
- The accounts of GOAP are made available by the A.G. on their website after they are presented to the legislature and this includes an easy to understand 'Accounts at a Glance'
- All important government orders are available on the website.

13.5 RTI Act 2003 has come into force and GOAP appointed 'information officers' in each office to provide information required by the public.

Announce appropriate release dates for AFF and for the public consultation process at least one month in advance

13.6 The AFF is not published and circulated widely for public to study and react. The draft budgets of 2002-03 and 2003-04 were circulated to the media inviting suggestion for improvements and comments. This practice has been stopped from 2004-05. It was informed that now as a matter of policy NGOs and Civil Society Organisations are not invited for discussions on matters relating to budget formulation. The Finance Department may have to take a re-look at this recommendation for necessary action.

13.7 The support to public consultation is not complete, nor unqualified. Some view (for good reasons) that budget is a complex and technical exercise by the government and it is the prerogative of an elected government to present the budget by adjusting the inter se priorities. The democratic process (and free media) permits different sections of society (the civil society) to voice their concerns and seek budgetary support for their specific needs. Access to public financial information is different matter.

- **Develop longer term plan for strengthening consultation over time (moving from current emphasis on transparency to greater focus on consultation over time)**

13.8 The Finance Department has not so far developed a plan to publish either the Budget or AFF to encourage public debate.

- **Investigate reasons for low participation of NGOs and other Civil Society Organisations in AFF consultative process.**
- **Provide financial information of general interest to stakeholders more frequently**.

13.9 The NGOs are not invited to participate in any debate to discuss fiscal matters. Accounts of the state government are prepared by the Accountant General and the accounts as compiled by the AG are presented to the legislature once in the year. No interim accounts are prepared by him.

- **Provide avenues for making, following up and redressing public grievances**

13.10 GOAP in 2002 issued orders to set up an effective grievance redressing mechanism in every office duly prescribing the time limit for disposal of grievances. Every grievance received was to be acknowledged forthwith duly indicating a reasonable time within which it would be disposed off. The progress of handling grievances was to be reviewed by the next higher authority every fortnight and a monthly review report was required to be sent to the General Administration Department. The General Administrative Department reviewed the position every month and communicated its findings and orders thereon to all concerned.

13.11 According to a review in September 2007 of the position of redressal of grievances in the state as a whole as at the end of July '07 was as follows.

Total number of grievances pending		4469
Pending for		
Less than	3 months	2832
More than	3 months	828
More than	6 months	380
More than	12 months	429

13.12 A report on the grievances of minorities is also similarly obtained and the number of grievances pending at the end of July was 196 in the entire state. In addition to these there is the RTI Act under which any information required by the public is made available to them through the Information officers and that is discussed above.

Conclusion

13.13 GOAP is in the forefront of states in providing all important fiscal information on its web-site. The budget and other connected documents are disseminated through the print media. The Accounts at a glance are now available on the web-site of the Accountant General and is also published in Telugu, the local language. GOAP has stopped publication of its budget before it is presented to the legislature from the year 2003-04 and the government can consider revival of the practice and obtain public reaction to the draft before finalizing the same. Under the RTI Act the government appointed information officers in every office to attend to enquiries as well as reactions to any policy of the government.

Annexure A

List of officials whom the IA-SFAA team met in connection with the study.

AP State Secretariat.

S/Sri:

1. Dinesh Kumar, IAS. Principal Secretary, Finance Department.
2. N. Ramesh Kumar, IAS. Principal Secretary, Finance Department.
3. Ch. Israil, Deputy Secretary, Finance Department.
4. K.S. Rajendran, Deputy Secretary. Finance Department.
5. S.N.L. Narasimham, Deputy Secretary. Finance Department.
6. Md. Baquer, Deputy Secretary. Finance Department.
7. Parthasarathy. Deputy Secretary Finance Department.
8. B.S.S. Sarma. Deputy F.A.to Govt/Ex officio Dy. Secy to Govt. Finance Department.
9. S. Chandrasekhara Rao. Asst. Secretary. Finance Department.
10. B. Srihari, Asst. Secretary. Finance Department.
11. A.V.G.K. Acharyulu, Asst. Secretary. Finance Department.
12. L. Subbireddy, Asst. Secretary. Finance Department.
13. Subba Rao, Asst. Director, Inteternal Audit.
14. Ilaiah, Addl Secretary, Education Department.
15. G. Krishna Murthy, F.A. Health Department.
16. Ramakrishnaih. O S D. Revenue Department.
17. Ramakrishna. Joint Secretary, G A D.
18. Simhachalam, Asst. Secretary. G. A. D.
19. K. Tuljanand Singh. Secretary, AP State Legislature.
20. Narasimha Raju. Deputy Secretary, A.P. State Legislature.

O/o The Principal Accountant-General [Audit] A.P/ Accountant-General [A & E] Hyderabad.

1. S.B. PILLAY, I.A.&.A.S., Principal Accountant General [Audit].
2. Smt. Parveen Mehta, I.A.&.A.S. Accountant General [A & E]
3. Syed Saheb. S.A.O., O/o A.G. [A.&. E]
4. Smt. Anusri Ray. A.O. A.G. [A. &. E]

Heads of Departments:

1. S. Balasubrahmanyam: I. A. S., Director School Education.
2. Dr. D. Rameshchandra, Director of Health.
3. N.C. Nagarjuna Reddy, Director of Treasuries and Accounts.
4. Ravindranath, Director of Insurance.
5. G.M. Majid. Director, State Audit.
6. G.V. Krishnaiah. Director of Works Accounts.
7. Nagireddy, Pay and Accounts Officer, Hyderabad.

Heads of Accounts Wings.

1. Dr. Brahmanand Rao, Finance Controller, Sarwa Siksha Abhiyan.

2. Smt K.A. Jhansi Sobhan. CAO, O/o D.S.E.
3. Smt. T.K. Jayasri. CAO, O/o Director of Health.

District Officers:

1. Ch. Ramana Kumar, D.E.O. Rangareddy District.
2. M. Ramalingam, D.E.O Guntur.
3. Lingaiah. D.E.O. Warngal.
4. Dr.K. Sobhavathy, D.M. & H.O. Rangareddy District.
5. Dr. K. Sureshkumar. D.M.&.O Guntur.
6. Dr. Jayachander. D.M.&.H.O. Warangal.
7. Sivakumar Reddy, D.T.O Rangareddy.
8. Prasadrao, D.T.O Guntur.
9. Tajuddin, D.T.O. Warangal.
10. Ch. Ramanakumar, I/c P.O. SSA. Rangareddy District.
11. Ramamurthy. APC, SSA.Guntur.
12. Sarvanan, I.F.S. P.O. SSA. Warangal.
13. NBG Sarma. P.A.O. [W & P] Guntur.
14. Asst. P A O. S>R>S>P
15. P A O [W & P] Rangareddy.