

# **Andhra Pradesh State Financial Accountability Assessment (State Government)**

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The **Andhra Pradesh State Financial Accountability Assessment** report contains the following five documents. These documents are paginated separately and arranged in the order given below:

1.	Executive Summary	26 pages
2.	Fiduciary Risk Assessment Report	144 pages
3.	Appendices to Fiduciary Risk Assessment Report	12 pages
4.	Development Report	22 pages
5.	Short Term and Long Term Recommendations	18 pages

# **Andhra Pradesh State Financial Accountability Assessment**

## **Executive Summary**



## Andhra Pradesh SFAA - Executive Summary

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**Andhra Pradesh State Financial  
Accountability Assessment  
Fiduciary Risk Assessment Report**



# ANDHRA PRADESH SFAA-FIDUCIARY RISK ASSESSMENT REPORT

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## **Andhra Pradesh State Financial Accountability Assessment**

### **Short Term and Long Term Recommendations**



## 1. Introduction

### 1.1 Background to the State Financial Accountability Assessment

As part of the ongoing fiscal reforms process, the Government of Andhra Pradesh (GoAP) decided to take a number of measures during 2002-03, including completion of a State Financial Accountability Assessment (SFAA) and related Action Programme covering the State Government. The SFAA is a GoAP exercise, undertaken by the Centre for Good Governance (CGG).

### 1.2 Objectives and scope of the SFAA

The SFAA has dual objectives, being:

- First, the development objective. Its key role is to facilitate a common understanding of GoAP's public financial management (PFM) arrangements, including identifying their strengths and weaknesses, thus contributing to the design and implementation of capacity building programmes for improved PFM;
- Secondly, the fiduciary objective which is to assess and manage the risk that government and donor funds might not be spent on authorised and intended purposes, as expressed in the Budget, and thus support the exercise of donors' fiduciary responsibilities.

A separate report covers developmental issues and includes recommendations and an action plan. This report covers the fiduciary objective, and thus examines key issues such as the extent to which the budget has been implemented as passed, whether the budget covers all significant parts of government activity, whether sufficient reliable information is provided on budget execution and whether practices match rules. The SFAA may use some audit techniques to assess these issues, but it is not to be considered, or represented, as an audit of any of the systems assessed. This assessment does not aim to assess the quality or value for money from public spending; this is the role of a Public Expenditure Review (PER). Nor does the SFAA assess the level of financial or sovereign risk. The scope of the SFAA covers only the State Government.

### 1.3 Methodology

The SFAA was undertaken using a diagnostic framework which compared GoAP against principles of good practice in containing fiduciary risk. These are normative principles, which are not necessarily implemented in specific governments. The principles have been derived from various documents issued by international authorities on public finance issues, with a specific reference to fiduciary risk. Evidence of GoAP practice was derived from a number of sources, with primary data gathered from controls testing, which is outlined in Figure 1.

**Figure 1: Overview of controls testing**

The SFAA team undertook controls testing in two departments: Primary Health and Primary Education. Controls testing was therefore undertaken at the Directorate of Public Health, Commissionerate & Directorate of School Education, and the State Project Director of the District Primary Education Programme (DPEP). Testing was undertaken in five districts, intended to cover the range of likely control environments: Mahbubnagar, Nalgonda, Visakhapatnam, Ranga Reddy and Guntur. Thus, five District Education Offices (DEOs) and five District Medical and Health Offices (DMHOs) were tested. Testing was also undertaken at ten Primary Health Centres (PHCs), seven Mandal Education Offices (MEOs), five District Primary Education Project (DPEP) offices and four primary schools. Testing was undertaken with the use of a detailed Internal Controls Questionnaire (ICQ). In addition to the five districts visited, the ICQ was sent to a further six districts, none of whom replied.

Controls were also tested at five District Treasury Offices (DTOs) and six sub-Treasury Offices (STOs) and the ICQ was also completed by the Directorate of Treasury and Accounts (DTA) who provided State-wide information. And, the ICQ was also sent to 17 Pay and Accounts Offices (PAOs) (Works and Projects), 10 Assistant PAOs (APAOs), and 4 Joint Directors of Works and Accounts, from whom replies were received in all cases.

The results of the controls testing have been examined in the context of corroborating evidence, including Accountant General (AG) Inspection Reports, internal audit reports, reports of Chartered Accountant audits, and the Comptroller and Auditor General (CAG) Audit Reports.

The SFAA also drew upon stakeholder consultation and desk review of a wide range of material, from AP, Indian, and international sources.

#### 1.4 GoAP vision and record of PFM reforms

GoAP's record of reforms in PFM and accountability since 1999-2000 reflects its commitment to minimising fiduciary risk and providing a sound fiscal basis for the development of the State. The initial focus of the reforms was on increasing the transparency of the budgetary process and fiscal discipline. GoAP's Strategy Paper on Fiscal Reforms in 2001 renewed GoAP's commitment to PFM reform and set out a vision of PFM. Four of the vision's key pillars, outlined in Figure 2 below, are critical to minimising fiduciary risk.

**Figure 2: Pillars of GoAP's Fiscal Reforms critical to minimising fiduciary risk**

- Creating the conditions for good operational management and improvement of services to the public, by empowering the government departments to take decisions in their remit while assuring accountability for the use of resources and for results;
- Assuring close correspondence between actual expenditures and the approved budget, thereby permitting the introduction of good cash management, and improving predictability throughout government;
- Modernising the financial management system by streamlining financial regulations and appropriate use of information technology;
- Enabling public participation in budget formulation and implementation by making budget documents simpler and disseminating government financial decisions in user-friendly forms.

*Source: GoAP Strategy Paper on Fiscal Reforms (2001)*

Guided by these medium term objectives, GoAP has implemented extensive reforms in most areas of PFM over which it has delegated authority. Many of the reforms, particularly those in budget formulation and execution will increasingly bear fruit over the coming years. For example, GoAP's groundbreaking reforms which promote greater budget realism, departmental ownership of their budgets and release of expenditure authorisation, should increase the potential for the budget to be implemented as passed, and for departments to be held accountable for their use of financial resources. While the divergence between budgeted and actual revenue and expenditure is narrowing over time, GoAP recognises that there is still some way to go to ensure that the budget is a reliable guide to actual expenditure.

Measures in other areas have had a more immediate impact. GoAP is now a leader in budget comprehensiveness, for example having brought previously off-budget borrowings on budget and by disclosing (and increasingly providing for) government guarantees. GoAP's reforms in the timeliness and reliability of financial information have also borne fruit in 2002-03, and will be strengthened further by the integration of systems in the coming year. Increasing the reliability of information on budget execution, and reducing fiduciary risk, relies on greater discipline in undertaking reconciliations, tackling large and non-transparent balances on the Public Account and deposit accounts.





GoAP has also undertaken a range of reforms aimed at strengthening controls and compliance in key areas of departmental budget execution to narrow divergences between formal PFM ‘theory’ and ‘practice’. Further improvements will be enabled by, first, the selective revision of the PFM rules and regulations to increase their transparency and accessibility, and secondly, by devising and implementing further mechanisms for their enforcement, such as the upgrading of the accountability framework, establishment of effective departmental internal audit functions, and improvement of financial competences at the district and field levels. A focus will be required on areas identified as particularly weak, such as asset management.

Much of the reform effort lies with GoAP. However, the CAG and PAC will continue to play a critical role in the minimisation of all aspects of fiduciary risk.

### 1.5 Structure of this report

This report is structured around the following key stages/aspects of PFM.

**PFM legal and institutional framework** (Chapter 3) examines the key laws, rules, regulations and practices underpinning PFM in GoAP.

**PFM process** examines four key stages: **Budget formulation** (Chapter 4), **Budget execution** (Chapter 5), **Accounting** (Chapter 6), **Monitoring and reporting** (Chapter 7).

**Assets and liabilities** selects for closer examination **Asset management** (Chapter 8), **Debt management** (Chapter 9), and **Contingent liabilities** (Chapter 10).

**Internal controls** (Chapter 11) highlights cross-cutting issues of how GoAP seeks to ensure the achievement of its objectives, specifically safeguarding resources and adherence to the legal framework.

**Scrutiny and accountability** analyses the main mechanisms by which stakeholders exercise their right to hold GoAP to account for PFM, being **External auditing** (Chapter 12), **Legislative scrutiny** (Chapter 13), and **Public access to information** (Chapter 14).

Each chapter starts with a shaded box containing the key conclusions of the SFAA in that area. This is followed by a summary of the assessment leading to those conclusions.

## 2. Legal and institutional framework

The extent to which the legal and institutional framework encourages a culture of compliance and creates a climate for PFM reform will play a significant role in determining the level of fiduciary risk.

Much of the legal and institutional framework, within which the GoAP PFM system operates, is prescribed by the Government of India (GoI) in accordance within the provisions of the Constitution of India. GoAP is thus constrained in many areas in its attempts to reform PFM, but has sought to supplement GoI requirements in some areas so as to minimise fiduciary risk, for example by increasing the availability of information on public finances in a transparent form. In other areas, such as the budget process, State Governments have delegated authority and GoAP has used this to good effect by undertaking reforms that seek to reduce fiduciary risk by increasing budget realism and budget comprehensiveness.

There are other areas contributing to fiduciary risk that can be tackled further by GoAP; these are highlighted in the relevant chapters of this report. Reforms in specific areas need to be underpinned by reforms that tackle weaknesses in the legal and institutional framework. Most urgently required is the selective modernisation, codification, and simplification of the legal framework based on clearly articulated principles and a complete and consistent accountability framework. This should increase compliance at the district and field levels, where the competence and motivation to comply can be weak. Reducing the risk of non-compliance relies on strengthening the organisational culture by reforming working practices; in-roads can be made by strengthening training and human resource management of finance staff.

Key aspects of PFM in the States are determined by the Constitution and GoI, including budget classification, budget documentation, the Legislative role in budgetary approval, financial rules and regulations, the basis of accounting, financial reporting formats and timing, debt management, the giving of guarantees and the audit of the accounts of States by the CAG. This report sets out the manner in which these provisions impact on PFM, and how GoAP has sought to supplement these provisions in such a way as to contain fiduciary risk.

Examples of divergences between PFM ‘theory’ and ‘practice’ are noted where relevant in this report. GoAP is seeking to devise and implement mechanisms that further enforce compliance in such a way as to enhance PFM. Central to this task is ensuring that the ‘theory’ is cohesive, relevant, up to date, comprehensive, transparent and accessible. The GoI Government Accounting Rules, Account Codes and General Financial Rules are the primary source of the ‘theory’. From these are derived the AP Financial Code, AP Accounts Code and AP Treasury Code. The key principles underpinning the Rules and Codes, in terms of roles, responsibilities and process, are not clearly enunciated. Many provisions are obsolete or redundant. The Rules and Codes need modernisation in many areas to ensure that they remain relevant to the needs of users, and reflect the variety of reforms being undertaken by GoAP, for example in the budgetary and accounting processes. The comprehensiveness of the Rules and Codes also needs expansion in several key areas such as asset management and computerisation. GoAP recognises these facts and has committed itself to a zero based review of all financial regulations with selective revision where necessary. In the meantime, GoAP has sought to update the framework by way of a series of Government Orders (GOs). When added to the range of other Codes and Manuals, it is difficult for officials to be sure that they have the complete picture.

Furthermore, the framework needs improvement in transparency and accessibility in order to increase compliance with the PFM rules in ‘spirit’ as well as “in letter”. The existing Rules and Codes are not user-friendly, adopting a style that is difficult for many to understand and interpret. GoAP has developed



a series of Departmental Manuals and Functionary Manuals in an attempt to provide more a user friendly source of guidance for officials. Many officials, especially at district and field levels, currently exhibit a low awareness of the Rules and Codes, and particularly of the Functionary Manuals.

GoAP is also devising mechanisms to enforce compliance through reforms which emphasise institutional and individual accountability. Given that they will demand a wide range of changes across various dimensions of GoAP activity, it is important that all of these reforms are moving GoAP consistently towards a clear, robust and consistent accountability framework. GoAP recognises that design and implementation of the performance budgeting reforms in particular must be based on a clearer understanding of the new institutional accountability framework that GoAP is working towards.

GoAP has made significant strides in recent years in clarifying responsibilities and fixing accountability on individual officials. One critical step forward in accountability was the issue of GO 507 in April 2002 as it clarified the responsibilities of Drawing and Disbursing Officers (DDOs) with regard to key accounting controls and imposed sanctions for failure to comply with them. But a DDO Manual, although developed as training materials, has not been provided directly to all DDOs in the field. There is scope to increase further the accountability accepted by some officials, particularly Heads of Departments (HoDs)/Chief Controlling Officers (CCOs) and subordinate Controlling Officers (COs). The Functionary Manuals have been an excellent step in clarifying controls and responsibilities of Treasury officials; the other Functionary Manuals need greater emphasis on the fiduciary responsibilities of departmental officials.

Further improvements in compliance also rely on building PFM skills and expertise across departments and levels of Government. This is a particular issue at the district and field levels, including among non-financial staff such as COs and DDOs. There is also a need to provide more specialised support to the Finance Department, for example experts in procurement, asset management, internal controls and accounting techniques. Finance Department is already taking the initiative by creating specialist internal audit and debt management cells. Such reforms are required to build the institutional capacity to deepen and widen the PFM reforms and realise their benefits.

The following four chapters cover the four main stages of the PFM process, being budget formulation, budget execution, accounting, and monitoring and reporting.

### 3. Budget formulation

The ability of a government to implement the budget as passed is dependent on the quality and realism of the budget itself, as it will be difficult to implement a budget that is based on unrealistic estimates of revenue and expenditure. Thus, budget formulation is a critical stage for fiduciary risk.

Budget realism is a challenge for all governments. GoAP forecasts of revenue are consistently below budget. However, they are within a low margin of error and the quality of these forecasts has generally been improving. Furthermore, much of the variance between budget and actual revenues is due to less than anticipated receipts from GoI. The revenue shortfall is one reason for downward revisions to budget allocations at the time of Revised Estimates, although these revisions also reflect the financial performance of departments in the year to date.

Therefore, downward revisions in expenditure from Budget do not necessarily imply over-estimation of expenditure at Budget time. Instead GoAP recognises that its debt servicing and salary commitments (combined with the policy of avoiding staff retrenchment) lead to some under-provision for non-salary O&M expenditure. These commitments also limit GoAP and line departments' flexibility in formulating their budgets. GoAP is working actively to reduce fiduciary risk, by developing initiatives that will improve departmental ownership, and the quality and realism of the budget, but these will largely only bear fruit in the medium term. These initiatives are the Medium Term Fiscal Framework (MTFF), Performance Budgeting and the pilot Medium Term Expenditure Frameworks (MTEFs). GoAP is also a leader among Indian states in reforms to enhance budget comprehensiveness. These reforms have reduced fiduciary risk in this important respect.

Ensuring that GoAP is able to implement the budget as passed depends upon the realism of the budget's revenue and expenditure estimates, which implies adequate provision for the cost of funding government activities. GoAP's actual revenue is consistently below budget but within a relatively small margin of error. Between 1998-99 and 2000-01, revenue receipts were between 90% and 93% of budget. Revenue forecasting is never 100% accurate in any government and there has been significant improvement in the accuracy of revenue forecasts in 2001-02, actual revenue receipts being 97.5% of the budget, although this improvement has not been totally sustained in the 2002-03 Revised Estimates (RE). The majority (83% in 2001-02) of the variance is driven by divergences between budgeted and actual revenue flows from GoI, although GoAP does make reasonably conservative assumptions in this respect. These variances are one reason for reductions in expenditure in RE, particularly in revenue expenditure.

Since 1999-00 revenue expenditure has been around 8% to 10% below budget, although the variance is narrowing over time. Yet, this does not necessarily imply that expenditure is over-provided for in the budget. GoAP recognises that it generally under-provides for non-salary operations and maintenance (O&M) expenditure, which tends to get squeezed by expenditure demands for salaries and debt servicing. This is reinforced by pressures on State Governments to continue to take on new activities in the Plan budget. While GoAP aims to increase this provision in the medium term, these factors mean that budget estimates tend to under-estimate the full cost of funding ongoing government activities, creating pressures for increases in this expenditure relative to budget. However, this fiduciary risk does not materialise during budget execution as Treasury controls prevent expenditure exceeding budget. Indeed, actual non-salary O&M expenditure is generally lower than budget, due to constraints facing departments in budget execution.



Departmental commitment to implementing the budget as passed may be influenced by the fact that most expenditure is committed in the short term, leaving departments with minimal flexibility year on year. Over 70% of the Plan budget is dictated by GoI and around 80% of the non-Plan budget is consumed by the committed costs of salaries and debt servicing. GoAP's policy decision to avoid retrenchment of staff means that expenditure flexibility can be achieved only in the medium term, through limits on recruitment. This effort to control salaries, together with GoAP's considerable efforts to control debt, should enable increased levels of discretionary expenditure over the medium-term. GoAP is using a MTEF as a tool to link medium term fiscal strategy to the annual budget process to help it achieve these goals.

The challenge of high levels of committed expenditure and departmental ownership is common to many Indian States. The 2003-04 "Draft Performance Budget Exercise" demonstrates that GoAP is taking steps to enhance departmental flexibility and accountability. Performance budgeting aims to focus departments on objectives and activities during budget formulation and to provide them with a greater level of autonomy in formulation of their budgets. However, the benefits of this exercise will be greater in the medium term as declining salary pressures provide departments with more flexibility. Realising benefits from the medium-term control of salary and debt costs will also depend on the progress of departments in reconciling their expenditure strategies with available resources through MTEFs. Expectations of the potential benefits of these reforms must be tempered by understanding of the short term constraints that GoAP and departments face. While the challenges in developing departmental MTEFs mean that it will be several years before the pilot initiatives in Primary Education and Health are spread across GoAP, the MTEF approach is key to developing affordable expenditure strategies.

These budget formulation reforms complement GoAP's pioneering efforts in the areas of budget comprehensiveness and transparency. In these areas GoAP is now a leader amongst Indian states. In particular, GoAP is now treating all borrowing through SPVs as government debt. Furthermore, as all donor financing is channelled through GoI, it is captured in the GoAP budget.

The provision of sufficient and reliable information is key to minimising fiduciary risk. Generally the budget documentation provides comprehensive and detailed information. While the level of detail can mask the "big picture" of where money will be spent, GoAP has made significant efforts to improve user-friendliness, such as through the Budget in Brief. These types of measures strengthen GoAP accountability by increasing the scope for public and Legislative Assembly scrutiny of the budget and its subsequent execution. The subject of budget execution is covered in the next chapter.

## 4. Budget execution

Key to managing fiduciary risk is ensuring that the processes and systems for budget execution ensure that funds are spent on authorised and intended purposes, as expressed in the budget. A key question therefore is the extent to which the budget is implemented as passed, and the extent to which the nature and scale of the divergence poses fiduciary risks of significant concern.

While revenue expenditure is typically less than budget, the correlation has improved in recent years. However, for at least the last two years, actual expenditure has been different from budget allocations at the Grant level, resulting in significant savings and some examples of excesses. The savings reflect factors such as lower than budgeted revenue, delays in release of GoI funds for Centrally Sponsored Schemes, delays in the issue of distribution statements at the district level and administrative bottlenecks. The savings and excesses do not indicate significant risk of funds being spent on unauthorised purposes as, in general, expenditure is less than appropriated and both Supplementary Estimates and “excess expenditure” are relatively low. However, the approval of the Assembly for those Supplementary Estimates is received on an ex-post basis; and excess expenditure remains “unregularised” year after year.

Whilst the Assembly appropriates at the Grant level, GoAP binds departments to appropriations at the sub-head level, in an effort to exercise fiduciary control over expenditure. GoAP has increased the flexibility of HoDs to re-appropriate (within certain limits) in order to respond to changing needs during the year. The extent of these re-appropriations is not known. There are also instances where funds released by Treasury departments for a particular scheme have been diverted to another scheme, the extent of this diversion is not known but is of concern to the CAG.

The relatively low excess expenditure can be attributed to budgetary control at the aggregate and Treasury levels. Indeed, compliance with controls is adequate in the Treasury system and in those departmental areas in which discipline can be enforced through the Treasury system, such as documentation supporting payments; hence the success of GO 507 in targeting key controls. In all other departmental areas (such as cash records, UCs, AC/DC bills and PD accounts) compliance has in the past been generally weak. In the latter three areas at least, GO 507 and other initiatives are strengthening controls and compliance considerably, albeit from April 2002 onwards. Further strengthening is required of other deposit accounts.

A key issue in determining the extent to which the budget is implemented as passed is the level of correlation between budget and actual expenditure. While revenue expenditure is typically less than budget, the correlation has improved in recent years from 89.5% of budget in 1999-00 to 94% in 2001-02. However, at the Grant level actual expenditure has been substantially different from the Budget Estimates for the last two years, resulting in significant savings and some examples of excesses.

While the correlation between budget and actual expenditure differs across grants, the general pattern is one of under-spending. In 2001-02 for example, an overall saving of Rs.3177.34 crore was achieved as a result of a saving of Rs.3605.03 crore in 109 items of grants and appropriations. The tendency for under-spending is partly due to revenue shortfalls, particularly in tax devolution and grants from GoI. Other reasons for the savings reflect factors such as lower than budgeted revenue, delays in the issue of distribution statements at the district level and administrative bottlenecks.

The divergences between budget and actual expenditure occur through a number of formal and informal mechanisms for within-year expenditure changes. A key principle of good practice is that within-year expenditure changes do not provide an avenue for re-writing the budget during execution. The following are the key formal processes for within-year changes to expenditure in AP.



- As data is not published on the number or value of re-appropriations, it is impossible to judge their scale. However, given the restrictions on re-appropriations, the value of re-appropriations is probably not significant. While the Legislative Assembly approves expenditure at the Grant level, GoAP controls expenditure at the Grant level under Revenue, Capital and Loans sections with some restrictions at the sub-head level, although recent reforms do increase the flexibility of line departments. As GoAP moves forward with its plans to gradually develop performance budgeting over time, it will be important that there is clarity about the underlying accountability framework so that there is an appropriate match between departmental flexibility in budget execution and accountability.
- The Finance Department can sanction an advance from the AP Contingency Fund for urgent unforeseen expenditure. It creates little fiduciary risk as it is less than 0.2% of total expenditure.
- Supplementary Estimates are not a significant cause of divergences from budget. Excluding Supplementary Estimates that relate to the repayment of overdrafts and ways and means advances, which are deficit neutral, Supplementary Estimates were only 3.8% of total budget expenditure in 2001-02. However, given that Supplementary Estimates are not submitted to the Legislative Assembly until the last few days of the financial year, the Finance Department authorises the release of much of the expenditure in anticipation of Supplementary Estimates. For example, CAG test checks of a sample of departments revealed 67 cases worth Rs.292.76 crores in 2001-02. In these cases, the Legislative Assembly's approval is effectively retrospective.

There are also some informal mechanisms for within-year changes to expenditure. An important example is the diversion of funds released from Treasury for a particular scheme. This has been a repeated feature of the CAG's audit reports for some years. The 2000-01 and 2001-02 CAG Audit Reports note higher value instances of diversions of funds over the period 1991 to 2002 of Rs.196.61 crore in the 2001-02 Audit Report and Rs.95.04 crore in the 2000-01 Audit Report. Overall, the diversion of funds appears to be insignificant relative to total expenditure over the ten year period (for example, annual expenditure in 2001-02 was Rs.31,583.34 crore). Although not alarming, there is scope to minimise these with improved controls, as the funds are not restored to the original scheme until year-end when they cannot be spent; in some cases, the funds are never restored. The expenditure will have been recorded under the original scheme, rather than under the scheme under which it is actually spent.

There are also instances of "excess expenditure" accounting for around 1% of total expenditure in 2001-02. There are two main reasons for this excess expenditure: first, authorised relaxation of Treasury controls in anticipation of Supplementary Estimates that were not provided; secondly, non-control items which are not checked against budget during budget execution. However, it is not possible to identify the relative importance of these different causes or whether they are other causes. The Appropriation Accounts do not provide a summary of the causes of excess expenditure. Instead only individual reasons are given by departments for each excess and these reasons are often simply that the budget provision was not sufficient. In a similar fashion, departmental explanations for savings are also often not intimated or are insufficient. And, there are delays in the regularisation of excess expenditure. For example, 115 cases of excess expenditure incurred without provision, either in the Budget or Supplementary Estimates, totalling Rs.1,976.35 crore for the years 1997-98 to 2000-01, had not yet been regularised by the Legislative Assembly. In addition, 61 cases totalling Rs.427.69 crore of excess expenditure during 2001-02 will also require regularisation. This is consistent with a similar pattern across India.

All of the above changes in expenditure are required to be reflected in the RE. It is also at the RE stage that GoAP will make any overall reductions required due to revenue short-falls or under-spending by departments. While REs are not approved by the Legislative Assembly (only increases in expenditure

through Supplementary Estimates), it is positive that these changes are now made through the RE process, rather than 'freeze orders' or delays in budget releases. However, the changes from Budget Estimates at this stage can often be significant and are distributed unevenly across departments. There are also relatively large divergences between REs and actual expenditure. For example, actual expenditure for Science and Technology was 92% of the budget estimate in 2001-02, despite an RE of 53.9% of Budget. Another example is Social Welfare, which expected to spend 93% of its 2001-02 original budget at the time of RE, but actual expenditure was only 74.5% of budget. This suggests there is scope for strengthening the accuracy of REs.

Differences between budget and actual expenditure can no longer be attributed to delays in the release of spending authority at the departmental level. GoAP has made significant progress in improving the timeliness of expenditure authorisations by way of Budget Release Orders (BROs). In fact, Centrally Sponsored Schemes provide the only examples the SFAA team has identified of delays in budget releases by the Finance Department. Lower than forecast grants-in-aid from GoI prevent the release of funds, and the matching State grants, for some Plan schemes. Lower than forecast Plan expenditure accounted for around 56% of the variance between budget and actual revenue expenditure in 2001-02.

Despite these improvements in budget releases, controls testing suggested that there still are significant delays in the issuing of distribution statements by departments to COs and DDOs. These delays could reflect under-spending against previous releases by district offices. However, they are likely to contribute to the 'March rush', with departments spending a large proportion of their budget in the last month of the fiscal year. For example, in 2001-02, 22% of annual expenditure was spent in March 2002, albeit representing an improvement from 2000-01 when 34% of the year's budget was spent in March 2001 alone.

GoAP's cash management has been sufficient to provide departments with greater predictability in budget releases and not resort to expenditure freezes in recent years. GoAP's tight cash position has posed some threat to this record. During 2000-01 and 2001-02, GoAP was either drawing on the ways and means advances or was in overdraft, except for ten weeks and four weeks respectively. There is evidence that GoAP's new electronic cash monitoring system is paying dividends. According to the Budget speech, GoAP had gone into overdraft for only 17 days in the year to December 2002.

Controls testing at the departmental levels revealed adequate controls and compliance in the main areas of payment transactions, except for budgetary control by DDOs and controls over cash and local bank accounts. The latter was particularly poor at district and field levels where cash books were not being regularly updated, closed, having balances struck, tallied with cash, being verified by management or being reconciled with local bank accounts. Furthermore, some of the local bank accounts, which were opened for the deposit of monies received for the various schemes, were neither authorised nor mandated by the schemes. And, interest earned on these bank accounts is not being surrendered to the Consolidated Fund.

Examination was also undertaken of a number of risk areas which involve the grant or advance of funds and which have a history of weak controls. These areas are amongst those targeted by GoAP in GO 507. The key results are as follows.

- Low levels of accountability for grants-in-aid are being tackled. Grants-in-aid constituted 32% of expenditure in 2001-02, yet grant receiving bodies have a poor record for submission of Utilisation Certificates (UCs), finalisation of their accounts, statutory audit of their accounts and response to audit observations. Until GO 507, new grants were given although UCs were outstanding. GO 507 is prompting grant receiving bodies to act in these areas. Yet, controls testing revealed that UC registers are still generally not maintained or kept updated.





- Inadequate controls over AC/DC bills are being strengthened. There has traditionally been a high level of AC bills pending adjustment by DC bills; GO 507 has addressed this problem to a significant extent, including by divesting the CO of responsibility for overseeing the expenditure he has sanctioned in the AC bill. In all cases tested, DCs were now being submitted within three months of the AC bills. Prior to GO 507, AC bills were only submitted after many months, if at all. Controls testing indicates that the register of AC bills is now being adequately maintained.
- High outstanding balances of loans and advances to municipalities, local bodies, Panchayat Raj institutions, totalled Rs.8,172.17 crores as at 31 March 2002. Manual records of loans and advances are maintained. The CAG is concerned at the high risk of misclassification, with high levels of unreconciled balances between the closing balances shown in the AG's main/control accounts and the Finance Department's detailed accounts. No specific action is taken to recover overdue amounts and new loans and advances are still being paid to institutions from whom loans and advances are overdue. As a result, 32% of loans and advances were overdue for recovery at 31 March 2002, of which 40% had been outstanding for more than 3 years. If GoAP does not intend to recover the loans and advances, the proper accounting treatment would be write off the loans and advances as irrecoverable.

Controls testing of DTOs in five districts indicated that the Treasury system does provide a generally adequate level of control and a reasonably reliable basis for accounting records (which form the basis for the compilation of the statutory Accounts). GoI's assessment of Treasury systems in other States has led it to a different conclusion; the result has been an India-wide policy for the funding for some schemes, such as the District Primary Education Project (DPEP), to be channelled directly to the implementing department/agency without routing them through the Treasury departments. The result in AP has been weaker financial control and accountability than in schemes receiving funds through the GoAP Treasury system. GoAP has thus joined other States to ask for the funds for such programmes to be passed through the State Government in future.

GoAP is increasing its control over, and the transparency of, lapsable PD accounts, which have been a source of major concern in recent years. The total balance in the PD accounts totalled Rs.115.26 crores as at 31 March 2002. Measures now limit opportunities for non-utilisation of funds provided for specific purposes and for the diversion of funds between schemes, and seek to ensure refund of lapsed balances.

Finally, departmental offices do not maintain a consolidated record of commitments, such that these could be used as an aggregate control. This creates a risk of expenditure commitments being greater than budgeted through excessive arrears generation.

## 5. Accounting

Robust accounting arrangements play a critical role in minimising fiduciary risk, by enabling financial monitoring and reporting, which, in turn, enables financial control and stakeholders to hold the government to account. The timeliness and reliability of GoAP's accounting has undergone significant improvements in recent years. Planned reforms, such as the integration and connectivity of financial systems, look promising.

However, fundamental weaknesses remain; a number of these, such as the accounting policies which impact on the relevance of the accounts, lie outside GoAP's direct control. Others, such as the minimal role of departments and GoAP in accounting, can only be tackled in the medium term. In order to moderate the levels of fiduciary risk in the short term, GoAP must tackle the timeliness of all key reconciliations and control over the Public Account. Overall, GoAP should be commended for the efforts it has made and continues to make. That accounting is at the forefront of reform in GoAP is creating an overall sense that 'something is being done', and this does appear to be changing understanding and behaviour, albeit gradually and thus far in selected areas only. In truth however, many of the challenges for accounting can be traced back to the field level where, during budget execution, motivation and capacity to strengthen accounting controls are low. Once the overall accounting systems are in place, the challenge facing GoAP is to work with the departments to extend the reforms further into the field.

The allocation of accounting roles and responsibilities in India differs from good practice. At the State level, it is the Treasury departments rather than line departments which process transactions and render accounts to the CAG. There is evidence that this undermines the accountability of line departments, particularly as department-wise accounts are not compiled. And, it is the CAG who generally compiles, prepares and submits the accounts of each State to the Governor, who presents the Accounts to the Legislative Assembly. This raises the risk that GoAP will not assume full accountability for its Accounts. In general, this does not appear to be so, evidence being GoAP's accounting reforms. Also, GoAP has a greater role in accounting than other States except Tamil Nadu. However, GoAP should work in closer co-operation with the AG to manage the Public Account. Note that GoI ministries have already moved to processing their own transactions and producing departmental accounts, and GoI and Government of Goa have opted to assume responsibility from the CAG for compiling their accounts.

GoAP is constrained in its accounting by India-wide Government Accounting Rules, Account Codes and General Financial Rules which form the basis for the AP Financial Code, AP Accounts Code and AP Treasury Code. These Rules and Codes do not clearly define and explain the accounting concepts and policies on which the detailed accounting procedures are based. This could breed a divergence between accounting 'theory' and 'practice'. The need for clarity has prompted the recent establishment by the CAG of the Government Accounting Standards Advisory Board (GASAB), charged with formulating Accounting Standards to bring "proper identity to the existing concepts enshrined in the current rules". These standards will limit the scope for differences of opinion about accounting treatments.

The India-wide Rules and Codes also insufficiently support the needs of the users of accounts, in their desire for relevant, understandable, reliable and comparable financial information. Specifically, the cash basis of accounting is prescribed for all of India. Cash accounting has many advantages: it is a relatively clear and objective form of accounting, easily understood and one which enhances financial control. However, it does not reflect information relevant to users about expenditure "incurred" and receipts "earned", nor about other assets and liabilities of Governments. Thus, the accounts could mask significant commitments and arrears, greater than the usual year-end spillover arrears, but no evidence has come to light that this is the case for GoAP.



A key dimension of relevance is the provision of financial information on a timely basis. GoAP has significantly strengthened the timeliness of its Treasury departments' monthly rendering of accounts to the AG, including by extending the PAO function to the Public Works Divisions (PWD) and Forest Divisions, and via computerisation. The year end accounts are consistently completed by 30 June (albeit not published until October/November). Both monthly and year end accounts are now produced on a timely basis. Furthermore, GoAP is increasing the reliability of its accounts, by strengthening:

- Accounting system integration and connectivity between the plethora of accounting systems. Compilation of Treasury Accounts (C-TAS) is a reasonably reliable system, but e-khazana and the Integrated Financial Information System (IFIS) will reduce the inefficiency and risk of error present in the monthly rendering of accounts by Treasury departments and manual re-entering of data by the AG;
- Reconciliations, which are a key accounting control and play a particularly critical role in the absence of integrated financial accounting systems. GoAP's introduction of GO 507 in April 2002 has directly resulted in DDOs/COs now undertaking timely reconciliations with the STOs/DTOs. And, reconciliations are satisfactorily undertaken by DTOs and by the AG with the banks. However, there are still large amounts of departmental unreconciled expenditure: at 31 December 2002, unreconciled amounts for 2001-02 was Rs.4,870.37 crores for all expenditure heads and Rs.3,395.07 crores for loan heads (comparative figures for 2000-01: Rs.3,335.31 crores and Rs.1,389.09 crores). Therefore, until the following reconciliations are promptly undertaken, the reliability of the accounts will be significantly impaired :
  - By CCOs with the AG, with serious consequences for the reliability of the accounts;
  - by departments in the twin cities with the PAO (Hyderabad);
  - by the PAO (Hyderabad) with cheques encashed by the bank. Unreconciled amounts total Rs.317.37 crores at 31 March 2002;
  - by the PAOs (Works and Projects)/PWDs and the divisional officers of the figures of actual cheques issued with those encashed, for the amount authorised and paid to the recipient with the records available in the Treasury.

Finally, weaknesses in the management of the Public Account must be tackled urgently. First, there are huge unreconciled balances between the closing ledger balances of the Public Account shown in the AG's main/control accounts and the detailed accounts maintained by AG, and secondly, there are certain accounts in the Public Account which are at higher than average risk of poor controls and incomplete and untimely accounting. These accounts include the following.

- Both the AP Government Life Insurance Fund (APGLI) and Class IV employees GPF are poorly controlled. In APGLI, Rs.128.67 crores (23%) of the balance has not been posted to individual subscribers' accounts as at 31 March 2000; accounts have not been produced since 1995-96; reconciliation with the AG is not undertaken. Similarly, 5% of Class IV GPF items remain unposted each year by the DTOs.
- Public Works remittances by PAOs (Works and Projects) are not being reconciled promptly with the DTOs, with delays of up to 27 months, as noted under 'reconciliations'. The balances outstanding under this account as at 31 March 2002 are Public Works Remittances totalling credit Rs.108 crores and Forest Remittances totalling debit Rs.49 crores.
- 'Suspense accounts' have seen a 295% increase to Rs.466.21 crore between 1999-2000 and 2001-02. Entries in these accounts lack transparency, and can mask misclassification, misappropriation, non-settlement and expenditure details.

The next chapter examines how accounting information is used for the purposes of monitoring and financial reporting.

## 6. Monitoring and reporting

The provision of timely and accessible financial information for monitoring and reporting enables financial control and effective scrutiny of PFM, and thereby helps to ensure that funds are spent on authorised or intended purposes, as expressed in the budget.

GoAP's efforts at increasing the timeliness and reliability of monitoring reports by improving reconciliations at CO/DDO level are commendable. However, the reliability and format of monitoring reports requires further improvement to enable proactive and effective departmental monitoring and financial control throughout budget execution.

The constraints placed by India-wide reporting formats seriously limit the relevance and understandability of GoAP's Accounts, and hence the scrutiny enabled by them. GoAP has made tremendous strides in containing fiduciary risk by increasing transparency and accessibility by publishing other financial reports. Despite this, the primary focus of the Legislative Assembly, the media and civil society tends to be on the budget for the forthcoming year and on certain areas of the Accounts, such as debt and contingent liabilities.

Monitoring is undertaken at both a departmental and aggregate level on a monthly basis. While departmental monitoring reports are produced on a timely basis, their reliability has been undermined by:

- The often serious lags in the provision of monthly expenditure statements from the DDOs. For example, as at end January 2003 only one Primary Education district was up to date in submitting monthly expenditure statements (although DSE should be commended for actively seeking to improve submission times). Similarly, delays in submission of monthly statements meant that Primary Health's monitoring report for the year to December 2002 only included actual data to September 2002, relying on budget release data, rather than information on actual expenditure;
- A poor record of departmental reconciliations, as noted in 'Accounting'. However, GO 507 has increased the frequency of reconciliations of DDOs and COs with the Treasuries.

The format of departmental monitoring reports could also be revised in order to strengthen their usefulness to departments in within-year expenditure management and control. In particular, the usefulness of monitoring information could be strengthened by providing cash/expenditure profiles (a comparison of actuals for the year to date with expected expenditure for that period rather than with the budget as a whole); an analysis of the underlying causes of variations from budget; a breakdown of control and non-control items; and an object-head breakdown of non-Plan expenditure. Creating a correlation between the expenditure monitoring and physical performance reports would also strengthen the usefulness of the reports. GO 506 was issued in April 2002 to this end, but departmental compliance with this is not known.

The aggregate monitoring reports are produced promptly after the month end and are sufficiently reliable to enable effective monitoring GoAP-wide. Monthly aggregate expenditure and revenue monitoring reports are prepared in GoAP. Increasing revenue enhancement has been a priority for GoAP; hence, monthly revenue monitoring meetings are held with the Chief Minister.

GoAP's financial reporting in the Appropriation Accounts and Finance Accounts is undertaken on a consistently timely basis, in November/December of the subsequent financial year. However, the relevance to users of financial information in the Accounts is constrained by the India-wide cash basis of accounting and reporting formats, which are neither transparent nor user friendly. The India-wide Accounts do not provide adequate financial information in a useful format in the following areas.



- Financial results: Expenditure has not previously been disclosed by department. The Accounts disclose only up to minor head (programme) level (unlike the Detailed Demands for Grants which disclose to a more detailed level). Salaries, grants-in-aid, subsidies and externally aided schemes are below the minor head level, and consequently are not clearly disclosed to the reader of the Accounts. No disclosure is made of the gross advances drawn from the Contingency Fund for various functions and recouped during the same year. Only the net amount and unrecovered amounts are disclosed;
- Financial position: the Accounts do not disclose separately externally aided loans funnelled through GoI or departmental/institutional details of recoveries in arrears of loans/advances. As India adopts the cash basis of accounting, the Accounts do not fully disclose assets and liabilities, although GoAP has chosen to disclose government guarantees;
- Cash flow: GoAP's cash flow statement is presented in the Finance Accounts, but as an Explanatory Note, and only at a very high level.

Accounts at a Glance is not part of the statutory Accounts, but is produced by the AG together with the Accounts and contains extremely useful summaries and some analysis. GoAP has sought to overcome the constraints of the India-wide formats by publishing the AFF and Budget in Brief with significantly improved disclosure, and in user friendly formats, in many of the key areas noted above. For example, they disclose the cash flows resulting from revenue, expenditure, and financing of the deficit at an appropriate level of detail, and ensure that the key facts are highlighted. Relevance to users could be enhanced further by disclosing (as memoranda) guarantees extended during the year, pension obligations, commitments and arrears, fixed assets, and stock of liabilities inclusive of those on Public Account.

The India-wide reporting formats do not provide for adequate disclosure of divergences between budget estimate and actual revenue/expenditure in the Appropriation Accounts. Variances are reported at too detailed a level with more significant variances masked. Furthermore, the 'reasons' for the savings/excesses provided by departments simply note what type of expenditure accounted for the variance, without informative analysis of the causes of the divergences. And, neither the Appropriation Accounts nor any other document discloses the Budget Estimates, Revised Estimates and actual for one complete year. It is necessary to flick through at least two budgets to assemble this information.

## 7. Asset management

Asset management is an area that any government concerned with fiduciary risk must tackle. The link with fiduciary risk is clear: in governments worldwide, poor controls over stocks, stores, assets, land and buildings have resulted in widespread theft and misuse.

As in many governments worldwide, the standard of asset management in GoAP is very weak. There is a widespread need to strengthen safeguards over assets so as to reduce the significant to high risk of loss and general wastage of its public resources. Risk is also heightened by the lack of relevant and reliable information about assets. A particularly effective measure would be to require offices and departments, and ultimately GoAP itself, to regularly report on its assets. Increasing transparency in this way would be a strong systemic motivation to improve discipline and accountability.

Asset management is the only area of PFM in which reforms have not made any headway. FRIC has drafted a paper on stock and asset registers and a Cabinet sub-Committee has been convened to examine asset management, but no action has been initiated as yet.

The India-wide Government Accounting Rules and General Financial Rules form the basis for the core asset management texts, being the AP Financial Code, AP Accounts Code and the District Office Manuals. The Codes and Manuals suffer significant weaknesses that increase the risk of divergence between rules and practice, in that they:

- Emphasise formats without sufficiently clearly stating the underlying principles or objectives;
- Apply definitions inconsistent with best practice;
- Do not prescribe some essential details (for example they do not require detail of the location, status or the exact description of the asset);
- Are incomplete in their coverage, for example of modern equipment and machinery;
- Adopt a style and format that is antiquated and not user friendly;
- Are not formulated as a coherent whole.

The Codes require three key sets of controls to safeguard GoAP assets, being:

- Physical controls, compliance with which was broadly adequate;
- Stock and asset registers. The maintenance of these is extremely poor, both because the requirements do not enable sufficient control and because of poor compliance with the existing requirements. Stock and asset registers are generally maintained but with insufficient information to enable the item to be properly utilised or to be physically verified; for example, they generally omit a full and clear description of the item or its location. Given that balances are infrequently struck in the stock registers and assets are rarely tagged, numbered or otherwise identified, neither the stock nor asset registers serve as a useful tool against which to check the actual items. Registers of land, buildings and works are not generally maintained at the field office;
- Physical verification by management. This verification ranges from very weak to non-existent. For example, the attestation by the Head of Office of stocks tends to be of the mathematical accuracy of the receipts and issues, rather than physical verification of the actual assets; there is little evidence of annual physical verification by the Head of the Office; and inspections by the COs tend to be of the records rather than of the physical items, cross-checked to the records. Even in the few cases noted where physical verification is undertaken and verification reports are produced, there is scant evidence of follow up action being taken as a result.



The impact on fiduciary risk of these poor controls is reinforced by the absence of independent physical verification as the CAG's audit also focuses exclusively on the standard of maintenance of the stock and asset registers. The usefulness of an audit which does not check the existence of the items themselves must be questioned. The absence of physical verification by auditors is a major contributory factor to poor safeguarding of these assets.

Fiduciary risk is heightened by the lack of relevant and reliable information about assets. The weaknesses in asset management can be traced in part to the fact that, in India, Governments do not report on their assets as they follow the cash basis of accounting. It is well recognised that there is generally a direct relationship between the quality of management of resources and the extent to which they have to be reported on publicly, as transparency engenders accountability. Yet, assets could be reported on by way of memoranda to the accounts even under cash accounting and reporting.

Furthermore, departments and offices do not submit periodic management reports on their assets, for example on the number, type and value of assets held. Increasing reporting and transparency in this way would be a strong systemic incentive for HoDs to improve discipline and accountability for assets and their management.

## 8. Debt management

A pro-active approach to debt management is critical to developing realistic budgets that are consistent with fiscal constraints and managing debt within affordable limits.

GoAP has now identified medium term objectives for the level of debt in its fiscal strategy paper and progress against these objectives is reported in the Annual Fiscal Framework. These objectives have not been entrenched in legislation.

GoAP has, in recent years, made significant efforts to improve the transparency and comprehensiveness of reporting on debt levels, which has strengthened the ability of the Legislative Assembly and the public to hold the Government to account.

GoAP faces a number of systemic constraints in determining its debt levels. A major portion of its debt is due to GoI and Plan expenditures have largely been financed in recent years from borrowings, as in most States. It is commendable, in these circumstances, that GoAP has chosen to set out a medium term objective of keeping debt within sustainable levels. The Strategy Paper on Fiscal Reforms and the MTFP highlight GoAP's aim of 'stabilising' its debt at around 31% of GSDP from 2006-07. While presenting the budget for 2003-04 the Finance Minister highlighted that debt would increasingly be used for capital expenditures and gross capital formation and that by 2005-06 revenue surpluses would also be generated for financing these. The explicit enunciation of a debt policy by GoAP also enhances the potential for the Assembly to undertake more focussed legislative scrutiny of debt management.

There is also an issue over whether it would be appropriate for GoAP to entrench fiscal objectives and reporting for debt in legislation. While there are currently no legislative restraints on debt policy, GoAP has committed to its debt objectives in the fiscal strategy paper, and has also made a commitment to report progress against these objectives, on an annual basis, in the AFF.

The capacity of GoAP to manage the cost of debt servicing in relation to its debt stock, and to explore alternative debt instruments, is limited as the bulk of GoAP's outstanding debt is to GoI. GoAP is exploring opportunities to minimise the cost of debt servicing and plans to strengthen institutional capacity for debt management by appointing consultants and by establishing a Debt Management Cell in the Finance Department.

Transparency in debt reporting has increased in recent years with the inclusion of outstanding public debt in the Budget in Brief and the bringing of off-budget borrowings into the budget and accounts. The total debt liabilities, including those under the Public Account, are disclosed in the Finance Accounts and the 2003-04 AFF, but the Budget in Brief gives only the stock of public debt under the Consolidated Fund. This notwithstanding, the increased transparency has enabled greater scrutiny of GoAP's debt management.





## 9. Contingent liabilities

Contingent liabilities can pose significant fiduciary risk. If they are realised, without having been adequately provided for, they imply either the diversion of budget expenditure or an increase in deficit and debt levels. Therefore, it is important that GoAP's contingent liabilities are carefully assessed, monitored and provided for where possible. Containing the fiduciary risk also requires their adequate disclosure.

GoAP has made tremendous strides in its treatment of government guarantees. Steps taken to provide for realisation of the liability and ensure greater transparency should substantially reduce the level of fiduciary risk arising from guarantees. GoAP's plans to extend the same level of prudence in providing for pension liabilities are promising.

Guarantees are the most important form of contingent liability for GoAP. These increased potential GoAP debt by around 10 percentage points of GSDP in 2001-02. Proposals for guarantees require the agreement of the Finance Department and GoAP intends to strictly enforce the requirement for adequate scrutiny of guarantee proposals; this would include, henceforth, a rigorous assessment of risk prior to extending a guarantee. This scrutiny could be rendered somewhat difficult, however, by the fact that the majority of guarantees are to cover loans to PSUs by GoI financial institutions. Given the composition and mix of government guarantees and the record of the recipient entities in honouring their financial commitments, GoAP is of the view that the flat guarantee fee that is charged adequately provides for the inherent risk.

GoAP is now providing for the realisation of guarantees through the establishment of a Guarantee Redemption Fund, into which contributions are made on the basis of risk assessment. This will significantly reduce the fiduciary risk from guarantees, by moderating the impact of their realisation on budgeted expenditure or debt levels. Restructuring, including closure if necessary, of State public enterprises (cooperatives included), which is being separately undertaken, will further reduce Government's need to provide guarantees and consequently its exposure to contingent liabilities.

Pension liabilities, GoAP's other major non-debt liability, are provided for in the budget on a pay-as-you-go basis. Provisions are typically made by way of a mark-up over the previous year, as GoAP does not have centralised statistics on existing or future pensioners to enable a calculation of the liability on any technical or actuarial basis. GoAP has recently commissioned a study of the demographic profile of its employees to enable a projection of the future pension liability with greater precision and to make contributions accordingly into a Pension Fund, which will be formally established shortly.

A list of guarantees given by GoAP is available in Volume V/4 of Part II of the Explanatory Memorandum to the Budget. It is only in the Finance Accounts that a more easily accessible list is available. In the interest of greater openness and easy accessibility of information to the public it is commendable that summary information has been included in the 2003-04 Budget in Brief. Once GoAP has a reasonable basis on which to estimate its pension liability over time, it should also disclose this in its budget and other financial documents.

## 10. Internal controls

Effective internal controls are a prerequisite to containing fiduciary risk, being the risk that funds might not be spent on authorised or intended purposes. In particular, controls aim to narrow the divergence between rules and practice. Evidence gathered suggests that prescribed controls in GoAP are sufficient in many areas; outdated and inadequately clear in others. Compliance with controls is adequate in the Treasury system and in those departmental areas discipline in which can be enforced through the Treasury system. In all other departmental areas, compliance is generally weak. Compliance is poorest at the DDO level in the field. The reasons for the divergence are many and diverse, but in general they relate to the overall control environment and accountability. The current departmental internal audit arrangements are unlikely to have a positive impact on controls and compliance.

The thrust and effectiveness of reforms in targeting specific controls are extremely promising: GoAP is proactively reducing inherent risk and tightening controls, through, for example, introducing direct payment of salaries into bank accounts, computerisation, enforcing reconciliations, and monitoring of PD accounts. Complementary reforms will be required to bring about sustainable change in the control environment in the medium term. HoDs must increase their commitment to ensuring adequate controls and compliance in their area of responsibility; regular reporting by them on the status of their controls would enhance their sense of accountability. Strengthened annual departmental inspection and internal audit functions would be powerful tools strengthening their ability to monitor and evaluate risks, controls and compliance, and report thereon.

Evidence about specific internal controls is set out throughout this report. The assessment below addresses only generic aspects of internal controls most directly related to fiduciary risk in GoAP. Controls testing raised some overarching issues, as follows.

- Computerisation and increasingly sophisticated equipment are presenting new challenges for fiduciary risk. Data security and secure records management are critical. Offices tested did not have IT policies (on backup, movement of data, maintenance, hardware and software), adequate back up arrangements and Disaster Recovery Plans or arrangements for alternative activity continuity facilities. Manuals must be revised promptly to ensure that they stay relevant and promote compliance. Staff require training in order to be confident in the use of technology, and contain the risk of error or loss of data.
- Understanding and appreciation of internal controls was relatively low amongst many officials, particularly at the field level. Departmental and Functionary Manuals do not cover the fiduciary responsibilities of departmental officials.
- HoDs and other managers are not adequately fulfilling their responsibilities for internal controls. They must display a more positive attitude to controls, and set the example for their staff to follow. Mechanisms are required to strengthen HoDs' and other managers' sense of accountability for internal controls.
- Managers, and COs in particular, must receive adequate training to enable them to manage their fiduciary responsibilities, and supervise staff working in these areas.

There are two key tools that, worldwide, have proved effective in increasing understanding and managerial accountability for internal controls, and thereby reducing fiduciary risk. The first is periodic formal risk and control assessment exercises. GoAP does not presently undertake such exercises.



The second is internal audit, the role of which is to undertake both the periodic assessments and, on an ongoing basis, evaluate and report to the head of the institution on the effectiveness of the internal control system, highlighting any deficiencies and the risks they pose. Internal audit is a relatively new phenomenon in State Governments in India. In GoAP, internal audit is undertaken only wherever the DTA has placed a Chief Accounts Officer (CAO) in a Directorate, i.e. in 20 Directorates. The CAO supervises the internal audits and reports to the HoD. Action to improve internal audit's effectiveness is required in the following areas.

- They lack the required objectivity and independence. The internal audits are undertaken by staff drawn from departmental functions, normally the Accounts Wing. Neither the staff, nor the CAO, are independent of the finance and accounts process. This fact renders the audits more akin to departmental inspection than internal audit.
- The auditors have passed departmental accounts examinations but have no specific internal audit qualifications; expertise in the purpose and methodologies of internal audit needs strengthening.
- The level of resources devoted to audits has been insufficient; this partly explains their hitherto inadequate coverage and timeliness (for example, district offices have been visited on average once every five years). The DSE is showing promise in this respect: it audited thirteen DEOs in 2002 and plans to audit the remainder in 2003.
- Responsiveness to internal audit has been extremely poor. Even the relatively more valuable internal audits undertaken by Primary Education in 2002 had not generated any responses from district offices as at February 2003. This is due to a number of factors, including the absence of internal audit committees at the district level.

The Treasury Departments' departmental inspection system seems to be more effective, although it also lacks the independence required of an internal audit function.

The Finance Department has launched an internal audit initiative in GoAP. An internal audit manual has been developed, through an intensely participative process involving Treasury officials, departmental CAOs and Chartered Accountants with private sector experience of internal audit. This manual will serve as the basis for the eventual rolling out of internal audit across GoAP. The first step will be the establishment of an internal audit cell in Finance Department. Teams comprising a Treasury official, a departmental representative (for example the CAO or Joint Director) and a Chartered Accountant will undertake audits of a department, reporting to the Finance Department. The report will be copied to the HoD, who will be required to report back on follow up actions taken. The initial focus of the audits will be on compliance with GO 507.

Internal audit has the potential substantially to reduce fiduciary risk; it is imperative that effective internal audit units (staffed by professionals with proven records of integrity) are established across GoAP, reporting to the HoD to build his accountability for internal controls, and that this initiative receives the requisite resources. The CAG could play a useful role in the internal audit initiative, without compromising his independence. The role of the CAG in external auditing is examined in the following chapter.

## 11. External auditing

The role of the CAG external audit function is to report to the Legislative Assembly on the exercise of PFM by the executive. The CAG thus stands at the apex of public accountability, with the potential to play a critical role in containing all dimensions of fiduciary risk. The CAG undertakes relatively high quality work in AP, and the Audit Reports ably reflect his insights and professionalism.

However, the system of audit needs strengthening in some key areas, for example by encompassing physical verification and increasing risk based audits/investigations into areas of potentially major irregularity. The form of audit reporting warrants change to clarify the opinion of the CAG on the Accounts and PFM. The responsiveness of government departments to audit observations is now being improved, following the introduction of GO 507. The Audit Reports are not considered by PAC on a timely basis. These factors combine to limit the extent to which audits can act as a deterrent to financial irregularities or result in systemic improvements across government. Signs of improvement are to be seen only in GoAP's rate of responsiveness to audit observations and timeliness of PAC's scrutiny.

Independence is the most single important quality of any Supreme Audit Institution such as the CAG. The CAG's independence from Government is well established in both the Constitution and in practice. This independence enables the CAG to comment freely on the extent to which GoAP has spent funds on authorised or intended purposes. The integrity of the audit staff has to be watched closely to uphold the credibility of audit. One question of objectivity remains however. The Constitution provides for the CAG to have a dual role, for both compilation and audit of the accounts. While accounts compilation is undertaken by the AG (Accounts Wing) and audit by the AG (Audit Wing), both wings fall within the overall responsibility of the CAG. And, as noted below, the CAG certifies both the Accounts and the Audit Reports. This is a highly unusual arrangement, divergent from international good practice.

The Constitution and the CAG (Duties, Powers and Conditions of Service) Act 1971 clearly set out the CAG's jurisdiction and grant the CAG the right of access, inspection and information. However, this right is supported by neither penalty nor sanction for the auditors to impose in the event of non-compliance nor power to enforce the implementation of its audit findings. The latter point is a major concern of a National Commission, which is considering mechanisms by which the CAG might be better enabled to enforce that implementation.

GoAP recognises that departmental responsiveness to audit observations needs improving, as consistently reported by the CAG in his Audit Reports. As at August 2002, Action Taken Notes (ATNs) had not been submitted to the PAC in respect of 47 out of 63 audit paras in 2000-01, 49 out of 69 for 1999-2000 and 26 of 64 for 1998-99, despite the deadline being three months of presentation of the Audit Reports to the Assembly. And, as at the end of June 2002, 83,305 audit paragraphs from Inspection Reports remained unsettled, albeit down from 85,256 at end June 2001 and 91,246 at end June 2000. Examination of responses in case study departments indicates that, not only do many unsettled responses date back as long as 15 years, the quality of responses is relatively low. The quality of responses also tends to be poor. GO 507 is improving the rate of responsiveness: for example, up to end March 2003, the threat of rejection of bills by DTOs for want of confirmation of cleared audit paras had resulted in 79% of audit paras pending at 31 March 2002 being cleared. This is proving less effective in PAOs (Works and Projects) where 67% of audit paras were still pending at 31 March 2002. A number of factors explain GoAP's record in responsiveness, including the compliance nature of audit observations which reduces the motivation of officials to respond, particularly if the



rule which was not complied with is viewed as impractical. Changing the balance of audit observations to those of a more value added and constructive nature should increase departmental responsiveness and allow the CAG to play a more positive role in enabling improvements to systems and controls across GoAP.

The audit approach is generally adequate, and could reasonably be expected to uncover many fiduciary risk factors, such as extra-budgetary activity and divergences from the budget. However, the further containment of fiduciary risk would benefit from a shift of audit focus to physical verification, and to a more risk based and investigative approach to highlight major cases of systemic failure, irregularity and other cases of public concern.

The CAG's main reporting mechanism is the annual Audit Reports, which are generally presented to the Legislative Assembly in late March of the year following the year of account. Audit reporting in India differs from standard international practice in several important respects. Firstly, the CAG signs off both the Accounts and the Audit Reports. Furthermore, the views expressed by the CAG in those Accounts and the Audit Reports can differ somewhat from each other. Secondly, the Audit Reports do not offer a standard audit opinion, such as is seen in the audit certificate of the accounts of all other governments and corporate entities. They do not contain a certificate which, in clear, unequivocal and generally accepted terms, expresses the CAG's opinion that, for example, the Accounts "properly present" financial transactions or are "true and fair". Rather, it is the CAG's certificate in the Accounts that serves as both an accountant's certificate and audit certificate, thus reflecting the inherent conflict of the CAG's dual role. The certificate states that the Accounts "have been prepared and examined under my direction" and that "according to the best of my information, as a result of audit of these accounts, the accounts now presented are correct subject to the observations in my Reports". Thirdly, the presentation of the Audit Reports is four to five months following the presentation of the Accounts to the Assembly in the previous November, whereas the two would ideally be read together to enable the reader to understand the CAG's observations (subject to which the Accounts were considered to be correct).

These comments notwithstanding, the Audit Report's standard of content, written in a clear and balanced manner, compares well to good practice internationally. The audience for the Audit Reports is the PAC. The role of the PAC, and other aspects of legislative scrutiny, is examined further in the following chapter.

## 12. Legislative scrutiny of public finances

Legislative scrutiny is key to managing fiduciary risk as it serves as a robust systemic 'check and balance', ensuring the accountability of the executive for its usage of public resources.

The AP Legislative Assembly and its committees - the Estimates Committee and the PAC - have a long-standing and well-established role in scrutinising public finances.

Both the Estimates Committee and the PAC play their role with a high degree of application, with the assistance of the Principal Accountant General. Their scrutiny of individuals and issues is rigorous and detailed. However, the PAC itself has been feeling the need to improve the timeliness of their scrutiny, to be more effective and contribute to the improvement of the system of PFM and accountability. The recent decision of the PAC Chairman to divide the time of PAC between recent years and the previous year augurs well for holding the Government and its officials to account in a quick and effective manner.

The role of the Legislative Assembly in budget approval is provided for in the Constitution. An important recent reform in Legislative scrutiny was, for the first time in AP and in India, the presentation of the draft Budget to the public (including their representatives) for comment before it is submitted to the Legislative Assembly for approval. The Estimates Committee assists the Assembly during budget formulation and approval to "suggest the form in which the estimates shall be presented in the Legislative Assembly", but does not analyse the budget appropriations. Unlike GoI, GoAP has no other standing committees in the Legislative Assembly, whose responsibility it would be to develop expertise in specific sectors or departments better to scrutinise their budgets (and to examine the performance during the year). Such standing committees would usefully supplement the Assembly's scrutiny of the budget.

Legislative approval of Supplementary Estimates in AP is provided, on an ex post facto basis. There are delays in the regularisation of excess expenditure by the Assembly. As noted, the total of expenditure awaiting regularisation for 1997-98 to 2000-01 is Rs.1,976.35 crore, and 61 cases totalling Rs.427.69 crore of excess expenditure during 2001-02 will also require regularisation. These amounts have gone unregularised largely due to delays by the departments in submitting explanations to the PAC. This is consistent with patterns in other States, where, in 2000, it was estimated that nearly Rs.94,000 crores of excess expenditure, dating back to the 1970s, remained unregularised.

The Assembly scrutinises budget execution directly through questions, and via the Estimates Committee. However, the Estimates Committee focuses more on its responsibilities at the budget formulation stage than on budget execution.

The role of the PAC is to undertake ex post facto scrutiny of GoAP's stewardship of public funds and hold the Government to account on behalf of the Assembly and the public. While the standard of PAC examination is high, the PAC has the potential to play an even greater role in containing fiduciary risk, maintaining high standards of financial accountability, and supporting Government-wide improvements in PFM. There has been, hitherto, a significant time lag in PAC's scrutiny of Audit Reports. For example, in 2002-03, PAC has been focused on examining audit paras from the year 1995-96, with examination of a small number of audit paras from the following two years. This does represent an improvement on previous years however as in 2001-02, PAC was focused on examination of audit paras as far back as 1993-94.

There are many reasons for the time lag, including significant increases in government expenditure resulting in more cases to be brought to public attention by the CAG. Hitherto, there has been no prioritisation of audit paragraphs and audit paragraphs are examined at random. The PAC has not taken up the option of convening sub-committees to speed up the examination process. In recognition



of the impact of these delays in scrutiny, the PAC Chairman has taken the decision to commit half of the PAC's time henceforth to considering the previous year's Audit Reports, and the remainder to working through the years chronologically. Examination on this basis has now started in early 2003. This should strengthen accountability significantly, with a positive impact on fiduciary risk.

Albeit delayed, the PAC does undertake a high standard of examination of officials: questioning is rigorous and detailed, and matters are pursued to their logical conclusion with great tenacity. Thus, whilst it will be the serving rather than the responsible official who is called for PAC examination, there are indications that appearance before the PAC does command an appropriate level of preparation and respect.

The rate of implementation of PAC's recommendations does not appear to be high. The CAG reports that, as at August 2002, 1,159 recommendations made between 1962-63 and 2000-01 were pending settlement. Of these, the PAC had received Action Taken Reports (ATRs) in respect of 313 recommendations. Of the remaining 846 for which ATRs had not been reviewed, no ATRs had been received from the concerned departments in 493 cases. Of these ATRs not received, 195 related to just one department, Irrigation and Command Area Development. The PAC has stated that it had received confirmation of only four and three of its 52 and 25 recommendations made for 2000-01 and 2001-02 respectively having been implemented. The PAC does not have any powers by which to enforce implementation of its recommendations.

In line with international good practice, the PAC is chaired by a member of the Opposition, but has cross-party membership. The tenure of the members of both the Estimates Committee and the PAC is for one year only. Extension of this tenure might allow for the further development of expertise and for continuity in the examination of PFM issues.

Neither of the Committees are open to the media or the public, although verbatim records of PAC hearings are made available to the media.

The following, and final, chapter examines the role of the public in supplementing legislative scrutiny to hold the Government to account.

### 13. Public access to information on public finances

Ensuring public access to information on public finance supports the minimisation of fiduciary risk by enabling the public to supplement the scrutiny of the legislature.

GoAP is making excellent progress in increasing public access to budget information, particularly through increasing the accessibility of budget and financial information, and opportunities for public consultation. While its initial focus is on transparency, it aims to create greater scope for public consultation and participation in public finance issues over time.

GoAP has taken, and plans, a number of steps to enhance public access to financial information. GoAP has drafted a Right to Information Bill. It has placed the Budget and other key documents on GoAP's web site, and has endeavoured to improve the transparency of financial documentation, such as the publication of the Budget in Brief and Accounts at a Glance, which contain useful summaries of the budgeted fiscal aggregates and final accounts respectively, and a draft Budget. However, while the budget documentation is included on the internet, other key financial monitoring and reporting documents, such as Accounts at a Glance, are not.

GoAP is committed to creating opportunities for public consultation in budget formulation. In particular, GoAP has produced draft budgets since the 2002-03 Budget and departments have prepared a Performance Budget for the 2003-04 Budget for public consultation. GoAP held a series of State and district workshops on performance budgets over a period of one month from January to February 2003. This reform responds to the need to focus consultation on GoAP's key expenditure objectives and activities. GoAP has also made efforts to expand the scope of consultation in the 2003-04 process, as it has been recognised that the reach of consultation was limited in the initial exercise. GoAP also recognises the need to begin consultation earlier in the budget formulation process, as the AFF exercise is currently very compressed. However, given the significant resources involved in running large-scale consultation processes, GoAP has decided to focus initially on enhancing transparency, moving to a greater focus on public consultation and participation over time.

While GoAP does not have direct mechanisms for public involvement in the monitoring of budget execution, there are a number of fora for the different levels of public representatives to scrutinise expenditure. GoAP is also actively implementing community development programmes in which communities are directly engaged in the execution of GoAP programmes.

The establishment of COPE may support GoAP in engaging people in identifying and solving problems leading to poor governance. However, given COPE was only established in December 2002, it's too early to judge its effectiveness.





## 1. Introduction

### 1.1 Background to the State Financial Accountability Assessment

As part of the ongoing fiscal reforms process, the Government of Andhra Pradesh (GoAP) decided to take a number of measures during 2002-03, including completion of a State Financial Accountability Assessment (SFAA) and related Action Programme covering the State Government. The SFAA is a GoAP exercise, undertaken by the Centre for Good Governance (CGG).

### 1.2 Objectives and scope of the SFAA

The SFAA has dual objectives, being:

- First, the development objective: its key role is to facilitate a common understanding of GoAP's public financial management (PFM) arrangements, including identifying their strengths and weaknesses, thus contributing to the design and implementation of capacity building programmes for improved PFM;
- Secondly, the fiduciary objective: to assess and manage the risk that government and donor funds might not be spent on authorised and intended purposes, as expressed in the Budget, and thus support the exercise of donors' fiduciary responsibilities.

A separate report covers developmental issues and includes recommendations and an action plan. This Report covers the fiduciary objective, and thus examines key issues such as the extent to which the budget has been implemented as passed, whether the budget covers all significant parts of government activity, whether sufficient reliable information is provided on budget execution and whether practices match rules. The SFAA may use some audit techniques to assess these issues, but it is not to be considered, or represented, as an audit of any of the systems assessed. This assessment does not aim to assess the quality or value for money from public spending; this is the role of a Public Expenditure Review (PER). Nor does the SFAA assess the level of financial or sovereign risk.

The scope of the SFAA covers only the State Government.

### 1.3 Methodology

#### 1.3.1 Diagnostic framework

To undertake the SFAA, the SFAA team developed a diagnostic framework. For each of the key stages in the PFM process (e.g. budget formulation, accounting, audit) and aspects of the PFM framework (e.g. internal controls) the diagnostic framework:

- Sets out the principles of good practice for containing fiduciary risk, against which GoAP systems, practices and procedures are benchmarked. These are normative principles, which are not necessarily implemented in specific governments. The principles have been derived from various documents issued by international authorities on public finance issues, with a specific reference to fiduciary risk;
- Sets out indicators that the principle is being applied or the feature is in evidence;
- Poses those questions whose answers will indicate the extent to which the principle is being applied, and assist the SFAA team in developing a holistic assessment.

Each of the chapters covering those stages/aspects has been structured around the principles; hence, all the principles against which GoAP has been assessed can be seen in the contents page.

#### 1.3.2 Sources of evidence

Evidence was derived from a number of sources, with primary data gathered from controls testing as outlined in Figure 1.

### Figure 1: Overview of controls testing

The SFAA team undertook controls testing in two departments: Primary Health and Primary Education. Controls testing was therefore undertaken at the Directorate of Public Health, Commissionerate & Directorate of School Education, and the State Project Director of the District Primary Education Programme (DPEP). Testing was undertaken in five districts, intended to cover the range of likely control environments: Mahbubnagar, Nalgonda, Visakhapatnam, Ranga Reddy and Guntur. Thus, five District Education Offices (DEOs) and five District Medical and Health Offices (DMHOs) were tested. Testing was also undertaken at ten Primary Health Centres (PHCs), seven Mandal Education Offices (MEOs), five District Primary Education Project (DPEP) offices and four primary schools. Testing was undertaken with the use of a detailed Internal Controls Questionnaire (ICQ). In addition to the five districts visited, the ICQ was sent to a further six districts, none of whom replied.

Controls were also tested at five District Treasury Offices (DTOs) and six sub-Treasury Offices (STOs) and the ICQ was also completed by the Directorate of Treasury and Accounts (DTA) who provided State-wide information. And, the ICQ was also sent to 17 Pay and Accounts Offices (PAOs) (Works and Projects), 10 Assistant PAOs (APAOs), and 4 Joint Directors of Works and Accounts, from whom replies were received in all cases.

The results of the controls testing have been examined in the context of corroborating evidence, including Accountant General (AG) Inspection Reports, internal audit reports, reports of Chartered Accountant audits, and the Comptroller and Auditor General (CAG) Audit Reports.

The SFAA also drew upon:

- Stakeholder consultation with officials in the Finance Department, Treasury departments, line departments (with a focus on primary health and primary education), other GoAP departments; representatives of the CAG, and parts of the Government of India (GoI); representatives of the Legislative Assembly; representatives of local and national civil society;
- Desk review of a wide range of material, from AP, Indian, and international sources.

#### 1.4 Structure of this report

Following this introductory chapter 1, and chapter 2 which sets out recent trends on PFM as background for the report, the main body of this report is structured around the key stages or aspects of PFM, as follows.

PFM legal and institutional framework (Chapter 3) examines the key laws, rules, regulations and practices underpinning PFM in GoAP.

PFM process examines four key stages: Budget formulation (Chapter 4), Budget execution (Chapter 5), Accounting (Chapter 6), Monitoring and reporting (Chapter 7).

Assets and liabilities selects for closer examination Asset management (Chapter 8), Debt management (Chapter 9), and Contingent liabilities (Chapter 10).

Internal controls (Chapter 11) highlights cross-cutting issues of how GoAP seeks to ensure the achievement of its objectives, specifically the safeguarding of resources and adherence to the legal framework.

Scrutiny and accountability analyses the main mechanisms by which stakeholders exercise their right to hold GoAP to account for PFM, being External auditing (Chapter 12), Legislative scrutiny (Chapter 13), and Public access to information (Chapter 14).



## 2. Recent trends in Public Financial Management

This chapter sets the scene for the SFAA:

- First, by providing an overview of GoAP's financial results and position;
- Secondly, by setting out an interpretation of recent fiscal trends;
- Thirdly, by outlining the key recent and ongoing reforms in PFM undertaken by GoAP.

### 2.1 An overview of GoAP financial results and position

Figure 2 sets out some key data about GoAP's finances.

**Figure 2: Key features of public finances of GoAP (Rs.crore)**

Item	Actuals 2000-01	Budget Estimates 2001-02	Actuals 2001-02	Budget Estimates 2002-03	Revised Estimates 2002-03	Budget Estimates 2003-04
Revenue receipts	19,475.24	22,406.02	21,845.06	25,674.79	24,106.79	29,295.42
Total receipts	37,956.16	35,823.63	42,747.45	39,420.00	38,870.71	43,466.69
Revenue expenditure	23,070.36	26,293.05	24,726.32	28,156.62	27,272.46	31,427.00
Capital expenditure	2,723.53	3,815.43	3,090.96	4,291.83	3,627.06	4,793.26

Source: Finance Accounts and Annual Fiscal Framework

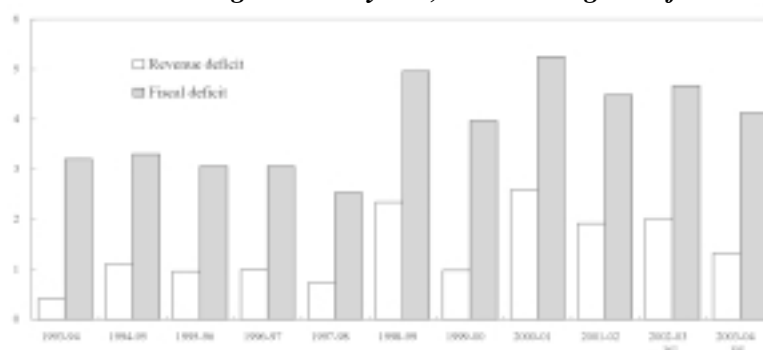
### 2.2 Interpretation of recent fiscal trends

AP, in common with other Indian States, suffered a fiscal deterioration during the second half of the 1990s. The fiscal deficit in AP rose to 5.3% of GSDP by 2000-01 (see Figure 3). This was driven by the increasing pressure of public pensions and wages on the budget, combined with the increasingly heavy burden of power subsidies. The consequential build-up of State debt led to increasing debt servicing costs (see Figure 4).

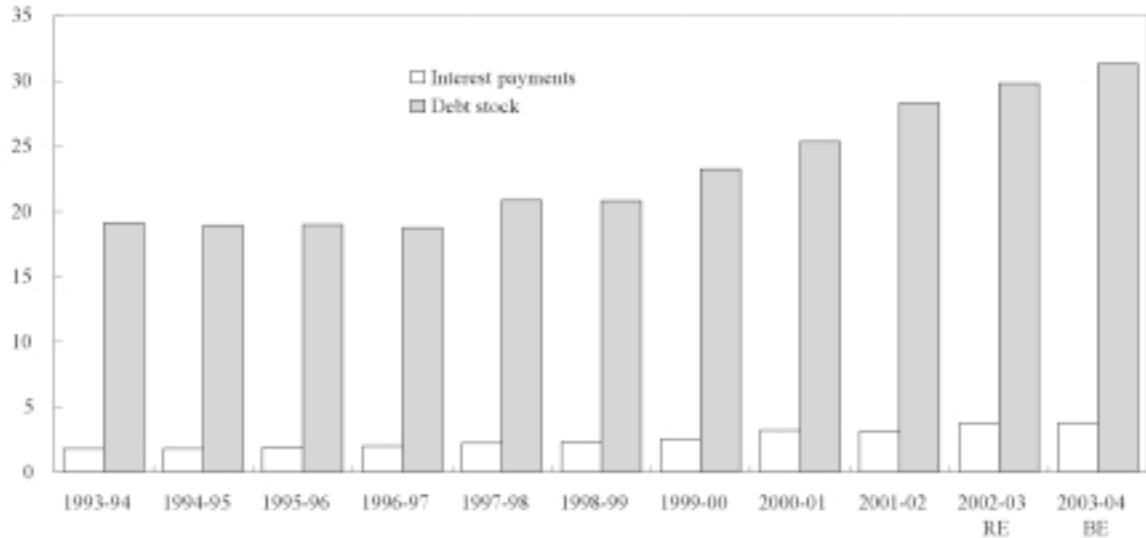
During the last five years, government debt has grown from 18.9% of GSDP in 1994-95 to reach 29% of GSDP in 2001-02. The burden of debt service and subsidies has grown dramatically as a share of total spending, diverting public resources away from critical development needs. However, the primary deficit actually peaked in 1998-99 (see Figure 5), but has shown steady improvement since then.

**Figure 3: Revenue and fiscal balance as % of GSDP**

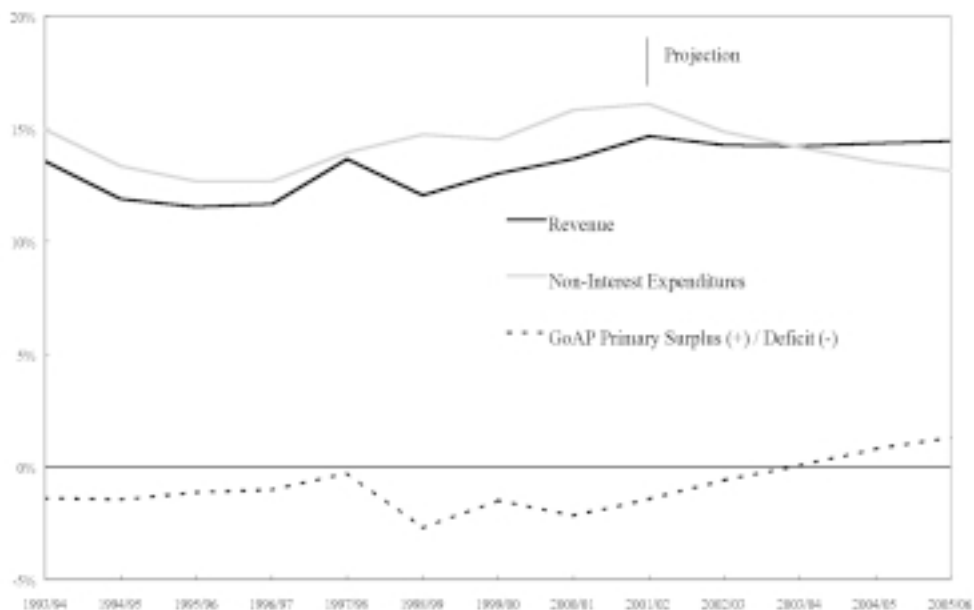
...deficits have been increasing in recent years, but have begun to fall since 2001-02...



**Figure 4: Debt stock as % of GSDP**  
 ...the levels of debt stock have risen steadily since 1996-97...



**Figure 5: Primary surplus and components as % of GDP**  
 ...the primary deficit peaked in 1998-99...

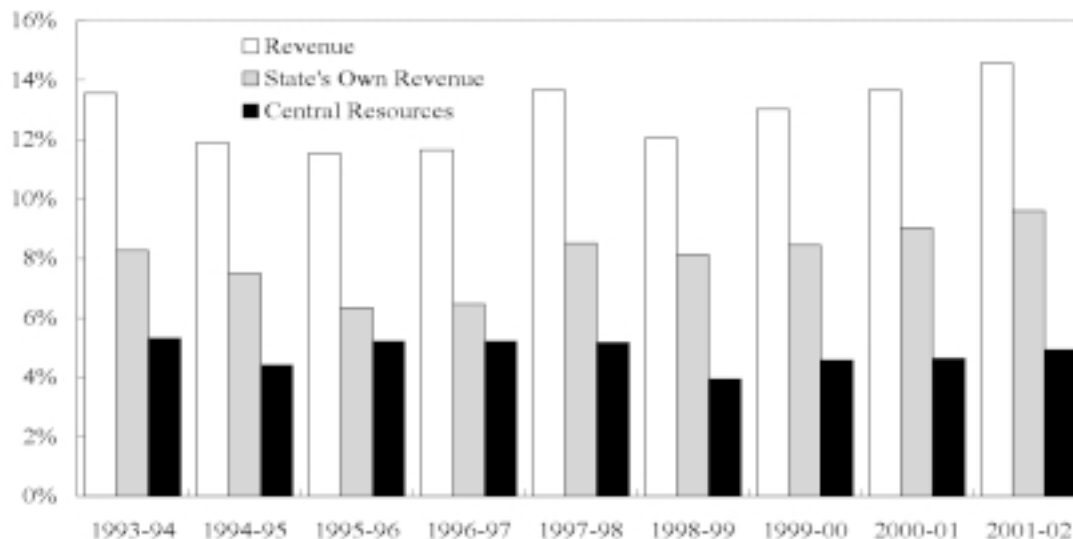


In 2001-02, even the revenue and fiscal deficit declined as a percentage of GSDP (see Figure 3). The main reason for this improvement has been improvements in State's own revenue from 6% of GSDP in the mid-1990s to around 9.6% in 2001-02 (see Figure 6). Although the Central Tax devolutions have declined from a peak of 3.7% in 1997-98 to 2.7% by 2001-02, there has been some recovery in overall revenues from GoI, from a low of 3.9% of GSDP in 1998-99 to 4.9% in 2001-02, largely on account of Plan grants under Externally Aided Projects. Expenditures have actually continued to increase as a percentage of GSDP.



**Figure 6: Actual revenue as % of GSDP**

...improvements in State's own revenue have contributed to reduction in primary deficit...



The major fiscal stabilisation goals of GoAP are reflected in the Medium Term Fiscal Framework (MTFF), which was used as the basis for preparation of the 2002-03 and 2003-04 budgets. The goal of the MTFF is to reduce the fiscal deficit to 2.6% of GSDP (see Figure 7), and generate a primary surplus of 1.3% of GSDP by 2005-06 (see Figure 5). This reflects intended curtailment of non-interest expenditure, particularly a planned sharp reduction in the power sector financing requirement. Due to the improvement in the primary deficit, the interest burden levels off and the rate of increase in debt also slows. The debt stock is forecast to rise from 28.6% in 2001-02 to 31.9% of GSDP in 2005-06.

**Figure 7: MTFF indicators as % of GSDP**

	2001-02		2002-03		2003-04		2004-05	2005-06
	MTFF	Actuals	MTFF	RE	MTFF	BE	MTFF	MTFF
Revenue deficit	2.29	1.92	1.69	1.92	1.22	1.17	0.39	0.35
Fiscal deficit	4.98	4.48	4.55	4.46	4.05	4.02	3.30	2.62
Debt	28.61	28.31	30.64	30.25	31.45	31.32	21.12	31.92
Guarantees	12.53	9.90	11.13	8.73	10.06	8.61	8.94	7.91

*Source: Budget Speech 2003-04*

### 2.3 Recent and ongoing reforms in PFM

GoAP's record of reforms in PFM and accountability since 1999-2000 reflects its commitment to providing a sound fiscal basis for the development of the State, and the minimisation of fiduciary risk. The initial focus of these PFM reforms was on increasing the transparency of the budgetary process and fiscal discipline. GoAP's Strategy Paper on Fiscal Reforms (2001) renewed GoAP's commitment to PFM reform and set out a vision of PFM. Four of the vision's key pillars are critical to containing fiduciary risk, as outlined in Figure 8 below.

**Figure 8: Pillars of GoAP's fiscal reforms strategy critical to minimising fiduciary risk**

- Creating the conditions for good operational management and improvement of services to the public, by empowering the government departments to take decisions in their remit while assuring accountability for the use of resources and for results;
- Assuring close correspondence between actual expenditures and the approved budget, thereby permitting the introduction of good cash management, and improving predictability throughout government;
- Modernising the financial management system by streamlining financial regulations and appropriate use of information technology;
- Enabling public participation in budget formulation and implementation by making budget documents simpler and disseminating government financial decisions in user-friendly forms.

*Source: GoAP Strategy Paper on Fiscal Reforms*

Guided by these medium term objectives, GoAP has implemented extensive reforms in most areas of PFM over which it has delegated authority. Many of the reforms, particularly those in budget formulation and execution will increasingly bear fruit over the coming years. For example, GoAP's reforms which promote greater budget realism, departmental ownership of their budgets and release of expenditure authorisation, should increase the potential for the budget to be implemented as passed, and for departments to be held accountable for their use of financial resources.

While the divergence between budgeted and actual revenue and expenditure is narrowing over time, GoAP recognises that there is still some scope to improve forecasting of its own revenues. However, there are limits to the extent to which such improvements will strengthen predictability due to fluctuations in central tax devolutions as well as Plan grants. GoAP has begun to use the Revised Estimates process to respond to these fluctuations and make the necessary within-year changes in expenditure.

Measures in other areas have had a more immediate impact. GoAP is now a leader in budget comprehensiveness, for example having brought previously off-budget borrowings on budget and by disclosing (and increasingly providing for) government guarantees. GoAP's reforms in the timeliness and reliability of financial information have also borne fruit in 2002-03, and will be strengthened further by the integration of systems in the coming year. Increasing the reliability of information on budget execution, and reducing fiduciary risk, relies on greater discipline in undertaking reconciliations, tackling large and non-transparent balances on the Public Account and all Personal Deposit (PD) accounts.

GoAP has also undertaken a range of reforms aimed at strengthening controls and compliance in key areas of departmental budget execution to narrow divergences between formal PFM 'theory' and 'practice'. Further improvements will be enabled by, first, the selective revision and updating of the PFM rules and regulations to increase their transparency and accessibility, and secondly, by devising and implementing further mechanisms for their enforcement, such as the upgrading of the accountability framework, establishment of effective departmental internal audit functions, and improvement of financial competences at the district and field levels. A focus will be required on areas identified as particularly weak, such as asset management.

Much of the reform effort lies with GoAP. However, the CAG and PAC will continue to play a critical role in the minimisation of all aspects of fiduciary risk.

Key recent and ongoing PFM reforms are outlined in Figure 9 below. These reforms are noted throughout the following chapters on each stage or aspect of PFM.



**Figure 9: Key PFM recent and ongoing reforms**

Reform content	Benefits of reform	Relevant section of report
<b>Legal and institutional framework</b>		
Ongoing revision of the budget manual	Increased clarity and compliance	3.4
Development of Departmental and Functionary Manuals for many departments	Increased clarity about roles and responsibilities	3.7
Government Order 507: targets key accounting controls with which compliance is low Links compliance with requirements (via the submission of regular signed statements of compliance) to the release of further funds	Increased compliance noted since introduction in April 2002	3.7
Treasury department Performance Monitoring Evaluation System (PMES)	Management information about performance of Treasury departments in key areas	3.7
<b>Budget formulation</b>		
Medium Term Fiscal Framework	Strategic framework for budget, moving away from only incremental approach to revenue forecasting to include GSDP and tax buoyancies	4.2
Establishment of Revenue Reform Committee	To consider how to strengthen tax forecasting and potential for enhancing tax collection	4.2
Cabinet sub-committee setting development priorities	Strategic framework for budget for development of line department expenditure strategies	N/a
Draft Performance Review and Budget process to review performance and set departmental expenditure strategies	Enhanced line department ownership and accountability for budgets	4.3
Pilot Medium Term Expenditure Frameworks in primary health and education	First steps towards developing costed expenditure strategies at the departmental level	4.3
Cabinet approved expenditure ceilings provided to line departments	Enhanced flexibility and predictability for line departments	4.3
Brought off-budget borrowings on to the budget	Strengthened comprehensiveness of the budget	4.4
Publication of Budget in Brief since 2001-02	Improved user-friendliness of budget documentation	4.5

Reform content	Benefits of reform	Relevant section of report
Simplification of the classification system: merging similar schemes into generic programmes to reduce the heads of account and weeding out obsolete and redundant heads of account	Increased transparency of the classification system	4.5
A computerised financial management system, an Oracle based system currently called the Resources Expenditure Information System (REINS), is under development to enable electronic submission of Budget Estimates but will not be functioning in the next couple of years	Enhanced efficiency and accuracy of budget preparation, as well as line department accountability for budgets	N/a
<b>Budget execution</b>		
Increased scope for departmental re-appropriations	Increased departmental flexibility	5.3
Advance release of budget spending authority for the first six months of the year, followed by quarterly releases.	Increased timeliness and predictability of departmental funding	5.4
Procurement reforms	Increased transparency of procurement	5.6
Implementation of scheme of payment of salaries to staff through banks	Reduced scope for irregularities that are possible under the current cash payment system	5.6
GO 507 strengthening range of accounting controls	Increased compliance and reduced fiduciary risk	5.7
Strengthening controls and transparency of Personal Deposit accounts	Reduced scope for diversion of funds for irregular purposes	5.7
GoAP has asked GoI to channel directly funded Centrally Sponsored Schemes through GoAP in future, although there is no indication that this will happen as yet	Strengthened budget comprehensiveness, Treasury control and transparency	5.7
<b>Accounting</b>		
The GASAB has been convened to formulate standardised Government Accounting Standards for India (GoI reform)	Enhance clarity of accounting principles and standards	6.3





Reform content	Benefits of reform	Relevant section of report
Integrated Financial Information System (IFIS), including e-khazana, integrated application software that can address all the functions of the Treasury departments and migrate the data and functionalities to the new system	Increased transparency, efficiency, integrity and timeliness of accounting information, providing efficient transfer, storage and retrieval of financial information	6.6
<b>Monitoring and reporting</b>		
Production of Accounts at a Glance since 1998-99	Increased transparency of financial reporting	7.3
<b>Asset management</b>		
GOAP appointed a Cabinet Sub Committee on Asset Management in 2001	More productive use of dormant government assets like land and buildings	N/a
<b>Debt management</b>		
Setting of debt objectives as part of the MTFE and debt limit	Represents a more proactive approach to debt management	9.2
GoAP has appointed two consultants from ICICI Bank (under the aegis of the Fiscal Reforms Implementation Committee (FRIC)) to advise the Government on debt strategies and to explore possibilities of debt/interest swaps, and other debt management issues	Enables GoAP to take advantage of falling interest rates to replace earlier high-cost debt (other than Central Loans) with lower coupon debt	9.3
GoAP plans to establish a Debt Management Cell in the Finance Department	Strengthened capacity for debt management	9.3
Inclusion of off-budget borrowings as at the end of 1999-2000 in the Public Debt of the State in the Accounts of 2000-01	Strengthened comprehensiveness and transparency of the budget	9.5
<b>Contingent liabilities</b>		
Guarantee Redemption Fund instituted in 2001-02	Supports management of risk associated with contingent liabilities	10.3
GoAP has also taken action to initiate a Pension Fund in which a certain proportion of the total pension liability of the year would be set apart from the Consolidated Fund and credited into the Fund account	Support movement to self-financing pension scheme	10.3

Reform content	Benefits of reform	Relevant section of report
<b>Internal controls</b>		
Development of Internal Audit Manual, as first step towards introducing internal audit function in GoAP.	Strengthened internal control monitoring, evaluation and compliance	11.4
Establishment of internal audit cell in Finance Department to undertake internal audits across GoAP	Strengthened internal control monitoring, evaluation and compliance	11.4
<b>External auditing</b>		
GO 507: DTOs not paying bills until the DDO submits a certificate that at least 50% of the pending audit paras for years up to and including 2000-01 have been replied to	Increased departmental responsiveness to audit paragraphs is key to accountability	12.5
<b>Legislative scrutiny</b>		
PAC now devoting half its time henceforth to examining previous year's Audit Reports	Significant enhancement of accountability	13.3
<b>Public access to information</b>		
Draft Rights to Information Bill - but not yet presented to Parliament	Increased transparency	14.2
Publishes the Budget and makes key budget documents accessible through GoAP's web site	Increased transparency	14.2
Publishes a AP Budget in Brief document	Increased transparency and user-friendliness of budget documentation	14.2
Published, for the first time in 2001-02 a draft budget (Annual Fiscal Framework)	Increased transparency and facilitates public consultation on the budget	14.2
Public participation and feedback sought during draft Performance Budget exercise	Increased civil society to examine budget execution and hold government to account	14.3
Establishment of COPE	Avenue for grievance hearing	14.4



### 3. PFM legal and institutional framework

The extent to which the legal and institutional framework encourages a culture of compliance, in which key stakeholders are motivated and equipped to support the principles of good practice in PFM, will play a significant role in determining the level of fiduciary risk.

Appendix 1 sets out the core components of the PFM legal framework. Note that, for the purpose of this report, the “legal framework” is understood to comprise the body of prescribed requirements, including those prescribed by the Constitution, laws, and subordinate legislation such as rules, regulations, codes, manuals and Government Orders (GOs). The GoI Government Accounting Rules, Account Codes and General Financial Rules are the primary source of GoAP’s AP Financial Code, AP Accounts Code and AP Treasury Code which determine PFM processes on a day to day basis. Appendix 2 outlines the roles and responsibilities allocated to institutions by the legal framework.

Much of the legal and institutional framework, within which the GoAP PFM system operates, is prescribed by GoI in accordance within the provisions of the Constitution of India, as set out at Figure 10 below.

**Figure 10: Key aspects of PFM determined by GoI and the Constitution**

The Constitution sets out provisions for distribution of revenues between GoI and States; provides for giving of grants from GoI to the States; prescribes conditions for raising of borrowings by States; includes enabling provisions for the setting of limits on borrowings by States and giving of guarantees; lays down the procedures at key stages of the PFM process, such as preparation of the annual financial statement, estimates, appropriation bills, supplementary grants, votes on account and so on; prescribes the GoI Government Accounting Rules, Account Codes and General Financial Rules; prescribes through the CAG the manner in which the accounts of States should be maintained; provides for the audit of the accounts of States through the CAG. Financial relations between GoI and States also transcend the Constitutional provisions, with the Planning Commission guiding the development of the Plan.

GoAP is, thus, constrained in many areas in its attempts to reform PFM, but has sought to supplement GoI requirements in some areas so as to minimise fiduciary risk, for example by increasing the availability of information on public finances in a transparent form. In other areas, such as the budget process, State Governments have delegated authority and GoAP has used this to good effect by undertaking reforms that seek to reduce fiduciary risk by increasing budget realism and budget comprehensiveness. There are other areas contributing to fiduciary risk that can be tackled further by GoAP; these are highlighted in the relevant chapters of this report.

#### 3.1 Principles of good practice

Figure 11 highlights those principles of good practice in the legal and institutional framework that are key to minimising fiduciary risk. As noted, these are normative principles, which are not necessarily implemented in specific governments.

**Figure 11: Principles of good practice for the legal and institutional framework to minimise fiduciary risk**

*Institutional capacity for PFM reform* is required to ensure that PFM reforms can be devised, co-ordinated and sustained (see section 3.2).

*Structure of PFM framework meets users’ needs.* Cascading levels of guidance are required for specific purposes and audiences, and the balance to be struck between stability and flexibility (see section 3.3).

***Comprehensive and relevant legal framework kept up to date.*** If key aspects of the PFM process are not governed by appropriate laws or delegated authority, there will be no basis for consistency, compliance or monitoring. Actual practice will increasingly diverge from good practice (see section 3.4).

***Transparent and accessible legal framework.*** Compliance with the legal framework as a safeguard against fiduciary risk depends on it being widely disseminated and well understood. As important as transparency of the detailed laws, rules and regulations is the clear statement of the principles to underpin the framework (see section 3.5).

***Clear institutional accountability framework established.*** This ensures that those charged with responsibilities for PFM can be held accountable for their stewardship which creates a culture of compliance, and an institutional environment in which fiduciary risk is minimised (see section 3.6).

***Clear accountability framework for individual officials*** is required to enable accountability to be fixed on individual officials and minimise the divergence between rules and practice (see section 3.7).

***Adequate levels of PFM expertise in GoAP*** ensure that officials with finance responsibilities are able to adhere to the principles of good practice and the PFM framework (see section 3.8).

This chapter analyses GoAP's legal and institutional structure for PFM in the context of these principles of good practice. Given the broad nature of this subject, it brings together cross-cutting issues, which are then covered in detail in the subsequent, more focused, chapters.

### **3.2 Institutional capacity for PFM reform and co-ordination**

The AP Government Business Rules and Secretariat Instructions assign responsibility for "all matters relative to financial procedure and the application of the principles of sound finance" to the Finance Department.<sup>1</sup> GoAP's increased commitment to strengthening PFM in the State has dramatically increased the range and level of demands placed on the Finance Department. Although Finance Department has contracted consultants as required to assist, their primary role is to support in the design and implementation of the reforms, rather than in ongoing monitoring, evaluation, enforcement, guidance and support to line departments. However, the placement of DTA officials as Chief Accounts Officers (CAOs) in Directorates does go some way in offering this support. Finance Department may benefit from institutional strengthening in key areas in order to enable the broadening and deepening of the reform process.

### **3.3 Structure of PFM framework meets users' needs**

It is important that different levels of the PFM framework exist to serve the different purposes of users. Good practice often establishes three broad levels, being:

- Legislation, providing the overall framework within which key stakeholders know their roles, responsibilities and how they will be held accountable, and establishing the broad principles of what is required by way of the qualitative characteristics of PFM, for example transparency and timely reporting. Legislation should be capable of providing stability and certainty over a long period of time, given that it is not easily altered;
- Regulatory, outlining how the principles should be applied;
- Practical guidance in the form of instructions, manuals etc, detailing who should do what on a day-to-day basis.

<sup>1</sup> AP Government Business Rules Part I, section I, article 11 (3) and section III B.



GoAP has:

- The Constitution, establishing key Constitutional authorities and assigning them responsibilities, and defining the key elements of the PFM process;
- The GoI Government Accounting Rules, Account Codes and General Financial Rules as the primary source of rules and regulations;
- Four key codes and manuals, which contain the “instructions” which dictate day-to-day operations in financial management, being the Budget Manual, AP Financial Code, AP Accounts Code and AP Treasury Code. These form subordinate legislation under the Constitution and are laid on the table of the Legislative Assembly, from where they derive their legal force.

This raises two issues. First, the Constitution is the main source for the PFM framework, and sets out some requirements in some detail. Secondly, delays in updating codes and manuals (see section 3.4) limit the extent to which there is a transparent “cascading down” of higher level legislation and regulations. Line departments must keep track of a large number of GOs to ensure that they are compliant, undermining the value of codes and manuals as reference documents. The ad hoc issuing of GOs also creates the risk of inconsistency in the changes to rules and regulations incorporated in the GOs.

### 3.4 Comprehensive and relevant legal framework kept up to date

A comprehensive legal framework is one that encompasses all the key stages of the PFM process. If key aspects are not governed by appropriate laws or delegated authority, this lack of accountability will manifest itself in weak fiduciary outcomes.

The Finance Department is responsible for revision and updation of the codes and manuals. However, the key codes and manuals have not been updated for some years, as shown in Figure 12 below.

Very often, GOs are issued to introduce changes in systems and procedures but consequent amendments to the codes and manuals are not issued immediately. A private sector publisher gathers together all new PFM-related GOs issued by the Finance Department and issues a new publication of the AP Treasury Code, AP Financial Code and AP Accounts Code.

**Figure 12: Date of updation of codes and manuals**

Name of Code or Manual	Date on which code or manual was last updated
AP Budget Manual	30 September 1988 (under revision)
AP Treasury Code Volume I and II	30 June 1981
AP Financial Code Volume I and II	30 June 1981
AP Accounts Code Volume I, II and III	30 June 1974
AP General Provident Fund Rules	31 December 2002
AP Fundamental Rules	20 June 1995
AP Travelling Allowance Rules	30 August 1996
AP Revised Pension Rules	31 October 1994

The legal framework requires updating to cover, or improved coverage of, the following key areas:

- The accountability framework (see section 3.6 and 3.7);
- Key principles governing PFM (see section 3.3);

- Public access to information. As chapter 14 highlights, open government is a key means by which to enhance financial accountability. GoAP has made tremendous strides in providing open public access to government functioning through traditional means of legislative debate, gazette notifications, departmental briefings, public hearings, media presence in video conferences, and Government web sites. GoAP is currently considering introducing a Right to Information Bill to the Assembly;
- Usage of automated systems. For example, during 2003, all DTOs and STOs will become operational on e-khazana, necessitating a thorough updating of the AP Treasury Code.

There will be greater value addition in updating the PFM framework when all relevant officials are aware of the new requirements. Circulation of information within the Government is crucial to ensure clarity and enable compliance. GoAP may wish to consider two issues with relation to how to update officials about changes in the PFM framework.

- First, controls testing revealed that a number of officials reported not having received a certain GO or having received it with some considerable delay, or being unaware of the existence of relevance of manuals.<sup>2</sup> There appears to be delays in the transfer down of GOs from Chief Controlling Officers (CCOs) to subordinate Controlling Officers (COs) and onto Drawing and Disbursing Officers (DDOs). Formal and robust mechanisms are needed to ensure information flows of relevant information. GoAP may wish to consider how best to communicate the array of reforms and new requirements to its network of officials throughout the State.
- Controls testing revealed that the Functionary Manuals have not reached their intended users. Officials' awareness of manuals is low. COs are aware of the existence of the manuals, but in none of the tested cases had they read them. No cases were found where other district officials had been made aware of the existence or contents of the Functionary Manuals.

### 3.5 Transparent and accessible legal framework

The effectiveness of the legal and institutional framework as a safeguard against fiduciary risk requires it to be consistently referred to and thus well understood. In turn, this depends on the user friendliness of the various PFM documents.

In contrast, much of the PFM framework is far from user friendly, in the following respects.

- Related topics are spread out over a range of different sections or texts, making it difficult to ensure that one has complied with all requirements.
- The texts are only produced in English, which disadvantages and disempowers many people, particularly in the districts.
- The style of English is archaic and difficult for many to understand and interpret.
- The codes are extremely detailed on many topics, without reference to the underlying substance or principles.
- The structure of the many of the texts originate from the 19th century. Although amendments have been issued, the basic structure of the texts has been left largely unchanged.
- Subjects are not well indexed.

The revision of the texts to consolidate, simplify, update, and codify the coverage of key PFM topics is long overdue. The GoAP approach has been to produce Functionary Manuals which highlight the key subjects.

2 Examples of GOs of which officials claimed not to be aware included those related to users charges. In addition, the existence and relevance of the MCR HRD Institute departmental and functionary manuals was not clear to all officials surveyed.



### 3.6 Clear institutional accountability framework established

GoAP's reforms to strengthen PFM and governance in general emphasise institutional and individual accountability. One of the most over-arching and challenging issues facing GoAP as it continues to reform its PFM system over time is ensuring clarity about what departments are accountable for. Traditionally, departments have been accountable within the budget process for ensuring expenditure is in line with budget. However, as GoAP moves towards a greater performance orientation in budgeting, departments will increasingly also be accountable for results.

GoAP recognises that greater accountability for results will go hand-in-hand with greater flexibility for departments in budget formulation and execution. GoAP is already initiating reforms to increase department flexibility including "Performance Budgets" and increasing the delegation of powers for re-appropriations to Heads of Department (HoDs). The challenge will be to ensure that these types of PFM reforms remain consistent with the over-arching accountability framework and that the framework takes into account financial management constraints on departments.

However, given the challenges in moving towards managerial accountability systems, financial accountability will continue to be the key form of accountability for the use of public expenditure in AP in the medium term. This would imply that while departments could be given moderate flexibility to shift resources between object-heads during budget execution, they would not be given flexibility to shift expenditure between schemes or programmes. GoAP's recent reforms to re-appropriations do give HoDs the power to re-appropriate within a Grant and between schemes or programmes within their control. Given that there are a number of restrictions on these re-appropriations, particularly at the object head level, the scope for such re-appropriations is probably limited. Furthermore, GoAP argues that it is giving this type of flexibility in order to enable it to hold departments accountable for results. However, accountability mechanisms for PFM, such as the Public Accounts Committee (PAC), are still very much geared towards financial accountability. The importance of department flexibility and accountability moving in tandem will increase as "performance budgeting" gradually evolves in AP. Some developed and developing countries have adopted a progressive approach to granting flexibility to line managers, linking it to some agreement on goals and performance. These issues are examined in greater depth in Figure 31 at section 5.3.1.

### 3.7 Clear accountability framework for individual officials

To enable institutional accountability, the accountability of individuals must be clearly established. The clear definition and allocation of roles and responsibilities is a prerequisite to this. GoAP has made significant strides in recent years in clarifying responsibilities and fixing accountabilities on a number of categories of individual officials. In the sections below we examine those areas where progress has been made and benefits reaped, as well as those where further clarification and discipline is required.

#### 3.7.1 Chief Controlling Officers and Subordinate Controlling Officers

The following departmental officials have a key role to play in PFM:

- CCOs, who are the HoDs, for example the Director of Health or Commissioner for School Education;
- COs, responsible for departmental matters at the district level, for example the DMHO or the DEO.

Good practice requires that CCOs are made clearly and specifically responsible for maintaining an adequate system of internal control to ensure that departmental mission, vision, objectives and targets are successfully achieved through the effective and efficient use of scarce public resources. Specifically, a key objective is the safeguarding of resources against loss due to waste, abuse, mismanagement, errors, fraud, and other irregularities.

While many of the departments now have Functionary Manuals of their own, these focus on the technical and operational aspects of their roles and responsibilities, with less attention paid to their fiduciary responsibilities. The Health Department Functionary Manual, for example, simply states “as a head of the department he shall exercise the statutory functions as defined and delegated in various rules and regulations viz. fundamental rules, A.P.T.A. Rules, Financial Code, Treasury Code, Budget Manual, Pension Code etc.” These functions are not clearly set out. The list is not comprehensive, as implied by the “etc”. Furthermore, the list is presented as a list of “duties” rather, than responsibilities, defining exactly how he will be held accountable for his fulfilment of his responsibilities.

The role of CO is particularly critical to minimise fiduciary risk at the district level. His duties with regard to budgetary formulation and reconciliation are set out in the Budget Manual, but his wider PFM roles and responsibilities have not been set out in a comprehensive way. Given the importance of COs discharging their duties with courage and conviction, they need to be governed by clearly laid down rules, regulations and principles.

### 3.7.2 Drawing and Disbursing Officers

The DDOs are also critical to minimising fiduciary risk. At the field level, the DDO will be the Medical Officer running each PHC or the headmaster of a primary school. At the district office level, the DDO will be the General Administration Officer (GAO), reporting to the CO. At the Directorate level, the CAO or any other designated official will be the DDO, reporting to the CCO.

The duties of DDOs are contained in various documents: the Budget Manual, which contains general instructions on budgetary preparation and reconciliations; the AP Financial Code on financial matters; and the AP Treasury Code on the custody of monies/payments of monies into/withdrawal of monies from the Government Account.

The HRD Institute did codify the key duties and responsibilities of DDOs in 1999. The HRD Institute used the codified DDO Manual as training material and a manual for the training of DDOs in their duties and responsibilities, and provided this to trainees. But the manual has not been provided directly to all DDOs in the field. This distribution is necessary in view of the history of weak compliance by DDOs. In recognition of this, Finance Department issued an important GO in April 2002, as outlined in Figure 13 on the following page.

The success of GO 507, and similar initiatives, will be greatly enhanced by departments supplementing Finance Department’s monitoring. It is not clear to what extent this monitoring is being undertaken across all departments, but is certainly being undertaken by Primary Education.<sup>3</sup>

**Figure 13: GO 507**

GO 507 is an important step forward in setting the framework for accountability for DDOs.<sup>4</sup> The GO targets specific key accounting controls with which compliance is low and which particularly adversely affect the timeliness and reliability of the accounts, being: replies to audit observations/ Inspection Reports; audit paras/PAC paras; Abstract Contingent (AC) and Detailed Contingent

3 In Primary Education, the CAO is monitoring the submission of monthly expenditure statements, AC bills pending clearance and the clearance of audit paras. The CAO is convening a monthly meeting for DEOs at which compliance with key requirements with GO 507 is reviewed. DEOs are expected to bring to the meeting the requisite documentation.

4 GO 507 states that: “it is ... imperative that Departments and particularly the DDOs are made more accountable for the proper and efficient use of Public Funds and the maintenance of accounts. Government ... has decided that the following norms of Financial Accountability shall be scrupulously adhered to by each Drawing and Disbursing Officer and enforced by the concerned Treasury departments, i.e. DTA/PAO/DWA and their subordinate officers at the level of DTO/STOs/PAOs Works and Accounts Department, at the time of acceptance of bills and pre-audit before release of funds under each Scheme/Programme.”





(DC) bills; reconciliations; submission of expenditure statements and Utilisation Certificates (UCs); recovery of loans; releases to local bodies, public sector enterprises, autonomous bodies, and other grant-in-aid institutions.<sup>5</sup>

GO 507 also states the responsibility of the DDOs so clearly and specifically as to - possibly for the first time - properly enable the enforcement of accountability and links compliance to the release of further funds or payment of bills, with enforcement via the Treasury departments.

***Performance indicator reports prepared by Finance Department, controls testing and stakeholder consultation indicate that GO 507 has been effective in increasing compliance in key areas.***

Performance monitoring reports maintained by Finance Department show that DTOs are rejecting bills if the DDOs fail to submit the requisite certificates. In March 2003, for example, 2,735 bills (being 0.7% of the 394,859 bills received) were rejected because they failed to provide one of the required certificates.

### 3.7.3 Treasury department officials

The majority of departmental transactions are processed by Treasury departments: the DTO and STOs; Pay and Accounts Offices (PAO) (Hyderabad); and the PAOs (Works and Projects). The key Treasury officials are the Director of Treasuries and Accounts (DTA) at the State-wide level, the District Treasury Officer (DTO) at the district level, and the Sub-Treasury Officer (STO) at the field level. The DTA plays a critical role in PFM, as all the public funds are funnelled through the Treasury system and he acts as a liaison between GoAP and the AG.

The individual duties, responsibilities and conduct rules of the Treasury officials have been laid down in the various GOs, Codes and Manuals, and have been brought together in the DTA Functionary Manual. Furthermore, the 'priority' responsibilities of the DTA, DTOs and STOs have established by way of the DTA Performance Monitoring Evaluation System (PMES). These priorities correspond to the accounting controls. The process of controls testing required extensive interaction with the DTA, DTOs and, to some extent STOs. They displayed a clear sense of, and acceptance of accountability for, their responsibilities.

### 3.8 Adequate levels of PFM expertise

A comprehensive and transparent legal framework is essential, but its success in strengthening PFM and reducing fiduciary risk is contingent to a significant extent on the competence, commitment, motivation, objectivity and ethics of the officials responsible for implementing it. All of these qualities are usually found in direct relation to the level of PFM knowledge and skills, the extent to which this imparted to them through various forms of training, and the extent to which their expertise is recognised.

Capacity building is required specifically in the following areas.

- Basic PFM techniques. In particular, many DDOs at the field level and COs at the district level appear to be weak in their understanding of PFM, and this undermines their ability to manage finances, and supervise staff, effectively.
- Information and Communication Technology. The staff using computers in the districts are usually staff on deputation from AP Technology Services. Many GoAP officials are not computer literate, and those who undertake training are still not comfortable with computer usage.
- Asset management. GoAP lacks both experts in asset management to design and enforce a GoAP-wide asset management system, and also understanding of asset management at the field level.

5 For example, all the Secretariat heads and HoDs are requested to take immediate action on the Inspection Reports/ audit paras/PAC paras for the year 2000-01, latest by September 2002, failing which further Budget Release Orders for the concerned schemes will be withheld by Finance Department.

- Supervisory and management skills. The risk of financial irregularity is higher when neither the supervising or authorising officer has neither sufficient financial expertise nor the skills to properly manage staff undertaking finance duties.

### **3.9 Conclusion**

GoAP's ambitious reform programme has sought to overcome many of the constraints of the India-wide framework. Reforms in specific areas of PFM need to be underpinned by reforms that tackle weaknesses in the legal and institutional framework. Most urgently required is the modernisation, codification, and simplification of the legal framework based on clearly articulated principles and a complete and consistent accountability framework. This should increase compliance at the district and field levels, where the competence and motivation to comply can be weak. Reducing the risk of non-compliance relies on strengthening the organisational culture by reforming working practices; in-roads can be made by strengthening training and human resource management of finance staff.



## 4. Budget formulation

### 4.1 Principles of good practice

Budget formulation is a critical stage for fiduciary risk. Ensuring that funds are spent on authorised or intended purposes, as expressed in the budget, relies on the budget being capable of being implemented as passed, and on the budget being comprehensive and transparent. Figure 14 highlights the relevant principles of good practice in budget formulation.

#### Figure 14: Key principles of good practice in budget formulation to minimise fiduciary risk

**Budget realism** is integral to fiduciary risk. If a budget is unrealistic it will be impossible to execute it as passed. An unrealistic budget undermines the credibility of the budget process, muddles rules for compliance and makes it difficult to hold departments accountable for its execution. This tends to create a vicious cycle: as departments realise that they will not be held to account for their budgets, their motivation to develop realistic estimates of the cost of their activities diminishes (see section 4.2).

**Spending departments' ownership of their budgets** is a prerequisite for a quality budget and to ensure that line departments can be held accountable for the execution of their budgets (see section 4.3).

**Budget comprehensiveness** is key to ensure that all public expenditure is subject to consistent PFM rules and that GoAP can be held accountable for the use of all public funds. Given that money is fungible, there is also a risk that, without budget comprehensiveness, donor budgetary funds will lead to other government funds being diverted to off-budget activities, reducing transparency and accountability (see section 4.4).

**Comprehensive, accessible and timely budget presentation** is critical to financial accountability and, therefore, to managing fiduciary risk. It enables both the legislature and civil society to hold the executive accountable for executing the budget as planned (see section 4.5).

This chapter analyses GoAP practice against these principles.

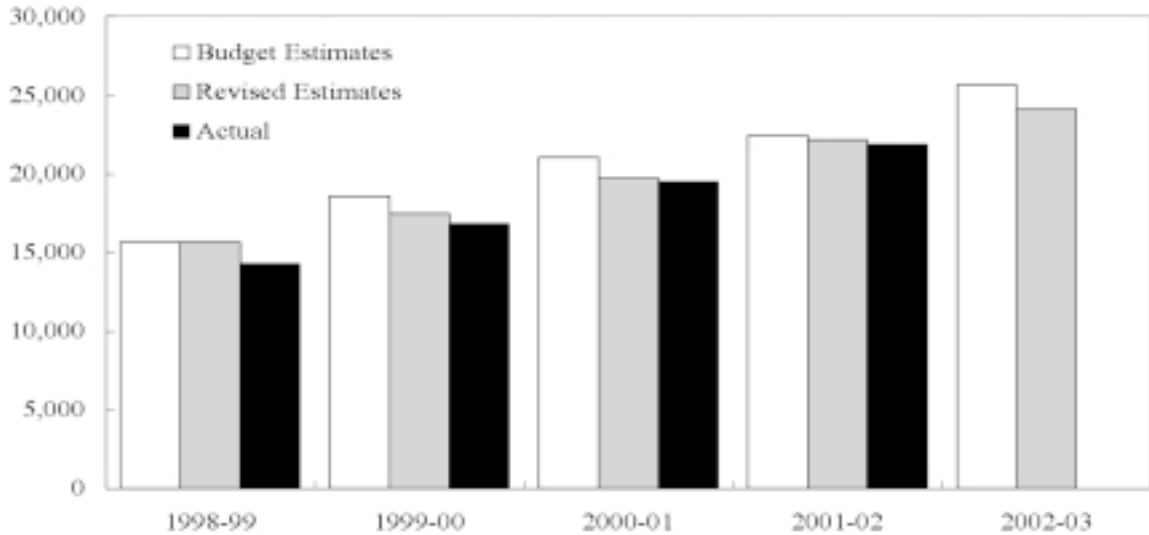
### 4.2 Budget realism

Budget realism is a question not only of revenue and expenditure “marksmanship”, but of whether budget formulation is undertaken so as to ensure a realistic estimate of revenue levels and expenditure needs. This section examines first, revenue, and secondly, expenditure.

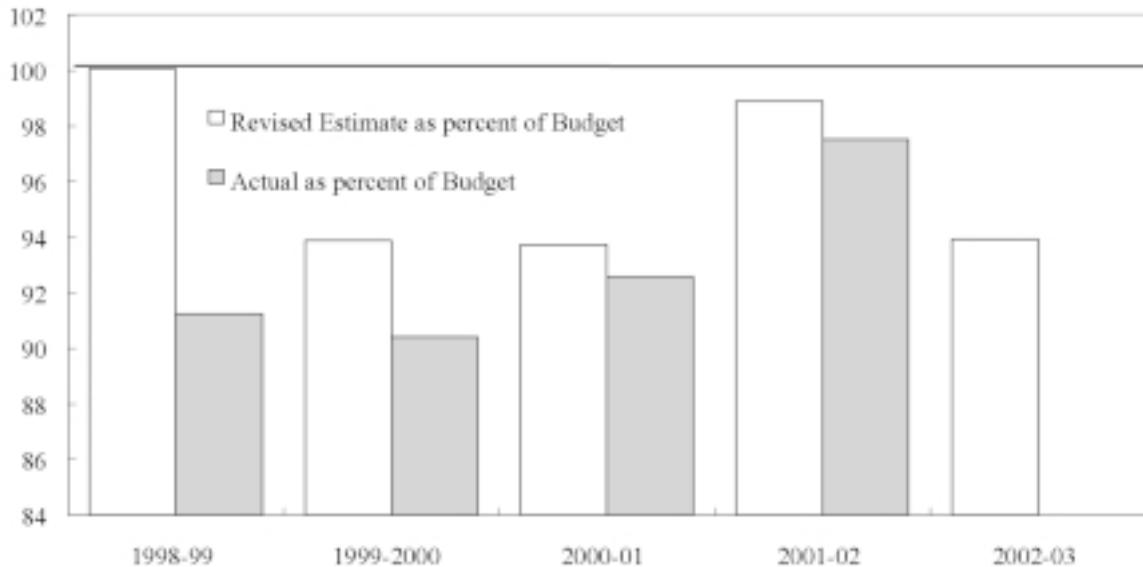
#### 4.2.1 Revenue

In AP, the level of revenue receipts have been consistently less than forecast during budget formulation for the last five years, with revenue estimates being gradually downgraded between Budget Estimates, Revised Estimates and actuals. Between 1998-99 and 2000-01, revenue receipts were between 90% and 93% of budget and revenue marksmanship showed substantial improvement in 2001-02, with actual revenue receipts being 97.5% of the budget (see Figure 15 and Figure 16). Unfortunately, it is not possible to determine whether there has been a sustainable improvement in revenue forecasting from one year, and this improvement has not been totally sustained in 2002-03 with the Revised Estimate for revenue receipts at 94% of budget. However, revenue forecasting will never be 100% accurate for any government and variances in recent years has been within a relatively small margin of error. Note that the 2002-03 figures are drawn from Revised Estimates, rather than actuals.

**Figure 15: Budget Estimates, Revised Estimates and actual revenue receipts (Rs. crore)**  
*... actual revenues are consistently less than budgeted ...*



**Figure 16: Revised Estimates and actual revenue receipts as % of Budget Estimates**  
*... there are signs of improvement in the accuracy of revenue forecasts ...*



Despite the improvements in accuracy, the consistent under-estimation of revenue suggests that forecast errors are not purely due to random unpredictable events. Some of the methodological limits to revenue forecasting in AP are explored in Figure 17.

**Figure 17: Methodological and process issues in revenue forecasting**

Traditionally, forecasts of the State’s tax and non-tax revenue have not been based on macro-economic forecasts or assumptions. Revenue departments generally base their forecasts for the following year on mark-ups over the expected receipts for the current year, although they do attempt to correct for any unusual factors or circumstances. The Department of Commercial Taxes, which accounts for around 67% of State tax revenue, does undertake quite detailed “revenue potential” assessments with each revenue unit, in an attempt to identify the key factors at the unit



level that will determine revenue collections. Whilst revenue departments submit their forecasts to the Finance Department around December of each year, it is ultimately the Finance Department which determines the revenue forecasts to be included in the budget; the forecasts are translated into targets for the revenue departments. Both the Finance and revenue departments acknowledge that these forecasts are typically higher than those initially provided by the revenue departments. They are based on anticipated growth rates in revenue in relation to the previous and current year trends.

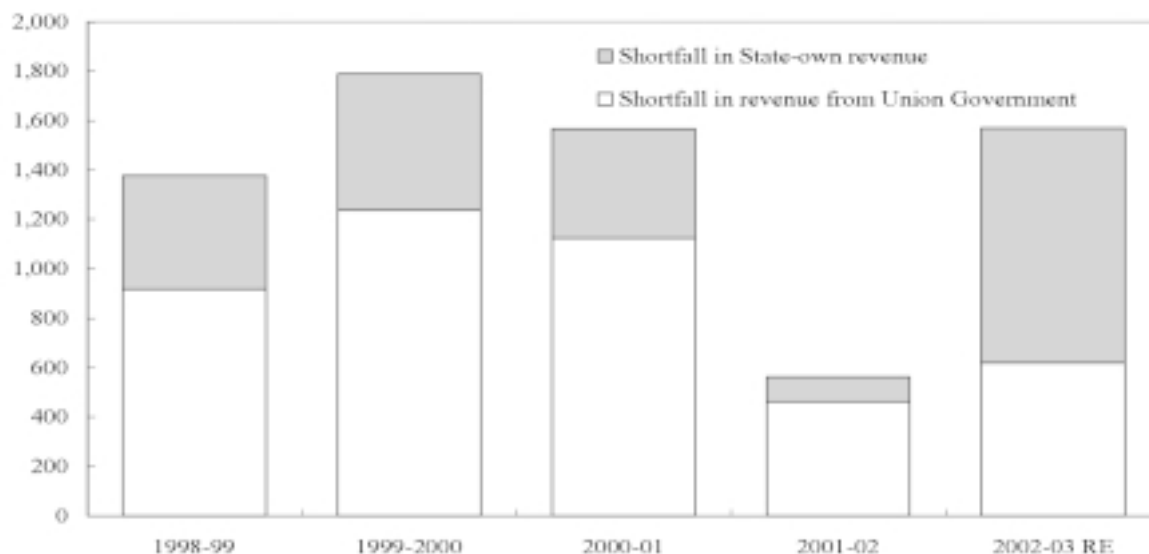
Given the limited economic information at the State level, it is not possible for the Finance Department to base its revenue estimates on any sophisticated economic models. Indeed, these techniques may give a misplaced sense of precision. Yet there is scope for the use of simple approaches to linking revenue and economic forecasts. The Finance Department developed a Medium Term Fiscal Framework (MTFF) in 2001, which makes assumptions about GSDP and tax buoyancies and has commissioned an academic economist to provide advice on developing a more sophisticated approach to revenue modelling. It has also established a Revenue Reform Committee to consider how to strengthen tax forecasting, in addition to assessing the potential for enhancing tax collection in AP. However, GoAP is yet to receive the Committee's recommendations.

However, while there is scope to strengthen revenue forecasting methodologies, it is critical to note that the primary reason for revenue uncertainty for GoAP is generally the unpredictability in revenue flows from GoI. For example, Figure 18 shows that, in 2001-02, 83% of the variance between budgeted and actual revenue related to differences in receipts from GoI. The variance reflects variability both in the budgeted State's share of central taxes and grants-in-aid (see Figure 19).

However, it should be noted, that on the basis of the 2002-03 Revised Estimates, this pattern might be reversed in 2002-03. In the Revised Estimates, the greatest contribution to the variation between the Budget and Revised Estimate for revenue in 2002-03 is actually State-own revenue (reflecting lower than budgeted receipts in both tax and non-tax revenue). Lower than budgeted transfers from GoI explain only 39% of the variance, with GoAP's share of central taxes actually higher than forecast in the Budget (shown as a negative contribution to the variance in Figure 19).

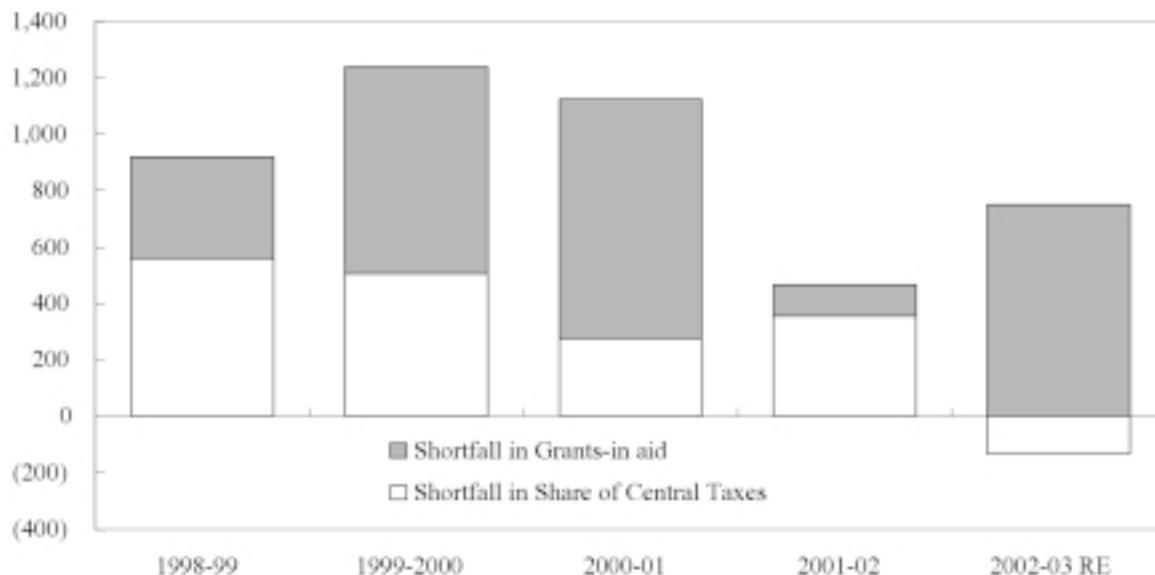
**Figure 18: Share of revenue shortfall attributed to State-owned revenue and revenue from GoI (Rs. crore)**

**... revenue uncertainty is mainly caused by unpredictable flows from GoI ...**



**Figure 19: Share of GoI revenue shortfall attributed to central taxes and grants-in-aid (Rs. crore)**

...until 2003 central taxes and grants-in-aid were both contributing to shortfall...



The difficulties in forecasting revenue from GoI stem from the fact that GoAP presents its budgets to the Legislative Assembly before the Union Budget is presented to the Parliament. Therefore, GoAP does not have final confirmation about the forecast level of grants-in-aid from GoI when it finalises its budget. Nor has GoI finalised its revenue forecasts, which have flow-on implications for the States' share in tax revenues. GoAP is compelled to make assumptions about the level of central transfers based on indications available from the Ministry of Finance during planning discussions with the Planning Commission in December each year. GoAP seems to make reasonably conservative assumptions about the revenue it will get from GoI, given that in both 2001-02 and 2002-03 GoAP forecasts of its share in taxes were less than ultimately forecast in the Union budget.

However, whatever the reasons for revenue shortfalls, the impact is still felt at the State level, as they are one cause of downward revisions in expenditure in the Revised Estimates.<sup>6</sup> Shortfalls in revenue from GoI also hit some elements of expenditure directly via delays/non-release of GoI funds for Centrally Sponsored Schemes, in which case the State also does not release its matching share. The negative impact of these factors on predictability for line departments suggests that GoAP may need to take an even more conservative approach to forecasting revenue from GoI.

#### 4.2.2 Expenditure

Since 1999-00, revenue expenditure has been around 8% to 10% below budget, although it has been improving over time (see Figure 20).<sup>7</sup> These within-year reductions in revenue expenditure do not necessarily imply that expenditure estimates in the budget had been too high. These reductions are at least partly driven by lower than forecast revenue, such as non-release of GoI funds for Centrally Sponsored Schemes.

<sup>6</sup> Under-spends in revenue expenditure have compensated for the revenue short-falls and thus prevented a significant deterioration in the fiscal deficit. The actual fiscal deficit was only Rs. 7,772 crore greater than budget in 1999-00 and was actually lower than budget by Rs. 11,537 crore in 2000-01 and Rs. 2,174 crore in 2001-02.

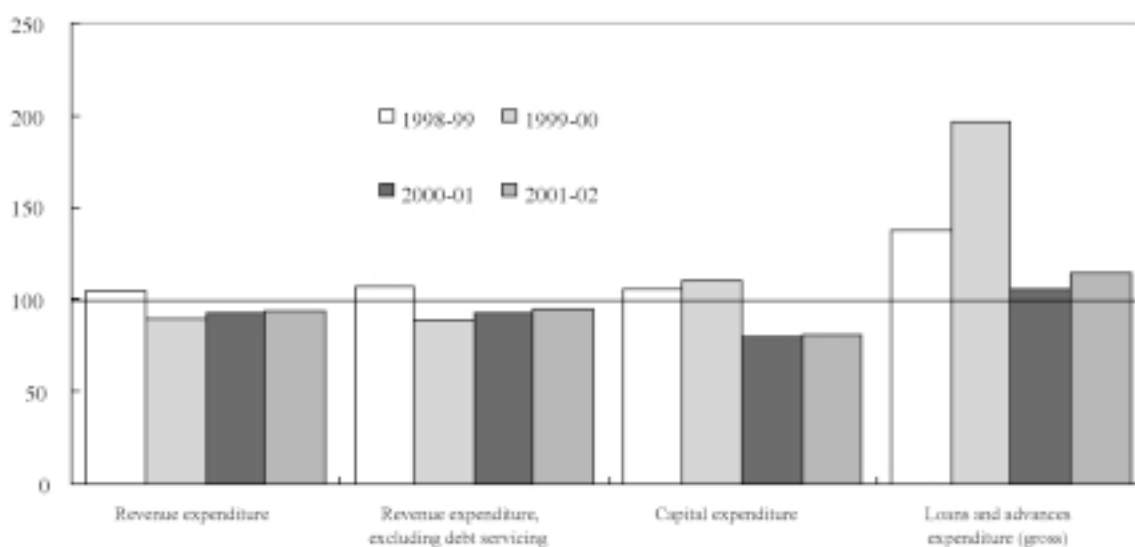
<sup>7</sup> Variations in capital expenditure have been more inconsistent over the same period, while loans and advances have been running over budget since 1998-99.



Indeed, rather than over-providing, GoAP recognises that it generally under-provides for non-salary operations and maintenance (O&M) expenditure, particularly maintenance expenditure. Non-salary O&M tends to get squeezed by expenditure demands for salaries and debt servicing, which absorb the lion's share of the non-Plan budget, together accounting for 79.6% of non-Plan expenditure in 2001-02 and 82.3% in the 2002-03 Revised Estimate (see Figure 21). These two components alone consumed around 57% of total (i.e. Plan and non-Plan) expenditure in 2001-02 and 2002-03 (in the Revised Estimates). The impact can be even more acute for particular departments, with salaries, for example, consuming 73% of total expenditure for the Department of Agriculture.

The pressures on O&M expenditure are further exacerbated by pressures on GoAP to take on new activities in the Plan budget, spreading available resources more thinly across Government activities. The Finance Commission has expressed concern that the distinction between Plan and non-Plan expenditure, as mandated by the CGA, creates a bias across all States towards Plan expenditure.<sup>8</sup> Perceptions of non-Plan expenditure as unproductive create pressures to maximise the size of Plan expenditure. This leads to incentives to spend on new Plan initiatives rather than maintain existing operations and assets within the non-Plan budget.<sup>9</sup> It also puts pressure on State Governments to maximise the size of the Plan by borrowing as much as GoI will allow, increasing future demands on the budget from debt servicing.

**Figure 20: Actual expenditure by economic classification compared to budget**  
*... since 1999-00 revenue expenditure has been consistently below budget ...*



GoAP recognises the issue of under-provision for non-salary O&M in its Strategy Paper on Fiscal Reforms which identifies “raising the efficiency of government expenditure, by a targeted focus on the more productive activities and thus more adequate funding of those activities”.<sup>10</sup> While GoAP aims to increase this provision in the medium term, these factors mean that Budget Estimates tend to under-estimate the full cost of funding ongoing government activities, creating pressures for increases in this expenditure relative to budget. However, this fiduciary risk does not materialise during budget execution as Treasury controls prevent expenditure exceeding budget. Indeed actual non-salary O&M expenditure is generally lower than budget, due to constraints facing departments in budget execution (see section 5.2).

<sup>8</sup> This was a subject for comment in the 11th Finance Commission.

<sup>9</sup> Although some Plan expenditure does provide for the ongoing costs of government operations.

<sup>10</sup> GoAP (2001) ‘Strategy Paper on Fiscal Reforms’, paragraph 87.

**Figure 21: Percent share of expenditure components**

	2000-01	2001-02	2002-03 (RE)
<b>Percent of non-Plan expenditure</b>			
Salaries	37.7	35.7	34.5
Pensions	12.7	11.7	12.1
Non salary O&M	6.1	6.3	4.6
Maintenance of capital assets	3.6	3.9	3.1
Subsidies and other grants-in-aid	10.4	8.9	7.9
Interest payments	23.1	26.0	28.7
Contra interest	6.2	6.2	7.0
Other non-Plan revenue expenditures	0.2	1.4	2.2
Salaries as % of expenditure net of debt servicing	53.3	52.6	53.6
<b>Percent of revenue expenditure</b>			
Salaries	33.0	31.5	30.8
Pensions	10.4	9.4	9.5
Non salary O&M	7.0	7.4	6.3
Maintenance of capital assets	3.9	3.9	3.8
Subsidies and other grants-in-aid	21.4	20.6	19.3
Interest payments	18.9	20.9	22.6
Contra interest	5.1	5.0	5.5
Other revenue expenditures	0.3	1.4	2.2
Salaries as % of revenue expenditure, excluding debt servicing	43.4	42.5	42.8
<b>Percent of total expenditure</b>			
Salaries	29.5	28.0	27.2
Pensions	9.3	8.3	8.4
Non salary O&M	6.3	6.6	5.6
Maintenance of capital assets	3.5	3.5	3.4
Subsidies and other grants-in-aid	19.2	18.3	17.1
Interest payments	16.9	18.5	20.0
Contra interest	4.5	4.4	4.8
Other revenue expenditures	0.3	1.3	2.0
Capital expenditure	10.6	11.1	11.5





	2000-01	2001-02	2002-03 (RE)
Salaries as % of total expenditure, excluding debt servicing	37.6	36.4	36.2
<p><b>Note:</b> As a basis of comparison: salary expenditure as a % of total expenditure in EU countries ranges from 5.6% (Sweden) to 29.7% (Portugal); median 11.2%; average 13.2% (Source: Nunberg (2000) World Bank Technical Paper No. 466). However, salary expenditure would generally be a higher proportion of expenditure in lower income countries due to differences in the relative cost of labour and other inputs.</p> <p><i>Source: Annual Fiscal Framework 2003-04 and Revised Estimates</i></p>			

### 4.3 Line department ownership of budgets

Line departments' ownership of budgets is important to fiduciary risk as it supports the development of realistic budgets, whilst building departmental commitment to implementing the budget as planned. GoAP recognises the importance of line department ownership of budgets. Indeed it is a key pillar of GoAP's fiscal strategy; the Strategy Paper on Fiscal Reforms refers to the aim of "creating the conditions for good operational management and improvement of services to the public, by empowering the government departments to take decisions in their remit while assuring accountability for the use of resources and their results".<sup>11</sup> GoAP has undertaken a number of reforms which aim to build line department ownership by providing a greater level of autonomy for line departments in developing their budgets. These next sections look at:

- Departmental involvement in budget formulation;
- District involvement in budget formulation.

#### 4.3.1 Departmental involvement in budget formulation

The key reform aimed at increasing departmental responsibility for budget formulation is the "Draft Performance Budget Exercise" undertaken during the 2003-04 budget formulation process. The exercise encourages departments to consider the linkages between their activities and performance indicators, with the aim of prompting them to consider whether they are undertaking an appropriate mix of activities. Therefore, it represents a positive and encouraging first step towards bringing discussion of activities and objectives into budget formulation. The exercise is described in

Figure 22 below.

This approach has the potential to increase departmental responsibility for developing an affordable expenditure strategy. Over the longer term, GoAP aims to further strengthen the links between expenditure strategies and available resources through the development of departmental Medium Term Expenditure Frameworks (MTEFs). Giving departments real flexibility and ownership of budgets depends on building their capacity to develop multi-year, costed expenditure policies or strategies. Departmental capacity to develop medium term expenditure strategies is currently weak. While departments often have strategies, linked to overall government strategies, these are usually not costed on an activity basis and are often not reconciled with available resources on an annual or medium term basis. As noted by the Strategy Paper on Fiscal Reform, "most programmes are of a continuing type with more or less firm commitments on the resources of the future ... therefore, the margin of resources available for new initiatives is extremely limited on a year-to-year basis, while new policies typically take more than a year to implement". A medium term approach facilitates more fundamental shifts in expenditure priorities by enabling them to be planned over a time span of several years.

<sup>11</sup> *ibid.*

**Figure 22: 2003-04 Performance Budgeting**

For the first time in the 2003-04 budget formulation process, GOAP undertook a “performance budgeting” exercise. As recognised by the Government, this exercise was not performance budgeting in the pure sense, but reflected GoAP’s efforts to facilitate greater political engagement in the setting of final expenditure ceilings and to encourage departments to think more about the linkages between their activities and performance indicators.

Departments were instructed to prepare initial estimates for non-Plan expenditure in late November.<sup>12</sup> Based on revenue forecasts (including the limits to borrowing) and “committed” non-Plan expenditure, the Finance Department determined the resources available for the Plan. The Finance Department communicated initial budget ceilings to line departments in early January. The budget ceilings were for both non-Plan (object-wise) and Plan (group sub-head wise) for each department for RE 2002-03 and BE 2003-04.

All HoDs were required to prepare a Performance Review indicating the actual achievements for 2001-02, progress towards targets for 2002-03 by December 2002 and targets for 2003-04 for each of their performance and process indicators. In their write-up of the Performance Review, all HoDs were required to explain their strategy and programme for implementing various schemes and projects in the coming year. They were also required to give sub head-wise details of the schemes under non-Plan and Plan proposed to be implemented in the coming year.<sup>13</sup>

These performance reviews were discussed at a State workshop (16-17 January 2003) and a series of district workshops. The State workshop was divided into eight groups where all Ministers, Secretaries and Heads of Departments (HoD) participated. All HoDs made presentations on their performance review and draft performance budget in their group and group recommendations were presented to the plenary session.

The Chief Minister released the Annual Fiscal Framework (AFF) on 22 January with indicative budgetary allocations to all departments. The concerned Ministers released the Group Reports on Departmental Performance Budgets from 23-27 January 2003. The State Government organised district level workshops from 27-31 January and further State level seminars were held from 3-7 February. A Cabinet Sub-Committee scrutinised the responses received from the public and departments and final guidelines for modifications were considered by the Council of Ministers on 10 February.

Departments were instructed to prepare detailed budget proposals on the basis of these expenditure ceilings. While these expenditure ceilings were then at the scheme and object head level for Plan and non-Plan expenditure respectively, departments had been closely involved in agreeing these ceilings. Departments finalised their detailed budget proposals between 11 and 17 February, with the final Budget presented to the Assembly on 22 February 2003.

Therefore, the pilot initiatives to develop MTEFs in the primary education and health sectors represent positive progress in this area. GoAP is only in the early stages of launching work for a pilot MTEF in the primary health sector and planned work on a primary education MTEF has not yet begun.<sup>14</sup> The development of medium term expenditure strategies for all departments is a challenging task that, if undertaken, is likely to take many years. However, international experience suggests that the most successful efforts at medium term and performance budgeting are those that are used as a strategic tool to make broad allocation decisions, rather than attempt to develop sophisticated performance budgeting techniques. Therefore, GoAP’s recent efforts to focus budget decision-making on activities or schemes and on performance have the potential to bring substantial benefits. These initial reforms could, therefore, focus budget decision-making on objectives and activities, and increase department ownership of budgets.

<sup>12</sup> G.O.M. No.34528-A/1137/BG/A1/2001, dated 15/11/2002.

<sup>13</sup> As per Chief Minister letter to all Secretaries, No.027/N/CMP/2003, dated 02.01.2003.

<sup>14</sup> Although an expenditure review of the Primary Education sector has been undertaken.



However, expectations of the potential benefits of these reforms must be tempered by understanding of the short term constraints that GoAP and departments face in terms of the scope to review their programmes or activities to develop an affordable and realistic expenditure strategy. In reality, most departments have very little real flexibility in the development of their budgets, due to the following factors:

- While, in theory, departments can re-allocate funding across schemes from the initial scheme-wise ceilings provided by the Finance Department, in reality most of the funding that departments receive under the Plan budget is tied to particular schemes by the GoI. Only around 27% of Plan expenditure is at the discretion of the State under “normal State Plan schemes.”<sup>15</sup>
- The majority of the non-Plan budget, which represents around 68% of total expenditure, is absorbed by salaries and debt servicing, as noted at section 4.2.2. Together salaries and debt servicing represent around 81% of total non-Plan expenditure (revenue and capital) in the 2002-03 Revised Estimates. For a number of departments, salaries are an even higher percentage of their budget.

These factors mean that departments have little incentive to discontinue low priority schemes or identify surplus labour nor any real capacity to reallocate expenditure. While departments can re-deploy staff to other activities, or surrender them and their budgets to the manpower cell, the relatively low level of O&M expenditure means that there is little non-salary funding to transfer to another activity as the result of the discontinuation of an activity.

Unfortunately, there is little scope for GoAP to address this issue in the short-term. The Finance Department states that any savings from the surrender of posts to the surplus manpower cell can not be retained by the department, given overall expenditure constraints, as the salary will need to be continued to be paid from a separate budget.<sup>16</sup> This position flows from GoAP policy of “focusing on human resource development and skill upgradation of its employees rather than any radical downsizing of the civil services. Towards this end, the government will continue with its policy of streamlining administration and staffing patterns in line with modern technological innovations and work norms and processes. This would be achieved through reorientation, retraining and redeployment of existing staff “.<sup>17</sup>

GoAP is seeking to increase flexibility by controlling salary costs, and has made significant progress in recent years through attrition and strict control of recruitment. GoAP has established a surplus manpower scheme in the Finance Department to regulate redeployment and instructions have been issued to all HoDs to obtain permission from Finance Department to recruit employees.<sup>18</sup> If GoAP succeeds in bringing down the overall salary burden over time, and achieves its objectives of reducing the debt servicing burden, this may bring greater scope to address under-funding of non-salary O&M expenditure.<sup>19</sup>

15 Of Plan expenditure in 2001-02 (based on Revised Estimates), 28% was external aid tied to particular projects and another 20% was tied to other projects over which GoAP does not have discretion. A further 5% of expenditure is absorbed by matching expenditure in centrally financed schemes. Once the power subsidy is excluded, this leaves only around 27% of Plan expenditure at the discretion of the State under normal State Plan schemes. As Plan expenditure is about 32% of total expenditure, this is only about 7% of total expenditure.

16 Note there is also a risk around giving departments greater flexibility to re-allocate between salaries and other expenditure arising from the non-control nature of salaries. Given that salaries are not checked against budget during execution, departments would face an incentive to under-estimate salaries to free funds for other expenditure, knowing that GoAP would be forced to meet salary commitments during budget execution. Therefore, greater flexibility in budget formulation would need to be matched by measures to ensure salaries are adequately provided for and entrench departmental accountability for under-providing for salary costs.

17 GoAP Strategy Paper on Fiscal Reforms (2001), paragraph 62.

18 GoAP Strategy Paper on Fiscal Reforms (2001), paragraph 63.

19 Note that even if it becomes possible in the longer-term to re-allocate funding from salaries to O&M expenditure during budget formulation, restrictions on reallocations between salary and non-salary expenditure during budget execution should be maintained.

### 4.3.2 District offices involvement in budget formulation

While ownership of the departmental budget by headquarters officials is important, ownership of their budgets by district offices is also key to developing a realistic budget that will be implemented as passed. The Budget Manual requires that the budget submissions of departments be based on the budget submissions of the relevant district offices.

However, Primary Health and Education advised that only around half of their district offices submitted Budget Estimates to the department. This pattern was confirmed by controls testing, which revealed that DMHOs and DEOs in only three out of the five surveyed districts submitted Budget Estimates. Offices in only one of the five districts were submitting number statements.<sup>20</sup> As another example, all the CCOs in the Roads and Buildings (R&B) Department submitted their budget estimates to the Administrative Department with delays ranging from 42 to 122 days. These estimates were in turn submitted by the R&B Department to the Finance Department during February/March (they should have been submitted in mid-October). In the absence of proposals from the Administrative Department, the budget estimates were finalised in the Finance Department, with the available information and the past actuals.<sup>21</sup>

Even when district offices do submit budget requests, these are not usually used by Primary Health and Primary Education, as the requests tend to be unrealistic in terms of expenditure ceilings. These district offices are often not even informed of their expenditure allocations for the full year and the first indication they get of their budget allocation is the distribution statement advising them of their first budget release (see section 5.4.1). While the quality of district expenditure submissions may warrant this approach, the lack of engagement with district offices means that their knowledge of local factors driving costs does not contribute to efforts to develop realistic budgets. There is a need to raise the capacity of district offices to participate in budget formulation to enable them to be held accountable for execution of the budget.

## 4.4 Budget comprehensiveness

Budget comprehensiveness is critical to fiduciary risk. Given that money is fungible, the risk is that donor budgetary funds will lead to other government funds being diverted to off-budget activities, which generally lack transparency. Overall, GoAP is now a leader amongst Indian States in budget comprehensiveness. Relevant issues in AP in relation to budget comprehensiveness are:

- Guarantees and special purpose vehicles (SPVs);
- Borrowing from the Public Account;
- Donor funding; and
- Directly funded Centrally Sponsored Schemes.

The following sections consider GoAP's performance in relation to each of these.

### 4.4.1 Guarantees and Special Purpose Vehicles (SPVs)

The Constitution requires that any State Government that has outstanding dues to GoI (which in effect means all State Governments) cannot raise any loan without the express approval of GoI.<sup>22</sup> However, no approval from GoI is required to give a guarantee and State Governments have relied extensively on this mechanism to mobilise resources. In the past, GoAP has, as in other States, used guaranteed Special Purpose Vehicles (SPVs) as a mechanism to increase borrowing over the levels agreed with GoI. In particular, four institutions (AP State Irrigation Development Corporation, AP Road Development Corporation, AP Water Resource Development Corporation, and AP Power Finance Corporation) were used for this purpose. Given that these institutions were not self-financing, and

<sup>20</sup> The DMHO and DEO in Visakhapatnam reported that they were submitting numbers statements.

<sup>21</sup> Report of the CAG of India for the Year ended 31 March 2002 (Civil) GoAP, see section 4.1.4.

<sup>22</sup> Article 293 of the Constitution.



their debt servicing obligations had to be financed through the Consolidated Fund, the budget figures understated the stock of Government debt. In substance, if not in form, these are Government borrowings.

**Figure 23: Previous-off budget borrowings**

Name of corporation	Balance as on 31/3/2002, Rs. Crore
AP State Irrigation Development Corporation	19.02
AP Water Resource Development Corporation	229.62
AP Road Development Corporation	145.00
AP Power Finance Corporation	2,291.58
<b>Total</b>	<b>2,685.22</b>
<i>Source: GoAP Finance Accounts 2001-02</i>	

Since 2000-01, GoAP has included all borrowings by SPVs as Government debt, and their interest liability is included under interest payments. Given that this debt was Rs.2,685.22 crore (see Figure 23) or 6.2% of total debt, as at 31 March 2002, this move is a substantial improvement in budget comprehensiveness.

The wider issue about the disclosure of government guarantees in budget and other financial documentation is addressed in Chapter 10 on contingent liabilities.

#### 4.4.2 Borrowing from the Public Account

The publication of the Budget in Brief has contributed to budget comprehensiveness as it includes debt stock figures, whilst previously the budget only contained information on debt repayments and new borrowings (flows). However, the debt figures in the Budget in Brief do not fully capture liabilities under the Public Account, which accounts for 27.9% of total debt in 2000-01 (see Figure 23). However, these liabilities are included in the Finance Accounts and were included for the first time in the 2003-04 AFF. The Finance Department rationale for not including these in the Budget in Brief is that this document is limited to Consolidated Fund transactions.

#### 4.4.3 Donor funding

As all donor financing to GoAP is channelled through GoI, it is captured in the GoAP budget (apart from those discussed in section 4.4.4). Expenditure financed from the funds is channelled through the Treasury system.

Donor financing is shown on both the revenue and expenditure sides of the budget.<sup>23</sup> Total donor financing (externally aided projects) is included as a source of receipts in the AFF. In addition, the Demand for Grants shows the amount that is externally financed under each scheme.

#### 4.4.4 Centrally sponsored schemes

In general, Centrally Sponsored Schemes are included in the budget. Funds received from GoI are disclosed as receipts, and funds spent on the schemes (both GoI and GoAP shares) through the Treasury system are disclosed as expenditure.

However, there are three exceptions to this rule: the District Primary Education Programme (DPEP), District Rural Development Authority (DRDA) and the Pradhan Mantri Grama Sadak Yojana (PMGSY). GoI provides funding directly to these three schemes, rather than through the GoAP Treasury system. GoAP is petitioning GoI to fund DPEP and PMGSY through the State budget, for reasons for financial control and accountability (outlined at section 5.8.4).

<sup>23</sup> Note that GoI provides funding for externally financed projects to States as 70% loan and 30% grant. Therefore, 70% would be shown in capital receipts and 30% would be shown in revenue receipts.

These schemes have also not previously been shown in the State's budget. However, from the 2002-03 Budget onwards GoAP has included the DPEP receipts and expenditure (both GoI and State funded) in the budget.

#### **4.5 Comprehensive, accessible and timely budget documentation**

Budget transparency enables the Legislative Assembly and civil society to hold GoAP accountable for its use of public resources. The following sections review GoAP budget documentation against three key dimensions: comprehensiveness, accessibility and timeliness.

##### **4.5.1 Comprehensiveness of budget documentation**

A significant amount of information is provided in the budget documentation to a detailed classification level. The structure of the budget documentation is outlined in appendix 3. The Annual Financial Statement, presented as part of the budget documentation, provides a detailed breakdown of revenue and capital receipts by type and source. It also provides a functional breakdown of both revenue and capital expenditure (i.e. at major head level). The Demands for Grants, which also distinguish between Plan and non-Plan expenditure, provide information to the sub-head level. The subsequent Detailed Demands for Grants provide information to the sub-detailed head level.

Budget documentation is generally comprehensive and consistent with the recommendations of the Core Group on Voluntary Disclosure Norms.<sup>24</sup> In particular, the Core Group's report commends GoAP for being one of the few States that provide a breakdown of Plan and non-Plan expenditure in the Annual Financial Statements, as well as for the publication of the Budget in Brief (see section 4.5.2.1).<sup>25</sup> GoAP has not taken up all of the Core Group's recommendations as many of these suggestions are aspirational and on the cutting edge of PFM reform. In particular, it does not provide information on the level of the financing to State public enterprises, and demarcation between the loan and equity components of this financing or a summary of major subsidies provided by GoAP and how these are reflected in the budget documents.

##### **4.5.2 Accessibility of budget documentation**

There are three key issues with regard to the accessibility of budget documentation, being:

- Revealing the big picture;
- The classification system;
- Consistency with Government Financial Statistics.

###### **4.5.2.1 Revealing the big picture**

The comprehensiveness of the Budget brings with it a high level of detail, which implies complexity. As in all States in India, the Budget is not user-friendly. The Demands for Grants are very technical documents that contain many pages of tabular material. It is very difficult for the average person to identify key fiscal trends or expenditure priorities from the pages of tabular material, undermining the scope for meaningful public discussion of the budget. The complicated detail of the budget makes it difficult for people to pick out the relevant information and understand the "big picture" of how money is spent. However, the form of the accounts is prescribed by the President on the advice of the CAG<sup>26</sup> and GoAP has made significant efforts to enhance user understanding, for example:

- The Budget in Brief, prepared since 2001-02, represents an excellent start in improving user-friendliness. This document provides useful summaries, including a graphical representation of

24 Reserve Bank of India (2001) Report on the Core Group on 'Voluntary Disclosure Norms for State Governments'. The Core Group was constituted in January 2000 with the Finance Secretaries of Gujarat, Kerala, Meghalaya and West Bengal. The Planning Commission and Ministry of Finance were also presented in the Group. The Group studied transparency issues in relation to State budgeting and made recommendations on ways in which States could improve transparency.

25 Reserve Bank of India (2001) 'Report on the Core Group on Voluntary Disclosure Norms for State Governments'.

26 Article 150 of the Constitution.



‘how the rupee comes’ and ‘how the rupee goes’ as recommended by the Core Group on Voluntary Disclosure Norms for State Governments.<sup>27</sup> However, given GoAP’s objective of increasing non-salary O&M expenditure over time, it would also be desirable to provide a breakdown of expenditure by economic classification. This would support the public in tracking the Government against this key objective over time.

- The Annual Fiscal Framework does, however, provide a break-down of expenditure by economic classification. While the AFF is the draft, rather than the final, budget, GoAP now intends to update the AFF once the Budget is passed. The updated AFF will be published on the internet for the first time for the 2003-04 Budget in May 2003.
- A Performance Budget is submitted by each department when their budget is presented to the Legislative Assembly. This outlines how its budget was utilised in the current year, in addition to information on the revised estimate relative to the budget estimate for the upcoming fiscal year. Performance Budgets are being expanded as part of the 2003-04 budget process to include broad objectives and performance indicators for Plan schemes.
- The format of the budget has been revised to make it more user friendly (see section 4.5.2.2).
- For the first time in the 2003-04 Budget GoAP published a summary of total appropriations on a department-wise basis. This was an improvement as previously no aggregated data was presented department-wise and a user would have needed to add up the totals of all the relevant Grants to identify the total expenditure for that department. Furthermore, each demand for grant included a break-down of expenditure under the relevant HoD, enabling a user to see which programmes and schemes are under the control of each HoD.
- The broad fiscal objectives and budget expenditure priorities of GoAP are outlined in the budget speech, including the MTF objectives for the revenue deficit, fiscal deficit, debt and guarantees.

#### **4.5.2.2 Classification system**

The expenditure classification system (sectors, major heads and minor heads) has been prescribed by GoI on the advice of the CAG so as to ensure uniformity in the accounts of GoI and the State Governments. The classification system is set out at appendix 4.

The complexity of the budget classification system does lead to some difficulties, being that the large number of classification categories at the detailed or object head level can be cumbersome; and instances of misclassification are reportedly numerous, and account for many of the discrepancies which are rectified by communicating variation statements to AG by the line departments.

However, the GoAP has made significant efforts since 1999 to simplify the classification system below minor head level. This has included merging similar schemes into generic programmes to reduce the detailed and sub-detailed heads of account and weeding out obsolete and redundant heads of account. As a result, 3,800 detailed and sub-detailed heads of accounts have been reduced to 2537 and budget pages reduced from 5,200 to 3000 in 2003-04. GoAP has also rationalised budget detailed heads of account from 139 to 91. In addition, the Finance Department reorganised the Budget Demands in 2001-02 to bring each Secretariat Department and concerned HoDs together. Further, in the 2003-04 Budget, each demand has been broken down HoD-wise under Plan and Non-Plan. These initiatives have all increased the transparency of the classification system.

#### **4.5.2.3 Consistency with Government Financial Statistics (GFS)**

While the classification system enables the Government to classify expenditure by functional and economic classification and revenue by economic classification, these are not reported on a basis consistent with the International Monetary Fund’s Government Financial Statistics (GFS). While

<sup>27</sup> Reserve Bank of India (2001) ‘Report on the Core Group on Voluntary Disclosure Norms for State Governments’.

GFS is not appropriate for use as an account classification system, it is considered good practice to publish supplementary expenditure and revenue statements on a GFS-consistent basis to facilitate international comparisons. The key divergence from GFS principles in the reporting of revenue and expenditure is the classification of new loans and borrowing as capital receipts (rather than a source of deficit financing) and capital disbursements as expenditure. However, GoAP is now separately providing a table showing how the deficit is financed in the AFF.

#### **4.5.3 Commitment to timely publication**

GoAP presents the budget to the Assembly before the commencement of the financial year. (as prescribed by Article 202 of the Constitution.) The 2001-02 and 2003-04 Budgets were submitted to the Assembly in February and approved in March of the relevant years.

The Constitution prescribes for the following financial documents:

- A statement of the estimated receipts and expenditure of the State for that year: the Annual Financial Statement (article 202);
- Supplementary Estimates (article 205);
- a Vote on Account in case the Budget Estimates are not passed by the start of the financial year (article 206).

These are the only legislative requirements for the publication of budget documentation.

#### **4.6 Conclusion**

Achieving budget realism is a challenge for all governments. GoAP forecasts of revenue are consistently below budget but within a low margin of error, and the quality of these forecasts has generally been improving. Furthermore, much of the variance between budget and actual revenues is due to less than anticipated receipts from GoI. The revenue shortfall is one reason for downward revisions to budget allocations at the time of Revised Estimates, although these revisions also reflect the financial performance of departments in the year to date.

Therefore, downward revisions in expenditure from Budget do not necessarily imply over-estimation of expenditure at Budget time. While there may be some tendencies for departments to over-estimate their capacity to implement activities and, therefore, their expenditure needs, there is actually some signs of under-provision for non-salary O&M expenditure. This is recognised by GoAP and they aim to increase it over time. While this under-provision could create pressure for expenditure to expand during budget execution, in practice this does not happen as Treasury controls prevent expenditure exceeding budget.

GoAP's debt servicing and salary commitments (combined with the policy of avoiding staff retrenchment) mean that GoAP has limited budget flexibility and, consequently, departmental flexibility in formulating their budgets is also limited. GoAP is developing initiatives such as the MTF, Performance Budgeting and MTEFs which will improve departmental ownership, and the quality and realism of the budget, but these will largely only bear fruit in the medium term.

GoAP is also a leader among Indian States in reforms to enhance budget comprehensiveness. These reforms have reduced fiduciary risk in this important respect.





## 5. Budget execution

### 5.1 Principles of good practice

Budget execution refers to the stage of the budget process where resources are released to spending agencies to implement expenditure programmes. Therefore, key to containing fiduciary risk are budget execution processes and systems that ensure that funds are spent on authorised and intended purposes, as expressed in the budget. A key question, therefore, is the extent to which the budget is implemented as passed, and the extent to which the nature and scale of any divergence poses fiduciary risks of significant concern. Figure 24 below highlights those principles of good practice in budget execution that are key to minimising fiduciary risk.

#### **Figure 24: Key principles of good practice in budget execution to minimise fiduciary risk**

*A high correlation between budget and actual expenditure* indicates that the budget was reasonably realistic. Changes should be limited to those that could not be anticipated during budget formulation and/or would have significant consequences if not addressed (see section 5.2).

*Transparent and clear processes for within-year expenditure changes*, such as re-appropriations, Supplementary Estimates and Revised Estimates, help ensure that the budget is implemented as passed by the legislature (see section 5.3).

*Predictability in expenditure allocations* including timely release of advice by the Finance Department to line departments of their budget allocation and expenditure releases (see section 5.4).

*Effective cash management* to ensure that departments can be provided with cash when required to execute the budget as passed by the legislature (see section 5.5).

*Departmental controls over approval and recording of transactions submitted for payment* help to ensure that there is budget availability for individual transactions, funds are used for intended or authorised purposes only, and that accurate records enable timely and reliable information on budget execution (see section 5.6).

*Monies granted or advanced promptly and accurately recorded, vouched or recovered* by departments. Wherever monies are granted or advanced as lump sums, subject to proper vouching or repayment, there is an increased risk that weak controls will lead to lack of accountability (see section 5.7)

*Financial transactions properly passed and accurately recorded*, primarily by the Treasury departments. The section also examines arrangements for payments not made through the Treasury departments (see section 5.8)

*Commitments and arrears are controlled*, thus minimising the extent to which excessive or unauthorised expenditure is incurred (see section 5.9).

This chapter assesses GoAP practice with respect to these principles.

### 5.2 High correlation between budget and actual expenditure

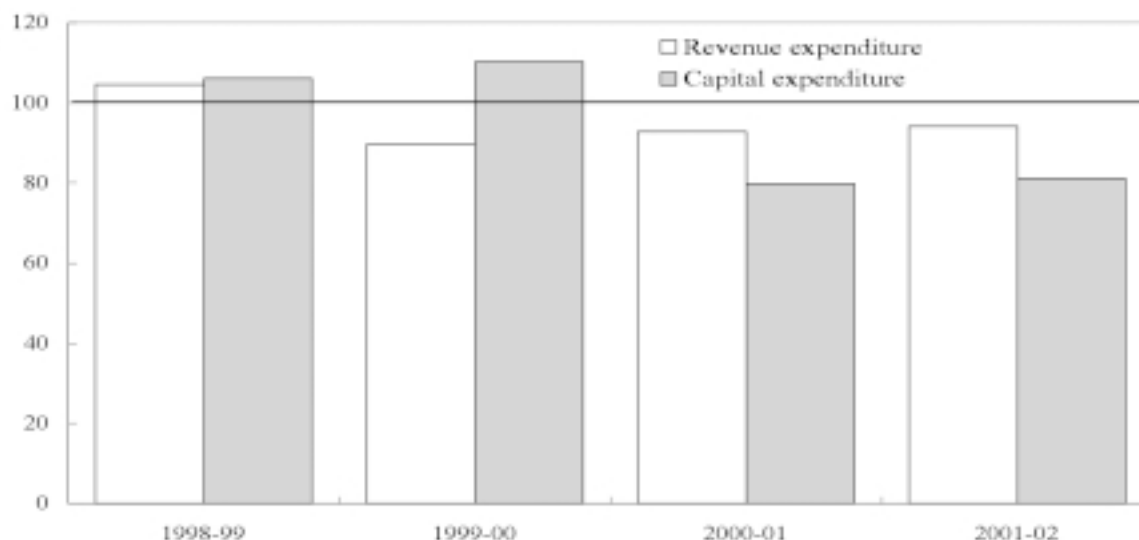
A key issue in determining the extent to which the budget is implemented as passed is the level of correlation between budget and actual expenditure.

#### 5.2.1 Aggregate expenditure

While revenue expenditure is typically less than budget, the correlation has improved in recent years from 89.5% of budget in 1999-00 to 94% in 2001-02 (see Figure 25). In the case of capital expenditure, actual expenditure was greater than budgeted in 1998-99 and 1999-2000 but was around 80% of

budget in 2000-01 and 2001-02. As discussed in section 4.2.2, differences between budget and actual expenditure are partly due to revenue shortfalls, particularly in tax devolution and grants from GoI.

**Figure 25 Revenue and capital expenditure compared with budget (actual as % of budget)  
...the correlation between budget and actual revenue expenditure improved in 2001-02...**



### 5.2.2 Expenditure at Grant level

At the Grant level actual expenditure has been substantially different from the Budget Estimates for the last two years, resulting in significant savings and some examples of excesses (see Figure 26).<sup>28</sup>

**Figure 26: Budget compared to actual expenditure by Grant in 2001-02**

No of grant	Name of Grant	Budget Estimate Rs. crore	Actual expenditure Rs. crore	Actual expenditure as % of Budget
I	State legislature	24	25	106.1
II	Governor and Council of Ministers	11	11	103.7
III	Administration of Justice	179	169	94.1
IV	Elections	6	20	335.3
V	Revenue and District Admin	366	311	85.2
VI	Stamps & Registration	42	39	93.7
VII	Excise Administration	99	118	118.9
VIII	Commercial Taxes Admin -voted	184	162	87.9
IX	Transport Administration-voted	25	123	486.1
X	Fiscal Administration	7738	7157	92.5
XI	General Administration	93	99	106.3
XII	Home Department	1148	1137	99.0

<sup>28</sup> As the SFAA team has only undertaken this variance analysis at the functional level for 2 years and at the grant level for 1 year, it is not possible for us to ascertain whether this trend has been evident for more than the last 2 years.



No of grant	Name of Grant	Budget Estimate Rs. crore	Actual expenditure Rs. crore	Actual expenditure as % of Budget
XIII	Jails Administration-voted	51	51	99.1
XIV	Roads Buildings and Ports	555	580	104.6
XV	School Education	3078	2846	92.4
XVI	Intermediate Education	250	253	101.4
XVII	Collegiate Education-voted	394	335	85.0
XVIII	Higher Education -voted	230	195	84.8
XIX	Technical Education-voted	97	88	90.9
XX	Sports Art and Culture-voted	149	84	56.0
XXI	Medical and Health	361	350	97.1
XXII	Primary Health & Family Welfare-Voted	757	719	95.0
XXIII	Medical Education-voted	510	251	49.2
XXIV	Public Health Voted	91	56	61.9
XXV	Housing-voted	183	137	75.1
XXVI	Urban Development	450	373	82.8
XXVII	Municipal Administration	186	173	93.1
XXVIII	Information & Publicity Voted	59	54	90.8
XXIX	Labour and Employment	76	65	86.0
XXX	Social Welfare	579	598	103.3
XXXI	Tribal Welfare voted	306	327	107.0
XXXII	Backward classes welfare	271	211	77.9
XXXIII	Minority Welfare voted	21	23	105.2
XXXIV	Disabled Welfare voted	21	22	101.8
XXXV	Women and Child Welfare voted	309	260	84.1
XXXVI	Relief on account of Natural Calamities	208	506	242.8
XXXVII	Admin. of Religious Endowments	16	15	93.4
XXXVIII	Agriculture	375	298	79.3
XXXIX	Horticulture voted	71	51	72.7
XL	Animal Husbandry and Dairy Development	161	149	92.9
XLI	Fisheries	19	20	104.6
XLII	Forests	215	210	97.8
XLIII	Co-operation	64	71	111.0
XLIV	Panchayat Raj	1037	1113	107.4
XLV	Rural Development	271	364	134.6

No of grant	Name of Grant	Budget Estimate Rs. crore	Actual expenditure Rs. crore	Actual expenditure as % of Budget
XLVI	Major Irrigation, Drainage, Flood control	1568	1350	86.1
XLVII	Medium Irrigation	155	149	96.0
XLVIII	Minor Irrigation	148	126	85.3
XLIX	Power Development	2244	2257	100.6
L	Industries	166	127	76.2
LI	Science Technology Environment	5	5	110.3
LII	Tourism voted	42	30	71.7
LIII	Planning Surveys Statistics	239	164	68.4
LIV	Civil Supplies Admin.	680	557	81.9
LV	Information Tech. & Communications	70	46	66.3
LVI	Public Enterprises voted	1	1	86.1
	<b>TOTAL</b>	<b>26654</b>	<b>25034</b>	<b>93.9</b>

*Source: Appropriation Accounts 2001-02*

However, these variations do not necessarily imply a significant risk of funds being spent on unauthorised purposes. In general, within year expenditure increases are captured in Supplementary Estimates, albeit on an ex post basis, and instances of unappropriated (excess) expenditure” are relatively low at around 1% of appropriations. However, these do remain unregularised for a number of years after the fact (see section 5.3.5).

Furthermore, the issue in terms of the correlation with the budget is more one of under-spending on authorised and intended purposes as in general, over 10% of appropriations were surrendered in 2000-01 and 2001-02. In 2001-02, for example, an overall saving of Rs.3177.34 crore was achieved as a result of a saving of Rs.3605.03 crore in 109 items of grants and appropriations. According to the CAG this was “due largely to postponement of works and failure to issue administrative sanction etc”.<sup>29</sup>

The high value of grant savings is partly due to lower than forecast grants-in-aid from GoI preventing the release of these funds, and the matching State Grants, for the relevant Plan Centrally Sponsored Schemes (see section 5.4.2.1). Lower than forecast Plan expenditure accounted for around 56% of the variance between budget and actual revenue expenditure in 2001-02. However, there are also significant variances in non-Plan expenditure items, particularly in the control items of non-salary O&M and maintenance of capital assets. Reasons for the savings reflect factors such as lower than budgeted revenue, delays in the issue of distribution statements at the district level and administrative bottlenecks. Note that reasons given by departments via the Appropriation Accounts for savings are very limited. Therefore, the SFAA team has been unable to assess the reasons for the shortfalls.

The variations between budget and actual expenditure also differ significantly across Grants (see Figure 26). Most grants show actual expenditure that is less than the budget, with Medical Education showing the greatest negative variation, with actual expenditure being 49.2% of budget. Some grants showed expenditure above budget in 2001-02, the most significant being the following three grants:

<sup>29</sup> Report of the CAG of India for the Year ended 31 March 2002 (Civil) GoAP, see para 2.3.

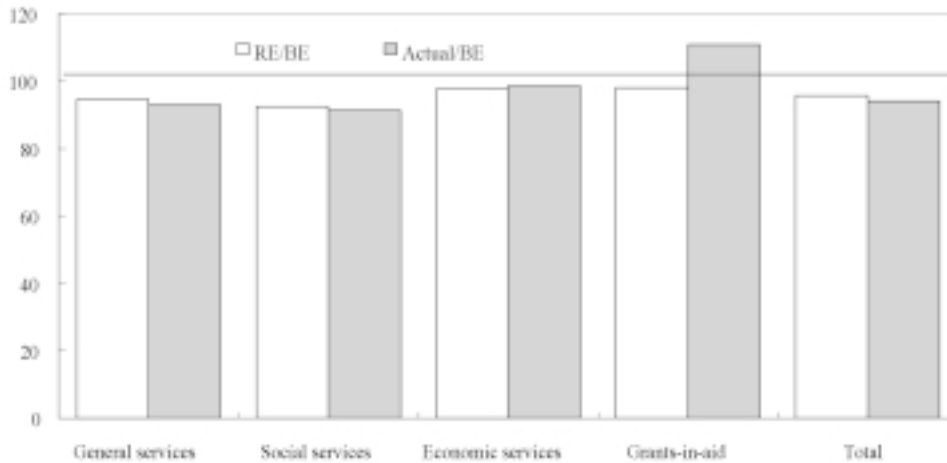


- Expenditure on Relief on account of Natural Calamities was 234% of budget, the severity of which cannot be anticipated;
- Elections expenditure was 335% of budget, but the absolute amount of variation is only Rs.14 crore, due to unforeseen election expenditure;
- Transport Administration was 486% of budget. The additional expenditure in transport was due to the announcement of a major transport scheme in the GoI budget after the GoAP Budget had been presented.

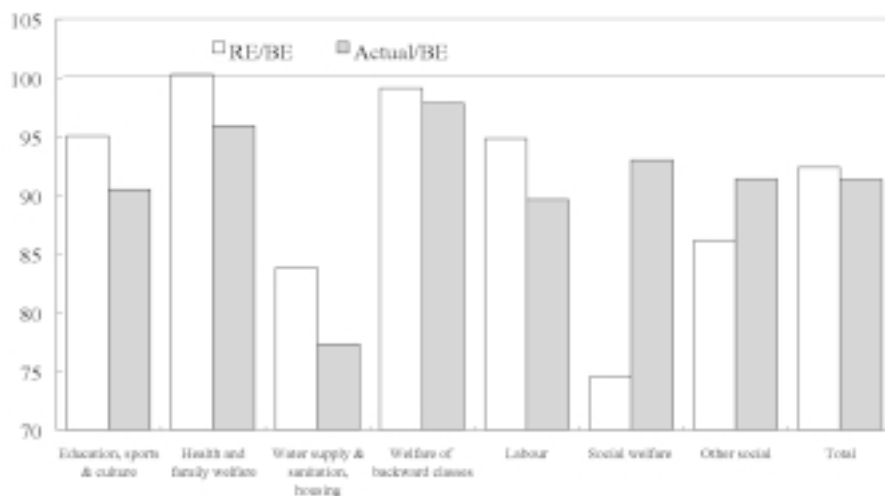
**5.2.3 Expenditure by function**

The difference between budget and actual expenditure also varies across functions.<sup>30</sup> General and Social Services showed the largest negative variance from budget in 2001-02 (see Figure 27). The variance in social services narrowed in 2001-02 as actual expenditure for social services was 84.4% in 2000-01 and 91.3% in 2001-02 as a percent of budget.

**Figure 27: Revised Estimates and actual expenditure as % of Budget Estimates, 2001-02**  
**... Social Services showed a negative variance from budget in 2001-02 ...**

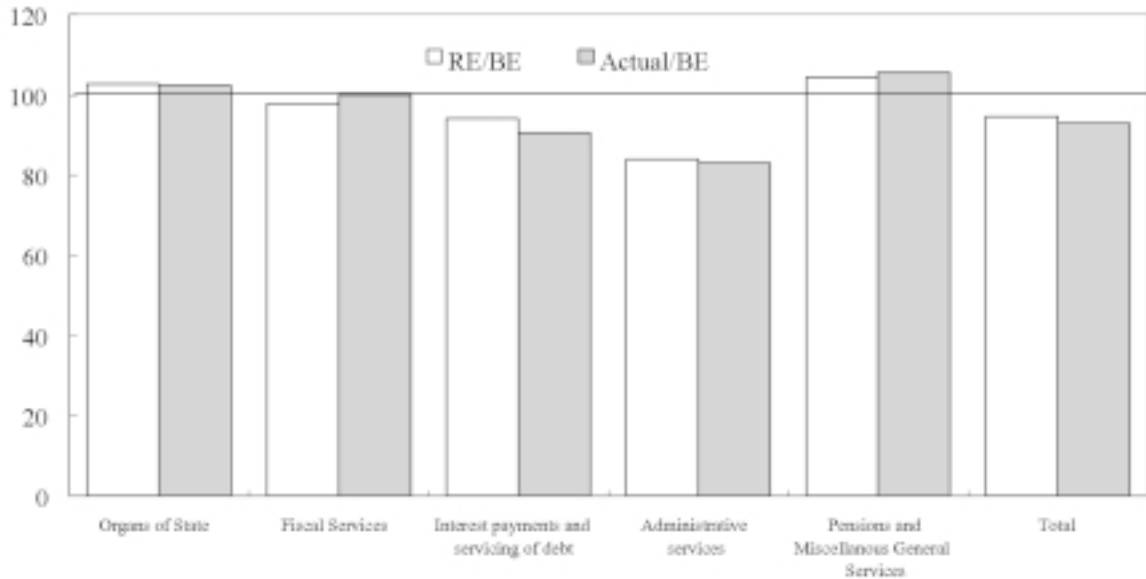


**Figure 28: Social Services RE and actual expenditure as % of Budget, 2001-02**  
**...some areas of social spending are significantly lower than budget...**



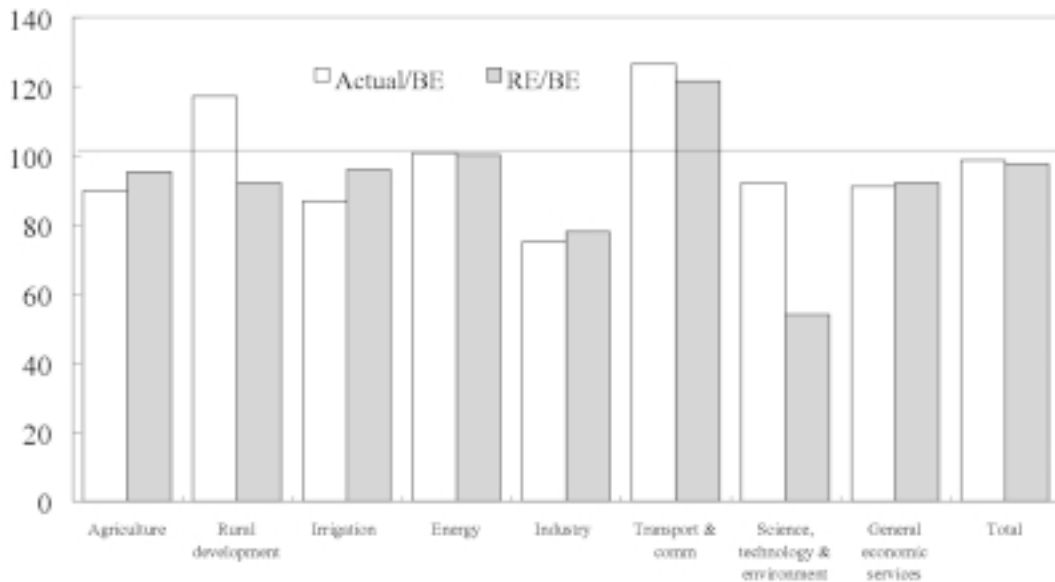
30 Note that the increase in actual expenditure over Budget for grants-in-aid was due to the additional funds granted to local bodies to combat widespread drought conditions, which could not have been anticipated.

**Figure 29: General services RE and actual expenditure as % of Budget, 2001-02**  
**...some savings are due to lower than forecast debt servicing...**



The range of variances is even greater within Social Services, and within General Services and Economic Services, as seen in Figure 28, Figure 29 and Figure 30.

**Figure 30: Economic services RE and actual as % of Budget, 2001-02**  
**...economic services show the lowest under-spending...**



### 5.3 Transparent and clear processes for within-year expenditure changes

Given the uncertainty involved in forecasting revenue and expenditure, the Budget can not be fixed in stone and some within-year changes to expenditure will always be necessary. However, it is critical that processes for within-year expenditure changes are transparent and carefully managed to *ensure that they do not provide an avenue for re-writing the budget during execution*. As a general rule,



changes should be limited to those that could not be anticipated during budget formulation and/or would have significant consequences if not addressed.

There are four key formal mechanisms by which budgetary allocations can be changed within or at the end of the year. These are:

- Re-appropriations, that is the transfer of savings within Grants;
- Use of the Contingency Fund;
- Increases in expenditure through Supplementary Estimates;
- Revised Estimates.

These mechanisms are examined in the sections below, and are followed by an examination of two other means by which expenditure can be made without an original budgetary allocation:

- Excess expenditure due to lack of checks over non-control items or authorised relaxation of Treasury controls in anticipation of Supplementary Estimates;
- Diversion of funds between schemes.

### 5.3.1 Re-appropriations

While the Legislative Assembly approves expenditure at the Grant level,<sup>31</sup> GoAP controls expenditure at the Grant level under Revenue, Capital and Loans sections and binds departments to appropriations at the sub-head level in an effort to exercise fiduciary control over expenditure. GoAP has increased the flexibility of HoDs to re-appropriate in order to respond to changing needs during the year. The extent of these re-appropriations is not known, as there is no published data on their level or value, but they do not contribute to the variations between Grants, as re-appropriations are a mechanism for within-year changes to expenditure within Grants only.

A summary of the HoD delegated powers and restrictions are set out at appendix 5. These re-appropriations rules do allow a HoD to re-appropriate between schemes (sub-head) and between programmes (minor heads) within a Grant that he/she is in charge of, subject to restrictions on the type of expenditure. For example, a HoD has delegated powers to re-appropriate between revenue to revenue, capital to capital and loans to loans. That means the HoD can re-appropriate from revenue expenditure in one sub-head or minor head to revenue expenditure in another sub-head or minor head respectively.

Most HoDs are responsible for more than one minor head. For example, the Director of School Education is responsible for two sub-major heads (Primary and Secondary Education) and all of the minor heads under these.<sup>32</sup> This means, for example, that in theory it is possible for the Director of School Education to re-appropriate between the non-Plan budget for primary education and secondary education.

Given that data is not published on re-appropriations, it is not possible to precisely determine to what extent these types of virement take place. However, in practice, the scope of HoDs to undertake such re-appropriation is limited given the number of other restrictions on re-appropriations. This is especially so given that such a large proportion of departmental budgets is devoted to salaries, and re-appropriations from the salary object-head are not permitted. Departments have also not been given any power to re-appropriate across Group Sub-Heads (or across groups of schemes funded from different sources). Therefore, in practice the restrictions on re-appropriations means that the value of re-appropriations is probably not significant.

31 The Appropriation Act includes a total for each Grant, that is not to be exceeded.

32 As other examples, the Commissioner for Agriculture and the Chief Conservator of Forests are also responsible for more than 15 minor heads (programmes).

While there is a restriction on re-appropriations to new schemes, it is also possible for HoDs to set up schemes with token amounts of money at budget time to maintain flexibility to take them up during the year. There are also a number of examples in the 2001-02 Demands for Grants of lump-sum provisions at the sub-head or detailed sub-head level. These were either re-appropriated or surrendered during the budget year.

GoAP's efforts to give departments greater flexibility in order to facilitate the effective and efficient use of resources are commendable. However, it is important that a balance be struck between financial control and accountability on the one hand, and line department flexibility on the other. In particular, the type of flexibility given the departments needs to be closely linked to what departments are held accountable for (see Figure 31).

**Figure 31: Alternative approaches to line department accountability**

In determining the appropriate type and degree of flexibility for line departments in budget execution, it is important to be clear about what they will be held accountable for. It is their accountability which dictates the appropriate type and degree of flexibility. In particular, GOAP needs to be clear whether line departments will be held responsible for using inputs in line with the budget, producing outputs that are specified in the budget or achieving outcomes in line with the Government's objectives. If line departments are to be accountable for the use of:

- \* **Inputs or object heads**, then the focus is solely on financial accountability for **compliance with the itemised Budget and financial management rules**. This implies limited scope to shift resources between line items during budget execution and **no scope for shifting funds** between schemes and between programmes;
- \* **Outputs**, then the focus of accountability is on what managers are **producing** rather than on what they are spending funds on. Performance indicators should focus on the goods or services produced through GoAP schemes and programmes and departments should be able to **change the mix of inputs** they use within those schemes and programmes to deliver outputs. However, the scope to allocate across schemes and programmes during budget execution would still be tightly controlled;
- \* **Outcomes**, then the focus of accountability is on what departments are **achieving** rather than on what they are producing or what they are spending funds on. Performance targets would be linked to GoAP objectives and departments would be able to **shift funds between schemes and programmes**, at least during budget formulation.

**Allowing HoDs to shift resources between schemes and programmes during budget execution implies accountability for outcomes rather than for delivering on the outputs specified in the budget.** This is perhaps risky given that GoAP is in the early days of developing systems for performance management. It is also unusual. While some countries use a mixture of output and outcome performance measures, it would be unusual for departments to have full flexibility in determining the mix of programmes best able to contribute to achievement of the Government's objectives. In particular, while departments may have flexibility to modify the mix of programmes during budget formulation, subject to agreement from Cabinet and the legislature, allowing these shifts during budget execution undermines the capacity of the political executive to set expenditure priorities.

To ensure accountability, HoDs who have the discretion to shift resources between programmes should be held accountable for the outcomes of expenditure. The fact the GoAP still imposes a number of restrictions on the re-appropriations of object heads (inputs) is a sign that AP does not yet have the wider accountability environment to support a movement to output or outcome accountability. These types of controls are needed during budget execution, as GoAP is only just beginning to develop





approaches to linking performance measurement to budget accountability. Without this capacity, allowing re-appropriations between activities is premature. Furthermore, increases in flexibility should be limited to inputs or schemes with common objectives - no country has a pure “outcome accountability” model.

GoAP does recognise the importance of ensuring accountability for use of funds and that flexibility for line departments during budget execution must be linked to accountability for performance. The Government’s view is that under the current framework the flexibility to shift between programmes is very limited due to the restrictions outlined. There is a need for greater clarity about the underlying accountability framework, particularly as GoAP moves towards performance budgeting over time.

### 5.3.2 Contingency Fund

If there is a need for urgent unforeseen expenditure, that can not be met from savings within the Grant, the Finance Department can sanction an advance from the AP Contingency Fund, pending the authorisation of funds by the Legislative Assembly.

The Contingency Fund is Rs.50 crore, less than 0.2% of total expenditure in 2001-02. If the corpus of the Contingency Fund is to be increased, the Act has to be amended and the funds for enhancement have to be appropriated by the Legislative Assembly.<sup>33</sup> Given that the Contingency Fund only represents a very small proportion of GoAP expenditure, it does not appear to pose any significant fiduciary risks. It is reasonable for government to put aside a small contingency to meet unforeseen circumstances.

**Figure 32: Sanctions from the Contingency Fund (Rs. crore)**

Financial year	Total advance sanctioned Rs. Crore	Advances recouped to the Fund during the year Rs. crore	Advances unrecouped during the year Rs. crore
1999-00	33.482	14.428	19.054
2000-01	26.481	22.622	3.859
2001-02	22.921	18.362	4.559
<i>Source: Finance Department</i>			

The recoupmnt of expenditure from the Contingency Fund is provided for in the Supplementary Estimates or the Budget Estimates of the next year. Provisions representing recoupmnt of advances sanctioned from the Contingency Fund are outlined in a explanatory note for each Grant concerned in the Supplementary or Budget Estimates. The transactions are included in the Appropriations Accounts and Finance Accounts under the relevant heads. The Finance Accounts show a summary of the amount debited from the Contingency Fund that have not yet been recouped at year end (and will be included in the next Budget Estimates).

### 5.3.3 Supplementary Estimates

While Supplementary Estimates are allowed under the Constitution,<sup>34</sup> significant access to them can undermine the motivation of departments to ensure accurate Budget Estimates and to control expenditure during budget execution.<sup>35</sup> On first inspection, the level of Supplementary Estimates seems very high in AP. Despite decreases in recent years, Supplementary Estimates were still around 29% of total budgeted disbursements in 2001-02 (see Figure 33).

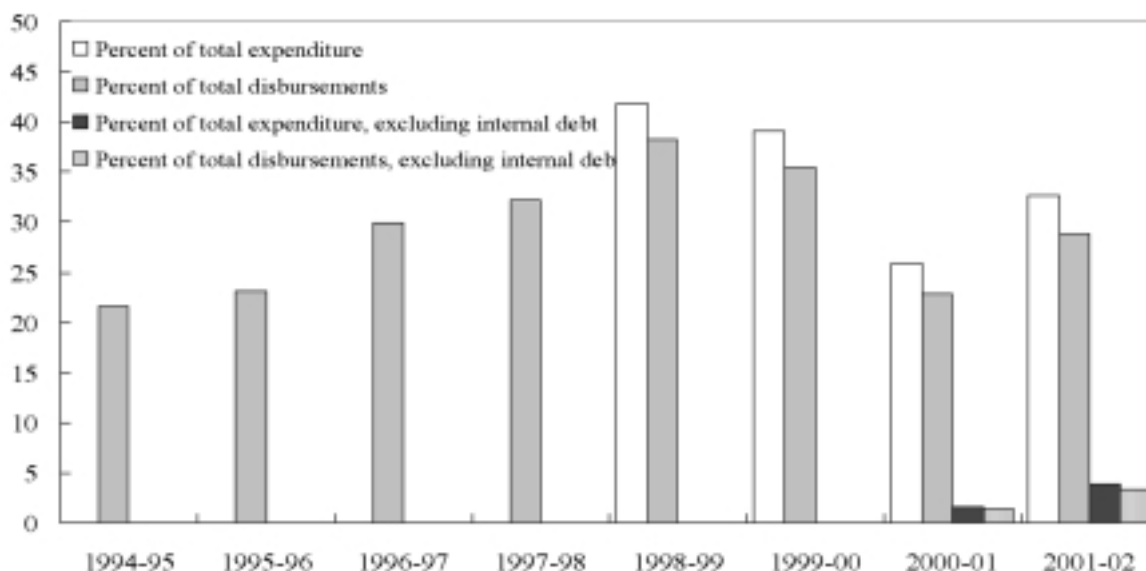
33 Therefore, the real value of the Contingency Fund (and its value as a percentage of total expenditure) has been declining over time.

34 Article 205 of the Constitution allows for Supplementary Estimates in State Governments.

35 Indeed, according to the Budget Manual, “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 will be caused to the public service”.

**Figure 33: Supplementary Estimates as a % of budgeted disbursements** <sup>36</sup>

*... Supplementary Estimates appear high but are insignificant when repayment of internal debt is excluded...*



Yet Supplementary Estimates are not a significant cause of divergences from budget. The vast majority of Supplementary Estimates actually relate to charged expenditure, which does not have to be voted and is included in the Budget Estimates and Supplementary Estimates in the interests of transparency. Furthermore, the majority of this charged expenditure is the repayment of overdraft and ways and means at the RBI (see section 5.5). Given that ways and means advances and overdraft must be repaid within the same financial year, this capital repayment is totally offset by capital receipts into the Consolidated Fund. This is effectively an accounting transaction reflecting the gross basis on which GoAP's accounts are based. The net impact on total expenditure (as opposed to total disbursements) and the fiscal deficit is nil. Supplementary Estimates excluding the repayment of internal debt were only 1.4% in 2000-01 and 3.4% in 2001-02 of total budget disbursements and 1.6% in 2000-01 and 3.8% in 2001-02 of total expenditure (excluding debt repayments). This low level of Supplementary Estimates is consistent with the fact that most departments actual expenditure is actually lower than budgeted.

Supplementary Estimates are not submitted to the Legislative Assembly until the last few days of the fiscal year. <sup>37</sup> The Finance Department authorises Treasury departments to release some of the expenditure in anticipation of Supplementary Estimates, as "authorised relaxations of Treasury control". In these cases, the Legislative Assembly's approval is effectively retrospective.

It is generally the view in AP that the ex-post appropriation is consistent with the Supplementary Estimates provision (article 205) of the Constitution, which states that the Governor shall use Supplementary Estimates:

- (a) if the amount authorised by any law made in accordance with the provisions of article 204 to be expended for a particular service for the current financial year is found to be insufficient for the

<sup>36</sup> Note that total expenditure (as opposed to total disbursements) data was not analysed for prior to 1998-99. Note also that Supplementary Estimates excluding the repayment of internal debt have only been calculated for 2000-01 and 2001-02.

<sup>37</sup> For example, the Supplementary Estimates for 2000-01 and for 2001-02 were presented to the Legislative Assembly on 27 March 2001 and 23 March 2002 respectively.



purposes of that year or when a need has arisen during the current financial year for supplementary or additional expenditure upon some new service not contemplated in the annual financial statement for that year; or

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

In some cases, expenditure made via relaxation of Treasury control in anticipation of Supplementary Estimates are not ultimately captured in Supplementary Estimates. The CAG does some test checks of a sample of departments, the results of which are shown in Figure 34. This shows that the trend for authorised relaxations has been downward over the past four years. However, there has not been a corresponding drop in 2001-02 in authorised relaxations not covered by Supplementary Estimates (see Figure 34).

**Figure 34: Expenditure sanctioned in relaxation of Treasury controls in anticipation of Supplementary Estimates (Rs. Crore)**

	1998-99	1999-00	2000-01	2001-02
<b>Amount sanctioned in relaxation of Treasury controls</b>				
Rs. Crore	851.03	858.52	414.39	292.76
Number of cases	228	298	84	67
<b>Amount not covered by Supplementary Estimates</b>				
Rs. Crore	175.7	49.24	11.05	94.05
Number of cases	76	28	4	18
Test check of departments	13	14	8	10
<i>Source: CAG's Audit Reports (Civil) 1998-99, 1999-2000, 2000-01, 2001-02 (para 2.3.19)</i>				

#### 5.3.4 Revised Estimates

While the Supplementary Estimates are not submitted to the Legislative Assembly until the end of March, they are incorporated in the Revised Estimates. These Revised Estimates represent an updated version of the originally approved estimates, which are revised to reflect changes to spending and revenue patterns which have occurred during the first six to ten months of the year.

In 2001-02 and 2002-03, Revised Estimates have been presented to the Legislative Assembly with the draft budget (the AFF) in January/February. As the Appropriation Act grants GoAP the power to spend up to the amount included in the Act for each grant, the Legislative Assembly does not approve the Revised Estimates, but only any increases in expenditure through the Supplementary Estimates. This means that the Assembly does not approve any within-year cuts in expenditure, departmental savings or re-appropriations.

Departments submitted their Revised Estimates to the Finance Department for 2002-03 with their initial Budget Estimates for 2003-04. If divergences between budget and actual expenditure create the need for within-year reductions in expenditure (see section 4.2), the adjustment in departmental appropriations is made via the Revised Estimates. In determining department's Revised Estimates, the Finance Department also takes into account budget utilisation throughout the year. It is commendable that these adjustments are now done through the Revised Estimates process, rather than through the use of ad hoc mechanisms such as freeze orders or moderations of budget releases. The Finance Department have also given line departments more flexibility to respond to these within year reductions by indicating only the ceilings of revised estimates and asking the line departments to make scheme-wise allocations within the ceilings.

However, the *impact of variation between budget and Revised Estimates for revenue expenditure varies significantly between functions and by grant. Furthermore, there were further significant changes, mostly reductions, in expenditure between Revised Estimates and actual expenditure for some functions.* These changes were significant for some sub-functions, suggesting that there is scope for strengthening the accuracy of Revised Estimates (see Figure 27 to Figure 30 in section 5.2.3).

### 5.3.5 Excess expenditure

Excess expenditure refers to expenditure that has not been appropriated, therefore it represents the use of monies from the Consolidated Fund for purposes not authorised by the Budget. The centralised expenditure release system requires checks against appropriations before funds are released for control items, in theory preventing expenditure exceeding the budgetary provision. However, as shown in Figure 35, there are *instances of “excess expenditure”; these accounted for around 1% of total expenditure in 2001-02.* This is not a significant amount; indeed, as noted, the issue in GoAP is more one of savings than excesses.

This excess expenditure could be caused by the following factors, being:

- *The lack of checks against budget for non-control items* as these “committed” expenditures must be made regardless of budget provision;
- *Authorised relaxation of Treasury controls in anticipation of Supplementary Estimates.* As discussed in section 5.3.3, given the late passage of Supplementary Estimates, the Finance Department sometimes provides authorisation for the relaxation of Treasury controls in anticipation of Supplementary Estimates. In some cases, the Supplementary Estimate never materialises, leading to unappropriated expenditure.

However, it is not possible to identify the relative contribution of these factors to the unappropriated expenditure, or, indeed, whether there are any other factors. The Appropriation Accounts do not provide a summary of the causes of excess expenditure. Instead, reasons are provided on a case by case basis, and these do not generally offer insights on the underlying causes of the excesses.

**Figure 35: Comparison between savings and unappropriated expenditure**

	1998-99 Rs. crore	1999-2000 Rs. crore	2000-01 Rs. crore	2001-02 Rs. crore
Total Grant or appropriation	28,499.52	34,404.75	41,604.02	46,338.44
Actual expenditure	27,199.19	30,783.72	38,457.59	43,161.10
<b><i>Expenditure compared with Grant or appropriation:</i></b>				
Saving	1,561.96	4,467.34	3,560.72	3,605.03
Excess	310.63	846.31	414.29	427.69
<b><i>Percent of appropriation:</i></b>				
Saving	5.5	13.0	8.6	7.8
Excess	1.1	2.5	1.0	0.9
<b><i>Source: Appropriation Accounts</i></b>				



**Figure 36: Excess and unregularised expenditure**

Year	Rs. crore	Number of cases
1997-98	405.12	32
1998-99	310.63	35
1999-00	846.31	27
2000-01	414.29	21
Total	1976.35	115
2001-02	427.69	22
Total	2404.04	176

*Source: Report of the CAG of India (Civil) for the Year Ended 31 March 2002*

Whatever the cause, unappropriated expenditure is required to be recommended by the PAC for “regularisation” to the Legislative Assembly. However, expenditure remains “un-regularised” for a number of years. The CAG Audit Report (Civil) 2001-02 states that, 115 cases of excess expenditure incurred without provision/supplementary grant/reappropriations, totalling Rs.1,976.35 crore for the years 1997-98 to 2000-01, had not yet been regularised by the Legislative Assembly (see 13.3).<sup>38</sup> In addition, the 61 cases totalling Rs.427.69 crore of excess expenditure during 2001-02 (noted above) will also require regularisation. The reasons for this situation are discussed in section 13.3.

### 5.3.6 Diversion of funds

One issue which has been a repeated feature of CAG Audit Reports is the diversion of funds released from Treasury departments for one particular scheme to another scheme. Under these circumstances, the expenditure is recorded under the original scheme, rather than under the scheme under which the expenditure is actually incurred.

No aggregate data is available about the scale of these diversion of funds. However, the CAG undertakes test checks for a sample of schemes and districts to determine the number of cases of such diversion of funds and lapses of funds intended for Centrally Sponsored Schemes to GoAP (see Figure 37). The 2000-01 and 2001-02 CAG Audit Reports note higher value instances of diversions of funds over the period 1991 to 2002 of Rs.196.61 crore in the 2001-02 Audit Report and Rs.95.04 crore in the 2000-01 Audit Report (see Figure 37). Overall, the diversion of funds appears to be insignificant relative to total expenditure over the ten year period (for example, annual expenditure in 2001-02 was Rs. 31,583.34). Although not alarming, there is scope to minimise these with improved controls.

**Figure 37: Examples of diversion of funds in CAG Audit Reports**

A test check of selected schemes for the 2001-02 audit revealed numerous cases of diversion of funds in eleven different districts. The **higher value instances noted totalled Rs.196.61 crore over the period 1992 to 2002**, consisting of:

Rs.1.41 crore released for the World Bank funded Agricultural Human Resources Development project was diverted towards salaries, internal travel, running and maintenance cost of training institutes and renovation of existing office buildings during 1995-2002 (see para 3.1.3B (iii));

<sup>38</sup> Report of the CAG of India for the Year ended 31 March 2002 (Civil) GoAP; see para 2.2.1 and appendix V. The requirement for regularisation is set down in Article 205 of the Constitution.

Rs.9.33 crore released for World Bank funded Second Technician Education Project was diverted to other purposes during the period 1992-99 (see para 3.1.4A);

Rs.67.73 crore released for rural housing schemes including Indira Awaas Yojana-centrally sponsored scheme was diverted to State Housing Scheme-Rural Permanent Housing Scheme during 1999-2002 (see para 7.5.4(iii));

Rs.39.06 crore released for PMGY diverted to State Housing Scheme during 2000-02 (see para 7.5.6B);

Rs.20.48 crore released as central subsidy diverted to a State scheme on which expenditure had already been incurred during 1999 (see para 7.5.6C);

Rs.42.66 crore released for SJGSY diverted to other schemes/purposes during 1999 (see para 7.6.4(a));

Rs.3.12 crore released for SGSY diverted to SRTRI during 1999 (see para 7.6.10(iii));

Rs.12.82 crore diverted under the orders of the collectors in six districts to other purposes, CMEY, tours, purchase of vehicles and other schemes not connected with programmes during 1999-02 (see para 7.6.12).

A test check of selected schemes for the 2000-01 audit revealed numerous cases of diversion of funds in seven different districts. The **higher value instances noted totalled Rs.95.04 crore over the period 1991-2001** consisting of:

- Rs.8.88 crore released for audio visual education in Operation Blackboard diverted to maintenance of residential junior colleges over the period 1991 to 1999 (see para 2.3.20);
- Rs.23.99 crore diverted from DRDA to CMEY based on 7 districts test checked (Youth advancement, Tourism and Culture department) over the period 1996-2001 (see para 3.2.4 B (i));
- Rs.13.63 crore intended for ongoing works of schemes diverted to maintenance of works already executed and payment of salaries (Panchayat Raj and Rural Development) during period 1995 to 2001(see para 7.6.4);
- Rs.3.73 crore of SCA scheme funds diverted to CMEY during 1997 to 1998 (Social Welfare) (see para 7.4(iii));
- Rs.1 crore of SCA funds diverted to Silver Jubilee Merit Scholarship programme over the period 1998-99 (Social Welfare) (see para 7.4(iii)b);
- Rs.19.75 crore of SCA funds diverted to administrative expenses over the period 1995 to 1999 (Social Welfare) (see para 7.7.6 (ii));
- Rs.22.47 crore diverted from DPEP funds to Janmabhoomi for purchase of furniture and vehicles equipment (see para 7.10.6);
- Rs.1.39 crore earmarked for developmental schemes diverted for construction of an office complex at Sangareddy over the period 2000-01 (see para 3.16).

There are also examples in the CAG 1999-2000 Audit Report (Civil) and AG Inspection Reports.

The diversion of funds between Personal Deposit (PD) accounts has been enabled in the past by weak controls over the accounts. However, as outlined in section 5.8.5, GoAP is making efforts to strengthen controls over PD accounts.

#### 5.4 Predictability in expenditure allocations

Predictability in expenditure allocations depends upon realism in budget formulation, as discussed in section 4.2, and the system for expenditure authority releases during budget execution. To ensure effective budget implementation, departments should receive timely:



- Advice as to their budget allocation;
- Releases of expenditure authorisations.

#### 5.4.1 Advice of budget allocation

Departments are now provided with broad guidance as to their expenditure allocations in expenditure ceilings issued by the Finance Department in early January. They were provided with final expenditure ceilings in the 2003-04 process by 10 February 2003. Each HoD and CCO is given final notice of allocations through the issue of the Appropriation Act in April.

It is the responsibility of CCOs to distribute that budget allocation to each of their COs, and thereon to their DDOs or Executive Engineers (the equivalent of DDOs in development projects) through distribution statements.<sup>39</sup> However, controls testing indicated that COs and DDOs are usually not informed by CCOs of the budget allocation for the full fiscal year.<sup>40</sup> Therefore, they are only advised of their budget for the first six months of the year, through distribution statements and on a quarterly basis thereafter (see section 5.4.2). Given that quarterly allocations are not necessarily equal, it is not possible for the CO or DDO to extrapolate the annual allocation from their first distribution statement. This lack of predictability usually leads the COs and DDOs to be conservative in their spending in the first two quarters, and the expenditure actually picks up in the last quarter once the final annual allocations are known.

#### 5.4.2 Release of expenditure authorisations

GoAP has improved the timeliness of expenditure authorisations through the system of Budget Release Orders (BROs). In particular, GoAP introduced, in April 2001, a system of advance release budget spending authority for the first six months of the year, followed by quarterly releases (see Figure 38).<sup>41</sup> This system has been further streamlined in April 2003, when the GOAP introduced advance release of the first three quarters spending authority in April, followed by a second and last instalment in January, based on Revised Estimates less earlier releases.

The following sections consider the timeliness:

- Of the issuing of BROs to departments by the Finance Department;
- The distribution of budget releases to the CCOs and DDOs.

##### 5.4.2.1 Issuing of BROs to departments

The Finance Department has advised the SFAA team that it issues BROs on a timely basis in line with GO 273. The only exceptions are BROs that relate to Centrally Sponsored Schemes, some of which GoAP releases only on receipt of funds from GoI. The Finance Department decides, in consultation with the Secretaries in the concerned administrative departments, as to the schemes for which a single BRO can be given at the beginning of the year and the schemes for which separate specific concurrence of Finance Department is needed before BROs can be issued by the Finance Department.<sup>42</sup> The Finance Department does not issue the BROs for these schemes (including its matching share) until the funds are received from GoI, except in pressing circumstances.

39 How the budget will be distributed is determined by the CCOs, but is usually in line with the budget estimates submitted by each CO during the budget formulation stage.

40 None of the five districts COs or DDOs were advised of their budget allocation.

41 BROs are released only for those expenditures that require Finance Department concurrence. This relates to Plan schemes and non-Plan control object-heads, such as operational and maintenance expenditure and grants-in-aid.

42 G.O.Ms No.59, Budget Monitoring - Budget Release Order - Certain Instructions - Regarding. Dated 30.3.2001.

**Figure 38: Reform in the BRO system**<sup>43</sup>

Under the new BRO system, the Government has decided to put 50% of the Budget Estimate provision of the financial year at the disposal of the HoD in the 1st week of April (first week of the financial year). The Finance Department releases 50% of the total budget estimate provisions specified under each scheme and items for which otherwise proposals used to come to the Finance Department for specific administrative sanction.

The second instalment will be released by 1st week of October of each year and shall be equal to the amount of expenditure incurred in the first quarter or 25% of the budget provision; whatever is less. The second instalment will be released only after the review of the schemes and achievement in performance indicators, actual expenditure incurred and subject to the actual receipt of inflows from GoI, National Bank for Agriculture and Rural Development (NABARD) or other financing institutions. In April 2003, the system of second instalment has been given up, and the first instalment is released for the first three quarters in April itself.

Each department will finalise a review of their schemes and submit estimates for Revised Estimates for the current year, as well as next year's Budget Estimates by the end of November each year. The Finance Department will estimate the overall availability of resources for the balance period of the year, as well as for the next year, and finalise the Revised Estimates for the current year and Budget Estimates for the next year by 25th December of each year. Consequently, the final instalment for each scheme will be decided and released by 1st week of January.

Given that lower than expected grants-in-aid have recently been the key driver in shortfalls in actual revenues relative to budget, this perhaps explains why non-salary Plan expenditure has been significantly below budget in recent years (see Figure 39). Overall, divergences between budget and actual Plan expenditure were responsible for 56.2% of the overall difference between budgeted and actual revenue expenditure in 2001-02. This contribution was 66.1% in terms of the 2002-03 Revised Estimate.

**Figure 39: Components of Plan expenditure as % of budget  
(2002-03 based on Revised Estimates)**

Component of Plan expenditure	2001-02	2002-03
Total Plan expenditure	84.7	90.1
Salaries	129.5	100.0
Non-salary O&M	66.7	83.9
Maintenance of capital assets	66.9	85.6
Subsidies and other grants-in-aid	82.5	89.1
Other expenditures	292.2	99.8
<i>Source: Annual Fiscal Framework 2003-04</i>		

#### 5.4.2.2 Delays in expenditure authorisations at district level

Despite improvements in the timeliness of BROs to departments, controls testing suggests that there are still significant delays in expenditure releases (via distribution statements) to COs and DDOs. Figure 40 provides examples of distribution statement dates as advised by COs and DDOs in Primary

<sup>43</sup> As outlined in G.O.Ms No.59, Budget Monitoring - Budget Release Order - Certain Instructions - Regarding. Dated 30.3.2001. and GO Ms No. 273, Dated April 1, 2003.





Health and Primary Education sector in Nalgonda district. Given that the same distribution statement, with information for all districts, is sent to each district, this can be accepted as indicative of budget releases for all districts. Note also that the figure includes date ranges. This is because there is a separate distribution statement for each Plan scheme and non-Plan control sub-head. Therefore, the figure shows the range of dates at which distribution statements were received.

**Figure 40: Nalgonda Primary Health and Education distribution statements dates for 2001-02 (range of dates)**

Qtr ending	Primary health				Primary education			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
	June	Sept	Dec	Mar	June	Sept	Dec	Mar
CCO (line department) to CO (DMHO or DEO)	22/5/01 to 22/6/01		24/8/01 to 24/12/01	02/2/02 to 14/03/02	16/4/01 to 20/5/02	29/6/01 to 28/7/01	14/10/01 to 19/11/01	15/1/02 to 22/2/02
CO to DDO (e.g. PHC or school)	29/5/01 to 11/7/01		10/9/01 to 28/2/02	25/2/02 to 28/3/02	3/6/01 to 22/6/01	4/7/01 to 14/8/01	27/10/01 to 25/11/01	20/2/02 to 10/3/02

*Source: Controls testing (Nalgonda)*

There are a number of issues to note from Figure 40, being as follows:

- There are significant delays in the communication of budget releases from the CCO to the CO level. For example, DMHOs are not generally provided with their first six months of expenditure authority until the second quarter of the year. They do not receive all of the distribution statements for the financial year until 14 March, only a few weeks before the end of the financial year.
- The delays are even greater for DDOs, with COs sometimes taking several weeks to communicate budget releases down to this next level. For example, PHCs were provided with their distribution statements for the final quarter of the year between 25 February and 28 March 2002. Therefore, the final distribution statement arrived within days of the end of the financial year.
- Expenditure releases for the Primary Education COs and DDOs are still on a quarterly basis for the whole year. However, Primary Health COs and DDOs were provided with an initial six-month expenditure authority release, although on a less timely basis than in primary education.

As a consequence of these expenditure release delays at the district level, GoAP is still experiencing the “March rush”, with departments spending a large proportion of their budget in the last month of the fiscal year. For example, in 2000-01 only 53% of total expenditure was incurred in the first three quarters of the year, 47% was spent in the last quarter and 34% was spent in March 2001 alone.<sup>44</sup> In 2001-02, 39% of annual expenditure was spent in the last quarter and 22% was spent in March 2002, showing some improvement in 2002 after the introduction of advance releases.<sup>45</sup>

## 5.5 Effective cash management

Effective cash management is critical to enabling GoAP to deliver predictability in funding to departments. Cash management is dependent on effective cash forecasting and monitoring.

The Finance Department estimates cash inflows by month based on the three streams of receipts: tax and non-tax revenue of the State; shares in central taxes and other central transfers and borrowings.

44 Report of the GAG of India for the year ended 31 March 2001 (Civil) GoAP, see para 2.3.18.

45 Report of the CAG of India for the Year ended 31 March 2002 (Civil) GoAP, see para 2.3.16.

Based on past trends, the estimated annual tax receipts are projected month-wise for the year. The dates on which central transfers will be received are known and the receipts on account of borrowings are taken into account depending on the borrowing schedule or timetable.

Expenditures are also projected over the year. Departments do not provide Finance Department with monthly forecasts of their expenditure needs, although they will advise Finance Department of any extraordinary expenditure. Instead Finance Department plots the cash implications of committed expenditures such as salaries and debt servicing, and uses seasonality patterns in past expenditure to allocate other Budget Estimates across the year.

Under an agreement with the RBI of India, the State Government has to maintain with the Bank a daily cash balance of Rs.3.32 crore. If the balance falls below on any day, the Government has to take ways and means advances or overdraft from the RBI. The Finance Department keeps a close watch on its cash balance, to avoid GoAP going into overdraft for more than 12 consecutive working days (over and above the ways and means advance provided by the RBI), and thus to avoid suspension of payments by RBI. GoAP is provided with data on cash receipts, payments and balances by the RBI and relevant banks on a daily basis. GoAP is now constantly monitoring its cash position through an electronic monitoring system.

These efforts do appear to be delivering dividends. According to the Budget speech, GoAP had gone into overdraft for only 17 days in the year to December 2002. This is a significant improvement to the last few years when GoAP was forced to resort to ways and means advances or overdraft for the majority of the year. Figure 41 shows that GoAP was in overdraft for 167 days in 2000-01, with the maximum amount of overdraft touching Rs.666.51 crore, and 172 days in 2001-02, with the highest level of overdraft being Rs.695.39 crore. Indeed, during 2000-01 except for ten weeks, and during 2001-02 except for four weeks, GoAP was either drawing on the ways and means advances or was in overdraft.

**Figure 41: Details of the extent to which GoAP was able to maintain a minimum balance with the Bank**

	1998-99 days	1999-00 days	2000-01 days	2001-02 days
1. Number of days on which the minimum balance was maintained without obtaining any advance	145	75	70	29
2. Number of days on which the minimum balance was maintained by taking ordinary ways and means	101	131	84	136
3. Number of days on which the minimum balance was maintained by taking special ways and means advance	29	43	37	28
4. Number of days on which there was a shortfall from agreed minimum balance, even after availing of the ordinary and special ways and means advances to the full extent, but no overdrafts were taken	1	0	7	0
5. Number of days on which overdraft were taken	89	117	167	172

*Source: Compiled from Finance Accounts: 1998-99, 1999-00, 2000-01 and 2001-02*



Historically, when GoAP, or any State Government, had been in overdraft for eight or nine days, and therefore in risk of RBI suspending its payments, it would instruct the Treasury to stop disbursing and to delay payment of non-essential bills. These “freeze orders” to Treasury were oral and not officially communicated to line departments, although they may have been told informally to “go slow” when there is a shortfall of cash. Alternatively, in periods of cash shortage the Finance Department would counter-sign any cash releases of more than Rs.1 crore and would restrict or moderate releases to cope with cash shortages. However, both the Finance Department and Treasury departments confirm that they have not resorted to such measures since 1999-2000. They have indicated that any decision to reduce departmental appropriations is made formally through the Revised Estimates process. There is also oral evidence from districts that they have not received “freeze orders” in the last year, or even two.

## 5.6 Departmental controls over approval, and recording of approved, transactions

Payment transactions originate with departmental DDOs,<sup>46</sup> although the majority of transactions are actually processed by the Treasury departments and paid by agency banks. The system of payment is examined at section 5.8. This section examines the stage of approval of transactions by departments, and the maintenance of basic accounting records, from which departments will compile monthly expenditure statements (see section 7.2.2.1) and which enable reconciliations to be undertaken with the records of Treasury departments (see section 6.6.4.1).

Controls testing at the departmental levels revealed adequate controls and compliance in the main areas of payment transactions, except for budgetary control by DDOs and maintenance of cash records and controls over cash and local bank accounts. The following sections set out the detailed results of the controls testing:

- Budgetary control (see section 5.6.1);
- Procurement of assets and supplies (see section 5.6.2);
- Salaries and allowances (see section 5.6.3);
- Verification of supporting documentation and sanction of payments (see section 5.6.4),
- Bank accounts, cash, cheques and demand drafts, and receipts (see section 5.6.5);
- Key departmental accounting records (see section 5.6.6).

### 5.6.1 Budgetary controls

All CCOs, COs and DDOs are required to maintain Budget Control Registers (BCRs) through which to monitor expenditure against the available budget. Checks against appropriations are only done for ‘control items’, basically, non-salary expenditure. Salaries are not checked against appropriations but are checked by the DDO against the service book and the pay bill register (see section 5.6.3).

The results of controls testing were encouraging in one sense: in the cases of the CCOs and COs tested, these BCRs were being adequately maintained, and kept up to date. This is believed to be the general pattern across the State, but exceptions were noted. For example, the Internal Audit report of CD&SE for DEO Kurnool notes the non-maintenance of the BCR.

However, with the exception of one PHC<sup>47</sup>, none of the DDOs were able to provide evidence that they maintained BCRs. It was the general view of the DDOs that budgetary control is the responsibility of the STOs. Examination of the AG Inspection Reports confirms that this is a general finding.

The CAG also comments on budgetary control. For example, his 2001-02 report notes that in 20 cases, departments surrendered amounts in excess of their actual savings and in 10 cases, surrenders were made even though expenditure was in excess of grant. As against savings of Rs.524.64 crore,

<sup>46</sup> State-wide there are some 45,000 DDOs. There may be some 100 within the jurisdiction of each STO.

<sup>47</sup> The exceptional PHC which was maintaining a BCR was in Vishakhapatnam district.

the amount surrendered was Rs.977.71 crore, indicating an excess surrender of Rs.453.07.<sup>48</sup> He also notes that such budgetary irregularities are being reported every year.

### 5.6.2 Procurement of assets and supplies

Procurement is a major issue of concern for the CAG, whose reports regularly note instances of irregularity in the procurement process. The overall impact of procurement irregularity on fiduciary risk and misuse of government funds can be significant. For example, procurements can exceed their competitive price, directly wasting government funds, or sub-optimal contracts can be awarded, leading to waste and excess expenditure required for problem rectification.

Most of the procurement for health and education in GoAP is centralised, with nominated corporations and bodies undertaking the procurement on behalf of the departments.<sup>49</sup> Figure 42 below outlines the procurement arrangements in the two case study departments.

The centralisation of procurement has necessarily reduced the potential for frauds, misappropriations and irregularities at district and field levels. Controls testing of primary health and primary education revealed satisfactory compliance with procedures, including documentation and approval limits.

#### Figure 42: Case study of Primary Health and Education procurement systems

For the Health Department, the AP Health Medical Housing and Infrastructure Development Corporation (APHMIDC) builds PHCs and undertakes procurement of all materials, technical equipment, medicines, and medical equipment. The issue of indent registers, pass books for medicines scheme-wise, stores and sub-stores books by APHMHIDC has improved the procurement and supply of medicines, as well ensured records maintenance. APHMHIDC locates an executive engineer in each district who oversees the process in the district. PHCs' Medical Officers will seek the approval of the DMHO for an issue from the APHMHIDC, and will submit the approval note to the APHMHIDC in order to obtain a release, for example of medicines. In this case, the budget is controlled by the DMHO.

For procurement above a specified level or for specified items, the budget is controlled by the HoD/CCO holding administrative sanction. Upon receipt of a requisition from the district, the HoD/CCO will consider its validity, seek the concurrence of the Finance Department (if appropriate) and pass the bill for payment to the APHMIDC via the PAO (Hyderabad). If the value of the procurement exceeds the powers of the HoD, he will seek administrative sanction from the Secretary.

Procurement at the district and field levels is thus very limited. For example, the DMHO has an annual limit of Rs.10,000 and each PHC Rs.2,500 per year to procure items such as furniture or medicines required at short notice from local suppliers.

In Education, too, procurement of Teaching and Learning Materials is centralised, with contracts let by the Director of School Education and materials distributed to each district. AP Text Book Press prints textbooks on their behalf and distributes them to the DEOs, who distribute them to the schools.

GoAP has launched a number of initiatives aimed at increasing the efficiency and transparency of the procurement process in GoAP. Examples of these are outlined at Figure 43 below.

48 Report of the CAG of India for the Year ended 31 March 2002 (Civil) GoAP, see para 2.3.12 and appendix XVII.

49 Other examples of agencies/departments/corporations nominated by the Government for procurement are: Printing and Stationery Department (stationery for all departments), State Health Transport Organisation (health transport vehicles), Police Transport Organisation (police department vehicles), Public Works Department Workshop (repairs agency) and AP Technology Services (computer hardware and software).



**Figure 43: Examples of GoAP reforms in procurement**

Publication of a Tender Digest, both in English and Telugu, aims to increase transparency about tenders and prevent restrictive practices.

Tenders are collected at more than one centre on the prescribed date and time. This is intended to prevent interference by local interests in the bid submissions.

Tenders can be submitted by email, opening the way for e-procurement.

E-procurement has been launched during 2003.

**5.6.3 Salaries and allowances****Figure 44 below sets out the process for the payment of salaries and allowances.**

Control testing of salaries and allowances revealed satisfactory results in the offices tested. In all cases where records could be inspected, all relevant records were being properly maintained, being kept up to date, and had been properly attested by the appropriate officer. No cases of arrears were noted; group insurance was being properly deducted; advances were being appropriately deducted. In all cases evidence was seen of the periodic attestation by the CO of the records. Compliance with controls over salaries and allowances has reportedly improved significantly over the past two to three years. While the traditional system of distribution of salary by the DDO poses some inherent and control risks, these are minimised by the centralised appointment system and employees signing for salary in a shared volume.

**Figure 44: Records and process for payment of salaries and allowances****The records:***Records maintained by the DDO:*

1. Service Book of the Government Servant which includes date of appointment, scale designation, pay events, annual verification reports, leave account, and sanction of periodic increments in pay.
2. Pay Bill register which includes month of salary, name, designation, pay and allowances grants for each employee, and authorised deductions. The Register also contains details of short term loans and advances to be recovered from the salary of each employee.
3. Stamps and acquittance rolls certifying receipt of the salary by each employee.
4. Leave records.

*Records maintained by the STO/DTO:*

1. Sanctioned cadre strength.
2. Fly leaves indicating the name of the employee and pay particulars of the employee occupying the relevant posts.
3. Budget sanction / BRO (salary).

*The process:*

1. Monthly salary bills are presented to the STO/DTO by the DDOs.
2. The STO/DTO verifies the sanction strength and checks the fly leaves for the names of the employees and their pay particulars.
3. The STO/DTO verifies the specimen signature of the DDO and arithmetical accuracy.
4. The STO/DTO passes the bill and sends it to the bank for payment.

If cash payments are to be made, cheques are issued in favour of the DDO. This cheque is encashed by the DDO who disburses the amounts to the individual employees. Proper stamped acquittance is taken by the DDO from the employees.

The piloting of direct payment of salaries and allowances to the personal bank accounts of all government employees, rather than relying on cash disbursements by the DDO, is a positive development. Direct payment is being piloted by the DTA in four districts, including two of the controls testing districts (Mahbubnagar and Nalgonda) with roll out across all districts during 2003. Districts reported considerable resistance from employees to the scheme as distance from the banks will mean additional delay in obtaining their salaries. However, the scheme will reduce the scope of possible irregularities that are possible under the current system of cash.

#### 5.6.4 Verification of supporting documentation and sanction of payments

DDOs are required to undertake initial checks on bills and requests for payment, including: availability of budgetary provision; proper sanction to incur expenditure (usually he/she who is responsible for the receipt of the goods/services to the department); submission of purchase order and invoice; arithmetical accuracy; and correct classification. The DDO will sign a certificate that these checks have been undertaken in accordance with the rules. All original invoices accompany the bill and are submitted to the Treasury department and then to the AG, after payment along with the monthly account sent by the DTO.

Controls testing revealed a satisfactory level of submission of supporting documentation for payments, checks undertaken by DDOs and completion of certificates by DDOs tested.

#### 5.6.5 Bank accounts, cash, cheques and demand drafts, and receipts

##### 5.6.5.1 Local bank accounts

Controls testing revealed that local bank accounts are maintained by many schemes to hold monies specific to those schemes. These accounts were neither authorised nor mandated by the competent authorities. These were amounts kept outside the Government Account.

#### Figure 45: Results of controls testing of local bank accounts

Local *unauthorised bank accounts* were being maintained by the PHCs at Nalgonda (e.g. PHC at Valigonda has a bank account with Nagarjuna Grameena Bank) and Visakhapatnam (e.g. PHC at Anandapuram has a bank account with Visakha Grameena Bank). These accounts were opened at the behest of the Medical Officer who is in charge of the PHC. The stated purpose of opening such local bank accounts was to dispense with the inconvenience of handling cash under various schemes. Most of the amounts received were for schemes such as the National Maternity Benefit Scheme (NMBS), Sukhibhava, and Family Planning. The accounts are used to make cheque payments to the beneficiaries of these schemes.

This pattern of local bank accounts was noted throughout districts. For example, as per the internal audit report, the bank passbooks of DEO Krishna revealed (on 23 November 2002), maintenance of 14 Bank accounts with a total sum of Rs.1,18,47,553.

Examples of interest on these bank accounts is not being surrendered to the Consolidated Fund were noted at DEO Mahbubnagar as follows. In some cases, interest earned on monies for Plan schemes was utilised for other purposes, even for non-Plan purposes.

- Large unutilised balances under the Non-Formal Education scheme in savings bank accounts earned interest of Rs.1,47,559.
- Interest earned and accrued on unspent balances totalled Rs.4,33,683 with respect to Operation Black Board. Of this, Rs.7,26,150 was diverted to the conduct of District School Common exams.
- Interest earned was Rs.1,36,757 on amounts sanctioned as merit scholarships. This interest plus the unspent balance of Vidya Volunteers honorarium (to the tune to Rs.12,72,000) was diverted as a loan towards 10th class examinations.



- Interest of Rs.4 lakhs earned on funds received under Xth finance scheme and Vidya Volunteers scheme was spent on construction of conference hall in DEO office. This represented a diversion of funds from Plan to Non-Plan.

#### 5.6.5.2 Cash

Three weaknesses were noted with regard to departmental controls over cash in the offices tested, as set out in Figure 46 below.

**Figure 46: Results of controls testing of cash**

- There were *no special security arrangements* made when cash amounts are drawn from Treasury and transported to the appropriate office. The Senior Assistant travels alone, or along with an assistant when carrying large amounts, by bus, rickshaw or scooter. despite the fact that officials are supposed to go with police escort whenever transporting more than Rs.2 lakhs. The sums involved are significant: the monthly average transported in cash to a PHC will be Rs.2 - 3 lakhs. Health and education salaries and allowances totalled Rs.1,068 crore in 2000-01; the total for all departments was Rs.4,327 crore. All these amounts will be paid in cash until the direct payment scheme is implemented (see section 5.6.3). While the Financial Code dictates that officers will be held personally held responsible for loss, no officials questioned were able to provide an answer as to how officials would held accountable if monies were lost or stolen;
- The Senior Assistant (UDC), entrusted with cash transactions under authorisation from the DDO, furnished *neither security deposit nor security nor bond*; <sup>50</sup>
- There was a completely inadequate level of *physical checks over cash and reconciliation with the cash book*.

One key physical control was being adequately complied with: in all cases tested, cash was maintained in lockers with one key under the control of cashier and the other key with the designated authority under a double lock system.

#### 5.6.5.3 Cheques and demand drafts

There is evidence of substantial loss of interest due to the delayed remittance of cheques/ demand drafts into Government accounts. In 2000-01 for example, delayed remittance of 942 demand drafts relating to 1995-99 valued at Rs.1.16 crore into Government accounts resulted in interest of Rs.17.58 lakhs being foregone.<sup>51</sup> Controls testing also revealed some examples of delayed remittances of demand drafts, including at DEO Guntur which had demand drafts almost two years old to the value of Rs.2.25 lakhs. Proper maintenance of registers and a periodical review by the Head of Office and a responsible official would have avoided the loss of interest. In these cases, accountability cannot even be enforced in the absence of adequate and sufficient record maintenance.

#### 5.6.5.4 Receipts

Testing was also conducted over user charges receipts and it was noted that:

- One PHC and all primary schools visited are collecting user charges in some cases, but in no cases tested were they remitting the sums collected to the Treasury departments. The sums involved are small: for example, the Parawada PHC in Vishakhapatnam had collected Rs.15,000 as user charges on disposable syringes since 1 April 2001, but had spent Rs.12,000 of this on developmental works for the PHC. The schools collect Rs.2 per student per examination. It seems that DDOs received GO 170 authorising them to collect user charges, but they claimed not to have received GO 601 which required the sums to be remitted to the Treasury;

<sup>50</sup> Vishakhapatnam DEO claimed that a security deposit had been paid, but produced no evidence to substantiate this.

<sup>51</sup> Report of the CAG of India for the Year ended 31 March 2001 (Civil) GoAP, see para 4.8.

- None of the PHCs or primary schools tested maintained receipts books.

### 5.6.6 Key departmental accounting records

The DDOs are responsible for maintaining strong controls in the form of accounting records, being:

- The cash book for cash transactions;
- Inward Register, Register of Bills and Treasury Bill Book.

#### 5.6.6.1 Cash book

Compliance with requirements and with good practice in maintaining cash records was consistently extremely poor, and exposes GoAP to a high risk of misappropriation and theft of funds.<sup>52</sup> The scope for this will be reduced by implementation of the direct system of payment of salaries. The results of the controls testing are set out in Figure 47 below.

**Figure 47: Results of controls testing of maintenance of cash book**

Specific observations were that *in all offices tested*:

- Cash books were ***not being updated*** with each transaction. The approximate average time lag for entry in the cash book was four months but some had not been updated for up to one year;
- The cash book was neither being closed, nor were balances calculated, on a regular basis. The periodicity of closing and balancing of cash book ranged from one to four months, with no discernable pattern in terms of districts or departments;<sup>53</sup>
- Officials were ***infrequently physically tallying*** the cash book balance with the cash available in the cash chest. This tallying was undertaken on a six monthly or annual basis, often only prompted by a forthcoming AG audit visit. This tallying should be undertaken whenever the cash book is closed and balances calculated;
- There was ***insufficient evidence of physical tallying*** having been undertaken - there were no notes in the cash book setting out the denominations of cash in the cash chest at the time of the reconciliation;
- The ***DDO or Head of Office was neither checking cash book nor physically verifying*** the cash chest (with the exception of Anandapuram PHC in Vishakhapatnam district where the DDO was attesting the register weekly/monthly, but there was still no mention of physical denomination);
- ***Cash balances were not being reconciled with those of the bank***, wherever bank accounts were maintained. All officials admitted to this;
- Due to the fact that cash books were not closed regularly and balances calculated, the aggregate of cash available in the ***contingent cash book and the Undisbursed Pay Book was not regularly being correlated*** with the actual physical cash;
- ***A consolidated cash book were not being maintained***, with exception of Vishakhapatnam DEO where it had not been updated for more than three months. Such consolidated cash books are required wherever separate (such as scheme specific) cash books are maintained, to ensure that the physical cash balance can be verified at any point of time;

52 The Treasury Code covers Moneys in the hands of Government Servants (Chapter IV). Financial Code covers receipts (Chapter III) and Responsibilities for Losses of Public Money or Property (Chapter XII).

53 Treasury Rule 10 allows the cash book to be closed less frequently than daily where there are no regular transactions and with the prior approval of the superior officer, but states the norm should be weekly, and in no circumstances less than monthly.





- In cases of schemes which mandated maintenance of joint accounts, ***accounts were actually maintained on a joint and several basis***, allowing a single person to draw the amount. For example, the joint signatories might be the chairman of the school committee and the headmaster. This provides scope for misuse.

#### 5.6.6.2 ***Inward Register, Register of Bills and Treasury Bill Book*** <sup>54</sup>

The following are the other key accounting records maintained at departmental level.

- The Inward Register records all financial and non-financial documents arriving in the office. Specifically, all invoices received will be noted here. In all cases tested, DDOs maintained the Inward Register and to a satisfactory standard.
- The Register of Bills (RoB) controls the process by which the bill will be supported by documentation and sanctioned for payment. The RoB enables the DDOs to complete the BCR and thus monitor expenditure against the allotments placed at their disposal and submit expenditure statements to their COs. In all cases tested, DDOs maintained RoBs and to a satisfactory standard.
- The Treasury Bill Book (TBB) contains the details of all bills passed for payment, either to the Treasury department or in cash. In all cases tested, DDOs maintained the TBB and to a satisfactory standard. The TBB is sent to the STO/DTO along with the bills passed for payment. The STO/DTO acknowledges receipt of the bills by certifying each bill in the relevant column of the TBB. In all cases tested the STO/DTO had properly certified the TBB. The STO/DTO will also issue a token to the DDO's clerk, for the clerk to surrender to the bank in return for release of the cheque/cash. In all cases tested, tokens were being properly issued and their numbers recorded in the TBB. (If the bill is subsequently rejected for payment by the STO/DTO, the token will be surrendered to the STO/DTO and re-submission of the bill required.)

The key accounting records were adequately maintained at the departmental level in the areas tested.

### 5.7 **Monies granted or advanced promptly and accurately recorded, and vouched or recovered**

There are a number of well-recognised 'risk areas' at the departmental level which are susceptible to higher than average risk of misappropriation or misuse, and of being inaccurately or inadequately accounted for. These areas are mentioned repeatedly in the CAG Audit Reports and are the subject of the Finance Department's GO 507 (see section 3.7.2), which seeks to enforce stricter accountability from departments, and DDOs in particular. These areas are:

- Grants-in-aid, and Utilisation Certificates (UCs) (see section 5.7.1);
- Abstract contingent (AC) bills, and the clearing thereof by Detailed Contingent (DC) Bills (see section 5.7.2);
- Loans and advances (see section 5.7.3).

#### 5.7.1 **Grants-in-aid and UCs**

A key risk area is that of grant-in-aid paid to local bodies, PSUs, autonomous bodies, NGOs, and other institutions to fund their expenditure. Grants may be for either general purposes or specific purposes.<sup>55</sup> Such grants totalled Rs.8,207 crore in 2000-01 and Rs.8,806 crore in 2001-02 thus constituting 32% of the total budget expenditure.<sup>56</sup> GoAP's accounting policy is to account for grants-

<sup>55</sup> General purpose grants are made to local bodies, municipalities, Zilla Parishads, Mandal Parishads, where they can be used for any purpose to support the operations of the organisation. Special purpose grants are made for the payment of salaries and building of basic infrastructure in grant aided schools, and to local bodies for local infrastructural facilities and the implementation of Plan schemes.

<sup>56</sup> Budget Estimates 2002-03, see pages 17, 23, 107 and 119 of Vol XI/2.

in-aid as expenditure when they are paid by the Treasury departments. The aided institutions only account for the use of the monies via the post-facto submission of UCs.<sup>57</sup> There are five issues with regard to grants-in-aid and UCs.

First, accountability by the aided institutions for the use of these grants-in-aid is lacking as **submission of UCs** is poor, as shown in Figure 48 below by the high numbers and values of UCs outstanding.<sup>58</sup> Figure 49 shows that some UCs had been outstanding for up to 10 years. Controls testing revealed that ZPP and MPP schools have a particularly poor record in submitting UCs.

**Figure 48: UCs pending**

Year	Number of UCs pending at year end	Value of UCs pending at year end	Date grants released up to, and UC due date	Notable departments from whom UCs pending
31 March 2002	3,234 UCs	Rs.613.93 crore	Released up to September 2000 (and UCs due by March 2002)	6 departments, with Revenue departments having 2,450 of the outstanding UCs. Details of other departments are in Figure 49 below.
31 March 2001	3,253 UCs	Rs.622.46 crore	Released up to September 1999 (and UCs due by March 2001)	6 departments, with Revenue department the worst offender with 2444 of these outstanding UCs.
31 March 2000	3,578 UCs	Rs.750.45 crore	Released up to September 1998 (and UCs due by March 2000)	7 departments, with Revenue department being the worst offender with 2470 of these outstanding UCs

*Source: Report of the CAG of India for the Year ended 31 March 2002 (Civil) GoAP, see para 7.2, and prior year Audit Reports*

Secondly, controls testing indicates that GoAP controls over UCs are generally inadequate. In controls testing, the grants-in-aid register, containing the sanction for the grant, was adequately maintained and properly attested in all ten district offices tested. But, **a control register for UCs was absent in eight out of ten district offices tested**. Only in Vishakhapatnam did the DEO and DMHO maintain UC registers, but these were not kept up to date and therefore of limited use in monitoring the submission of UCs. None of the officials questioned were able to supply details of UCs furnished against each grant and UCs pending, so we were unable to confirm grants had been properly accounted for.

**Figure 49: Departments with highest number/value of pending UCs**

Department	Number of UCs pending at 31 March 2003	Value of UCs pending at 31 March 2003	Earliest year of pendency
Revenue (Relief on account of natural calamities)	2,450	478.72	1993-94
Panchayati Raj and Rural Development	634	71.01	1991-92

57 In Karnataka, all local bodies are required to present their bills to Treasury for payment from the Consolidated Fund, rather than using the grants-in-aid system. Thus, expenditure is accounted for only when made.

58 The due date for submission of UCs is eighteen months following the date of sanction.



Department	Number of UCs pending at 31 March 2003	Value of UCs pending at 31 March 2003	Earliest year of pendency
Social Welfare (including Tribal Welfare)	42	37.67	1992-93
Panchayati Raj & Rural Development, and Municipal Administration and Urban Development	63	22.51	1998-99
School Education	4	1.44	1992-93
Municipal Administration and Urban Development	41	2.58	1998-99

**Source: Report of the CAG of India for the Year ended 31 March 2002 (Civil) GoAP, see para 7.2.**

Thirdly, many unused specific purpose grants are not being remitted to the Treasury departments. The sanction order releasing the amounts specifies that unused amounts from the 'specific purpose' grants should be rendered back to the Government ('general purpose' grants do not have to be remitted). Of the ten district offices tested, only Vishakhapatnam DMHO was remitting grants unutilised by the grant recipients. The other offices were unable to provide a reason for the non-remittance. Furthermore, there is a risk in the way in which the grants-in-aid are maintained deposited in the deposit accounts of the local bodies (see section 5.8.5).

Fourthly, grant aided institutions have a poor record for the finalisation of their accounts, statutory audit of their accounts and response to audit observations. Thus, neither directly (i.e. via UCs) nor indirectly is GoAP always able to have much reassurance about the usage of grant-in-aid funds. Furthermore, in the case of education, audits of aided institutions are to be conducted annually by the audit staff positioned in offices of DSE and the DEO. Controls testing revealed that, due to shortage of adequate staff, these audits are not being undertaken on annual basis.

Fifthly, the UCs themselves merely state the value of monies utilised. They do not provide sufficient relevant information in a transparent manner on how the funds were utilised exactly. Nor do the UCs require any disclosure about what was achieved with the funds. This raises fundamental questions about the effective use of the grant-in-aid funds and the extent to which GoAP can monitor and improve the performance of aided institutions.

Grants-in-aid and UCs are a key target for GoAP reforms. GO 507 placed additional controls over grants-in-aid.<sup>59</sup> While the GO was date specific, the requirement for stricter discipline is ongoing. Before financial releases may be made, institutions must have submitted a certificate to the effect shown in Figure 50 below.

**Figure 50: Results of DTO performance monitoring system for GO 507 compliance in grants-in-aid**

Local bodies, PSUs, autonomous bodies, NGOs, and other institutions required to certify that they:	Example of results, as per DTO performance monitoring system for year to end March 2003
Have submitted their UCs accounting for funds spent, duly certified by the statutory auditor	122 of the relevant 504 claims (24%) received in the year to 31 March 2003 were rejected due to lack of certification on this point.
Would maintain accounts in a format prescribed by CAG	63 of the relevant 326 claims (19%) received were rejected due to lack of certification on this point.

59 GOM 507, Finance (TFR) Department, dated 10 April 2002.

Have completed their statutory audit for 1999-2000	702 of the relevant 1646 claims (42%) received were rejected due to lack of certification of audit completion. This is thus the least complied with requirement.
Would clear their audit objections by 50% by September 2002, with the balance by December 2002	179 of the relevant 622 claims (29%) received were rejected due to lack of certification on this point.
<i>Source: DTO monitoring reports</i>	

Responsibility for enforcing compliance lies with the concerned Finance Secretary, the HoD and the DDO. It is also, henceforth, the responsibility of each DTO to scrutinise claims and certificates. In the first instance, the performance of the DTO in this scrutiny and enforcing the GO is being monitored. Figure 50 also shows the level of rejection by DTOs of claims from those receiving grants-in-aid, due to their failure to comply. Note that this information has not been independently verified.

While this strengthened discipline seems to be addressing the lack of accountability of institutions receiving grants-in-aid, this discipline applies to fresh monies granted from April 2002 onwards. The lack of accountability for funds granted prior to that date remains.

### 5.7.2 AC/DC bills <sup>60</sup>

Monies are drawn on AC bills, where monies are required in advance and yet the exact amount required for the purpose cannot be specifically calculated.<sup>61</sup> AC bills are required to be adjusted within one month (previously three months) from the drawal of funds on the AC bills by the submission of a DC bill which accounts for the funds utilised. In recent years, the AG maintained computerised records of outstanding AC bills department-wise, better to monitor them.

AC bills are charged as expenditure. Thus, to the extent that these AC bills have not been adjusted by the submission of DC bills confirming actual expenditure, expenditure is overstated or unaccounted for in the accounts. As can be seen from Figure 51 on the following page, there has been a high potential for both overstatement and for poor accountability for government funds. The CAG report attributes the pendency of AC bills to non-receipt of vouchers from the subordinate officers, non-receipt, of condonation orders of government for delay in submission of DC bills and want of stock entries on original bills.<sup>62</sup>

60 Procedures for AC/DC bills are covered in the AP Financial Code Article 102 - 104.

61 For example, an AC bill will be issued to a medical officer needing to pay cash to patients organising a sterilisation camp and needing funds to pay patients and motivators. The medical officer will then submit a DC bill to account for the advance, submitting documentary evidence of actual expenditure. In this example, the medical officer should submit a statement of sterilisations undertaken, containing the signatures or thumbprints of people who had undergone operations.

62 Report of the CAG of India for the Year ended 31 March 2002 (Civil) GoAP, see para 2.3.20.



**Figure 51: AC bills pending adjustment**

Year	Number of AC bills pending	Value of AC bills pending	Year of AC bills pending	Value of bills pending > 3 years	Notable departments with high values of AC bills pending adjustment
30 September 2002	95,749	Rs.288 crore	1985-86 to date	No data made available	Family Welfare: 64,619 bills for Rs.56 crore from 1991-92; Education: 19,662 bills for Rs.24 crore from 1991-92; Police 1,608 bills for Rs.26 crore from 1991-92; Natural calamities: 1,791 bills for Rs.122 crore from 1992-93; Medical: 338 bills for Rs.15 crore from 1993-94
30 June 2002	1,24,509	Rs.597.10 crore (at end March 2002, Rs.88.95 crore of pending amount was drawn on AC bills during 2001-02)	1975 to to date	Rs.419.68 crore (70%)	Medical and General Administration (Elections) Departments: Rs.57.83 crore
31 March 2001	94,854	Rs.549.63 crore	1971 to date	Rs.334.82 crore	Police and Revenue Departments: Rs.252.43 crore
31 March 2000	1,17,097	Rs.581.56 crore	1971 to date	Rs.310 crore	Education Rs.78.92 crore; Family Welfare Rs.39.58 crore
<i>Sources: data for September 2002 was provided by AG, December 2002. Other data: Report of the CAG of India for the Year ended 31 March 2002 (Civil) GoAP para 2.2 and 2.3 and Report of the CAG of India for the Year ended 31 March 2001 (Civil) GoAP.</i>					

Figure 51 shows a significant reduction in the value of AC bills pending adjustment as at 30 September 2002. Particularly striking is that GoAP has deleted AC bills from 1971 to 1985. The reduction has also been achieved by the introduction and enforcement of GO 507 in April 2002, which set down the requirements in Figure 52.<sup>63</sup>

**Figure 52: GO 507 requirements for AC/DC bills**

- For drawal of the third AC bill, the first AC bill must have been adjusted, thus the maximum number of pending AC bills can never exceed two.
- Simplification of the AC/DC bill process was prescribed, whereby the countersignatories of higher authorities are no longer required for the DC bills. The fact that DC bills had previously been pending for long periods can be, at least in part, attributed to the fact that COs were unwilling to verify and countersign DC bills due to the passage of substantial time between drawal of amount on AC bill and submission of DC bill, often, a change in incumbency of

<sup>63</sup> As per GOMs 507, Finance (TFR) Department, dated 10 April 2002 read with memo no. 268/15154-A/TFR/2002 dated 18/5/2002.

DDOs and COs and unestablished veracity of the DC bills. Neither the STOs nor the AG are in an informed position to vouch the integrity of the underlying vouchers.

- The GO clearly stated the DDO is responsible for submission of the DC bills.
- The vouchers supporting the AC and DC bills exceeding Rs.1000 are required to be submitted to the STO, which only processes payment of the AC bills and clears the AC bill with a DC bill following examination of the supporting vouchers. The STO sends the documentation to the AG for their audit and monitoring purposes.

The significant impact of the reforms was noted during controls testing, with staff attributing the following to the introduction and enforcement of the GO.

- In all offices, there had been a significant improvement in the speed with which DCs are being submitted to clear AC bills. Nalgonda DEO might be taken as a typical example: a total of 32 AC bills were pending as at 31 December 2002 for an amount of Rs.51.38 lakhs. Of these, 16 pertained to 1997-98 and 16 to 1999-2000 to July 2002. None of the AC bills paid during the period August to December 2002 were still pending. Across all the offices tested, the speed of submission of DC bills ranged from 10-15 days to three months, depending on the frequency of expenditure. But, in all cases since the GO 507 being into effect, DCs were being submitted within three months of the AC bills. Prior to that date, AC bills were only being submitted after many months, if at all.
- In all offices tested, the register of AC bills was being adequately maintained. Records were being kept up to date; expenditure was supported by appropriate vouchers; expenditure was properly classified; and proper attestation had been received on a regular basis. It was notable that the standard of records improved significantly during 2002. Prior to that date, the register was generally inadequately maintained.

Two concerns remain with regard to AC/DC bills, being:

- DC bills pending for the period prior to April 2002. As for UCs, while it is encouraging that the system has been strengthened going forward, accountability for the period prior to April 2002 is seriously lacking.
- Supporting vouchers for AC/DC bills less than Rs.1000 are retained by the DDO. These vouchers should be cancelled with cancellation attested by the responsible officer. No cases requiring cancellation were noted, therefore the effectiveness of controls in this area could not be tested.

### 5.7.3 Loans and advances

Consolidated Fund sector F loans and advances of Rs.1,697.54 crore were made by departments in 2001-02. The account had a debit closing balance of Rs.8,405.35 crore at 31 March 2002. These loans and advances are made:

- To Municipalities, local bodies, Panchayat Raj institutions, with Rs.8,172.17 crore outstanding at 31 March 2002, an increase of 26.4% over 31 March 2000, and 150% over a five year period. Rs.4,958.88 crore (61%) of the outstanding balance at 31 March 2002 represents Loans for Power Projects;
- To government servants, with Rs.233.12 crore outstanding at 31 March 2002. Testing of controls over these loans in the case study departments/districts found controls to be adequate and generally adequately complied with;<sup>64</sup>

<sup>64</sup> These loans and advances are for (1) long term (house building, purchase of motor conveyances and other conveyances, purchase of computers etc) for which records are being maintained by AG. Controls were tested in the districts and found to be satisfactory in all districts tested. (2) short term loans (festival, marriage). Testing revealed that all of the district offices, all but one of the schools, but only one of the PHCs tested maintained separate Watch Registers. Those that did not maintain a separate Watch Register, did monitor recovery of the loan/advance adequately through the Pay Register.



- for miscellaneous purposes, with Rs.0.06 crore outstanding at 31 March 2002.

Loans and advances are of concern from a regularity perspective (i.e. the extent to which monies are being disbursed for the proper purposes and recovered promptly to minimise loss to the Consolidated Fund) and from an accounting perspective. The high balance of loans and advances to municipalities, local bodies and Panchayat Raj institutions are of particular concern.

GOs sanctioning the loans to these institutions are issued by the respective departments with the concurrence of the Finance Department. The loan amounts are drawn and disbursed to the institutions by the Finance Department, usually through cheques. Since 1996-97, Finance Department has been responsible for maintaining detailed accounts and sub-accounts for the loans/advances, monitoring the loan, collecting interest and recovering the loan at the due dates. The CAG's Audit Report (Civil) for 2000-01 concludes: "the non-maintenance of proper loan records and failure in monitoring recovery of loan repayments ... and sanction of loans to the unviable units in disregard of the financial interests of the State were a contributing factor to the worsening financial condition of the State Government." These issues, and others, are examined in more detail below.

First, there are weaknesses in the recording and monitoring of loans and advances. The Finance Department maintains the records of each loan and each institution indicating the repayment schedule and overdue principal and interest. Whenever remittances are made towards the repayments are made, these are noted. However:

- The records are maintained only manually, although software for monitoring the recovery of the loans is being developed;
- There are no periodical reports on the status of the loans;
- No consolidated records are maintained.

Secondly, there is inadequate recovery of the loans and advances, and interest due, in that:

- New loans and advances are still being disbursed, despite the fact that previous loans and advances are overdue. In this case, the amount is paid net of the overdue amount;
- Most of the institutions and PSUs are in the process of winding up or closure stage. Fresh loans are sanctioned largely for the purposes of funding Voluntary Retirement Schemes of their employees. Once the institution is wound up, the remaining assets, if any exist, are adjusted towards the principal and interest of the loan;
- No specific action is taken by Finance Department to recover overdue amounts.

As a result, Rs.,2629.14 crore (i.e. 32%) of these loans and advances (and Rs.411.64 crore interest) was overdue for recovery at 31 March 2002, of which Rs.1,042.96 crore (i.e. 13%) had been outstanding more than three years. Note that the amounts due for recovery and outstanding for more than three years have increased significantly in the last two years, by 131% and 23% respectively.<sup>65</sup> Poor rates of recovery have been mentioned regularly in the CAG's Audit Reports. In the CAG report for 2000-2001, the CAG reported that recovery had worsened just as loans and advances had accelerated: recovery declined from 45% of the opening balance of outstanding loans in 1996-97 to 4% in 1999-2000 and 6% in 2000-01.

Recovery of loans and advances was better than anticipated in 2001-02. Recovery of Rs.280.29 crore was estimated; actual was Rs.946.66 crore, more than three times estimated. Of this total recovered, Rs.838.74 crore related to institutional loans and advances. However, note that this amount related to

<sup>65</sup> Of the overdue amount, Rs. 560.61 crore relate to total loans outstanding against the AP State Electricity Board made at the end of January 1999. The orders of GoAP on the splitting of the assets and liabilities of the Board after the creation of AP Genco and AP Transco have yet to be received enabling the calculation and thus recovery of the outstanding amounts.

the recovery of just four loans.<sup>66</sup> If GoAP does not intend to recover the loans and advances, the proper accounting treatment would be write off the loans and advances as irrecoverable.

The third key issue is that CAG's Audit Reports express concern about the risk of *misclassification* of loans and advances by departments, with the strong possibility that many of the loans and advances are actually investments, grants or expenditure, in which case they should be accounted for as such. Depending on the extent of the misclassification, this has the potential to have a major impact on the real size of revenue deficit.

Fourthly, the Finance Accounts indicate that there are unreconciled balances between the closing balances shown in the AG's main/control accounts and the detailed accounts maintained in the Finance Department for loans and advances.<sup>67</sup> The Finance Accounts 2001-02 quote seven major heads with unreconciled differences in balances, totalling Rs.87.78 crore.<sup>68</sup> But, this may be a fraction of the total unreconciled differences in reality, as only examples are provided and these are the net differences, not the total gross differences. Most of the differences in the loans and advances appear to date back to the early 1990s. The majority of the difference in value is comprised of a difference relating to loans and advances to Loans for Power Projects at Rs.81.70 crore, a difference dating only to the current year of account.<sup>69</sup> The CAG notes though that balances are communicated to departmental officers every year for verification and acceptance, in many cases, such acceptances have not been received. Some of the acceptances, albeit for lakhs rather than crore of rupees, have been outstanding since the 1980s.<sup>70</sup> However, it is the weak controls that are the focus here, rather than the value. Many entries are unreconciled due to the fact that the AG has not received adequate details and documents from the DTOs or departmental offices.

Finally, the reporting of loans and advances is impeded by lack of information. Information about loans and advances is compiled by the AG, and disclosed in the Finance Accounts, on an annual basis, for which purpose the AG is dependent on annual returns by the departments.<sup>71</sup> There are standing instructions from GoAP that information about overdue amounts as on 31 March, together with steps taken for the recovery of arrears, should be sent by the HoDs to the AG by 30 June each year for the previous financial year. As at August 2002 however, information about the overdue amounts as at 31 March 2002, the detailed accounts of which are maintained by departmental officers, had not yet been received from any of the offices by the AG. The same had been true in the preceding two years.

66 The recoveries were from: AP Transco (Rs. 375.25 crore), AP Housing Board (Rs. 347.79 crore), AP Urban Infrastructure Corporation (Rs. 81.32 crore), and AP Genco (Rs. 34.38 crore).

67 The AG maintains detailed or separate registers, known as broadsheets, indicating ledger balances in respect of all heads which are closed to balances under Public Debt and Loans and Advances (under the Consolidated Fund), and Deposits, Reserve Funds, Suspense and Remittances (under the Public Account).

68 Statement 8 of the Finance Accounts states: "In a number of cases, there are unreconciled differences between the closing balances shown in Statement 16 and 18 of the Finance Accounts and those shown in separate registers or other records maintained in the Accounts Office/Departmental offices for the purpose. Steps are being taken to settle the discrepancies as soon as possible. In many cases the full details and documents required for the purpose are awaited from the Departmental/Treasury Officers."

69 Explanatory Notes to Statement No.8 of the Finance Accounts: Summary of Balances under Consolidated Fund, Contingency Fund and Public Account as on 31 March 2002.

70 Appendix II to the Finance Accounts.

71 Details about the recipient of loans and advances (with balance brought forward, amounts advanced/recovered in the year, and closing balance) are provided in Statement No. 18 of the Finance Accounts. A summary of loans/advances by each sub-sector is provided at Statement No. 5 of the Finance Accounts. Statement 5 also discloses overdue recoveries and amounts outstanding more than three years.





## 5.8 Financial transactions properly passed and accurately recorded

The majority of departmental transactions<sup>72</sup>, are processed by Treasury departments, rather than line departments. All of the Treasury departments are under the administrative control of the Finance Department and are outlined in Figure 53.<sup>73</sup>

GoAP recognises the inefficiency of the “two layers engaged in the verification of documents - one the department and another in the Treasury”,<sup>74</sup> together with the impact on the accountability of departments of having the Treasuries processing their transactions. GoAP’s medium term aim is therefore to delegate “enhanced financial powers .... (so that departments can) be held responsible for payments, accounting and accountability<sup>75</sup>. In the meantime, transaction processing will remain with the Treasury departments.

An assessment of each of the Treasury departments, in terms of the controls they maintain over finances is set out in the following sections. Section 5.8.4 examines controls over funds circumventing the Treasury departments.

**Figure 53: GoAP Treasury departments**

There are three main Treasury departments in GoAP as follows:

**DTO and STOs**, which transact the Government Accounts in the districts with the exception of those undertaken by the PAOs (Works and Projects) below. There is one DTO in each district. Each DTO will have a number of STOs under its control. There are 297 STOs across AP. Regional Joint Directors of Treasuries, based in Visakhapatnam, Cuddapah and Hyderabad, oversee the DTOs in each region.

**PAO (Hyderabad)**. From five separate locations across the twin cities, PAOs transact government expenditure, largely pay and allowances, for the headquarters of departments. (Their receipts are handled through the DTOs.) The systems and procedures of the PAO (Hyderabad) are virtually identical to those of the DTO. A PAO (AP) also exists in New Delhi, making payments on behalf of AP’s interests in the capital.

**Finance (Works and Projects) Department**, which transacts the Government Accounts in the districts in Irrigation, Transport, Roads and Buildings, National Highways, Public Health Engineering, Panchayat Raj, and Forest Department units. Under the Finance (Works and Projects) Department, there are 34 **PAOs (Works and Projects)** who pay the works bills of their projects, and the payment of pay and allowances for Irrigation Departments. The non-project expenditure of these departments, such as salaries and office expenses, still passes through the Treasury system.

### 5.8.1 District Treasury Offices

The standard system for most AP government departments is the DTO system, with some 70% of expenditure passing through DTOs. The workings of the DTO system are set out in the Treasuries and Accounts Functionary Manual. There are two types of Treasuries, being:

72 Note that some departments and government institutions retain some limited cheque drawing powers. Payments are also made by the Pension Payment Office, Pension Payment Office (legislature), and PAO (AP) in New Delhi.

73 The administrative headquarters of the Treasury system is the DTA which operates under the administrative control of the Finance Department. The establishment and service matters of the DAOs and the PAOs are overseen by the Finance (Works and Projects) Department. The functionary control of PAOs including Joint Director Offices is also exercised by the Finance (Works and Projects) Departments.

74 GoAP Strategy Paper on Fiscal Reforms (2001), paragraph 98.

75 GoAP Strategy Paper on Fiscal Reforms (2001), paragraph 93.

- Banking treasuries, of which there are 240 in AP, hold no cash, and transact all their business through local branches of agency (nationalised) banks representing the RBI;
- Non-banking treasuries, of which there are 57, all located in remote areas of the districts, transact entirely in cash, as there is no local banking infrastructure. RBI therefore maintains a currency chest at each of the treasuries.

Controls testing of banking treasuries in five districts indicated adequate controls had been established in the areas tested, and adequate compliance with the key controls, in the following areas of their operations.

#### **5.8.1.1 Receipt of bills (accounting control)**

DDOs submit their salary or establishment bills between the 17 - 20th of each month to ensure payment at the month end. Other expenditure bills are submitted to the Treasuries at any time of the month. The receipt of bills for payment is controlled via a Bills Inward Register, in which a discrete bill number is allotted to each bill. The Bills Inward Register was properly maintained in all DTOs tested. In all DTOs tested, a paper token system was being operated adequately. The DDO's clerk is given the token (in the DDO's name) in return for the bill, to enable him to present the token to the bank in return for payment.

#### **5.8.1.2 Pre-audit (budgetary control)**

All bills are subjected to pre-audit to check compliance with a number of requirements. The first check is on the availability of budgetary provision. DTOs/STOs maintain a manual BCR, head-wise and DDO-wise. DTOs/STOs are notified of the original budget allocation and any revisions both via the DTA and via the department, and the budget is entered in the BCR. While departments, certainly at the district office level and above, do maintain BCRs (see section 5.6.1), the main budgetary control in practice is therefore via the Treasury BCR.

Bills submitted for payment are checked against this BCR. Checks against appropriations are only done for 'control items' (basically, non-salary expenditure). However, salaries (the main non-control expenditure) are also required to be checked by the DDO against the service book and the pay bill register and by the DTO against the sanction cadre strength and the fly leaves (see section 5.6.3).

In all DTOs tested, the BCR was being adequately maintained, albeit manually. Each entry in the BCR was checked and attested by the supervising official. Random checks are undertaken by the DTO himself to ensure that budget provisions have been recorded correctly and that additions/alterations have been correctly recorded. Examination of the BCRs also confirmed that alterations made to budgetary allocations had been properly attested. Budgetary control by the Treasury departments will be further strengthened by the full implementation of e-khazana (see section 6.6.1).

#### **5.8.1.3 Pre-audit (regularity and propriety)**

Pre-audit also checks:

- Budgetary availability;
- Proper sanction to incur expenditure;
- Specimen signature of the DDO, against the approved list. The specimen signature of a new DDO is obtained immediately at the time he takes charge and is attested by the outgoing DDO. In any other case, it is attested by his CO;
- Budgetary classification;
- Arithmetical accuracy;
- Adequacy of documentation supporting payment;
- Rates, for example in the case of allowances.



An examination of bills processed over a period of time confirmed that there was adequate evidence that these checks were being undertaken and certified by the auditor as having been undertaken.

All non-compliant bills are rejected and returned to the DDO. Note that DTOs/STOs do not communicate the remaining balance of the budgetary provision to DDOs. All bills that exceed the budgetary provisions are rejected without warning.

#### **5.8.1.4 Authorisation and dispatch of passed bills to bank (physical and accounting controls)**

The pay order is recorded on each bill and signed by the DTO/Assistant Treasury Officer (ATO)/STO. The DTO/ATO/STO supervise the placing of the Register of Bills and the passed bills in the box to be sent to the agency bank for payment. The box is locked, with the keys being held only by the DTO/ATO/STO and the concerned bank manager in which the account is operated. Controls testing confirmed that these controls were being maintained in the DTOs tested. The agency banks make the payment, and send the cheque either to the payee or to the DDO for them to disburse to the payee.

#### **5.8.1.5 Record keeping and reconciliation (accounting control)**

Each Treasury will maintain accounting records, for expenditure and receipts, with the key records set out in Figure 54. For the last ten years, all STOs and DTOs have used Treasury Accounting software called Compilation of Treasury Accounts (C-TAS) to account for their transactions. C-TAS is a batch mode and off line system, based on UNIX Cobol software.

#### **Figure 54: Summary of DTOs' key accounting records and results of controls testing**

Unless otherwise noted the following accounting records to record transactions are maintained in C-TAS.

**Day books:** details bills/challan-wise transactions.

**Check list:** lists bills/challans, sub-account wise, to enable bank reconciliation.

**Sub accounts:** totals for sub accounts, department-wise at the detailed head level. Sub accounts are maintained as a complementary record to enable compilation and rendering of monthly account to AG (rather than primary accounting entry), thus might not be completed in 'real time'.

**Main accounts:** details of major head wise/sub account wise transactions in a month.

**Deposit ledger, funds ledger and loans ledgers** are all maintained manually.

**List of Payments (LOPs):** details of major head-wise transactions, and rendered to AG on monthly basis.

**Sanctions register:** DDO-wise sanctions regarding establishment, specifying number of posts in each cadre, permanent or temporary, and Plan or non-Plan; period of establishment in case of temporary.

**Fly leaf:** pay levels of each employee indicating the scale, DDO-wise. Maintained manually.

**Reconciliation records:** undertaken manually on a sub account-wise basis, resulting in variation statements.

**Pension lists:** STO-wise and pensioner-wise pension drawing particulars.

**Pension Bank bills:** Consisting consolidated bills consisting pensioners, pensions to be adjusted to pensioner accounts.

**GO 507 Register:** enable Finance Department to monitor departmental compliance with key accounting controls, the results of which are noted throughout this report wherever relevant.

**In all cases tested, these accounting records were being maintained.** In some cases, some columns of the records were not completed, however the information omitted was not essential. In the cases of the complementary records these were not updated in 'real time', i.e. often after the end of the working day on which the transaction was processed. In conclusion therefore, maintenance of these key accounting records in all the DTOs tested was *satisfactory*.

On a daily basis, the bank list of payments and receipts transactions (known as the “SCROLL”) is received from the banks and reconciled with the Treasury records the same day. Any discrepancies are promptly resolved. The DTO/STO verifies the reconciliation. On a monthly basis, a Verified Daily Monthly Statement (VDMS) is received from the bank and is reconciled with Treasury records and certified. Controls tested confirmed that these reconciliations were being promptly and properly undertaken in the Treasuries tested.

#### **5.8.1.6 Non-banking treasuries**

In the case of the non-banking treasuries, cash payments are made and entries made in the accounting records accordingly. The cash basis means that these Treasuries are subject to greater inherent risk than banking treasuries. They are subject to various inspections: from RBI, AG, Regional Joint Director (Treasury) and the DTO. Daily reconciliations, between RBI and Treasury figures, are undertaken in the Treasury, and monthly at the AG. These inspections, together with other controls, may mitigate the level of inherent risk, but the SFAA team has not undertaken controls testing at any non-banking treasuries.

#### **5.8.1.7 Pension payments**

Pensions are paid through the Pensions through Electronic Network (PEN) system, which has been in operation since 1998. All pensioners receive pension payments directly into their bank accounts, with single payment drawn by Treasury. Treasuries are serving about 3.69 lakh pensioners through 4,000 bank branches across the State. GoAP believes that AP is the only State in India, and a singular exception among developing countries, to have a fully electronic payment of pensions.<sup>76</sup> Although the system and controls have not been examined in detail or tested, it is understood that the system is working effectively.

### **5.8.2 PAO (Hyderabad)**

PAO (Hyderabad) is essentially the DTO for all Government departments based in the twin cities. The rationale for having a separate function from the Treasury system is clear: the Treasury system can not cope with the large volume of transactions coming through the PAO system in the twin cities. The value of payments transacted through the PAO (Hyderabad) has increased substantially in recent years, although the number of bills remains relatively steady.<sup>77</sup>

The departments’ 1,090 DDOs present their non-pension bills for payment to the PAO, and the process followed thereon is virtually identical to those for the DTOs, except that:

- The PAO (Hyderabad) issues cheques, whereas, in the DTOs the cheques are issued by the agency banks. PAO (Hyderabad) has a poor record in undertaking reconciliations with cheques issued by the bank (see section 6.6.4.2). However, of late, PAO (Hyderabad) has outsourced this cheque reconciliation and expects to complete this work by July 2003;
- PAO (Hyderabad) only pay by cheque, not in cash as in the non-banking Treasury system;
- PAO (Hyderabad) focuses more on pre-audit than the Treasury system as, previously, the functions now undertaken by the PAO system were undertaken by the AG.<sup>78</sup>

### **5.8.3 Finance (Works and Projects) Department**

Since the 1950s, special arrangements have been made for the payments of major Irrigation projects. In April 2001, these arrangements were extended to other wings of Irrigation department, and the Public Works Divisions (PWDs) of Transport, Roads and Buildings, National Highways, Public Health

<sup>76</sup> GoAP Strategy Paper on Fiscal Reforms, paragraph 103.

<sup>77</sup> In 1984-85, expenditure booked through the PAO was Rs.645 crore; in 2000-01 it was Rs.7,147. In 2001-02, up to January 2002, it was already Rs.7,637 crore.

<sup>78</sup> In some other States, the pre-audit function is still undertaken at the State capital by the AG. In AP, the function was transferred to the PAO system in 1971.



Engineering, Panchayat Raj, and Forest Departments. The PAOs (Works and Projects) now provide payment services for all the projects of the above named departments in each district. There are now 34 such PAOs/APAOs located at 37 places (23 districts plus 14 at irrigation projects). There are also 12 independent divisions which have direct cheque drawing powers.<sup>79</sup> And, for payments made by Forest Divisions, the District Forest Officer has limited cheque drawing powers in respect of Civil Works not exceeding Rs.10 lakhs each.

For all other payments, the PAOs (Works and Projects) undertake pre-audit of the bills, checking sanction, adequate budget, coding etc, before issuing the cheque, drawn on the agency bank representing the RBI.

Each of the PWDs using the PAOs (Works and Projects) function has a Divisional Accounts Officer (DAO). The DAOs assist the Divisional Officers in the PWDs to pass bills for payment after undertaking basic checks on the invoice, in particular having obtained the sanction of the project's Executive Engineer (who is the DDO for that Division) that goods or services have been received and payment is properly due in line with the invoice.

There are six Joint Directors of Works Accounts (JDWAs) who have management control over the PAOs/APAOs under them. They post check the paid bills crossing 40% and 80% stage of agreement value and also undertake inspections of PAO offices and as part of an internal audit review the paid vouchers above Rs.2 lakhs value each.

Works accounting has been computerised, with the implementation of FACTS. FACTS is a relational database management system developed in Oracle, using the Windows NT operating system. The FACTS version 2 for processing of bills and generation of cheques is under finalisation. The implementation of FACTS has substantially improved the timeliness and reliability of rendering of monthly accounts by PAOs (Works and Projects) to AG during the last two years (see section 6.5). FACTS has not yet been subjected to an IT audit. The system's weaknesses in terms of connectivity are noted at section 6.6.2.1.

Key issues with regard to internal controls in PAOs (Works and Projects) were noted to be that:

- The department has an internal test check system, and a vigilance cell at the secretariat level, but no internal audit function;
- The procedure of obtaining bank guarantees (towards performance security or mobilisation advances or equipment advances) needs to be examined as PAO (Works and Projects) report cases of fake bank guarantees;
- There are delays ranging from one to 27 months in the reconciliation of cheques, submission of schedules, and Schedule of Settlement with Treasuries (SSTs) with the AG (see section 6.6.4.2);
- The operation of cash settlement suspense (for inter-departmental transactions) by the PAOs/PWDs has been discontinued, yet the outstanding balances have not yet been cleared. The outstanding balance at 31 March 2002 was debit Rs.65.57 crore.

#### **5.8.4 Funds circumventing both the GoAP Treasury system and the Government Account**

As noted at section 4.4.4, there are three Centrally Sponsored Schemes, being DPEP, DRDA and PMGSY, whose funds are channelled directly to the implementing department/agency without routing them through the Treasury departments. These arrangements stem from an India-wide policy based on GoI's assessment of control and efficiency of Treasury systems in other States.

The result in AP has been weaker financial control and accountability than in schemes receiving funds through the GoAP Treasury system. GoAP has thus joined other States to ask for the funds for such programmes to be passed through the State Government in future. Figure 55 below sets out a case study of one such scheme, DPEP, highlighting weaknesses in financial control and accountability.

<sup>79</sup> Including dredging; Marine; TB dam; emergency cyclone relief programme.

**Figure 55: Case study of DPEP**

The DPEP, started in 1994, is a Centrally Sponsored Scheme, with the objective of universalisation of elementary education. The programme supplements the existing system through additional inputs in terms of construction of school buildings, Vidhya Volunteer teachers and provision of teaching and learning materials. DPEP is based on the concept of community participation. School Education Committees (SECs) manage the 54,000 schools involved (about 80% of all schools) - they procure the construction, recruit and monitor teachers' performance and procure materials. DPEP is jointly funded by GoI (85 %) and GoAP (15 %). The DPEP appears in the budget and the accounts of GoAP only to the extent of State's share of expenditure. And, funds are not passed through the Treasury function.

The DPEP is implemented by AP Pradhamika Vidya Parishattu which is registered as a society. Management at State level is by the State Project Director (SPD). At the district level, the District Education Officer acts as the programme co-ordinator (PC) assisted by full time Additional Project Coordinator (APC), working under the control and supervision of the relevant District Collector. The APC of the District is supported by the Mandal Resources Persons (MRPs) at the Mandal level.

The SPD obtains the funds directly from the GoI and GoAP via demand drafts and the funds are parked in DPEP accounts maintained with nationalised banks in Hyderabad. Funds are distributed to the district units, who in turn park their funds in the nationalised/rural banks. Funds are then distributed to each SEC, which makes disbursements locally.

Monthly expenditure statements are required to be submitted by the MRPs, who compile them and submit them to the district, who in turn compile them and submit them to the DPEP SPD. The SPD compiles the accounts of the DPEP and should submit a monthly account to Education Department, and a quarterly report to GoI. The accounts of DPEP as well as the district units are audited by a Chartered Accountant and are subjected to external audit by the AG annually.

Preliminary results of testing indicate the following issues: cash books and other ledgers are not properly maintained at the district level; bank reconciliations are not being conducted consistently; interest on accounts in which DPEP monies are held are not properly accounted for; inadequate/no monitoring of expenditure statements from the SECs by the districts (but, expenditure statement is sent to the SPD each month promptly from the particulars available in their office); an annual working plan and budget (AWP&B) is prepared by the district unit and submitted to SPD through district collector who is responsible for the execution of the programme in that district, i.e. districts release monies up until the point that money runs out; UCs are pending for monies given as grants-in-aid (in Nalgonda, pending UCs totalled Rs.130 lakhs and in Vishakhapatnam Rs.25 lakhs); AG Inspection Reports and audit paras are not responded to promptly; in Nalgonda the monthly accounts are not being audited by a Chartered Accountant on monthly basis but alongside the annual accounts; the assets register was not maintained; there is no register indicating the list of civil works undertaken and expenditure incurred on each unit in each Mandal for each year. Furthermore, follow up actions on the remarks of the Chartered Accountant auditor are yet to be taken. Similarly, AG Inspection Reports and audit paras are not responded to promptly.

#### **5.8.5 Controls on PD and other deposit accounts in the Public Account**

PD and other deposit accounts have been an issue of concern for GoAP for some time.

The general financial rules prohibit the drawal of monies from the Treasury unless required for immediate disbursement. However, the rules do allow authorised officials to draw monies from Treasuries and place them in local agency banks in deposit accounts, outside the Consolidated Fund, in the Public Account (thus still within the Government Account).<sup>80</sup>

<sup>80</sup> The deposit accounts are disclosed under sector K major head 8443 Civil Deposits in statement 16 of the Finance Accounts.



The deposit accounts will be classified as non-lapsable or lapsable. In the latter cases, funds will lapse on 31 March of the financial year following the year in which the funds were released. The deposit accounts thus provide for contravention of the annuality principle, which requires funds to be returned to the Consolidated Fund at the end of each financial year. The risk is that unutilised budgeted funds will be transferred to deposit accounts to prevent the allocations from lapsing so that the money can be utilised after the close of the financial year.

Monies withdrawn from the Treasury and deposited in the PD accounts are accounted for as expenditure, pending submission of monthly PD account statements by the PD account administrator. Thus unspent balances in PD accounts represent an understatement of expenditure. The CAG in his 2001-02 report expresses concern at the unspent balances under deposit heads included as expenditure: as at end March 2002 they totalled Rs.68 crore, compared to Rs.56 crore as at end March 2001 and Rs. 113 crore as at end March 2000.<sup>81</sup>

Retention of large amounts in deposit accounts by the officers for long periods is also fraught with the risk of diversion and misappropriation of the funds provided for specific purposes, and also non-implementation of the schemes. Unutilised funds provided for specific schemes in the Budget should, unless re-appropriated, be surrendered to the Government at the end of the year.

GoAP's major concern has been about one type of deposit account, being the PD account, whose total balance was Rs.115.26 crore at 31 March 2002.<sup>82</sup> GoAP is increasing its control over, and the transparency of, lapsable PD accounts. PD accounts are allowed only in a number of specified circumstances, but the most common is for the execution of schemes in the districts over a number of years. Having access to a PD account enables the PD administrator (for example, the District Collector) to draw upon funds quickly when monies are required at short notice.

GoAP recognises the risks posed by the PD account system, and hence has implemented stricter controls over the PD accounts in four key areas, as follows.

First, opening of accounts. The opening of a PD account is subject to the prior authorisation of the AG and the accounts are managed by an authorised PD account administrator. Stricter discipline has been enforced by the AG over the last five to six years. This discipline has prevented the opening of further accounts.

Secondly, withdrawals from accounts. Until April 2000, there were no standard procedures adopted for withdrawals from the deposit accounts. At that time, Finance Department issued detailed instructions, simplifying and standardising the procedures.<sup>83</sup> Compliance with this appears to be adequate. Only upon specific authorisation of the AG will the DTO issue a cheque book to the PD account administrator.

Thirdly, transparency about accounts, account transactions and account balances, which has been very limited in the past. Finance Department has taken the following steps to increase transparency in this area. As of December 2001, PD Account administrators have been required to submit information on district-wise actual expenditure from the PD accounts, together with certified copies of the bank balances used for each scheme, while sending the cheque for countersignature in Finance Department. A Certificate of Acceptance of Balances (CAB) is also required to be sent by the PD account administrators by 30 June of the succeeding financial year.<sup>84</sup> However, compliance with this requirement was reported to be low, hence requiring alternative approaches. And, as of April 2002, the Treasury departments are required to collate information on PD accounts in their district.<sup>85</sup> As at end March

81 Report of the CAG of India for the Year ended 31 March 2002 (Civil) GoAP, see para 1.9.2 - 1.9.3.

82 The provisions for such accounts are set out in the AP Financial Code Volume I Article 267 to 272 and Treasury Code, Treasury Rules 10 and 16.

83 As per GOM No. 43 Fin. & Plg (W&M) Dept., dated 22 April 2000.

84 As per GOM No. 41377-A/1233/A2/W&M/2001, dated 27 December 2001.

85 GOM 507, Finance (TFR) Department, dated 10 April 2002.

2003, DTOs have reported, under GO 507 requirements, their knowledge of 1,176 lapsable PD accounts and 116 bank accounts.

Fourthly, accumulation of high balances in accounts. Traditionally, DTOs released further funds to deposit accounts, regardless of the fact that the account might already have high unutilised balances.<sup>86</sup> Controls to prevent high balances accumulating have been enforced, being as follows.

- DTOs are required to obtain information on the utilisation of funds from, and balances available in, the PD accounts before any further amounts are credited.<sup>87</sup> Bank certified balances are required for all bank balances. No further amounts shall be credited to PD accounts until and unless 75% of the amounts released previously have been drawn and spent. DTA performance monitoring of compliance by the DTOs reported a reasonably high level of compliance.
- GoAP is seeking the refund of lapsable balances from accounts. For example, of the Rs.144.49 crore in the PD accounts notified by the DTOs as at end November 2002, Rs.56.86 crore is lapsable. Of this total, Rs.54.29 crore has been recovered to date. While the recovery to the Consolidated Fund of these lapsable funds is an achievement, it is still of concern that the rules on lapses are counter to the annuality rules. If the benefit in terms of efficiency and effectiveness of schemes justifies this rule, the rule should be clearly disclosed in the accounts.

#### **5.8.6 Commitment and arrears are controlled**

Expenditure control systems are focused on budgetary controls at the Treasury level, before payments are released, not before expenditures are committed or incurred. Departmental offices do not maintain a record of their consolidated commitments, such that these could be used as an aggregate control. Furthermore, as noted at section 5.6.1, DDOs at the field level do not generally maintain BCRs. Thus, although arrears are calculated at the end of year for inclusion in the next year's Budget Estimates, the DDOs' records do not enable these to be calculated relatively easily. This creates a risk of expenditure commitments being greater than budgeted through arrears generation.

86 The CAG's report for 2000-01 noted that a test check of the accounts of 18 offices under four departments revealed that out of the amounts drawn on various dates between March 1987 and March 2001, Rs. 7.89 crore were still lying unutilised at September 2001 in PD accounts (Rs. 0.36 crore), deposits in banks/post offices (Rs. 4.47 crore), demand drafts (Rs. 1.39 crore) and other deposit including cash (Rs. 1.67 crore). GoAP has taken significant steps to remedy this situation.

87 GOM 507, Finance (TFR) Department, dated 10 April 2002.





## 5.9 Conclusion

For the last two years actual expenditure has been different from budget allocations at the Grant level, resulting in significant savings and some examples of excesses. The savings reflect factors such as lower than budgeted revenue, delays in release of GoI funds for Centrally Sponsored Schemes, delays in the issue of distribution statements at the district level and administrative bottlenecks. The savings and excesses do not indicate significant risk of funds being spent on unauthorised purposes as, in general, expenditure is less than appropriated and both Supplementary Estimates and “excess expenditure” are relatively low. However, the approval of the Assembly for those Supplementary Estimates is received on an ex-post basis; and excess expenditure remains “un-regularised” year after year.

Whilst the Assembly appropriates at the Grant level, GoAP binds departments to appropriations at the sub-head level, in an effort to exercise fiduciary control over expenditure. GoAP has increased the flexibility of HoDs to re-appropriate (within certain limits) in order to respond to changing needs during the year. The extent of these re-appropriations are not known. There are also instances where funds released by Treasury departments for a particular scheme have been diverted to another scheme; the extent of this diversion is not known but is of concern to the CAG.

The relatively low excess expenditure can be attributed to budgetary control at the aggregate and Treasury levels. Indeed, compliance with controls is adequate in the Treasury system and in those departmental areas in which discipline can be enforced through the Treasury system, such as documentation supporting payments; hence the success of GO 507 in targeting key controls. In all other departmental areas (such as cash records, UCs, AC/DC bills and PD accounts) compliance has in the past been generally weak. In the latter three areas at least, GO 507 and other initiatives are strengthening controls and compliance considerably, albeit from April 2002 onwards. Further strengthening is required of other deposit accounts.

## 6. Accounting

### 6.1 Principles of good practice

Accounting plays a critical role in minimising fiduciary risk. First, it enables government to monitor budget execution and maintain financial control (see examination of monitoring at section 7.2), and secondly, it enables financial reporting (see section 7.3). And, thirdly, it is financial reporting which enables accountability through audit (see chapter 12), the Legislative Assembly (see chapter 13), and public access to information (see chapter 14). Figure 56 below highlights those principles of good practice in accounting that are key to minimising fiduciary risk.

**Figure 56: Key principles of good practice in accounting to minimise fiduciary risk**

*Clear and optimal roles and responsibilities in the accounting process* support accountability for accounting systems, accounting records, and the production of accounts (see section 6.2).

*Clearly defined accounting concepts, policies and procedures* ensure consistent accounting treatment and disclosure, and enable users of the accounts to interpret them so as to be able to understand the financial results and position of the government (see section 6.3).

*Accounting policies support the needs of the user of the accounts* and enable them to hold the government to account (see section 6.4).

*Timely rendering, compilation and production of accounts* enables prompt scrutiny and action (see section 6.5).

*Systems and controls support relevant and reliable accounting* and provide reassurance that the accounts properly present the government's financial results and position (see section 6.6).

*Complete and reliable accounting for funds held outside the Consolidated Fund* as these are of higher inherent risk of lack of transparency, irregularity, and poor accountability (see section 6.7).

This chapter assesses GoAP practice with respect to these principles. The chapter will refer to the four stages of the accounting process in GoAP, as outlined in Figure 57 below.

**Figure 57: The four stages of the accounting process**

The four stages in the accounting process are:

*Stage 1: departmental maintenance of accounting records* for transactions approved by the departments and sent to be processed by the Treasury departments and payment by agency banks;

*Stage 2: rendering of monthly accounts* by the Treasury departments to the AG (Accounts Wing). (Accounts are also sent daily by the Treasury departments) to the DTA to enable monitoring of budget execution;

*Stage 3: the compilation and presentation of monthly government accounts* by the AG, based on the hard copies of the accounts rendered, inputs from RBI and from intergovernmental transaction data maintained by the AG;

*Stage 4: the compilation and preparation of the year-end accounts by the AG.* These form the basis for the annual Appropriation Accounts and Finance Accounts (examined at section 7.3).

### 6.2 Clear and optimal roles and responsibilities in the accounting process

Containing fiduciary risks depends on the clear allocation of roles and responsibilities to institutions in such a way as to support accountability for accounting systems, the maintenance of accounting records, compiling accounts and sound financial management. Roles, responsibilities and procedures for each aspect of accounting and reporting are contained within the core PFM documents, set out at appendix 1.



The allocation of accounting roles and responsibilities in India is as follows.

### **6.2.1 Stage 1: departmental maintenance of accounting records and Stage 2: rendering of monthly accounts by Treasury departments to the AG**

At the State level in India, it is generally the Treasury departments which process transactions and render accounts to the CAG, based on their processing of departmental transactions as detailed at section 5.8.<sup>88</sup> Thus, the line departments do not produce their own publicly available accounts. Indeed, accounts are structured major head-wise, rather than department-wise. These arrangements raise the risk that:

- Departments might not accept sufficient responsibility for their accounts and have insufficient motivation to build their financial management capacity. The lack of timely departmental reconciliations, prior to GO 507, reflects this fact;
- Departments could not be held sufficiently accountable for their financial management. The CAG could not issue department-wise audit opinions for example.

Good practice notwithstanding, the clear conclusion of the SFAA is that there is currently insufficient departmental capacity for, and commitment to, financial management and accounting to enable the transfer of responsibility to the departments in the short term. Clearly, GoAP is facing a vicious cycle here: until the departments are forced to be accountable for the production of their accounts, their PFM expertise and commitment will not increase significantly. However, this consideration must take a back seat to the overall objective of GoAP-wide financial control and accountability. As this chapter will conclude, GoAP has made significant advances in increasing the timeliness and reliability of its accounts. Too rapid a transfer of responsibility for financial transaction processing and accounting to the departments would undermine these advances. Rather, some interim measures could be put in place to start building departmental capacity and financial accountability with a view to transferring responsibility to departments in the medium term. Indeed, GoAP does intend to transfer responsibility for payments, accounting and accountability to the line departments in the medium term.

### **6.2.2 Stage 3 and 4: Compilation and presentation of government accounts by the AG on monthly and annual basis**

The CAG is empowered to prepare and submit the accounts of the Union or each State.<sup>89</sup> Section 10(1) of the CAG (Duties, Powers and Conditions of Service) Act, 1971 specifically empowers the President or the Governor of the State to relieve the CAG of the responsibility for compiling the accounts of the State or departments or of a particular class or character. However, only Goa (and GoI) has opted to take over the accounts function from the CAG.

Within AP, it is therefore the AG (Accounts Wing), on behalf of the CAG of India, who compiles the Finance Accounts and Appropriation Accounts and presents them to the Governor, after approval by the CAG, to be laid on the Table of the Legislative Assembly.<sup>90</sup> GoAP does not prepare, sign, or present its accounts. Nor does GoAP have a significant role in the management of the Public Account. The independence of the AG from GoAP provides some degree of reassurance about the objectivity and reliability of the accounts. And, there is little doubt that, currently, the AG is best placed to undertake this role in terms of its expertise. However, the risk remains that GoAP's accountability for its accounts is undermined. In general, this does not appear to be so, evidence being GoAP's accounting reforms. Furthermore, it is noteworthy that AP is one of only two States where the AG's accounting

88 Note that GoI ministries have already moved to processing their own transactions and producing departmental accounts.

89 Article 150 of the Constitution gives the President of India, on the advice of the CAG, responsibility for deciding the form of the accounts. The CAG (Duties, Powers and Conditions of Service) Act, 1971 elaborates the responsibility of the CAG with regard to the accounts as being to prepare and submit them.

90 At the GoI level, the CAG was relieved of responsibility for keeping the accounts of the Union Government under section 10 of the Act, as amended in 1976. An Office of CGA was created, in the Department of Expenditure of the Ministry of Finance, to establish and maintain a sound accounting system in the ministries and departments now undertaking their own accounting.

role starts at the point of secondary level compilation, with primary level compilation being undertaken by the Treasury departments.<sup>91</sup> In all other States the AG also undertakes the primary (voucher level) compilation also. Thus, relatively speaking, GoAP has a greater role in accounting than most other States. The risk of reduced reliability is mitigated by the detailed checks undertaken by the AG (Accounts Wing).

### 6.3 Clearly defined accounting concepts, policies and procedures

GoAP's accounting concepts, policies and procedures are to be found in the AP Accounts Code, the AP Financial Code and the AP Treasury Code, all of which draw upon the GoI Government Accounting Rules, Account Codes and General Financial Rules. Coverage of accounting concepts, policies and procedures within the Codes is as follows.

- **Accounting concepts**, such as materiality, prudence, neutrality, or accounting for items on the basis of their "substance" over their "form", are not specifically set down in any of the Codes.
- **Accounting policies**, which are the specific principles, bases, conventions, rules and practices adopted in accounting and presenting financial statements, are set down in the AP Accounts Code are included under various headings such as "general principles and methods of accounts", "general methods of accounting" and the "directions" governing the accounting for specific items. Key accounting policies include those for: cash basis of accounting, accounting treatment of sale proceeds from land, cost of acquisition, losses, and capital expenditure. However, the accounting policies are not stated to be based on any fundamental accounting concepts. In their most useful form, the accounting policies would be reflected in a set of comprehensive and consistent accounting standards tailored specifically to the needs of a country's accounting and financial reporting needs.
- **Accounting procedures** constitute the practical guidance required to ensure consistency in, for example, the bookkeeping entries for specific transactions, and how and when accounts should be put together. The accounting procedures are set down throughout the AP Accounts Code, with support derived from procedures prescribed under the AP Financial Code (which governs DDOs' financial procedures) and the AP Treasury Code (which governs the procedures of the Treasury departments).

Therefore, the accounting concepts and policies are neither described clearly (the emphasis being on the "form" of accounting procedure, rather than "substance") nor set out in a structured manner that would enable them to be easily identified. It is perhaps inevitable that both the Codes/Rules/manuals, and - the risk is - the finance officials themselves, 'cannot see the wood for the trees'. Indeed, the main weakness (and some strengths) of the PFM legal and procedural framework in this regard was recognised by the CAG in his recent inaugural address to the Government Accounting Standards Advisory Board (GASAB)<sup>92</sup>:

*"The Accounts Code, the Financial Code, the Treasury Codes, the departmental accounting rules etc all form an elaborate structure of a well established accounting system which has been functioning quite efficiently ... our existing accounting rules are not operating without a system ... they have underlying accounting concepts. But the problem is that we cannot identify these principles readily and distinctly. Consequently, they do not respond to our changing needs."*

91 Tamil Nadu is the other State.

92 The first meeting of GASAB was convened on 7 November 2002 by Mr V.N. Kaul, CAG.



A key question is the extent to which the lack of clarity has had a concrete impact in practice. The best examples include the accounting treatment of off-budget debt and contingent liabilities, such as government guarantees. GoAP has taken action on both these areas, but (and this is surely the point) of its own volition. Standardised requirements for accounting treatment are a clear necessity. The GASAB has been charged with the responsibility of bringing “proper identity to the existing concepts enshrined in the current rules”, and thus of delivering standardisation by formulating Government Accounting Standards for India.

In the meantime, the lack of standardisation provides scope for differences of opinion about accounting treatment. Recent CAG reports have commented on misclassifications of some items in the Finance Accounts, which, in his view have created “serious distortions” in the financial reports of GoAP.<sup>93</sup> We have come across two examples of this.

First, in 2000-01 a subsidy of Rs.1,667 crore (out of total of Rs.2,228 crore) to the energy sector was classified under Plan expenditure. However, GoAP believes that CAG’s view of the distortion is not justified from an accounting principles point of view. Revenue expenditure under both the Plan and non-Plan is calculated to arrive at the revenue deficit or surplus. Therefore, whether the subsidy is classified as Plan or non-Plan would not affect the revenue deficit and therefore cannot ‘distort’ the financial position of GoAP.<sup>94</sup> The Accounts Code sets down a clear distinction only between revenue and capital expenditure.<sup>95</sup>

Secondly, in 2001-02 Rs.761.59 crore, and in 2000-2001 Rs.553.7 crore, of grants-in-aid were disclosed as capital, instead of revenue.<sup>96</sup> The CAG’s objection was based on his view that such grants should not be disclosed as capital unless that expenditure increases the capital value of government assets, and that the impact has been to understate the revenue deficit. Indeed, the Accounts Code clearly states that “expenditure on grants-in-aid to local bodies or institutions cannot legitimately be considered capital expenditure”.<sup>97</sup> GoAP’s contention is that the secondary tier of Panchayat Raj bodies (i.e. Zilla and Mandal Parishads) are treated almost on par with Government, in that they are amenable to Writ jurisdiction of judicial courts; their employees are paid salaries and pensions through Consolidated Fund of GoAP, their capital works are carried out through GoAP PR Engineering department; maintenance of assets is fully paid for by GoAP. GoAP believes that the assets are actually ‘owned’ by GoAP but only managed/supervised by Zilla and Mandal Parishads. Furthermore, only those expenditure which actually were incurred for asset building were treated as ‘capital’. The CAG has now referred the issue to the GASAB for a review.

While differences of opinion about accounting treatments between institutions and their auditors are inevitable to some degree, the difference of opinion in this case does highlight the need for increased clarity and need for standardisation.

#### **6.4 Accounting policies support the needs of the user of the accounts**

Good practice defines four principal qualitative characteristics for accounting (and financial reporting) which enable users of accounts to interpret them and find them useful in holding the government to

93 Report of the CAG of India for the Year ended 31 March 2001 (Civil) GoAP.

94 GoAP also believes the classification was justified on the following grounds: the Planning Commission itself approved power subsidy as a part of the Approved Plan Outlay of GoAP, since the amount was being given not only to meet the revenue shortfall but also to bring about power sector structural reforms. The World Bank SAL is also to meet the structural adjustment costs that include power sector and Public Enterprise Restructuring costs. The GoI has a ‘Plan’ scheme of Accelerated Power Development and Reforms Program (APDRP) to provide subsidies to power utilities to meet their revenue shortfalls.

95 Accounts Code Volume I Article 30A.

96 Requirement is laid down in Rule 26 of the Form of Accounts of the Union and States (Basic) Rules. Misclassification reported in Report of the CAG of India for the Year ended 31 March 2001 (Civil) GoAP. The Audit Report adjusts for the misclassification when presenting its abridged statements.

97 Accounts Code Article 30A(2).

account.<sup>98</sup> These characteristics would assume more significance under an accruals accounting base of accounting that requires the application of significant levels of judgement in deciding accounting treatments. It is however the pursuit of these characteristics which drives the decision about the basis of accounting itself. These characteristics are set out in Figure 58 below.

**Figure 58: Principal qualitative characteristics for accounts and financial reports**

**Relevance:** information is relevant to users if it can be used to assist them in evaluating past, present or future events or in confirming or correcting past evaluations. Relevance is determined by its nature and materiality. Information is material if its omission or misstatement could influence the decisions or assessments of readers. For example, relevance might require the preparation of accounts of losses during the year, or accounting classifications, which enable areas of public concern to be disclosed in more detail.

**Understandability:** seeking to ensure that readers might reasonably be expected to comprehend the meaning of the accounts. Information about complex matters should not be excluded merely on the grounds that it may prove too difficult for certain users to understand.

**Reliability:** information is reliable if it free from material error or bias. The information in the accounts should be complete within the boundaries of materiality and cost; be faithfully represented in a neutral manner; be accounted for in a manner which reflects its underlying substance rather than simply its apparent form; and, wherever estimates are required, these be based on prudence (not generally relevant to cash accounting).

**Comparability:** information is comparable when users are able to identify similarities and differences between that information and information in other reports. It is critical therefore that items are accounted for in such a way to enable users of the account to compare between periods of account.

These characteristics will be particularly important as benchmarks against which financial reporting will be assessed in chapter 7.

India's accounting rules were developed well before the needs of the users were considered paramount. As a result, the Rules and Codes insufficiently support the needs of the users of accounts, in their desire for the relevant, understandable, reliable and comparable financial information. The Government Accounting Standards to be produced by GASAB aims to "promote best practices on the basis of generally accepted principles of Government accounting" and thus deal with the lacunae in the current system. They will be in keeping with both the Constitution and legal framework of India, but also international norms. The key criterion identified by the CAG in his inaugural address to the GASAB as driving the development of the standards was the needs of the user.<sup>99</sup> Therefore, we can reasonably expect the standards to address the "substance over form" issue and the relevance of financial information.

The following are the key areas for improvement of the usefulness of the accounts, in terms of accounting.

#### 6.4.1 Cash basis of accounting

At the heart of a country's accounting framework is the decision about the basis of accounting, and it is this which has a fundamental impact on the usefulness of the accounts. The cash basis of accounting is prescribed for all of India, subject to "such book adjustments as may be authorised".<sup>100</sup> GoAP has

98 International good practice is defined as the International Public Sector Accounting Standards (IPSAS) issued by the International Federation of Accountants (IFAC). IFAC has issued 20 IPSASs, all based on accruals accounting. An Exposure Draft (ED) 9 has been issued with respect to cash accounting. Although not yet an IPSAS, the principles set out in ED 9 are considered to be the principles of good practice in this area. The ED sets out these qualitative characteristics. IFAC's website is <http://www.ifac.org>.

99 Inaugural address of the CAG to GASAB, 7 November 2002.

100 The cash basis of accounting is laid down by the AP Accounts Code, Article 22.



expressed its intention to move towards a system of modified accruals accounting initially, implying that a full accruals system would follow.<sup>101</sup> While good practice is increasingly moving towards accruals accounting, or modified forms of it, the reality is that most governments still account on a cash basis.<sup>102</sup> Cash accounting has many advantages: it is a relatively clear and objective form of accounting, easily understood and one, which enhances financial control. The case for and against moving to a nationwide accruals accounting will be examined in depth by GASAB. The case for accruals accounting will doubtless consider the key limitations of cash accounting, being as follows. First, information about expenditure “incurred”, and revenue “earned” is not reflected, as cash accounting reflects only that “paid” and “received”. Thus, the accounts could mask significant excessive commitments and arrears of payment and revenue, greater than the usual year-end spillover arrears:

- Excessive payment arrears of Rs.1,800 crore accumulated in 1999-2000, the risk of which GoAP contained by adopting a zero based budgeting approach. Controls testing confirms that records of commitments and arrears are not maintained at the departmental level or elsewhere (see section 5.8.6). In the absence of such record keeping it is not possible to determine the existence or extent of excessive commitments and arrears. No evidence has come to light indicating that excessive arrears have once again accumulated.
- The CAG reports that the arrears of revenue pending collection are significant (at the level of Rs.2,231 crore as at end March 2002, comprising 14% of revenue raised under principal heads of revenue) but decreasing.<sup>103</sup> However, 51% of the arrears were pending for more than 5 years.<sup>104</sup>

Secondly, cash accounting and the annuality rule would typically incentivise dysfunctional behaviours: the “March rush”, expenditure in advance of need, inappropriate expenditure undertaken without proper due, and withdrawing funds from Treasury and placing them in non-transparent PD accounts.

Thirdly, the financial position of GoAP is inadequately reflected, as there is no balance sheet, such as would be found in company accounts. Particularly important for GoAP is the accounting for:

- Fixed assets, which, if disclosed, would increase the incentive for their safeguarding, valuation and proper management (see section 8.5);
- Some types of liabilities, specifically commitments and arrears, which would reveal the extent to which the next year’s budget was already committed expenditure;
- Major contingent liabilities, notably pension liabilities, and liabilities likely to arise as a result of the negative net worth of PSUs. While contingent liabilities in the form of government guarantees are disclosed in the Finance Accounts, there is no accounting policy to govern provisioning for contingent liabilities which might fall due as actual liabilities.

GoAP’s Strategy Paper on Fiscal Reforms specifically mentions that GoAP plans to complement its accounting with “financial reporting of arrears and commitments, reporting of guarantees accompanied by likely losses arising therefrom, likely losses on government investments including loans, financial assets, government debt showing accrued interest, and partial summary of fixed assets.”<sup>105</sup>

101 GoAP Strategy Paper on Fiscal Reforms, paragraph 100.

102 Over half of OECD countries (notably New Zealand, the United Kingdom (resource accounting), Australia, United States (at the federal level)) have now adopted accruals to some degree, and more are planning to do so. France, Canada and Spain account on a modified accruals basis. Latin American countries tend to follow modified cash accounting.

103 Report of the CAG of India for the Year ended 31 March 2002 (Revenue receipts) GoAP.

104 Report of the CAG of India for the Year ended 31 March 2002 (Civil) GoAP, see para 1.10.3.

105 GoAP Strategy Paper on Fiscal Reforms (2001), paragraph 100.

Fourthly, cash accounting limits the standard disclosure that seeks to ensure transparency and consistency.

#### 6.4.2 Accounting for donor funded projects and grants-in-kind

There is no specific accounting policy to determine the accounting treatment of donor funds received in kind, for example medicines or vehicles, and grants-in-kind are not disclosed. Furthermore, donor funded projects are not separately accounted or disclosed in the Accounts (although they are disclosed in the Budget).

#### 6.4.3 Accounting for investments

Some other accounting policies applied by GoAP might reduce transparency to users of the accounts. In particular, investments made by the Government, mostly in PSUs, are valued and disclosed in the Finance Accounts at cost (original amounts invested) rather than market values, which are likely to be considerably lower. Disclosure of the accounting policy in this respect might be useful to the reader.

### 6.5 Timely rendering, compilation and production of accounts

Unless accounts are rendered, compiled and presented on a timely basis, GoAP and stakeholders will be unable to assess whether the budget is being, or has been, executed in line with Legislative authority. GoAP has significantly strengthened the timeliness of its Treasury departments' monthly rendering of accounts to the AG, including by extending the PAO function to the PWDs and Forest Divisions (see Figure 53), and via computerisation. Both monthly and year end accounts are now produced on a timely basis. The overall timeliness of the accounting process at each stage is set out in Figure 59 below.

**Figure 59: Timeliness of the accounting process**

**Stage 1 departmental level.** As no records are maintained about commitments and arrears at the departmental level, it is impossible to know the average time periods over which liabilities are incurred, bills are received from suppliers, and bills are submitted to Treasury departments to be passed for payment. However, controls testing in the departments indicates that there is often a significant delay even between the receipt of the bill and it being passed for payment. This may be for a variety of reasons, including the lack of budgetary provision to finance the expenditure.

**Stage 2 Treasury level.** Different type of bills have been prescribed different payment terms. Treasury departments are required by the Citizens Charter to pass non-pay bills within 3 days. Pay bills are invariably paid on the first day of the month irrespective of the date on which they are submitted. It is believed that these dates are generally complied with.

Treasury departments are required to render their monthly accounts to the AG by a prescribed date, generally 6th to 10th of the month following that to which the accounts relate, but the date differs between offices of the Treasury departments, depending on their location in the State and the adequacy of communications.

The timeliness with which monthly accounts are rendered to the AG, and thus completeness of the consolidated monthly accounts, has improved dramatically, as follows:

- **2000-01:** the CAG's report for 2000-01 stated that sixteen accounts from nine PWDs and two accounts from two Forest Divisions were delayed by 31 to 118 days affecting the schedule of finalisation of the monthly accounts. The data provided by the AG paints a worse picture however: it shows 40 PWD accounts and three forest accounts being excluded from the monthly accounts.<sup>106</sup> The values of excluded accounts are low however: an average of Rs.2.68 crore per month for PWDs for example. In only 22 of these cases, were the accounts included in the subsequent month's accounts, but in all cases they were included in the year end accounts.<sup>107</sup>

<sup>106</sup> Data provided by the AG on 25 February 2003 in response to a request.

<sup>107</sup> The Report of the CAG of India for the Year ended 31 March 2001 (Civil) GoAP.





The CAG concluded that “as a result of large scale exclusions, the monthly accounts failed to reflect reliable picture of appropriations against grants and progress of expenditure”.

- **2001-02:** the Accounts at a Glance for 2001-02 stated that fifteen PWDs and seven Forest Divisions submitted their accounts “very late” in different months during the year. The delay ranged from ten days to 61 days. Once again, the AG provides different data: 21 Public Works division accounts, averaging Rs.3.3 crore per month.<sup>108</sup> And, there was a delay of ten to 34 days in the receipt of accounts from some DTOs during the year, as a result of which July 2001’s monthly accounts excluded one Treasury’s Rs.864.69 crore of expenditure and August 2001’s monthly accounts excluded two Treasuries’ Rs.844.36 crore of expenditure. This notwithstanding, the AG concluded that the rendition of initial accounts by the Treasuries was “satisfactory”. Note that, during 2001-02, all expenditure excluded from the monthly accounts was included in the following month’s accounts and the year end accounts.<sup>109</sup>
- **2002-03:** in February 2003, commenting on performance for 2002-03, the AG reported that only three Forest Department accounts and three PWD accounts had been delayed and thus excluded from monthly accounts.<sup>110</sup> Again, the values are very low. Furthermore, delays from these offices were down to an average of just seven days, and the values of excluded accounts were low. The improvement appears to be due to the PAO function being extended to PWD and Forest Departments, and to the introduction of FACTS. The delay in receipt of Treasury accounts ranges from one to 30 days, with less expenditure excluded from monthly accounts than in 2001-02: Rs.219.07 crore from two Treasuries was excluded from the April 2002 monthly accounts and Rs.97.87 crore from the October 2002 monthly accounts (both were included in the following month’s accounts and year end accounts).<sup>111</sup>

The RBI is responsible for rendering two important sets of information: first, the monthly closing statement on GoAP’s account with the RBI; secondly, the clearance memo confirming that inter-governmental transactions effected through the Central Accounts Section of the RBI have been cleared. Without this information, the AG would be unable to compile the monthly accounts. The RBI consistently renders this information on a timely basis before the 25th of the following month.

**Stage 3 compilation and presentation of monthly accounts by the AG.** Since April 2001, monthly accounts are required to be submitted by the AG to the Finance Department by the 25th of the month following the month of account. Examination of submission dates confirms that, whilst submission has, on occasion, been after the 25th, accounts have been submitted on a consistently timely basis, certainly before the end of the month.

**Stage 4 preparation of the year-end accounts by the AG.** Before it can compile the year end accounts, the AG is required to carry out necessary periodical adjustments such as the clearing of suspense accounts, adjustment of interest on Provident Fund Account to the respective accounts, adjustment of establishment and tools and plant charges to the respective works accounts (see section 6.7 for examination of how these issues impact on the reliability of the accounts). Furthermore, the AG undertakes rectification of misclassifications or any other errors pointed out or suggested out by the HoDs after reconciliations have been undertaken.

The compilation of year end accounts by the AG is being completed by 30th June, the date prescribed by the CAG; this is an excellent achievement in timeliness. All of the accounts excluded from the monthly accounts (now only being the PWDs and Forest Divisions’ accounts) are included in the year end accounts.

108 Data provided by the AG on 25 February 2003 in response to a request.

109 Accountant General (A&E) ‘Accounts at a Glance 2001-02’.

110 Data provided by the AG on 25 February 2003 in response to a request.

111 The data on excluded accounts was provided by the AG on 25 February 2003.

It is clear therefore that, with the exception of the PWDs and Forest Divisions' accounts absence from the monthly accounts - which is improving significantly - the problem is no longer one of timeliness. Rather, the challenge facing GoAP is one of the relevance and reliability of those timely accounts.

## **6.6 Systems and controls support relevant and reliable accounting**

To be useful for monitoring and financial reporting, accounts must support the qualitative characteristics of relevance and reliability, as set out at section 6.4.

In the sections below we examine key issues for relevance and reliability, which are:

- Systems and controls over departmental accounting (i.e. stage 1) (see section 6.6.1);
- Systems and controls over accounting by Treasury departments and AG (i.e. stages 2 and 3) (see section 6.6.2);
- The bookkeeping system maintained throughout GoAP (see section 6.6.3);
- Extent and timeliness of reconciliations, specifically between the accounts maintained by the departments, Treasury departments and the AG (see section 6.6.4).

### **6.6.1 Systems and controls over departmental accounting (Stage 1)**

Although departments do not produce accounts, the reliability of their accounting records remains important, to ensure:

- Departments maintain proper control and recovery of amounts, and ensure accurate transactions are passed to the Treasury departments, for example DC bills clearing AC bills (see section 5.7).
- The accuracy of the monthly expenditure statements, which form the basis for departmental monitoring (see section 7.2.2.1).
- The ability of the departments to undertake reconciliations with the accounting records of the Treasury departments. It is these reconciliations which constitute the key accounting control in the GoAP financial management system (see section 6.6.4.1).

However, there are four main areas of concern about departmental accounting, being:

- Their reliance on manual systems;
- The adequacy of their manual accounting records. The controls testing revealed that the main accounting records (Pay Bill register, supporting personnel records, Inward Register, Register of Bills and Treasury Bill Book) were being maintained to a satisfactory standard (see section 5.6.3 and 5.6.6.2). However, cash records were not being adequately maintained (see section 5.6.6.1);
- The low level of financial expertise of departmental officials, which increases the risk of error or irregularity. The inadequate numbers of officials with financial expertise emerged as a key concern of departments at the district level;
- The risks posed by monies advanced or granted not being recovered or properly accounted for. For example, there is a risk that expenditure, grants or investments may be understated to the extent that expenditure has been misclassified as loans or advances (see section 5.7.3). Similarly, AC bills are charged as expenditure. Thus, to the extent that these AC bills have not been adjusted by the submission of DC bills confirming actual expenditure, expenditure is overstated in the accounts (see section 5.7).

### **6.6.2 Systems and controls over accounting by Treasury departments and AG (stage 2 and 3)**

This section first examines the limitations on Treasury systems in terms of the lack of integration and connectivity, and then sets out GoAP's plans to address the problem by way of introducing new systems, and enabling integration and connectivity.



### 6.6.2.1 Integration and connectivity

Robust accounting systems and controls are particularly critical in the Treasury departments. The main Treasury system, C-TAS, noted at section 5.8.1.5, has been subjected to an extensive IT audit by the AG and has been confirmed as reliable.

The key issue for the Treasury departments is one of integration and connectivity between the plethora of financial systems being operated. These systems are as follows:

- DTOs/STOs and PAO (Hyderabad) operate C-TAS, Daily Information through Electronic Transfer (DIET), PEN and the Class IV GPF Accounting System;
- PAOs (Works and Projects) operates FACTS;
- The Director of Insurance in the Finance Department operates the AP Government Life Insurance Scheme system;
- SmartGov, which is a document management system operates in the Secretariat;
- The AG operates a Voucher Level Compilation (VLC) system to compile the accounts rendered to them by the Treasury departments.

Connectivity does exist for the daily transfer of information about totals of transactions from the Treasury departments to DTA via DIET; this enables Finance Department to undertake monitoring and cash management at an aggregate level. However, there is no other integration or connectivity between systems, in particular, between the Treasury systems and the AG to enable the electronic transfer of monthly accounts.<sup>112</sup> The lack of integration and connectivity requires the monthly accounts to be rendered in hard copy by the Treasury departments to the AG. The re-entry of data is inefficient and involves a high inherent risk of error. The AG (Accounts Wing) aims to minimise the risk of error by undertaking a series of checks and controls on the accounts rendered, as set out in Figure 60 below.

#### **Figure 60: Checks and controls undertaken on hard copy accounts by the AG**

On receipt of the main accounts from the Treasury departments, the AG (Accounts Wing) checks the arithmetical accuracy of the accounts and agrees the major head total shown in the Treasury main accounts with that shown in the sub accounts. The main account is also checked with other supporting documents or prescribed schedules and passed for booking. Then this account is transmitted for compilation of monthly civil accounts by major head totals.

The sub accounts along with vouchers, list of payments (LOP), list of schedules and challans are transmitted to the departmental compilation section, where the LOP and vouchers are cross-checked. The amounts for which vouchers are not received are kept under “objection” and entered in the register of wanting vouchers. This will be pursued separately with the Treasury concerned. The totals of LOP and schedules are checked for arithmetical accuracy and the corresponding abstract of totals in the sub-accounts are agreed. The recovery statements are agreed with the recovery totals. The prescribed certificates of the Treasury will also be scrutinised. Then the sub accounts will be ‘passed for booking’ and countersigned by the superior officer and sent for compilation using VLC system. (The vouchers with LOP are then transferred to the AG Audit for central audit.) Although not tested, it is believed that the rate of error in the re-entry of data is extremely low, due to the strict controls in place including validation checks incorporated in the software.

112 Attempts were made by the DTA to render the accounts for a few Treasuries through magnetic media, but this data could not be imported to AG’s system due to a lack of compatibility and suitable interface in AG’s VLC system. Moreover, there were differences between the hard and soft copy figures due to late changes made by the Treasuries. And, the soft copy figures were not authenticated. Rendering of soft copy of accounts to the AG was thus discontinued.

Nonetheless, recognising the risks posed by the lack of integration and connectivity, GoAP has in progress an ambitious integration programme, as follows.

### 6.6.2.2 E-khazana

At the heart of that reform programme is e-khazana, an online Treasury system to replace C-TAS. The salient features of E-khazana are set out in Figure 61 below. As the system is not yet operational, an IT audit of e-khazana has not yet been undertaken, and the SFAA team has not been able undertake a detailed examination of e-khazana. However, it does appear that it has a number of advantageous features which are likely to strengthen transaction processing, accounting and reporting.

E-khazana is being implemented in stages, and it is expected that parallel records will be maintained until April 2003, when the system is due to go online. Most of the DTOs have e-khazana and are entering data in it. Some of the new hardware for the e-khazana implementation has been installed at some of the STOs, but they are not yet operational with e-khazana and still rely on C-TAS. E-khazana cannot become fully operational until and unless network connectivity is established by the creation of the AP State Wide Area Network (APSWAN); its integration with other systems will be enabled by the Integrated Financial Information System (IFIS).

**Figure 61: The salient features of e-khazana**

*In-house development:* software has been developed in house, and is thus tailored to the specific needs of the Treasury system.

*Coverage:* e-khazana will operate in DTOs, STOs and PAOs, and cover all key Treasury functions, also enabling, for the first time, payroll.

*Strong internal processes and controls:* token issuing, budget verification, DDO verification, Bank list generation, report generation and monthly accounts to AG. For example, once the budgetary provision has been entered on the system, it will block any payments which would lead the provision to be exceeded.

*Reporting:* e-khazana will generate on-line classified accounts for the AG. The new software will also generate reports on compliance with GO 507, receipts and payments reconciliation DDO/HoD wise, pensions, Budget vs expenditure for class IV GPF and employees census.

*Easy maintenance and cost effectiveness:* developed with Oracle integrated application software on LINUX operating system, accessible through any standard browser front-end.

*Web-enabled system:* developed using current technologies (HTML, Java Script, PL/SQL server pages, web server) enables connectivity.

*High integrity, reliability, security and consistency of data:* based on the Oracle 8i Object Relational Data Base.

*User friendly and simple to use:* no specialised training is required as it is user friendly and interactive features are made available.

### 6.6.2.3 Integrated Financial Information System

The implementation of the IFIS will enable the full integration of all GoAP financial systems. Like e-khazana, IFIS is dependent on APSWAN, together with the AP State Information and Communication Network (APSION) which aims to bring connectivity to mandal and even village level. GoAP's vision of IFIS is set out in Figure 62 below.



**Figure 62: GoAP vision of IFIS**

The objective of IFIS is to provide efficient transfer, storage and retrieval of financial information throughout GoAP.

To achieve this, IFIS will:

- provide an interface between the applications used by Finance Department, DTA, PAO, PAOs (Works and Projects), payroll, Government Life Insurance, Small Savings, HoDs, District Officer, Sub-district officers, audit, local bodies and Secretariat (including SmartGov);
- allow integration with the systems of external entities such as RBI, AG, GoI, agency banks, and financial institutions.

The proposed architecture for IFIS to address the issue of multiple data sources will use Oracle adaptors, Oracle database adaptors, Fox Plus adaptors and flat file adaptors. IFIS will enable Treasury departments to supply their monthly accounts from e-khazana to the AG's VLC system electronically, removing the need for the AG to re-enter the Treasury departments' data. Hardware has already been installed by GoAP at the VLC site in the AG's office; APSWAN connectivity is being established and the network being tested. Direct transfer of data will release human resources and eliminate the potential for error when data is re-entered. Furthermore, it will facilitate easier reconciliations, an issue examined in section 6.6.3 below. It is reasonable to expect that IFIS will significantly improve the quality, timeliness and reliability of accounting and financial information. However, an IT audit will not be undertaken until the system is fully operational.

#### **6.6.2.4 FACTS connectivity to the AG**

APSWAN will also enable connectivity between the PAOs (Works and Projects) system, FACTS, and the AG, removing the need for data re-entry. Though training has been provided to officials, the system is being maintained and operated by one Data Processing Operator provided by AP Technology Services in each office.

However, online connectivity has not yet been established with the CCOs. Thus, for example, the Engineer-in-Chief (Irrigation Projects), the CCO for irrigation projects, is dependent on the PAOs (Works and Projects) for the expenditure statements on irrigation projects on a monthly basis. Online connectivity between the PAOs (Works and Projects) and the CCOs would enable the CCOs better to monitor the projects and control their expenditure.

#### **6.6.3 Bookkeeping system**

The system of bookkeeping maintained determines to a significant extent the assurance which can be drawn about the reliability of the accounts, in particular because a double entry system enables reconciliations, which are a key accounting control.

GoAP's bookkeeping system, as mandated by the President of India on the advice of the CAG and thus common across India, is neither a traditional single entry nor double entry system. Rather, it is a hybrid system in which each account rendering source (e.g. DTOs):

- records each transaction on a gross basis against the relevant classification;
- as far as the corresponding double entry (i.e. cash, bank etc), makes double entries on a net basis only for all transactions within the month.<sup>113</sup>

These net totals are journalised by the AG on receipt of the monthly accounts i.e. the AG (Accounts Wing) passes journal entries for the net totals, enabling the production of a trial balance, thus providing reassurance about the accuracy of the accounts.

113 The following example demonstrates how the system works. Assume the following were the total transactions in a month: payment: debit expenditure Rs. 3 crore, credit bank Rs. 3 crore; receipt: credit receipts Rs. 1 crore; debt bank Rs. 1 crore. The accounts on the net basis would simply show debit to expenditure of Rs. 2 crore, credit to bank Rs. 2 crore.

This can be compared to the standard double entry system, in which both the debit and credit for any transaction would be entered at the same time, thus all on a gross basis. The GoAP hybrid system does appear to operate satisfactorily, as it enables reliable reconciliations.

#### 6.6.4 Reconciliations

Reconciliations are the key control in ensuring that funds have been spent on the purposes intended and authorised, and in providing accurate accounting information; they play a particularly critical role in the absence of integrated financial accounting systems as noted above. The extent to which reconciliations are undertaken will thus play a significant role in the assessment of fiduciary risk. In the past, the major flaw in GoAP's accounting systems and processes has been the infrequency of its reconciliations. GoAP has taken tremendous steps to infuse greater discipline into the reconciliation system, yet until key reconciliations are promptly undertaken, the reliability of the accounts will remain significantly impaired. The sections below examine the two key types of reconciliation undertaken, being:

- Between the records of the department and the relevant Treasury department/AG. Such reconciliations aim to ensure that the receipts/payments processed through the Treasury department are as intended by the sanctioning authority;
- Between the records of the relevant Treasury department/AG and the bank. Such reconciliations aim to ensure that the payments made by the bank are as processed by the Treasury department.

##### 6.6.4.1 Departmental to Treasury/AG reconciliations

A series of departmental reconciliations are required as accounts pass up from the STOs to the DTOs, and thereon to the AG. Historically, the reliability of the accounts has been seriously undermined by the lack or irregularity of reconciliations between departmental figures at each level and those of the STOs, DTOs, and the AG. However, the reconciliation of accounts and submission of Expenditure Statements with Reconciliation Certificates are subject to increased discipline under GO 507 which was introduced in April 2002, as set out in Figure 63 below.<sup>114</sup>

#### Figure 63: GO 507 requirements for reconciliations

GO 507 required that:

- DTOs and PAOs shall furnish the lists of DDOs who have failed to reconcile their figures with those of the STOs/DTOs to the HoD for further action. DTA confirms that this is happening;
- DTOs and PAOs are required to maintain a register showing the dates on which drawals have been reconciled with the departmental figures. This register should facilitate the checking of the certificate of reconciliation furnished by DDOs. The fact that DTOs are reporting on reconciliations by departments indicates that DTOs are maintaining this register;
- No Treasury officer shall permit any amount to be drawn by non-compliant DDOs after the 10th of the month until and unless reconciliation of accounts up to the previous month is completed and the relevant certificate confirming that is appended to bills submitted to the Treasury/PAOs for payment;
- Treasuries are empowered to stop the salary of any DDO, CO or CCO not undertaking regular reconciliations. However, DTA has reported that this sanction is not being applied in practice. The withholding of authorisation for payment is proving sufficient, without DTOs having to attempt to withhold salaries, which would be difficult in practice.

<sup>114</sup> GOM 507, Finance (TFR) Department, dated 10 April 2002. Previous requirements in this regard are set out in the Budget Manual and GOM No. 277, dated 6 June 1990.



**Figure 64: Adequacy of reconciliations between DDOs/CO/CCOs and STOs/DTOs/AG**

There are three stages in the upwards chain:

- Stage 1 at DDO level:** After the month end, DDOs are required to reconcile their figures with those of their STOs by the fourth of each month following the month to which they relate. The DDOs' clerks normally undertake the reconciliation on their behalf. This reconciliation should be certified by the STO as correct. Each month, after reconciliation with the STOs' figures, the DDO should forward the Expenditure Statement and a Statement of Receipts, and the certified reconciliation statement, to the CO immediately superior to him. Controls testing of five districts for primary health and education reveals substantial delays, but that GO 507 has resulted in considerable reductions in these delays and thus improvements in compliance with the requirements for reconciliation. **Thus, while months previous to April/May 2002 remain unreconciled, months since that date have been satisfactorily reconciled.**
- Stage 2 at District level:** each CO should use these monthly Expenditure Statements as the basis for the district-wide monitoring of expenditure and receipts. The COs - represented by their Gazetted Administration Officer (GAO) - should consolidate the information from DDOs, reconcile with the **DTO** at the district level by the ninth of each month, and forward the statements to the CCO. Yet for 2001-02, Rs.8,265.44 crore, constituting 30% of the total expenditure was not reconciled as of June 2002 by COs in 14 departments.<sup>115</sup> The unreconciled amount was up from Rs.4,724.40 crore (18% of expenditure) as at April 2001. Controls testing of five districts for primary health and education reveals **delays, but that GO 507 has resulted in considerable reductions in these delays and thus improvements in compliance with the requirements for monthly reconciliation.** The DTO performance monitoring reports support this finding across all districts: for example, only 1,182 of the 41,357 expenditure reconciliations required to be undertaken by departments for March 2003 were still pending at mid April 2003. Thus, 93% of expenditure processed through the DTOs had been reconciled for March. The equivalent results for revenue reconciliations were 614 (being 22%) of the 2802 reconciliations required were still pending, and 88% of revenue reconciled. DTOs have enforced this increased rate of reconciliation by withholding payment: in March 2003, DTOs rejected 199 bills due to pending reconciliations. Similarly, in the PAOs (Works & Projects) at end March 2003, only 64 of a total of 695 expenditure reconciliations for the month of March 2003 were still pending, i.e. 89% of expenditure had been reconciled. While the results are encouraging, it should be noted that the data does not reveal the significant backlog of accounts prior to April 2002, which are still unreconciled.
- Stage 3 at State level:** The CCO - represented by his CAO - should consolidate registers from COs and undertake a reconciliation at the State level with the AG's figures of payments and receipts actually paid and received (which the AG will have received via the DTOs). When the figures have been reconciled, the CCO should send monthly Reconciliation Certificates to the AG every quarter, stating that the figures in his registers have been reconciled with those in the books of the AG. **Compliance with this reconciliation requirement is still poor.** As at end December 2002, unreconciled amounts for 2001-02 totalled Rs.4,870.37 crore for all expenditure heads and Rs.3,395.07 crore for loan heads; comparative figures for 2000-01 are Rs.3,335.31 crore and Rs.1389.09 crore.<sup>116</sup>

115 Report of the CAG of India for the Year ended 31 March 2002 (Civil) GoAP, see para 2.3.17 and appendix XVIII.

116 Data provided by AG, December 2002.

The increased discipline does appear to be having an impact on departmental reconciliations. The DTA sends monthly reports to Finance Department on the extent of departmental reconciliations. These, together with the results of controls testing, show a marked improvement in the timeliness of reconciliations, as outlined in Figure 64 above.

In summary, DDOs and COs are now complying with the requirement for prompt monthly reconciliations. However, this compliance relates only to periods of account after April 2002, with accounts prior to that remaining seriously in arrears. Furthermore, CCOs are still not complying with reconciliation requirements. Reconciliation at the CCO level is critical for three reasons, being that:

- There may be errors in classification during district level consolidation of STO figures at the DTOs and State level consolidation of DTO figures at the AG;
- CCOs are not aware of the book adjustments carried out by AG on account of inter-departmental/ inter-governmental transactions and PWD and Forest accounts;
- Significant amounts of expenditure are spent at the CCO levels.

The prescribed process is that the CCO should reconcile the consolidated figures with those of the AG and issue a Reconciliation Certificate once having completed this reconciliation. It should be noted that:

- CCOs who do not undertake these State level reconciliations tend to accept the AG's figures as correct and adjust their own accounting records accordingly. There are inherent risks in accepting these figures for a number of reasons. Furthermore, it is reasonable to assume that this approach seriously undermines the departments' sense of responsibility and accountability for maintaining their own accurate accounts;
- The AG reports that some departments do undertake the reconciliations but do not actually submit the certificate, so, in official terms will not be recognised as having undertaken the reconciliation;
- Those departments who do undertake reconciliations issue variation statements, requesting expenditure to be moved between heads. It is essential that the AG verifies the backing vouchers to ensure that the variation is valid, otherwise this variation can involve expenditure being wrongly re-classified.

Accounts at a Glance publishes a list of departments/CCOs who have persistently defaulted in their reconciliations in the past few years, in an attempt to 'name and shame'.<sup>117</sup> There does not seem to be one specific reason why CCOs are failing to reconcile to the AG's figures. However, it is notable that GO 507 and the DTA monitoring has been credited with improvements at DDO and CO levels, no such arrangements exist for the CCO level. Similar exercises in discipline might enforce reconciliations at the CCO level.

Furthermore, it is believed that the record for reconciliations by departments in the twin cities with the figures of the PAO (Hyderabad) remains extremely poor. However, no monitoring is undertaken of this, so no data is available. There are some 1,090 DDOs in the area who, it is believed, are failing to reconcile their monthly accounts.

#### **6.6.4.2 Treasury/AG to bank reconciliations**

The picture is somewhat better with regard to the DTO/bank reconciliation, with evidence that it is being undertaken satisfactorily. Controls testing confirmed that all five DTOs tested received a day-

<sup>117</sup> The worst offenders, with reconciliations not undertaken since late 1980s and early 1990s, include the Chief Commissioner of Land Revenue, Director of Works and Accounts, Commissioner Commercial Taxes, Commissioner and Director of Municipal Administration, and the Commissioner Municipal Corporation of Hyderabad.





wise monthly statement (DMS) from the bank and reconciled it with its own records of passed payments. This is believed to be the position across all DTOs/STOs. Each DTO completes this bank reconciliation promptly, to enable it to produce monthly accounts for the AG. AP is the only State to undertake this reconciliation.

However, significant problems exist with the PAO (Hyderabad) reconciliation with cheques encashed by the bank. Unreconciled entries comprise a credit balance of Rs.317.37 crore at 31 March 2002 representing unencashed pre-audit cheques of Rs.279.56 crore issued by PAO (Hyderabad) and departmental cheques of Rs.37.82 crore issued by the Pension Payment Office, Hyderabad. PAO (Hyderabad) and the Pension Payment Office are required to reconcile every month the cheques issued by the department with the paid cheques to arrive at the balance of unencashed cheques with details of the unencashed cheques. Between the time when the PAO assumed responsibility for the Treasury function from the AG in 1971 and 1996-97, the reconciliation was not undertaken. In 1997-98, attempts at reconciliation were made. However, as at December 2002, reconciliation was 16 months in arrears, as the huge volume of transactions has proved too great for the PAO to keep reconciliations up to date. If this reconciliation is not undertaken systematically and promptly, there is a significant risk of non-detection of encashment of fraudulent cheques. Finance Department has engaged consultants to get the reconciliation up to date and exclusive software is being implemented in PAO (Hyderabad) to enable reconciliation of cheques and also to reduce the arrears. Work on software development has stated to be completed by 31st March 2003. The reconciliation work is likely to be completed by end of May 2003. Problems remain also in terms of the cheque issuing departments, i.e. PAO (Works and Projects) and PWDs in terms of their bank reconciliations. The PAOs (Works and Projects)/PWDs send their payments to the agency bank for payment. The paid cheques go to the DTO for onward transmission to AG, after payment by the agency bank. The PAOs (Works and Projects)/PWDs have to reconcile departmental figures of actual cheques issued with those encashed, for the amount authorised and paid to the recipient with the records available in the Treasury. However, this reconciliation process is severely in arrears due to problems remaining from the period previous to the introduction of FACTS. Monthly reconciliations are currently undertaken for the current months.

The AG to RBI reconciliation is satisfactory. The monthly closing balance statement of the RBI is received by the AG on the 20th of the following month. Reconciliation between the AG's and RBI's figures is undertaken on a monthly basis, and a certificate to that effect, together with a discrepancy statement, is submitted to the CAG by the first week of the second succeeding month, i.e. the November reconciliation statement will be submitted in the first week of January. The reconciliation process has been computerised since 1993. A discrepancy statement and an analysis of the discrepancies are produced automatically. These documents are sent to the DTO, RBI and the agency for them to resolve the discrepancies. Any outstanding discrepancies are resolved during periodic meetings are held between the AG, RBI, agency banks, DTA officials and Finance Department. However, the AG has not been submitting the discrepancy statements to the Finance Department along with the monthly civil account.

The unreconciled amounts between the debit bank balance in the AG's records and that under the head deposits of the RBI was Rs.13,64.82 lakh on 31 March 2000, Rs.10,38.43 lakh on 31 March 2001, but had decreased to Rs.12,81.38 lakh by 31 March 2002.<sup>118</sup> However, the unreconciled balance had been reduced to Rs.1,13.29 lakh by end June 2002, significantly down from the same period in previous years, which indicates an improvement in controls over the accounts.

118 The figure reflected in the accounts was Rs.51.94 crore debit, compared to the balance of Rs.39.13 crore debt intimated by the RBI. See Report of the CAG of India for the Year ended 31 March 2002 (Civil) GoAP, Explanatory Notes to Exhibits I, II and III, (5).

## 6.7 Complete and reliable accounting for funds held outside the Consolidated Fund

There are two key issues with regard to accounts held in the Public Account, as follows.

First, there are significant unreconciled balances between the closing ledger balances of the Public Account shown in the AG's main/control accounts and the detailed accounts maintained by AG.<sup>119</sup> The explanatory notes to Statement 8 of the Finance Accounts state that these unreconciled balances exist "in a number of cases", but discloses only some of the differences relating to loan heads (as noted at section 5.7.3).<sup>120</sup> And, these are the net differences, not the total gross differences, which, in fact, run into hundreds of crore. Many entries are unreconciled due to the fact that the AG has not received adequate details and documents from the DTOs or departmental offices.

Secondly, there are certain accounts in the Public Account that are at higher than average risk of poor controls and incomplete and untimely accounting. These are outlined in Figure 65 below.

**Figure 65: Accounts at risk of incomplete and untimely accounting**

Sector I Small Savings, Provident Funds etc: *AP Government Life Insurance Fund (APGLI)*, which had a credit balance of Rs.765.60 crore at 31 March 2002 and *AP State Govt Employees Group Insurance Scheme*, which had a credit balance of Rs.313.78 crore as at 31 March 2002.

Sector I Small Savings, Provident Funds etc: *General Provident Fund*, which had a credit balance of Rs.2650.58 crore at 31 March 2002, but with regard to which the riskier area appears to be Class IV Employees contributions maintained by the DTOs.

Sector K *Deposits and advances*, which had a credit balance of Rs.4,671.58 crore at 31 March 2002.

Sector L *Suspense accounts* under major head 8658 which had a net debit balance of Rs.466.21 crore at 31 March 2002.

Sector L '*Other accounts*' under major head 8670 had a net credit balance of Rs.317.38 crore at 31 March 2002 representing unreconciled balances relating to the PAO (Hyderabad)/bank reconciliation (see section 6.6.4.2).

Sector J *Reserve Funds*, which had a credit balance at 31 March 2002 of Rs.260.13 crore, but which has a large value of receipts from the Consolidated Fund and expenditure during the year

Each of these accounts is analysed in the following sections.

### 6.7.1 AP Government Life Insurance Fund

Sector I Small Savings, Provident Funds etc: APGLI (coded as 8011/105 State Government Insurance Funds) had a credit balance of Rs.765.60 crore at 31 March 2002; this has increased 62% on the balance at 31 March 1999. The AP State Govt Employees Group Insurance Scheme had a credit balance of Rs.313.78 crore as at 31 March 2002.

The APGLI consists of compulsory contributions by government employees towards endowment insurance; the number of subscribers was 4.41 lakhs as at 31 March 2002. The total subscription together with interest is to be paid back to the employee on retirement or death. Detailed accounts of individuals' subscriptions to the APGLI are maintained by the Director of APGLI in Finance Department. Management of the Fund has suffered from the following weaknesses.

119 The AG maintains detailed or separate registers, known as broadsheets, indicating ledger balances in respect of all heads which are closed to balances under Deposits, Reserve Funds, Suspense and Remittances (under the Public Account) and Public Debt and Loans and Advances (under the Consolidated Fund).

120 Statement 8 of the Finance Accounts states: "In a number of cases, there are unreconciled differences between the closing balances shown in Statement 16 and 18 of the Finance Accounts and those shown in separate registers or other records maintained in the Accounts Office/Departmental offices for the purpose. Steps are being taken to settle the discrepancies as soon as possible. In many cases the full details and documents required for the purpose are awaited from the Departmental/Treasury Officers."



- Accounts for the Fund have not been produced since 1995-96. The Director of Insurance plans to complete the production of the accounts in arrears by March 2004.
- 23% of the Fund balance had not been posted to individual subscribers' accounts as at 31 March 2000. No figures are available since that date, but it is believed that the high proportion of unposted items persists.
- There is a high suspense account balance as reconciliations between the Director of Insurance's detailed accounts with the AG's ledger accounts are outstanding since 1994-95. The absence of reconciliation raises the risk of incompleteness of balances of individual subscribers. This reconciliation is the responsibility of the Director of Insurance.
- As the APGLI Fund does not maintain actual detailed balances, the Director of Insurance apportions the balances obtained from the AG between insurance and savings funds on an ad hoc basis, rather than according to the actual detailed balances. The annual interest is therefore also only calculated on these ad hoc balances. This leads to the total of individual subscriber balances not agreeing with the total balances, overcharging of interest and the risk of rising unclaimed balances.
- Account slips, notifying policy holders the balance of their fund, have not been issued since 1998-99. The Director of Insurance has stated that the account slips with the balance as at 31 March 2002 will be issued shortly during 2003.
- There is no internal audit function operating to monitor the quality of, and compliance with, controls in the management of the APGLI. The Director of Insurance undertakes annual inspections of the district offices.

The presence of these weaknesses, particularly the absence of completion of annual accounts and issue of account slips to individual subscribers, presents a significant risk of manipulation of figures, drawal of fraudulent cheques and tampering of records. Without proper management and control, the monies in the Fund could prove insufficient to cover the Fund's liabilities and constitute a liability for the government, or employees might be denied sums to which they are entitled. In recognition of the weaknesses noted above, GoAP started computerisation of accounts in 1997 but it has yet to be completed. The clearing of arrears has not yet been undertaken.

The AP State Govt Employees Group Insurance Scheme is a mandatory fund contributed to by all State Government employees. Accounts for the Fund were not produced between 1995-96 and 2000-01.

### 6.7.2 General Provident Fund

Sector I Small Savings, Provident Funds etc: General Provident Fund had a credit balance of Rs.2,650.58 crore at 31 March 2002, increased significantly 49% since 31 March 1999.

The high risk area of the General Provident Fund is the Class IV employees' General Provident Fund, accounts for which are maintained by the DTOs. The accounts have significant amounts of amounts unposted to individual subscribers' accounts. The volume of unposted items is mounting each year: Rs.1.19 crore in 1999-2000, Rs.1.24 crore in 2000-01 and Rs.1.49 crore in 2001-02 remained unposted to individual subscribers' accounts in 22 districts (excluding Hyderabad headquarters).<sup>121</sup> Approximately 5% of subscriptions remain unposted each year.

Controls testing at DTOs confirmed that these accounts are not being properly maintained. Details of the name and account number of the Class IV employees GPF were not given in the schedules enclosed with the salary bills by DDOs. It is the DTOs' responsibility to insist on receiving this information before passing the salary bills for payment. In some cases, the GPF account numbers of Class IV employees had not be communicated by the DTOs to the DDOs in the first place. Review of AG audit

<sup>121</sup> Information provide by DTA on 1 February 2003.

Inspection Reports confirms that these problems are prevalent.<sup>122</sup> No specific action is being taken by the DDOs in furnishing the required data to the DTOs to clear the serious backlog built up over several years.

### 6.7.3 Public account Deposits and advances

Sector K *Deposits and advances* had a credit balance of Rs.4,671.58 crore at 31 March 2002, an increase of 35% since 31 March 1999, but a relatively steady balance since 31 March 2000.

Of the total deposits and advances, key balances at 31 March 2002 consisted of:

- Deposits of Local Funds Rs.1,524.04 crore and miscellaneous deposits of Rs.805.16 crore. This is the total of the deposit accounts, concerns about which were noted at section 5.8.5;
- Miscellaneous Public Works remittances by PAOs (Works and Projects), an account maintained by the AG. The balances outstanding under this account as at 31 March 2002 total credit Rs.108 crore for Public Works Remittances and debit Rs.49 crore for Forest Remittances. The remittances represent cheques issued by PAO (Works and Projects) and remittances made into the Treasury. These balances are not being reconciled promptly with the DTOs, with delays of up to 27 months, as noted at section 6.6.4.2. The CAG has expressed concern about the outstanding balances under this head.<sup>123</sup>

### 6.7.4 Public Account Suspense accounts

Sector L *Suspense accounts* under major head 8658 had a net debit balance of Rs.466.21 crore at 31 March 2002, a 295% increase since 31 March 2000.

At only 1.7% of total expenditure in 2001-02, the amounts involved in the suspense accounts are not material even if they were all properly classified as expenditure, which they would not be. Rather, the risk is that items in suspense lack transparency, and can mask misclassification, misappropriation and poor control. And, the suspense balances are increasing rapidly.

Suspense accounts are used to record transactions that cannot be brought to final head of account immediately, for a number of reasons. For example, vouchers or schedules may be awaited to identify the proper classification of the transaction. It also includes intergovernmental transactions that are to be adjusted eventually by the other accounts offices for which monetary settlement is awaited. In the absence of prompt provision of these by the departmental officers or other accounts offices, it is difficult to have assurance as to the underlying visibility of individual transactions passing through suspense accounts, and to confirm whether items should not be properly charged to expenditure or receipts.

122 For example, the AG's Inspection Report for Nalgonda DTO, inspected in December 2001, notes an unposted amount of Rs.12.71 lakhs in these accounts, and that inadequate documentation was maintained and reconciliations undertaken to clear balances to individual subscribers' accounts.

123 Report of the CAG of India for the Year ended 31 March 2002 (Civil) GoAP, para 4.1.5.



**A summary of the four largest balances is provided in**

Figure 66 below, together with overall figures for the suspense accounts.

**Figure 66: Analysis of larger suspense account balances**

Account	Balance at 31 March 2002	Reason for balance
PAO suspense	Debit balance of Rs.168.16 crore, which represents a 42% increase compared in two years. However, efforts have been made to reduce the balance from a high of debit Rs.185.68 crore in 2000-01.	Rs.13.58 crore pertains to Ministry of Finance and Rs.154.70 crore to Ministry of Shipping and Transport. Of this an amount of Rs.44.31 crore relating to National Highways pertains to the period up to 1997-98. The pending items are being pursued by AG. The reasons for the high balance are examined in the case study at Figure 67 below.
Suspense Account (Civil)	Credit balance of Rs.109.04 crore, representing a significant increase from a debit balance of Rs.49.64 crore at 31 March 2000.	The entries to this account represent expenditure borne by GoAP but waiting to be reimbursed by Defence and Railways Accounts Officers. The vouchers are to be sent directly by the Treasuries to those Accounts Officers to enable reimbursement. The AG raises the claims for reimbursement and sends these to the Accounts Officers. Treasuries claim that their vouchers are sent; Accounts Officers claim these are not received. Therefore the AG's claims remain unsettled.
Cash Settlement Suspense Account	This head is no longer in operation - it exists only to clear outstanding balances but the debit balance of Rs.65.58 crore has been reduced by only 1% since 1999-00.	This pertains to period earlier than the entrustment of Divisions to PAOs. The amounts are outstanding due to non-availability of detailed information from PW Divisions, many of whom have been merged or discontinued.
RBI Suspense - Central Accounts Office	This account has seen a substantially increased balance, from credit of Rs.98.54 crore at 31 March 2000 to debit of Rs,365.92 at 31 March 2002.	The debit balance is on account of non-adjustment of interest payments on securities, due to non-receipt/late receipt of interest warrants from various branches of RBI.

As a point of interest, we have selected one of the larger balances for a more detailed review in an attempt to understand the systemic weaknesses leading to large suspense balances (see case study in Figure 67 below).

**Figure 67: Case study of expenditure on national highways**

The expenditure incurred on national highways by the PWD (National Highways) is accounted for under “PAO suspense-PAO (GoI) Ministry of Shipping and Transport” in the State accounts. The expenditure is initially borne by GoAP. The accounts along with the vouchers are sent to the AG by the PAO/PWDs (National Highways). AG raises an account claiming reimbursement from the PAO Ministry of Shipping and Transport. On receipt of the demand draft or cheque for the reimbursement, the debit balance under the suspense head is cleared by crediting to the same head of account.

The problems in the system are: all the vouchers for the expenditure are not sent by the PAO (National Highways)/PWD to AG. This restricts the claim by the AG to the extent of available vouchers; there is inordinate delay by the PAO Ministry of Shipping and Transport in reimbursement; reimbursements are not made for the entire amount of vouchers as some vouchers are rejected by the PAO Ministry of Shipping and Transport stating that there are inadmissible expenditure relating to State Government; pending vouchers are not properly pursued with the division/PAO concerned; the outstanding suspense balances are also not properly pursued with the PAO Ministry of Shipping & Transport; sometimes the PAO Ministry of Shipping and Transport does not reimburse for want of budget provision from GoI.

**6.7.5 Other accounts**

Sector L ‘Other accounts’ under major head 8670 had a net credit balance of Rs.317.38 crore at 31 March 2002 representing unreconciled balances relating to the PAO (Hyderabad)/bank reconciliation (see section 6.6.4.2).

**6.7.6 Reserve Funds**

Sector J Reserve Funds, which had a credit balance at 31 March 2002 of Rs.260.13 crore, but which has a large value of receipts from the Consolidated Fund and expenditure during the year

The Sector J Reserve Funds include the sinking fund, Industrial Development, Other Development and Welfare Fund, Calamity Relief Fund, and National Calamity Contingency Fund. In total, these Reserve Funds total Rs.260.13 crore at 31 March 2002.

Whilst noting that the amounts were relatively small, the Preliminary SFAA raised the issue of earmarked Funds and expressed concern about their use on the grounds that “payments made out of earmarked funds are not included in the Budget ...there does not appear to be clearly laid down policies relating to transfers of amounts to these earmarked funds and withdrawals from these funds.”<sup>124</sup> We have undertaken a review of these funds but have no great cause for concern, on the following grounds.

- The procedures for transfers to the Reserve Funds from the Consolidated Fund, draws from the Funds and List of Major and Minor Heads of Account of Union and States, are set out in the Ministry of Finance Department of Expenditure Controller General of Accounts 2001, General Directions 3.4.
- The amounts are included in the Budget. The expenditure to be incurred from these funds is initially debited under the regular functional expenditure head within the Consolidated Fund. An equivalent entry is then credited to the Consolidated Fund head, and debited to the appropriate Fund as a deduct entry wise “902- Deduct-Amount- met from..... (name of the reserve fund)”.
- In this way, the Legislative Assembly is considered to be informed about the expenditure under the Fund.

<sup>124</sup> AP Programmatic Structural Adjustment Loan (2001) ‘Note on Public Financial Accountability in AP’.



## 6.8 Conclusion

The timeliness and reliability of GoAP's accounting has undergone significant improvements in recent years. Planned reforms, such as the integration and connectivity of financial systems, look promising.

However, fundamental weaknesses remain; a number of these, such as the accounting policies which impact on the relevance of the accounts, lie outside GoAP's direct control. Others, such as the role of departments and GoAP in accounting, can only be tackled in the medium term. In order to moderate the levels of fiduciary risk in the short term, GoAP must tackle the timeliness of all key reconciliations and control over the Public Account.

GoAP should be commended for the efforts it has made and continues to make. That accounting is at the forefront of reform in GoAP is creating an overall sense that 'something is being done', and this does appear to be changing understanding and behaviour, albeit gradually and thus far in selected areas only. In truth however, many of the challenges for accounting can be traced back to the field level where, during budget execution, motivation and capacity to strengthen accounting controls are low. Once the overall accounting systems are in place, the challenge facing GoAP is to work with the departments to extend the reforms further into the field.

## 7. Monitoring and reporting

### 7.1 Principles of good practice

The provision of timely and accessible financial information for monitoring and reporting enables financial control and effective scrutiny of PFM, and thereby helps to ensure that funds are spent on authorised or intended purposes, as expressed in the budget. Figure 68 highlights those principles of good practice in monitoring and reporting that are key to minimising fiduciary risk.

#### Figure 68: Principles of good practice in monitoring and reporting to minimise fiduciary risk

*Timely, relevant and reliable monitoring of budget execution* enables line departments, Finance Department, and other stakeholders to exercise financial control and undertake corrective action as necessary (see section 7.2).

*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 authorised purposes (see section 7.3).

This chapter assesses GoAP practice with respect to these principles.

### 7.2 Timely, relevant and reliable monitoring of budget execution

This section examines:

- The forms of in-year reporting, and their timeliness;
- The reliability and relevance of monitoring reports;
- Pro-active use of monitoring information for within year management.

#### 7.2.1 Timeliness of monitoring reports

The timely provision of information on expenditure and revenue enables GoAP to assess the extent to which the budget is being implemented as planned and understand what factors are driving the divergence. This provides an opportunity to both:

- Hold officials accountable for those factors that are controllable within-year, providing a potential opportunity to reverse significant deviations from budget;
- Proactively manage the consequences of factors outside of the Government's control, such as the impact of a slowdown in the economy on economic growth.

Good practice suggests that the financial implementation of the budget should be available and reviewed monthly.

Monthly expenditure and revenue monitoring reports are prepared in GoAP both at the aggregate level (by the AG) and at the departmental level. In particular, the following reports are prepared:

- Departments prepare monthly expenditure monitoring reports for plan and non-plan expenditure, which are submitted to the Head of Department within a week of the end of the month.<sup>125</sup> They are based on expenditure statements prepared monthly by the DDOs and consolidated at each level. However, some DDOs are lax in submitting monthly reports, which undermines the accuracy of the monthly reports (see section 7.2.2);
- The AG (Accounts Wing) produces a monthly Civil Account, as noted at section 6.5. The Civil Account shows the major head-wise figures under the three parts of government accounts for the current month and progressive up to the end of the month, and also the closing balance as per the accounts. These are full monthly accounts that set out receipts, payments and closing

<sup>125</sup> For example, the Department of Health submitted their monthly expenditure review report for the year to December 2002 to the Finance Department by 5 January 2003.





cash balances. These are based on the hard copies of the accounts received from the DTOs, inputs from RBI and from data they maintain themselves (i.e. the intergovernmental transactions). It is rendered to the Finance Department by 25th of the following month to which the accounts relate;

- The AG (Accounts Wing) produces monthly Appropriation Accounts. The AG also compiles detailed head-wise accounts indicating monthly progressive figures under each detailed head. This provides details of expenditure under various heads of account in excess of budget provision and expenditure without budget provision. These are also distributed to the concerned departmental CCOs. They are produced around a month and a half after the end of the month.
- A monthly revenue monitoring statement is produced around 10 days after the end of the month by the Revenue Division of the Finance Department (on the basis of information provided by the main revenue departments).

### 7.2.2 The reliability and relevance of monitoring reports

Effective financial monitoring is not just about the production of information, but also about ensuring that information is reliable and relevant, and produced in a format which enables GoAP to use it effectively to minimise fiduciary risks. There are two key issues:

- Quality of the data on which monitoring reports are based;
- The user-friendliness of monitoring reports.

#### 7.2.2.1 Quality of data

The reliability of the departmental and the aggregate monitoring reports depends, to a large extent, on the quality of the information they receive from within the department. There are two key issues, being that:

- The quality of the departmental monthly expenditure statements has been undermined by delays and non-completion of reconciliations undertaken by departments at the various levels. However, GoAP is making efforts to enforce more speedy compliance with reconciliation requirements and there is evidence that the situations has improved for months since April 2002 (see section 6.6.4.1);
- There are often serious lags in the provision of monthly expenditure statements from the DDOs to the line department, for example see instance from case study departments at Figure 69. This means that departmental monitoring reports rely on budget release data, rather than information on actual expenditure, for the last part of the monitoring period. There can be significant differences between budget releases and actual expenditure as district agencies may not have spent their full release and non-control items may be lower or higher than budget. Therefore, the reliance of monitoring reports on budget releases, due to lags in the collection of information on actual expenditure, undermines the usefulness of monitoring reports to decision-makers attempting to manage within-year expenditure.

#### Figure 69: Delays in submission of monthly expenditure statements

Primary education: as at end January 2003, only one district (Nellore) was up to date in submission of statements. A further four had submitted statements for December, but had failed to submit one or more statements for previous months. Of the 23 DEOs, approximately half had failed to submit statements from as far back July (on average) but April and May in three cases, even though they might have submitted one or two statements for months since then. Despite this poor record by the DEOs, *the CCO and CAO should be commended for the monitoring system they have put in place to ensure the prompt provision of this information.*

Primary health: the monthly expenditure statements provided to the Finance Department by the Health Department for the year to December 2002, only includes actual data to September 2002.

The reported actual expenditure for the December 2002 quarter is actually only provisional data based upon the quarterly budget releases.

#### 7.2.2.2 *User-friendliness of reports*

There is no prescribed format for the departmental expenditure monitoring reports. Examination of four departments did result in some observations:<sup>126</sup>

- As discussed in section 5.8.6, there is no within-year monitoring of overall commitments and arrears;
- In general, there appears to be little monitoring of the components of non-plan expenditure. For example, monthly expenditure statements show only total non-plan expenditure. They do not provide an object-head breakdown or distinguish between control and non-control items. Given that non-control expenditure is not subject to Treasury checks against appropriations, the latter distinction seems key in understanding the causes of divergences between budget and actual expenditures.
- No analysis is provided as to the reasons for divergence between budgets and actuals, whether these factors are controllable and whether these divergences are temporary or will persist throughout the financial year;
- Actual expenditure for the year to date is compared with the budget for the year as a whole. This makes it difficult to see whether actual expenditure is at the expected level for this stage of the year.<sup>127</sup> For a user to be able to identify whether the budget is being implemented as planned, they would need to compare the expenditure that was budgeted for the year to date compared with the actual expenditure for the year to date. Note that the revenue monitoring report does compare actual revenues against both the annual target for the year and a proportionate target for the year to date;
- It would also be informative to compare the expenditure that was budgeted for the month compared with actual expenditure for the month;

However, providing these types of comparison in the monthly monitoring reports would require departments to develop a monthly expenditure profile during budget formulation. There is currently only a quarterly expenditure profile. Given this constraint, it would be useful to show actual expenditure as a percent of budget and to compare actual expenditure against the quarterly allocations in the reports that fall at the end of the quarters. The Finance Department does require departments to fill out a proforma, on a quarterly basis, that requires departments to estimate expenditure for the remaining quarters. If completed accurately, this provides some guidance as to whether there is likely to be significant variations between budget and actual expenditure at end year.

#### 7.2.3 **Pro-active use of monitoring information for within year management of the fiscal position**

The value of monitoring information lies in its use to manage the fiscal position of the Government within year. In particular:

- Departments need to use monitoring information to ensure there are managing their expenditure in line with budget. A system of mid-year reviews of budgetary performance of line departments was introduced in April 2002.<sup>128</sup>
- It is the responsibility of the Finance Department to monitor the overall financial position and take corrective action as needed.

<sup>126</sup> The four departments were Primary Health, Primary Education, Treasury and Accounts and Public Works (PAO - Works).

<sup>127</sup> To make any assessment, the user would need to calculate actual expenditure as a percent of budget. However, even this would only be a rough indication as it does not take account of seasonal variations in the pattern of expenditure.

<sup>128</sup> G.O.M. No.506/Finance(BG) dated 10 April 2002.



### 7.2.3.1 Line departments

It is the responsibility of line departments, specifically HoDs, to monitor implementation of their budgets. Based on the consultations with departments during the SFAA review it does appear that HoDs take seriously the need to monitor their expenditure against budget. They all were aware of the need to re-allocate funds (and the need to get the appropriate approval) in cases where there was likely to be an overspend against a particular budget allocation.

However, as noted above, given the weaknesses in reliability, relevance and format of the monthly expenditure reports it would be difficult for departments to use them as a tool to proactively manage expenditure throughout budget execution.

### 7.2.3.2 Finance Department

The overall result of the GoAP within-year monitoring is the production of Revised Estimates, which are presented to the Assembly for approval in January/February for the current year. These Revised Estimates represent an updated version of the originally approved estimates, which are revised to reflect changes to spending and revenue patterns which have occurred during the first six to ten months of the year. For example, in the Revised Estimates for 2002-03, provision is being made for additional costs incurred by GoAP in tackling the problems caused by the severe drought which has hit the State.

The Revised Estimates also takes into account changes in forecast revenue yields. If revenue is running below forecast, then savings must be achieved either through surrenders of savings by departments or enforced cutbacks. It has not been possible for the SFAA team to assess the extent to which changes in revised estimates reflect savings or enforced cuts. However, there is scope to consider approaches to using within year monitoring more proactively to enable early identification of the need for cuts or reductions in departmental appropriations.

## 7.3 Timely, relevant, understandable and comparable financial reporting

In this section, we evaluate GoAP's financial reporting against the key characteristics of accounting and reporting: timeliness, relevance, understandability, and comparability. Unless financial results and position are reported on a timely basis, stakeholders lose the interest and ability to scrutinise and take correct action; the key remaining issues are issues of disclosure.

GoAP's actual financial results and position are disclosed and analysed in different publications at different times, summarised in Figure 70 below and set out in detail at Appendix 6.

In general, GoAP's financial reporting by way of the Accounts is undertaken on a consistently timely basis, some seven months after the financial year end. However, as detailed below, the usefulness to users of these Accounts (and even the more useful Accounts at a Glance) is constrained by their prescribed India-wide formats. More relevant and useful information about actuals for the previous financial year is included in AFF and Budget in Brief, and thus becomes available on the publication in January and March of the following financial year end.

GoAP has limited control over the formats of its financial reports. The formats of the Appropriation Accounts and Finance Accounts are laid down for all of India and are therefore outside the control of the State Governments.<sup>129</sup> Even the format of the Accounts at a Glance is determined by the AG in consultation with the CAG. The Budget in Brief is not laid down as such, but good practice has been developed by the RBI-led Core Group on Voluntary Disclosure Norms for State Governments. The Voluntary Disclosure Norms exercise has developed voluntary disclosure norms which enable State Governments to supplement their reporting, in a consistent way, with information useful to readers, specifically to "enable the legislature and the public to enhance their understanding of State finances".<sup>130</sup>

<sup>129</sup> The format of the Appropriation Accounts and Finance Accounts is set down in detail by the CAG's Manual of Standing Orders Volume II.

<sup>130</sup> RBI (2001) 'Report of the Core Group on Voluntary Disclosure Norms for State Governments'.

Another aim of this exercise is enhance transparency and uniformity in the dissemination of information by the States to facilitate market decisions on lending to State Governments.

**Figure 70: Summary of forms, purposes and timings of financial reporting**

The primary financial reports are the Annual Accounts, consisting of the Appropriation Accounts and Finance Accounts. *The Appropriation Accounts and Finance Accounts, are produced and presented to the Legislative Assembly within seven to eight months after the end of the financial year.*<sup>131</sup> The Appropriation Accounts record the grant-wise expenditure against provision approved by the Legislative Assembly and offer explanations for variations between the actual expenditure and the funds provided. *The Finance Accounts* are statements of accounts of the Consolidated Fund, Contingency Fund and the Public Account. They present the accounts of receipts and disbursements of GoAP for the year together with the financial position disclosed by the revenue and capital accounts, the accounts of the public debt and the liabilities and assets as worked out from the balances recorded in the accounts.<sup>132</sup> *Accounts at a Glance is issued with the Appropriation Accounts and Finance Accounts.* It provides a broad overview of Government finances, using brief explanations, statements and graphs to highlight key information is presented. The report has three sections: Overview, which outlines the structure of the government accounts, and the general purpose and content of the Finance Accounts and the Appropriation Accounts; Highlights of the accounts, which highlights key elements of revenue and expenditure and financial position items, for example loans and advances, debts and liabilities; Trends in government revenue and expenditure, which builds on the Highlights section to show comparatives over recent years. The section ends with a simplified cash flow statement.

The *Budget, presented to the Legislative Assembly in February/March*, contains information about actuals for the previous financial year (i.e. FY 1), the Budget Estimates and Revised Estimates for the current financial year (i.e. FY 2), and Budget Estimates for the ensuing year (i.e. FY 3) whose Demands for Grants are under consideration by the Legislative Assembly. The key document is the Budget in Brief. *This document is frequently the only one with actuals data that is actually reviewed by many stakeholders.*

The *CAG's Audit Report also provides useful abridged accounts. The Audit Report is currently issued in March in the year following the year of account.* The CAG issues its annual Audit Reports with regard to GoAP in three parts: Civil, covering GoAP expenditure; Revenue Receipts; and Commercial, covering PSUs. The abridged accounts in the Audit Report (Civil) are: Summarised Financial Position of the GoAP at the year end, calculated on a cash basis; Abstract of Receipts and Disbursements for the current year; Sources and Application of Funds, essentially a cash flow statement; Time series data on State Government finances.

The AFF and the Budget in Brief with their significantly improved disclosure in user friendly formats represent GoAP's efforts to overcome the constraints of the India-wide formats.

The sections below set out the weaknesses of the Appropriation Accounts and Finance Accounts, and the extent to which these have been overcome by other financial reporting, in particular the AFF and Budget Brief.

### 7.3.1 Financial results

The role of the Appropriation Accounts is to report on actual results against budget. Useful variance analysis is critical to inform the Legislative Assembly and the public of the extent to which the budget has been implemented as passed. The Appropriation Accounts disclose variances between actual

131 The 2001-02 Finance Accounts and Appropriation Accounts were produced on 4 October 2002; 2000-01 on 15 November 2001; 1999-2000 on 9 November 2000. The 2001-02 Accounts were presented to the Legislative Assembly on 22 November 2002.

132 AG 'Accounts at a Glance 2001-02'.



revenue/expenditure and the budget estimate, whenever an excess in a Grant exceeds Rs.10 lakhs and savings in a Grant exceed Rs.20 lakhs. Insufficient information and analysis of variances is provided in the Appropriation Accounts between actual revenue/expenditure and the budget estimate in that:

- Variances are reported at too detailed a level, as Rs.10 lakhs is a relatively small amount. Analysis at this level of detail lengthens the Appropriation Accounts, and could allow some more significant variances to go unnoticed;
- Invariably the 'reasons' provided simply note which minor and sub-heads accounted for the increase/decrease compared to budget. There is rarely any analysis of the underlying reason why that revenue/expenditure was more/less than budgeted. Furthermore, the CAG reports that explanations for savings/excesses were not received or were received incomplete in respect of 81% of the total number of heads of account (i.e. 645 of the total 793)<sup>133</sup>;
- Neither the Appropriation Accounts nor any other document discloses the Budget Estimates, Revised Estimates and actual for one complete year. It is necessary to flick through at least two budgets to assemble this information.

Furthermore, the Appropriation Accounts do not provide a summary comparison of the implications of the variances for fiscal aggregates.

The Finance Accounts provide comprehensive information about the receipts and payments of the State during the year, and in many cases provide the comparable figures for the previous year.<sup>134</sup> Again, the reasons for the variances are of limited usefulness.

The all-India prescribed format of the Accounts undermines relevance, understandability and comparability in the following ways:

- Expenditure has not previously been disclosed by department;
- No disclosure is made of the gross advances drawn from the Contingency Fund for various functions and recouped during the same year. Only the net amount and unrecouped amounts are disclosed;
- The Accounts disclose only up to minor head (programme) level (unlike the Detailed Demands for Grants which disclose to a more detailed level). Salaries, grants-in-aid, subsidies and externally aided schemes are below the minor head level, and consequently are not clearly disclosed to the reader of the Accounts.

The AFF and Budget in Brief produced by GoAP do provide significantly improved and increased disclosure of in the areas of omissions noted. The 2002-03 Budget in Brief also provides an explanation of expenditure in key priority sectors.

Note that, for many years, insufficient information has been provided to the AG on capital works and irrigation projects to enable Statement 1 and 3 of the Finance Accounts to be presented. The cash accounting policy is disclosed in the Finance Accounts, but as an explanatory note to Statement 8.

### 7.3.2 Financial position

In line with the cash basis of accounting prescribed throughout India, the Accounts do not have a Balance Sheet in the commercial style. However, the Finance Accounts do disclose information about the financial position of GoAP. The format and cash basis of accounting of the Finance Accounts also undermines relevance, understandability and comparability in the case of financial position information in not disclosing:

<sup>133</sup> Report of the CAG of India for the Year ended 31 March 2002 (Civil) GoAP, see para 2.3.15.

<sup>134</sup> Explanatory Notes to Statement 1 of the Finance Accounts.

- Commitments and arrears;
- Any valuations of fixed (such as land, property and computers) or current assets (stores and supplies);
- Other assets: miscellaneous public works advances (MPWA) and arrears of receipts.

Furthermore, the Finance Accounts provides an incomplete picture of arrears in recovery of loans and advances. Departmental and Institutional details of recoveries in arrears are not provided.

GoAP has substantially improved the relevance and transparency of its financial reporting of contingent liabilities by bringing on budget the government guarantees. The Finance Accounts do not yet disclose pension obligations and contingent liabilities arising out of the negative net worth of PSUs. The issue of disclosure of contingent liabilities is examined in more detail at section 10.4.2. While the Budget in Brief and AFF do not provide additional disclosure in terms of assets and liabilities, they do present the information in more understandable manner. As they are relatively widely read, it would be useful to add disclosure about significant areas of GoAP's financial position (which are disclosed in the Finance Accounts), in the following areas:

- Comprehensive picture of the stock of total liabilities (i.e. inclusive of the liabilities on Public Account, as noted at section 4.4.2);
- Information on guarantees provided during the year. As per the RBI technical committee on State guarantees, summary information on guarantees is now included in the Budget in Brief for 2003-04.

### 7.3.3 Cash flow statement

GoAP's cash flow statement - whose format is also prescribed India-wide - is presented in the Finance Accounts, disclosing for the current and previous financial year the opening cash balance, the cash flows on all three components of the Government Account, the net receipt/payment within each component, the overall deficit or surplus during the year and the closing cash balance. The statement is included as an Explanatory Note to Statement No. 1 Summary of Transactions, rather than as a separate cash flow statement. Cash flows are disclosed at a high level. While much of the required detail for each of the cash flows can be found throughout the Finance Accounts, these are not cross referenced to or disclosed elsewhere in a way which would be relatively easy for the reader to connect the summary to the detail.

The Budget in Brief and AFF do substantially enhance the user's understanding of cash flow. While they also do not structure cash flows around operating, investing and financing flows, they do disclose the cash flows resulting from revenue, expenditure, and financing of the deficit at an appropriate level of detail, and ensure that the key facts are highlighted. Although not produced by GoAP, the CAG Audit Report (Civil) also provides some useful information about cash flows.<sup>135</sup>

## 7.4 Conclusion

GoAP's efforts at increasing the timeliness and reliability of monitoring reports by improving reconciliations at CO/DDO level are commendable. However, the reliability and format of monitoring reports requires further improvement to enable proactive and effective departmental monitoring and financial control throughout budget execution.

The constraints placed by India-wide reporting formats seriously limit the relevance and understandability of GoAP's Accounts, and hence the scrutiny enabled by them. GoAP has made tremendous strides in containing fiduciary risk by increasing transparency and accessibility by publishing other financial reports.

<sup>135</sup> Report of the CAG of India for the Year ended 31 March 2001 (Civil) GoAP, Exhibit III.



## 8. Asset management

### 8.1 Principles of good practice

Asset management is an area that any government concerned with the management of public resources must tackle as a matter of urgency. The link with fiduciary risk is clear: in governments worldwide, poor controls over stocks, stores, fixed assets, land and buildings have resulted in widespread theft and misuse. Figure 71 highlights those principles of good practice in asset management that are key to minimising fiduciary risk.

#### Figure 71: Key principles of good practice in asset management to minimise fiduciary risk

*Clear and appropriate asset management rules* enable safeguarding of all types of government assets (see section 8.2)

*Adequate provisions for safeguarding of assets* will include stock and asset registers, and other internal controls and procedures (see section 8.3).

*Independent and regular scrutiny of assets* provides the government with some assurance about the extent to which controls and provisions are being enforced, and assets properly managed (see section 8.4).

*Disclosure and transparency* of assets owned enables government's accountability for their purchase, usage and disposal (see section 8.5).

This chapter assesses GoAP practice with respect to these principles.

### 8.2 Clear and appropriate asset management rules

The India-wide Government Accounting Rules and General Financial Rules form the basis for the following Codes and Manuals which contain the requirements for asset management:

- AP Financial Code: covers the procedures for the acquisition and management of stocks and stores, works, land and buildings in all departments. This is the core text for asset management;<sup>136</sup>
- AP Accounts Code: covers how to account for the cost and sale proceeds of land and buildings, and how PWDs and Forest Divisions should account for their assets;<sup>137</sup>
- District Office Manual (DOM): covers the procedures and detailed format for maintaining stock and asset registers in the district offices.

The Codes and Manual suffer significant weaknesses which increase the risk of divergence between rules and practice. In particular:

- They do not rely on any clearly stated underlying principles, with more emphasis on formats and detail;
- They apply definitions not consistent with best practice. For example, the definition of stores in the Financial Code includes some items that would ordinarily be defined as fixed assets, such as furniture, appliances, tools and plants. Practical application of the definition tends to include other fixed asset items, such as medical and educational equipment;<sup>138</sup>

<sup>136</sup> AP Financial Code Volume I Chapter VII, articles 122 to 146, together with corresponding instructions (Stocks and stores for all departments); AP Financial Code Volume I Chapter VIII, articles 147 to 208 (Works (construction, maintenance and repairs)); AP Financial Code Volume I Chapter IX, article 210 (Land and buildings).

<sup>137</sup> AP Accounts Code, Volume I, Article 38 and 39 (accounting for cost and sale proceeds); AP Accounts Code Volume III chapters III (store accounts, public works) and VI (store accounts, forest).

<sup>138</sup> AP Financial Code Volume I Chapter VII, article 122: stores are defined as "all articles and materials required for public service coming into an officer's possession for various purposes e.g. furniture, chemicals, scientific instruments, appliances and stationery articles, articles of diet in Hospitals and Jails, Materials for construction of buildings, manufacturing stores, tools and plants."

- They do not prescribe some essential details (for example they do not require detail of the location, status or the exact description of the asset);
- Their coverage is incomplete, for example there is minimal coverage of how to manage fixed assets such as equipment, machinery, land and buildings;
- They are generally of low transparency in that their style and format is antiquated, very detailed, and not user friendly;
- They are not formulated as a coherent whole, rather they are contained in a number of different sources.

The inadequacy of the guidelines with regard to fixed assets (as opposed to stocks and stores) reflects the fact that, until relatively recently, assets held in the districts were largely land, buildings and furniture. Increasingly, districts have valuable office equipment, such as computers, photocopiers and printers, and technical equipment, such as testing equipment, microscopes, and laboratory equipment. There is thus increased urgency for modernising and strengthening the asset management guidelines and, clearly, enforcement.

### **8.3 Adequate provisions for safeguarding of assets**

Robust systems and controls are required to ensure that assets are retained in the proper custody, are used as prescribed and are not misappropriated or misused. Key requirements are for:

- Physical controls;
- Rigorously maintained stock and asset registers;
- Physical verification by management;
- Controls over the disposal of assets.

#### **8.3.1 Physical controls**

Controls testing revealed that the standard of physical controls over different forms of assets was broadly adequate. Specific observations are as follows:

- All stocks and stores inspected were kept under lock and key, with safeguards against theft, pilferage, damage, and risks posed by the weather;
- Fixed assets in regular use, such as furniture, were not subject to any specific controls (but this is difficult to achieve, and control objectives are better served by other forms of control such as tagging, well maintained records, and regular physical verification);
- High value fixed assets were, in all cases tested, subjected to greater, and adequate, physical controls. For example, medical equipment such as microscope and centrifugal are kept under lock and key by the Head of Office (for example, the Medical Officer of the PHC) when not being used.

#### **8.3.2 Stock and asset registers**

The maintenance of stock and asset registers is extremely poor, both because the requirements do not enable sufficient control and because of poor compliance with the existing requirements.

Responsibility for maintenance of stock and asset registers lies with the senior assistant, or equivalent, on behalf of the Head of the Office. Figure 72 below sets out the results of controls testing of stock and asset registers.





**Figure 72: Compliance with requirements for stock and asset registers**

**Stocks and stores:** offices are required to maintain stock registers, being a day book of receipts and issues of stocks and stores, and also a ledger for each type of article.<sup>139</sup> The controls testing revealed that the requirements do not enable sufficient controls and compliance with the existing controls is very weak. Specifically, although the day book is generally maintained (for example in all of the PHCs where testing was possible), and balances indicated in the ledger of balances in most cases, the registers:

- Do not contain full information such as location or clear and full description of the item, which would enable physical verification of the items to be undertaken;
- Are not kept sufficiently up to date. In particular, the balance might only be updated weekly, monthly or even less frequently, preventing regular or surprise check physical verification;
- Entries could not be verified, due to the absence of records of receipts or issues. For example, in the PHCs, the day book is being completed by the pharmacist, but no copies of the prescriptions are retained. The Medical Officer attests the receipts and issues by memory;
- Are not regularly reconciled to the actual stocks and stores by the person in charge, for example by the pharmacist.

For **fixed assets** such as computers and furniture, the departments should maintain asset registers indicating the existence and nature of the asset, and the length of the asset's shelf life.<sup>140</sup> However, most departments rarely maintain these asset registers to an adequate standard, if at all. All of the offices tested were able to produce a document they called an Asset Register. However, none of these assets registers even approached the prescribed standards. Furthermore, in none of the offices tested were any assets tagged, numbered or otherwise identified, preventing registers being maintained in any meaningful sense.

The register formats themselves are inadequate in that they:

- Require only basic details such as the date on which the asset was received; name of the asset type (for example: "table", "chair"); and date of disposal. Detailed descriptions such as physical condition, brand, colour, manufacturer, or identification numbers are neither prescribed nor provided. The register is thus insufficient to enable physical verification of the assets and thus adequate controls. For example, low quality assets could easily be substituted for higher quality assets owned by GoAP and this could go undetected;
- Do not require the location of the asset to be entered. Again, this makes physical verification difficult.

Registers of land, buildings and works are not generally maintained. This exposes GoAP to the risk that, over a long period of time, there may be doubt over actual ownership, and even the existence, of land and buildings. The land and buildings may then be 'illegally' occupied or utilised. Such encroachment has been observed in a number of cases (although the role of ownership records was not noted in the reports of the cases). For example, the AG Inspection Report of the CDSE for 2001-02 notes that land of Rs.2.10 crore relating to the Institute of Advanced Study was encroached and held by 'land grabbers'. None of the offices tested during control testing was able to provide any records of the land and buildings they occupied.

Without proper maintenance of records, GoAP has no reassurance that assets sold, written off or otherwise disposed of are being properly dealt with, and at a fair price where appropriate.

139 AP Financial Code Article 134 and 135.

140 AP Financial Code and District Office Manual.

The Finance Department has taken the initiative on the subject of asset registers, and has sought a submission from the Fiscal Reforms Implementation Committee on proposals to introduce reliable and accurate asset registers. A Cabinet sub-committee under the chairmanship of the Finance Minister with the Secretary Planning as its convenor was formed but no evidence that progress has taken place.

The non-maintenance of stock and asset registers is repeatedly highlighted in the CAG Audit Reports, Inspection Reports, and internal audit reports.

### 8.3.3 Physical verification by management

Physical verification by management ranges from very weak to non-existent.

There are three forms of physical verification required: first, regular attestation of the accuracy of the records; secondly, verification by the Head of Office at least once a year, and thirdly, authentication by the CO during the periodic inspections, for which advance notice is given. If there are substantial stocks and stores (again, considered to include assets), and thus it is difficult for an annual verification to occur, the Codes allow for the verification to be continuous.<sup>141</sup> Figure 73 below sets out the results of testing of physical verification undertaken by management.

#### Figure 73: Compliance with requirements for physical verification

**Stocks and stores:** controls testing revealed that there is very little physical verification of stocks and stores. Specifically:

- **Attestation:** Testing of the PHC pharmacies revealed that while the stock registers are attested by Medical Officers, this attestation is of the mathematical accuracy of receipts and issues, and does not involve physical verification.
- **Annual verification by the Head of Office:** all but one of the PHCs tested were unable to provide evidence of annual verification, by way of signatures on the accounts. However, officials also admitted that it was common practice for the person in charge of the stores to do that verification, and for the Medical Officer to simply sign the record as if he had personally verified it. In the case of the schools, the headmaster both maintains the stores and undertakes the regular and annual verification. Separation of this function is difficult to achieve in small field offices;
- **Authentication by the DEO/DMHO:** four of the ten PHCs, for which records could be examined, were able to show the signature of the DMHO authenticating the records during an inspection visit. However, staff also admitted that the authentication is cursory, and PHCs have taken the records to the DMHO office for “authentication”, even though clearly the DMHO cannot be checking the records against the stocks and stores.

Even in the few cases noted where physical verification is undertaken and verification reports are produced, there is scant evidence of follow up action being taken as a result.

**Fixed assets:** Physical verification of fixed assets appears to be variable. Health officials stated that verification is undertaken annually, but were unable to provide any evidence, such as signatures on registers or verification reports, to confirm this. Education officials were able to provide some evidence by way of signatures.

**Land, buildings and completed works:** physical verification of land, buildings and completed works is virtually non-existent. None of the offices tested was able to provide evidence of physical verification of land and buildings.

141 AP Financial Code Volume I Chapter VII, article 137, Memo no. 10970/228/TFR/90-1, Fin. & Plg., Dt. 10-11-1992 and Article 143.



Physical verification of all types of assets is made difficult by:

- The fact that there are very few reliable stock or asset registers or other records against which to verify the assets;
- The absence of transparent and reliable data on expenditure on certain types of assets from accounting records prevents reconciliation of assets purchased or constructed to actual assets observed. It is not possible to deduce the level of expenditure on categories of assets such as computers, furniture, construction or lease of buildings.<sup>142</sup> This information is not available without a detailed examination of the original vouchers.

#### 8.3.4 Disposal of assets

No disposals of assets had been undertaken within the offices tested, therefore the controls could not be tested. However, this is noteworthy in itself. Officials reported that the process for disposal is so cumbersome, and the monies raised so little, that sale by the required methods was not cost effective. Hence, unserviceable stores and assets continue to be held, appear in records and have not been written off.

#### 8.4 Independent and regular scrutiny of assets

The impact on fiduciary risk of poor controls is reinforced by the absence of independent physical verification. The CAG is empowered to conduct an audit of all stocks, stores and assets.<sup>143</sup> The auditors conduct a test check and highlight the results in the Inspection Reports, with important and prominent irregularities appearing in Chapter V of the Audit Report. However, this audit is basically of the documentation involved in maintaining assets, such as the stock and asset registers; it does not generally involve physical verification of the items themselves. The usefulness of this audit must therefore be questioned. The absence of physical verification by auditors is a major contributory factor to poor safeguarding of these assets.

#### 8.5 Disclosure and transparency

Fiduciary risk is heightened by the lack of relevant and reliable information about assets. The weaknesses in asset management can be traced in part to the fact that, in India, Governments do not report on their assets as they use the cash basis of accounting. It is well recognised that there is generally a direct relationship between the quality of management of resources and the extent to which they have to be reported on publicly, as transparency engenders accountability. Furthermore, departments and offices do not submit periodic management reports on their assets, for example on the number, type and value of assets held. Increasing reporting and transparency in this way would be a strong systemic incentive for HoDs to improve discipline and accountability for assets and their management.

#### 8.6 Conclusion

As in many governments worldwide, the standard of asset management in GoAP is very weak. There is a widespread need to strengthen safeguards over assets so as to reduce the significant to high risk of loss and general wastage of its public resources. Risk is also heightened by the lack of relevant and reliable information about assets. A particularly effective measure would be to require offices and departments, and ultimately GoAP itself, to regularly report on its assets. Increasing transparency in this way would be a strong systemic motivation to improve discipline and accountability. Asset management is the only area of PFM in which reforms have not made any headway. FRIC has drafted a paper on stock and asset registers and a Cabinet sub-Committee has been convened to examine asset management, but no actions have been initiated as yet.

<sup>142</sup> For example, computers, stationery and furniture are coded under office expenses.

<sup>143</sup> In fact, the DPC Act 1971 empowers the CAG to audit “stores and stocks”, but in practice this is interpreted to include all assets which are the property of GoAP.

## 9. Debt management

### 9.1 Principles of good practice

Prudent debt management is central to fiduciary risk. A pro-active approach to debt management is critical to developing realistic budgets that are consistent with fiscal constraints and to managing debt within affordable limits. Furthermore, if the government does not report on its debt in a transparent and timely fashion, with effective mechanisms for legislative and public scrutiny, it will not be held to account for its management of debt. Recognition of these links has informed the development of well-established principles of good practice with regard to debt management. Figure 74 below highlights those principles of good practice that are key to minimising fiduciary risk.

#### Figure 74: Key principles of good practice in debt management to minimise fiduciary risk

**Pro-active approach to developing a debt policy.** The identification of debt objectives provides a fiscal framework for budget development by, given revenue forecasts, identifying the overall fiscal constraints within which the budget must be prepared. This supports the longer-term sustainability of fiscal policy (see section 9.2).

**Pro-active approach to debt management** ensures that the government's debt is held in a form that minimises the costs of servicing the debt (see section 9.3).

**Effective forecasting and monitoring of debt levels and maturity profiles** in relation to government revenues ensures that the government can meet its debt repayment and servicing obligations without significant disruption to other expenditures (see section 9.4).

**Comprehensive and transparent reporting of debt.** Debt is an important measure of the financial health of any government. It is therefore important that there is transparency in the disclosure of all public debt in the government's financial statements, to enable accountability for PFM (see section 9.5).

**Effective scrutiny of debt policy and performance.** The purpose of the transparent reporting of debt is to enable the legislature and civil society to scrutinise the government's debt policy and performance in managing debt (see section 9.6).

This chapter assesses GoAP practice with respect to these principles.

### 9.2 Pro-active approach to developing a debt policy

GoAP, in common with other Indian States, faces high levels of debt to Gross State Domestic Product (GSDP). The types of State debt and GoI role in determining the level of debt are outlined in Figure 75.

#### Figure 75: Components of State debt

The following are the four main components of GoAP's debt:

- **Loans and advances from GoI.** The bulk of GoAP's debt is to GoI. This includes non-Plan loans, loan assistance for implementation of the State Plan,<sup>144</sup> loan assistance for Centrally Sponsored Schemes and loans against Small Savings collections, which depends on the net Small Savings collections in the State in any given year.<sup>145</sup>

144 Plan Assistance for State Plans, consisting of formula based allocation under Revised Gadgil Formula, assistance for specific Plan programmes, assistance for externally aided projects, has both a loan and grant component.

145 Small Savings are financial instruments promoted by GoI, mostly postal savings instruments, designed to encourage savings in the household sector. States receive loans against the net Small Savings collections in their State in any given year. Since 1999-2000, loans against Small Savings collections have ceased to be classified as loans from GoI. Loans against Small Savings collections are now shown as Special Securities issued to the National Small Savings Fund (NSSF).



- **Internal debt, comprising market borrowings and loans from central financial institutions.** This comprises:
  - market borrowings: RBI and GoI (Finance Ministry and Planning Commission) determine the market borrowings that a State may raise in any year. These are generally determined in the context of the annual Plan exercise, as Plan financing. The RBI manages the debt issue on behalf of the States. The loans are generally subscribed to by nationalised banks (and others) to meet their statutory liquidity ratio requirements;
  - institutional loans from central government financing institutions:<sup>146</sup> These loans are tied to specific purposes, projects or schemes. The quantum of such loans is largely determined by the Planning Commission as part of the annual Plan exercise, again as part of Plan financing.
- **Net accretions to the Public Account.** This includes provident funds, reserve funds and deposits, disbursements from which are not subject to the vote of the Legislative Assembly. The State acts as ‘banker’ in respect of the balances in the account. Since the Public Account is not funded, and the balances in the Account are merged in the cash balances of the State, they legitimately constitute a debt or liability.<sup>147</sup> Of late, AP (and other States) are resorting to substantial drafts on the Public Account. To illustrate, AFF 2003-04 shows that as much as 35% of the fiscal deficit for 2003-04 would be met from balances in the Public Account, including 25% from Small Savings.
- **Off-budget or ‘proxy’ borrowings.** As noted section 4.4.1, many States, including AP, have resorted in recent years, to off-budget borrowings, thus in effect circumventing a Constitutional provision placing a restriction on States’ borrowings.

The categorisation in Figure 75 demonstrates that States only enjoy total independence in respect of debt/liabilities incurred on the Public Account, including Small Savings (and the level of this is limited to the net amount of Small Savings collections in the year) and off-budget borrowings.<sup>148</sup>

It is noteworthy that 70% of funding for Central Plan Assistance is provided by GoI as loans to State Governments. This means that States would have to forgo the 30% grant funding and resist GoI inducement to implement the Centrally supported Plan programs, if they were concerned about the impact of these loans on their overall debt levels. Therefore, much of GoAP’s debt to GoI (which as, Figure 76 shows, represents the bulk of State debt) is determined by decisions made by GoI, including the Planning Commission, which sets the Annual and Five Year Plan size of a State.

146 Central government financing institutions include the Life Insurance Corporation (LIC), General Insurance Corporation of India (GIC), NABARD, Rural Electrification Corporation (REC), and Power Finance Corporation (PFC).

147 A distinction needs to be made between debt and liability. Balances in the Public Account would normally constitute a liability of the State, but to the extent such balances are used for financing the fiscal gap, they would acquire the characteristics of debt. The terms ‘debt-liability’ or ‘debt/liability’ have been used to avoid having to distinguish between the two each time.

148 Efforts are currently underway to restrict the freedom of States to raise off-budget borrowings.

**Figure 76: Net borrowing of GoAP (total borrowing less the cash balance at year end)**

Borrowings	Balance at 31-Mar-00 Rs. crore	% of gross borrowings Rs. crore	Balance at 31-3-01	% of gross borrowings Rs. crore	Balance at 31-3-02	% of gross borrowings
Loans and advances from GoI	16,556	62%	16,510	52%	19,033	53%
Market Loans	7,739	29%	9,138	29%	11,038	31%
Loans from other institutions	1,602	6%	1,932	6%	1,905	5%
Total internal debt	9,341	35%	11,070	35%	12,943	36%
Off budget borrowings	206	1%	1,707	5%	2,685	7%
Net Public Account	623	2%	2,728	9%	1,378	4%
Gross borrowings	26,726	100%	32,015	100%	36,039	100%
Closing balance (cash)	(282)		(36)		(64)	
Net borrowings	26,444		31,979		35,975	

These factors mean that there are systemic constraints on the extent to which GoAP, and other States, can drive their own debt policy. However, it must still be recognised that GoI only places maximum constraints on State borrowing. This does not exempt GoAP from its responsibility to ensure that the debt strategy it implicitly agrees with GoI, in accepting GoI loans, is sustainable.

It is commendable, in the circumstances, that GoAP has chosen to set out a medium term objective of keeping debt within sustainable levels. It is conscious of the need to take a more pro-active approach to setting debt policy in order to keep debt within sustainable and affordable limits, particularly given that debt servicing continues to consume a high share of revenue. The Strategy Paper on Fiscal Reforms and the MTFP highlight the aim of ‘stabilising’ debt from its current levels (see Figure 76) to around 31% of GSDP from 2006-07.<sup>149</sup> The longer-term aim is for reductions in debt as a percent of GSDP, given expectations that the major costs of power sector restructuring will have been met by 2006-07. And, while presenting the budget for 2003-04 the Finance Minister has highlighted that debt would increasingly be used for capital expenditures and gross capital formation and that by 2005-06 revenue surpluses would also be generated for financing these.

There is also an issue over whether it would be appropriate for GoAP to entrench fiscal objectives and reporting for debt in legislation. In addition to publishing its medium term objectives in the fiscal strategy paper, it has made a commitment to report progress against these objectives, on an annual basis, in the AFF.

The Constitution provides for States to place a limit of borrowing to enhance their fiscal discipline.<sup>150</sup> Until recently no State, including AP, had developed debt limits but some States are now incorporating

<sup>149</sup> GoAP Strategy Paper on Fiscal Reforms (2001), paragraph 94 and figure 23.

<sup>150</sup> Article 293 (1) of the Constitution of India: “Subject to the provisions of this article, the executive power of a State extends to borrowing within the territory of India upon the security of the Consolidated Fund of the State within such limits, if any, as may from time to time be fixed by the legislature of such State by law and to the giving of guarantees within such limits, if any, as may be so fixed”.



limits on borrowing through the adoption of fiscal responsibility legislation. Karnataka, for example has enacted such legislation, and Maharashtra has introduced a bill in the last winter session of its Assembly. Similarly, Punjab Government has decided to enact a Fiscal Responsibility and Budget Management Act in order to fix certain targets for fiscal correction and Kerala has proposed introducing a Fiscal Accountability Bill to provide a legal framework for fiscal reforms. For more details on Fiscal Responsibility Acts, see appendix 7.

### 9.3 Pro-active approach to debt management

GoAP recognises the importance of installing sound institutional arrangements to enable effective decisions on debt issues. Within GoAP, it is the Finance Department that is responsible for all aspects of debt management.

Good debt management requires the Government to actively seek to minimise the cost of debt servicing. However, the scope for treasury management is somewhat limited given that the bulk of GoAP's outstanding debt is to GoI. For all loans from central institutions GoAP can do nothing to reschedule or otherwise reduce servicing costs as terms are set by those institutions. States thus have little discretion or say in the maturity and structure of such loans.

However, initiatives are under way between GoI and States to devise some arrangement to take advantage of falling interest rates to replace earlier high-cost debt (other than Central Loans) with lower coupon debt. GoAP has appointed two consultants from ICICI Bank under the aegis of the FRIC to advise the Government on debt strategies and to explore possibilities of debt/interest swaps, and other debt management issues.

GoAP also plans to strengthen in-house institutional capacity for debt management by establishing a Debt Management Cell in the Finance Department. This cell would be a specialist unit with accurate and timely data regarding the stock of debt, interest rates and Government policies. In the meantime, the Department's Loans Section is undertaking the cell's functions.

### 9.4 Effective forecasting and monitoring of debt levels and maturity

Key to effective debt management is the forecasting and monitoring of:

- Overall debt levels against the objectives set in GoAP's fiscal strategy;
- The maturity profiles of debt to ensure that GoAP has the revenue flows to meet debt servicing obligations without crowding out other expenditures.

The Finance Department maintains a list of all outstanding borrowings and the schedule of payments of interest and debt repayment over time for the outstanding stock of debt. Debt service, including repayment, is charged (not voted) and not a control item. Appropriate provisions are made in the budget for discharge of interest and debt repayment, and the Central Accounts Section of RBI in Nagpur is duly advised to make the payments on schedule.

### 9.5 Comprehensiveness and transparency in the reporting of debt

Transparency is about providing the public with an understanding of the Government's debt policy and progress against its objectives. Transparency in debt reporting has increased in recent years with the:

- Inclusion of off-budget borrowings into debt figures in the Budget and Accounts since the Accounts of 2000-01 (see section 4.4.1).
- Inclusion of outstanding Consolidated Fund public debt in the Annual Fiscal Framework. GoAP may also consider providing a more comprehensive picture of debt by including the Public Account debt/liabilities in the Budget in Brief. (see section 4.4.2).

The increased transparency has enabled greater scrutiny of GoAP's debt management.

## **9.6 Effective scrutiny of debt policy and performance**

The role of the Assembly to undertake more focussed legislative scrutiny and provide for greater Public Accountability has been enhanced by the more explicit enunciation of a debt policy by GoAP in its strategy paper on fiscal reforms. Further, GOAP's policy of putting its draft budget to public scrutiny for the last two years has focussed public attention on this important aspect of debt management. While the strategy paper is not updated before each budget, key fiscal indicators are covered in the Budget Speech.

## **9.7 Conclusion**

GoAP has now identified medium term objectives for the level of debt. These objectives have not been entrenched in legislation, unlike a few States that have recently opted for Fiscal Responsibility legislation. GoAP has, in recent years, made significant efforts to improve the transparency and comprehensiveness of reporting on debt levels, which have strengthened the ability of the Legislative Assembly and the public to hold the Government to account.





## 10. Contingent liabilities

### 10.1 Principles of good practice

Contingent liabilities are obligations triggered by a discrete event that may or may not occur. The probability of the contingency occurring and the magnitude of the government outlay required to settle the ensuing obligation are difficult to forecast. Contingent liabilities can pose significant fiduciary risk. If they are realised, without having been adequately provided for, they imply either the diversion of budget expenditure or an increase in deficit and debt levels.

GoAP's contingent liabilities arise mainly from guarantees extended by the Government with respect to loans raised by statutory corporations, government companies, local bodies and other institutions. Liabilities could be triggered by other eventualities as well.<sup>151</sup> While pension liabilities are not contingent, in the sense that they will definitely eventuate, they are included in this chapter as they are a significant non-debt liability and GoAP is uncertain of their magnitude. The negative net worth of public enterprises could also be considered a contingent liability as ultimately these are GoAP's responsibility. However, they are not considered in this report as public enterprises are beyond the scope of the SFAA. Besides, restructuring (and closure if necessary) of public enterprises, including co-operatives, is separately being implemented by GoAP.

Figure 77 below highlights those principles of good practice in contingent liabilities that are key to minimising fiduciary risk.

**Figure 77: Key principles of good practice in the management of contingent liabilities to minimise fiduciary risk**

*Guarantees extended subject to risk assessment and proper approval.* It is important that government takes on contingent liabilities fully conscious of the consequences and implications of any such decision, thus requiring detailed consideration of likely scenarios (see section 10.2).

*Contingent liabilities estimated and adequately provided for.* The Government must have the information and modelling capacity to enable estimation of the timing, potential and likely cost of contingent liabilities. Based on this estimate, and the risk assessment, the government should make an appropriate provision for some items, whilst others may simply be disclosed in the financial statements. It is also important to monitor contingent liabilities and re-evaluate the necessary provision as required (see section 10.3).

*Transparent reporting of contingent liabilities.* Disclosure of contingent liabilities is key to enabling the legislature and civil society to hold the government to account for the overall fiscal situation (section 10.4).

This chapter assesses GoAP practice with respect to these principles.

### 10.2 Guarantees extended subject to risk assessment and proper approval

Guarantees are the most important form of contingent liabilities for GoAP. The value of government guarantees outstanding as at 31 March 2002 was Rs.14,855 crore (9.90% of GSDP); these increased potential GoAP debt by around 10 percentage points of GSDP in 2001-02. By the end of 2002-03 the value of guarantees is expected to decline marginally to Rs.14,382 crore (8.73% of GSDP). The Budget Estimates for 2003-04 place the estimated level of government guarantees at the end of 2003-04 at Rs.15,709 crore (8.61% of GSDP).<sup>152</sup> GoAP has set targets for the reduction of guarantees in the MTFE, although this is not a statutory limit as adopted by some other states. The MTFE envisages that, by its terminal year (2006-07), contingent liabilities would constitute only 7.6% of GSDP.

<sup>151</sup> A useful discussion on contingent liabilities of Indian States including some comparative figures can be found in: Usha Thorat and Sunando Roy: 'Contingent Liabilities at the State Level - The Indian Experience', a paper presented at the World Bank Conference 'Fiscal Policies to Accelerate Economic Growth' May 2001, New Delhi.

<sup>152</sup> Budget in Brief 2003-04.

A large portion of government guarantees is to central financial institutions, which routinely seek State Government guarantees for loans extended to State enterprises, co-operative institutions, and parastatal entities. Proposals for extending government guarantees emanate from the concerned line department but need the concurrence of the Finance Department and such other approvals as may be prescribed under the transaction of business rules of government. GoAP intends hence forth to strictly enforce the requirement for adequate scrutiny of guarantee proposals, including an assessment of risk. The Budget for 2003-04 states that the Government has initiated a process of rigorous risk assessment before giving government guarantees and takes adequate precautions to ensure proper use of funds by the PSUs to avoid devolvement of liability on the Government.

Undertaking this scrutiny may be rendered difficult, however, by the fact that most guarantees are for loans to State entities by central government financial institutions, unless the State succeeds in its endeavours to prevail upon central financial institutions to withdraw or modify their requirement of a State Government guarantee. In this, the State Government has the tacit endorsement of the RBI, which has said that a government guarantee cannot be a substitute for the viability of projects.

GoAP charges a flat percentage of the amount guaranteed as guarantee fee. Given the composition and mix of government guarantees and the record of the recipient entities in honouring their financial commitments, GoAP is of the view that the flat guarantee fee that is charged adequately provides for the inherent risk.

### **10.3 Contingent liabilities being adequately provided for**

Minimising the fiduciary risk of contingent liabilities being realised depends on their being adequately provided for in the budget. This section examines GoAP provisions for, first, government guarantees, and secondly, pensions.

#### **10.3.1 Government guarantees**

In 2001-02, GoAP instituted a Guarantee Redemption Fund, with an initial contribution of Rs.12.1 crore. The Government proposes to contribute 1% of outstanding guarantees every year, plus whatever guarantee fees are collected from public enterprises, to the Fund. This Fund is maintained and operated by the RBI on behalf of the State.

In setting up and making provisions for the Guarantee Redemption Fund, GoAP is, to a significant extent, guided by the suggestions and recommendations of an RBI technical committee on State Government guarantees. The basis for provisions into the Fund is intended to reflect the degree of risk and the likelihood of its materialising, having regard to the 'riskiness' of the sector, credit worthiness of the borrower, and the credit history of the borrower. The normative provisions GoAP makes for the Guarantee Redemption Fund are based on a conscious evaluation of risk of the entities on whose behalf the guarantees are given.

The initiative to set up a Guarantee Redemption Fund suggests that GoAP is endeavouring to bring about greater transparency in the treatment of guarantees and to put in place institutional mechanisms to deal with any resulting contingent liabilities. This will significantly reduce the fiduciary risk from guarantees, by moderating the impact of their realisation on budgeted expenditure or debt levels.

Restructuring, including closure if necessary, of State public enterprises (co-operatives included) which is being separately undertaken, would further reduce the Government's need to provide guarantees and consequently its exposure to contingent liabilities.

#### **10.3.2 Pensions**

Expenditure on pensions has increased significantly over the last 5 years, as shown in Figure 78.

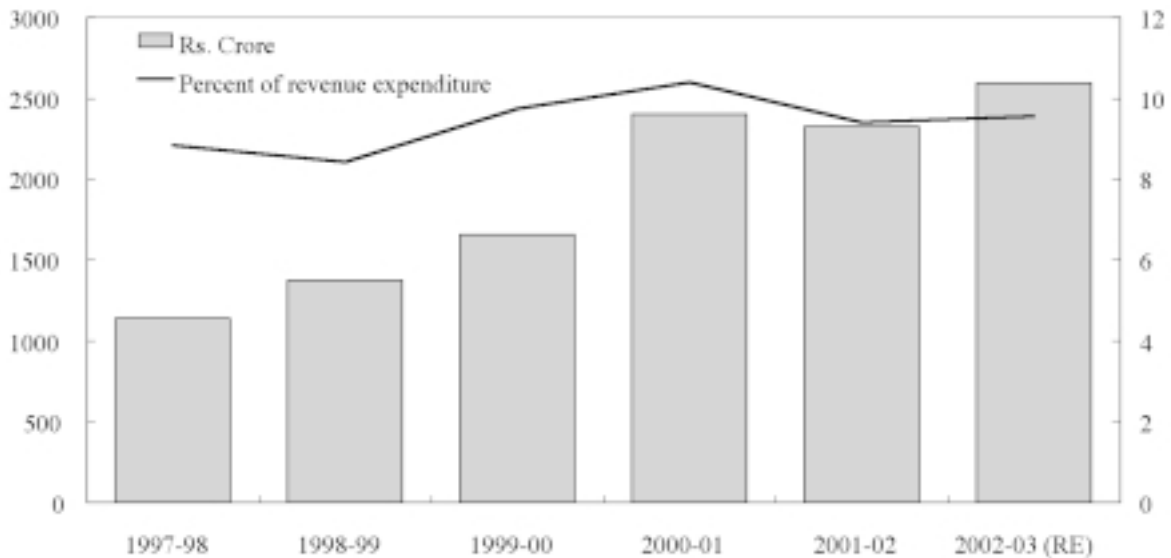
Pensions are estimated to be 9.5% of revenue expenditure in 2002-03 (per the Revised Estimates); this is greater than expenditure on non-salary O&M (3.6%) or maintenance of capital assets (2.4%) or even subsidies and other grants-in-aid, at 6% of revenue expenditure.



While pension expenditure appears to have peaked as a percentage of revenue expenditure, it is still growing in nominal terms (see Figure 78). The extension of pension to employees of local bodies and aided institutions has swelled the number of pensioners. The significant increase in expenditure during 2000-01 was due to the implementation of revised rates of retirement benefits on account of revision of pay scales by GoAP. The marginal decrease during 2001-02 was due to non-sanctioning of half yearly dearness relief to pensioners by GoAP for more than a year and a half. As soon as GoAP releases the dearness relief to all pensioners, pension expenditure is likely to increase as usual. Consequently, the liability will also increase.

Thus, the issue of accurately estimating the pension liability and adequately providing for the pension liability in the budget is becoming increasingly important. The pension liability depends on a range of well-recognised factors.<sup>153</sup> However, GoAP does not have any centralised statistics on existing pensioners, such as the amount of their basic pension and age, nor on the number of employees under different cadres likely to retire in the next 5 years, which would enable it to draw up a retirement profile of its employees. Thus, GoAP does not calculate its pension liability on any technical or actuarial basis and has not prepared a time series of its pension liability. Pensions are provided in the budget on a pay-as-you-go (PAYG) basis. The provision for pension payments in the budget is usually an ad hoc percentage increase over the previous year.

**Figure 78: Expenditure on pensions (Rs. crore on left hand side; % of revenue expenditure on right hand side)**



Recognising that the pension liability is growing very rapidly and could place considerable strain on the State’s delicate fiscal position, GoAP has commissioned a Mumbai based consultant to undertake a study of the demographic profile of its employees and build up its capacity to project the future pension liability with greater precision. GoAP has also taken action to initiate a Pension Fund in which a certain proportion of the total pension liability of the year would be set apart from the Consolidated Fund and credited into the Fund account. This would be over and above the actual

<sup>153</sup> Key factors determining the pension liability are: salary increases, both on account of natural progression and periodic pay revisions (as pension is a percentage of the last pay drawn); inflation (since pensions are indexed on cost of living increases); age profile of employees in the different pay categories; age profile of pensioners - some pensioners will die, yielding place to family pension, which in due course will also cease as family pensioners too die; full pension is restored after 15 years to those who have commuted (bought the discounted value of) a portion of their pensions.

pension payout at present, so that over a period of time, a corpus is built up to make it self-sustaining.

#### **10.4 Transparent reporting of contingent liabilities**

Disclosure of all contingent liabilities is a key factor in ensuring fiscal transparency. Given that these liabilities can be significant, comprehensive and accessible disclosure is key to ensuring accountability for public finances.

##### **10.4.1 Government guarantees**

The RBI technical committee on State guarantees recommends that comprehensive information on guarantees, as well as letters of comfort wherever issued, should be disclosed by State Governments in a major budget document on 'as contemporaneous a basis as possible'.<sup>154</sup> In particular, it recommends that a list of guarantees be included in the Budget in Brief.

A list of guarantees given by GoAP is available in Volume V/4 of Part II of the Explanatory Memorandum to the Budget. It is only in the Finance Accounts that a more easily accessible list is available. In the interest of greater openness and easy accessibility of information to the public it is commendable that summary information has been included in the 2003-04 Budget in Brief.

##### **10.4.2 Pensions**

There is no disclosure in the budget documents of the contingent liability on account of pensions. Once GoAP has a reasonable basis on which to estimate its pension liability over time, it should disclose this in its budget and other financial documents and make adequate provisions on that basis.

#### **10.5 Conclusion**

GoAP is bringing about greater transparency of contingent liabilities and making provision for their realisation. These efforts include initiating a process of rigorous risk assessment before giving government guarantees, improvements in monitoring and disclosing government guarantees; making budgetary provision for select government guarantees taken on by the government; and setting up of a guarantee redemption fund into which contributions are made on the basis of risk assessment. GoAP has also commissioned a study to strengthen its capacity to accurately provide for pension liability in the Pension Fund, which is formally being set up shortly. Furthermore, once GoAP has a reasonable basis on which to estimate its pension liability, it should disclose this.

These reforms represent tremendous strides in GoAP's treatment of government guarantees. Steps taken to provide for realisation of the liability and ensure greater transparency should substantially reduce the level of fiduciary risk arising from guarantees. GoAP's plans to extend the same level of prudence in providing for pension liabilities are promising.

<sup>154</sup> RBI (2001) 'Report on the Core Group on Voluntary Disclosure Norms for State Governments'.



## 11. Internal controls

### 11.1 Principles of good practice

An internal control system is comprised of those internal systems, procedures, plans, attitudes and methods which ensure that an organisation's mission, vision, objectives and targets are successfully achieved through the effective and efficient use of scarce public resources. Specifically, internal control systems strengthen a government's hand in the achievement of those government objectives set out in Figure 79 below.

**Figure 79: Internal control objectives**

- Safeguarding resources against loss due to waste, abuse, mismanagement, errors, fraud, and other irregularities;
- Adhering to laws, regulations, and management directives;
- Developing and maintaining reliable financial and management data and fairly disclosing that data in timely reports;
- Promoting orderly, economical, efficient and effective operations and quality products and services consistent with the organisation's mission.<sup>155</sup>

Hence, strong internal controls are a prerequisite in containing fiduciary risk, being the risk that funds might not be spent on authorised or intended purposes. Internal controls aim to prevent the risk arising, highlight breaches or failures and aid detection of irregularity.

The quality of GoAP's internal controls, and the extent of compliance with them, is examined in detail throughout this report where relevant, specifically in the chapters on Budget Execution (see chapter 5), Accounting (see chapter 6) and Asset Management (see section 8). However, while it includes a summary of the key issues surrounding these specific internal controls at section 11.3, this chapter focuses on the wider internal control system, comparing GoAP against the relevant principles of good practice, as set down by the International Organization of Supreme Audit Institutions (INTOSAI).<sup>156</sup> Figure 80 below highlights those principles of good practice in internal controls that are key to minimising fiduciary risk.

**Figure 80: Key principles of good practice in internal controls to minimise fiduciary risk**

***Clear accountability for internal controls*** must be set down. The mitigation of fiduciary risk depends directly on accountability being fixed for establishing an effective control system in each institution, and operating specific internal controls (see section 11.2).

***Effective internal controls designed, installed and operated*** in key areas narrow the divergence between rules and practice. Section 11.3 provides a summary assessment of GoAP's controls, cross referring to the detail wherever it is set down throughout this report.

***Monitoring and evaluation of risks, controls and compliance***, with provisions for corrective action, can ensure that areas of fiduciary risk can be progressively identified and effectively addressed (see section 11.4).

### 11.2 Clear accountability for internal controls

Persuasive evidence was gathered which suggested that HoDs and other managers such as COs are not adequately fulfilling their responsibilities for internal controls, for example by not undertaking management verification. They must display a more positive attitude to controls, and set an example

<sup>155</sup> International Organization of Supreme Audit Institutions (INTOSAI) (1992) 'Guidelines for Internal Control Standards'.

<sup>156</sup> Within INTOSAI, the Internal Control Standards Committee has specific authority in the field of internal controls. The Committee has issued three useful resources: Guidelines for Internal Control Standards (1992); Guidelines for Reporting on the Effectiveness of Internal Controls: SAI Experiences in Implementing and Evaluating Internal Controls (1997); Internal Control: Providing a Foundation for Accountability in Government.

for their staff to follow. Mechanisms are required to strengthen HoDs' and other managers' sense of accountability. There are three issues to consider, as follows.

- While GoAP increasingly favours listing the duties of departmental officials, such as the CO at the district level, for example in the Functionary Manuals, internal controls do not yet feature in the implied ambit of their responsibilities. This notwithstanding, all officials questioned during controls testing were able to identify the Head of Office as being responsible for internal controls (albeit applying a narrow definition of internal controls). However, they were not able to point out where this was laid down specifically.
- HoDs and other managers are not required to make a formal statement as to their responsibilities for the control system and how they intend to ensure that a system of control is designed, installed, operated and complied with; nor do they report on the state of the internal control system.
- Managers, and COs in particular, do not receive adequate training to enable them to manage their fiduciary responsibilities, and supervise staff working in these areas.

Furthermore, there are no job descriptions in which to set out responsibilities for the operating of controls by all levels of departmental official. Lack of accountability for internal control in line departments will result in an increased risk of control failures and breaches.

In contrast, the DTA Functionary Manual sets out with clarity and in some detail the responsibilities of Treasury officials for internal controls.

### **11.3 Effective internal controls designed, installed and operated**

To assess the adequacy of controls, and compliance with them, the SFAA team undertook controls testing, supplemented by the gathering of supporting evidence.

Evidence gathered suggests that prescribed controls in GoAP are sufficient in many areas; outdated and inadequately clear in others. Compliance with controls is adequate in the Treasury system and in those departmental areas discipline in which can be enforced through the Treasury system, such as documentation supporting payments. In all other departmental areas, such as cash records, asset management or reconciliations at the CCO level, compliance is generally weak. Compliance is poorest at the DDO level in the field.

GoAP recognises the need to strengthen internal controls and is working actively towards this end. Examples of areas targeted by Finance Department for reform are outlined in Figure 81 below.

#### **Figure 81: Examples of Finance Department target areas for strengthening internal controls**

Examples include:

- Computerisation of the accounting systems (which reduces inherent risk of reliance on manual systems);
- Strengthened budgetary control in e-khazana;
- Bank reconciliations;
- Reconciliations between Treasury and departmental records;
- Submission of UCs;
- Submission of DC bills;
- Restrictions on usage of PD accounts;
- Direct payment of salaries into bank accounts (which reduces the inherent risk of reliance on cash);
- Monitoring of DTOs of their performance in enforcing key controls in GO 507;
- Planned expansion and improvement of internal audit.



The sections following set out a summary of the results of the controls testing exercise, referring to the detail of the results wherever covered in this report.

### 11.3.1 Documentation supporting internal control system, transactions and events

Good practice dictates that all transactions and significant events must be clearly, comprehensively and accurately documented to enable each transaction or event to be traced from its inception through to its completion. Documentation must be readily available for examination. Results of controls testing in this area were as outlined in Figure 82 below.

**Figure 82: Results of controls testing**

- Payments, with the exception of AC bills pending DC bills, are generally properly supported by vouchers (see section 5.6.4).
- Absence of receipt books (see section 5.6.5.4).
- Absence of control registers to ensure receipt of UCs (see section 5.7.1).
- Absence of commitment and arrears control means that transactions cannot be traced from their inception (see section 5.8.6).
- Internal controls systems, and responsibility for them, are insufficiently well defined (see section 11.1).
- Key codes and manuals are generally not transparent (see section 3.5).
- Asset registers do not contain details of their cost nor the payment transactions, thus preventing assets being traced back to their original purchase documentation (see section 8.3.2).
- Key registers and documents were generally made available for inspection on site. However, supporting documentation and responses to the SFAA Internal Control Questionnaire were generally tardy, suggesting that supporting documentation was not readily available.

One area that is particularly weak is records management, which together with accounting, is in the process of being computerised. It is essential that arrangements are in place to back up data and ensure that records can be maintained or recreated to ensure data security and the availability of financial information. However, controls testing noted that:

- There was an absence of policies regarding maintenance, backup, movement of data, hardware and software in each department;
- Inadequate back up arrangements had been made. Although DTO offices take back ups on hard, floppy and compact discs, they are stored in the same room as the main data source;
- No Disaster Recovery Plan (DRP) or arrangements for alternative activity continuity facilities had been made;
- Furthermore, staff require more training in order to be confident in using technology. This will reduce the risk of error in data entry.

### 11.3.2 Prompt and proper classification and recording of transactions and events

Transactions and events must be promptly and accurately classified and recorded, in order to ensure the timeliness and reliability of information, particularly where this has financial consequences. Results of controls testing in this area were as outlined in Figure 83 below.

**Figure 83: Results of controls testing**

- BCRs being kept up to date by Treasuries (see section 5.8.1.2) and district offices, but not maintained by DDOs in the majority of cases (see section 5.6.1).
- Personnel and salary records, including loans and advances to staff, are generally being kept up to date (see section 5.6.3).
- Cash books are generally not kept up to date (see section 5.6.6.1).

- APGLI records are not kept adequately updated (see section 6.7.1).
- Stock accounts and asset registers are generally not kept up to date (see section 8.3.2).
- Audit Objection Watch Registers are not generally being kept up to date (see section 12.5).

### 11.3.3 Authorisation and execution of transactions and events

Internal control standards require that transactions and events are authorised and executed only by persons acting within the scope of their laid down authority, for example within the limit of their expenditure authorisation. Results of controls testing in this area were as outlined in Figure 84 below.

**Figure 84: Results of controls testing**

- Proper approval is generally obtained for procurements and payments (see section 5.6.4).
- Treasury controls generally sufficient to ensure that DDOs are not approving transactions in excess of their laid down authority (see section 5.8.1.3).
- DTOs are properly approving pay orders (see section 5.8.1.4).

### 11.3.4 Separation of duties

The risks of error, waste or wrongful acts increase substantially when one person has control over all key stages of a transaction (e.g. a procurement) or event. Hence, key duties and responsibilities in requisitioning, authorising, processing, recording, receiving, and reviewing transactions and events must be separated out amongst individuals, functions or even organisations. Separation of duties is sometimes difficult for small organisations, or those with staff with insufficient skills, to achieve. Results of controls testing in this area were as outlined in Figure 85 below.

**Figure 85: Results of controls testing**

- There is a lack of specialised procurement staff means that procurement being undertaken by staff with other interests which could cause conflict of interest.
- There is an inadequate separation of duties in transaction processing in departments, due to the small size of units.
- There is inadequate separation of duties in the receipt and management of stocks and assets.

### 11.3.5 Supervision

Proper supervision of employees, contracts, processes and transactions is a key type of control. Supervision acts as a detection and deterrent, and also provides a mechanism through which guidance and training can be provided, thus strengthening the control environment. Results of controls testing in this area were as outlined in Figure 86 below.

**Figure 86: Results of controls testing**

- COs are generally not fulfilling their responsibilities for verification of records (e.g. cash records, see section 5.6.6.1) and stores and assets (see section 8.3.3).
- Treasury officials are undertaking proper supervision of their staff (see section 5.8).

### 11.3.6 Access to, and accountability for, resources and records

Access to resources and records must be limited to those authorised individuals who are accountable for their custody or use. Key resources, access to which must be controlled, include cash, cheque books, stamps, valuable assets and supplies. Resources also includes systems and data, hence the need to strictly control password access to computers, specifically to sensitive programmes or data files.





**Figure 87: Results of controls testing**

- Inadequate arrangements for transport of significant amounts of cash (see section 5.6.5.2), despite significant inherent risk.
- Absence of bank reconciliations by departments (see section 5.6.5).
- Absence of regular reconciliations by departments to Treasury/AG records, with a particular problem remaining with reconciliations by CCOs at the State level with the AG (see section 6.6.4.1).
- Inadequate reconciliations between PAOs (Works and Projects) and bank (see section 6.6.4.2).
- Inadequate reconciliations between PAO (Hyderabad) and bank (see section 6.6.4.2).
- Adequate Treasury/AG to bank reconciliations (see section 6.6.4.2).
- Inadequate reconciliations of suspense accounts, resulting in large uncleared balances (see section 6.7.4).
- Generally adequate physical controls over assets (see section 8.3.1) undermined by absence of physical verification of assets with reference to records by COs (see section 8.3.3).
- Lack of reconciliation between expenditure records and physical assets and stock/asset registers (see section 8.3.2).
- Absence of independent scrutiny over assets by AG audit (see section 8.4).

Reconciling the resource (e.g. the bank balance) against the record (e.g. the Treasury departments' records) on a regular basis will strengthen the control, and accountability for the usage of the resource. The frequency of this check will depend on the mobility and value of the resource. For example, in asset management, the existence of land will be subject to less frequent checks and computers to more frequent checks. Cash book checks should be undertaken daily, and bank reconciliation weekly or monthly. Results of controls testing in this area were as outlined in Figure 87 above.

#### **11.4 Monitoring and evaluation of risks, controls and compliance**

There are two key tools that generally prove effective in increasing understanding of, and managerial accountability for, internal controls, and thereby in reducing fiduciary risk. These are:

- Periodic formal risk and control assessment exercises; and
- Internal audit, which is itself a critical form of management control.

##### **11.4.1 Risk and control self-assessments**

GoAP does not presently undertake periodic formal risk and control assessments. None of the officials, largely DDOs and COs, but several CCOs, with whom the issue of risk and control assessment was raised were familiar with the concept of such assessments; nor were they generally able to identify the key financial risks facing their institutions or offices.

Such assessments are an extremely useful tool that can be used to regularly and systemically monitor and evaluate the effectiveness of the overall control system, by:

- Identifying key operational, financial, compliance and reputational risks, both current and potential.
- Understanding how the risks arise.
- Prioritising the risks.
- Checking that the internal controls in place are addressing each of the key risks faced.
- Focusing attention on those key controls to be strengthened as a matter of priority.

Risk and controls self-assessments can serve as an excellent basis for self-reporting. Thus, not only do they lead to successive improvements in controls, they also enhance the sense of responsibility and accountability of officials for controls, and for the breakdown of controls.

#### 11.4.2 Internal audit

The role of internal audit is to evaluate and report on the effectiveness of the internal control system, highlighting any deficiencies and the risks they pose for the achievement of the organisation's objectives (as set out in Figure 79).

Internal audit is a relatively new phenomenon in State Governments in India. The Functionary Manual requires the establishment of an internal audit function in each GoAP Directorate. It is the placement by DTA of a CAO in each of these Directorates which enables internal audit to be undertaken. The CAO supervises the internal audits and reports to the HoD. Elsewhere there is no internal audit undertaken.

However, an evaluation revealed significant weaknesses in the internal audit arrangements of three departments/projects - DSE, DHMS and DPEP.<sup>157</sup> It is understood that many, if not all, departments share these weaknesses. Indeed, the features of the internal audit functions are such that the internal audit might be better described as departmental inspection. Figure 88 below sets out these key features, highlighting the weaknesses.

**Figure 88: Departmental internal audit**

**Objectivity and independence of auditors.** There are no separate internal audit functions in line departments. Instead, internal audits are undertaken by staff drawn together from different departmental functions, normally the Accounts Wing. This arrangement has a number of implications that potentially compromise the objectivity and independence of auditors in evaluating the adequacy of controls, for example:

- Their accounts duties will habitually lead them to work with district and field accounts staff and undertake accounts work;
- The staff in at least one department (DHMS) are also responsible for answering AG audit observations on behalf of the department.

**Objectivity and independence of management of internal audit.** As laid down by the Functionary Manuals (and the various GOs drawn upon to compile the Manual), internal audit is the responsibility of the CAO. The overall audit function thus lacks the required independence, as the CAO is also responsible for the accounts and thus financial control.<sup>158</sup>

**Proper understanding of the role of internal audit appears to be lacking in some quarters.** For example:

- The Functionary Manual sets down the role of internal audit as being is to “conduct internal audit of all *monetary transactions* in the department”. (This notwithstanding, the DSE internal audits do focus on controls rather than monetary transactions);
- Internal audit reports often start with a statement that the auditors have conducted an audit of the *accounts*;
- Internal audit reports state that they cover a *number of years*, i.e. the period from e.g. 1997 - 2002. This defeats the objective of internal audit, which is not to cover transactions (and

<sup>157</sup> Good practice is represented by the Institute of Internal Auditors (IIA), which is an international professional association and is the acknowledged leader in research, education, technology, certification and risk management for the internal auditing profession worldwide. See more details at <http://www.iiia.org>. Particularly useful are the standards issued by IIA against which the operations of an internal audit function can be evaluated.

<sup>158</sup> For example, the Health Department Functionary Manual sets out this requirement at section 4.7.



therefore could cover several years) but to evaluate and report on the effectiveness of internal controls. While controls can be evaluated for their effectiveness over time, this period would not normally exceed one year.

**Audit approach.** The DSE audit teams have compiled an internal audit questionnaire. However, only since 2002 has this questionnaire actually been completed. Hence, prior to this date there is no audit trail of results and conclusions on which to base the audit reports. The DHMS team uses no audit checklist or questionnaire. This raises considerable risks.

**Sufficiency and proficiency.** DSE has five staff, DHMS three staff and DPEP two staff undertaking internal audit, but (as noted above) these staff are not deployed on internal audit full time. This deployment is thus inadequate. The auditors are usually graduates who have passed the accounts tests of the Treasuries and Accounts department, however they have no specific internal audit qualifications.

**Inadequate coverage and timeliness.** Coverage and timeliness of audits has generally been inadequate, as set out below.

- The DHMS only undertakes audit visits to four DMHOs per year. Thus, each DMHO is only audited every 5 years approximately. PHCs and schools are visited much less often of course; some visited during SFAA controls testing had not been audited since 1994. Clearly, the huge number of PHCs will make regular audits of them difficult, but the same cannot be said for district offices. The irregularity of the visits undermines the validity of the audit substantially. It will be difficult to determine which rules were in place at the time of the transaction or event, to gather required documentation, and to hold officers accountable.
- Until 2002, the picture was much the same for DSE, with visits to each district only once every 3-4, but in some cases 5 - 6 years. In 2002, a comprehensive programme of visits was developed, and thirteen DEOs were audited during 2002. And, the department plans to complete the audits of all the DEOs by the end of March 2003, and to complete the audit of all the MEOs within one year, assuming that the vacancies have been filled. The internal audit aims to test one or two primary schools in each district.

**Inadequate responsiveness to internal audit:** Departmental responsiveness to internal audits is extremely poor. Even the significantly more valuable internal audits undertaken by DSE during 2002 have not generated any responses from districts offices as at February 2003. This is due to a number of factors, but the fact that there no internal audit committees at the district level may also play a role.

In summary, therefore, although the work is known as “internal audit” in many ways it is more akin to inspection visits. Furthermore, its effectiveness has been low. Primary Education is at least trying to improve the situation, and should be encouraged.

The Treasury departments’ departmental inspection system seems to be more effective, although it also lacks the required independence.

The DTA in house departmental inspection function undertakes inspections of the 23 DTOs. Each DTO is inspected on a biennial basis. Of the twelve to thirteen inspections undertaken annually, the Director of Treasury and Accounts himself conducts three to four. The remainder are conducted on his behalf by a nominated Deputy Director, Joint Director or the relevant Regional Joint Directors (RJD). The nominated official will be assisted during the audit by one junior accounts officer and two senior accountants drawn from the DTA accounts wing. STOs are inspected by the DTOs, covering 50% to 60% a year. In addition, the RJDs conduct surprise checks on the non-banking sub-Treasuries to ensure proper functioning.

The Finance Department has launched an internal audit initiative in GoAP. An internal audit manual has been developed, through an intensely participative process involving Treasury officials, departmental CAOs and Chartered Accountants with private sector experience of internal audit. This manual will serve as the basis for the eventual rolling out of internal audit across GoAP. The first step will be the establishment of an internal audit cell in Finance Department. Teams comprising a Treasury official, a departmental representative (for example the CAO or Joint Director) and a Chartered Accountant will undertake audits of any department, reporting to the Finance Department. The report will be copied to the HoD, who will be required to report back on follow up actions taken. The initial focus of the audits will be on compliance with GO 507.

Internal audit has the potential substantially to reduce fiduciary risk; it is imperative that effective internal audit units (staffed by professionals with proven records of integrity) are established across GoAP, reporting to the HoD to build his accountability for internal controls, and that this initiative receives the requisite resources.

### **11.5 Conclusion**

Evidence gathered suggests that controls in GoAP are sufficient in many areas; outdated and inadequately clear in others. Compliance with controls is adequate in the Treasury system and in those departmental areas discipline in which can be enforced through the Treasury system. In all other departmental areas, compliance is generally weak. Compliance is poorest at the DDO level in the field. The reasons for the divergence are many and diverse, but in general they relate to the overall control environment and accountability. The current departmental internal audit arrangements are unlikely to have a positive impact on controls and compliance.

The thrust and effectiveness of reforms in targeting specific controls are extremely promising: GoAP is proactively reducing inherent risk and tightening controls through, for example, introducing direct payment of salaries into bank accounts, computerisation, enforcing reconciliations, and monitoring of PD accounts. Complementary reforms in line departments will be required to bring about sustainable change in the control environment in the medium term. HoDs must increase their commitment to ensuring adequate controls and compliance in their area of responsibility; regular reporting by them on the status of their controls would enhance their sense of accountability. Strengthened annual departmental inspection and internal audit functions would be powerful tools strengthening their ability to monitor and evaluate risks, controls and compliance, and report thereon.



## 12. External auditing

### 12.1 Principles of good practice

The role of external audit is to assist the legislature in the exercise of financial control over the executive. The executive, and not audit, is responsible for enforcing economy and efficiency in the expenditure of public monies. It is however the duty of external audit to bring to light examples of deviations from accepted standards, wastefulness, failures, system weaknesses, deficiencies and the circumstances leading to infructuous expenditure. The role of audit is thus to enable and enforce accountability, and to facilitate steps to render such breaches more difficult. The Supreme Audit Institution of any country thus stands at the apex of public accountability, with the potential to play a critical role in containing all dimensions of fiduciary risk.

The Supreme Audit Institution of India is the CAG of India, a Constitutional authority. In AP, the CAG is represented by one Principal Accountant General and two Accountants General (AGs), but the institution in the State is known generically as “the AG”.<sup>159</sup> The assessment of the CAG and AG draws upon the work of the National Commission to Review the Working of the Constitution, which is undertaking a review of the CAG at the national level.<sup>160</sup> The following analysis refers to the thinking of the Commission, as reflected in their consultation paper, wherever justified by an assessment of the CAG’s work in AP.

Figure 89 highlights those principles of good practice in external auditing that are key to minimising fiduciary risk.<sup>161</sup>

#### Figure 89: Principles of good practice in external auditing to minimise fiduciary risk

***Clearly established, sufficient and enforced independence, duties, jurisdiction and powers.***

Without independence, a Supreme Audit Institution is unable to undertake an objective audit and report, with credibility, to the legislature. The independence must carry Constitutional or legislative weight and be supported in practice, for example in the appointment of the head of the Supreme Audit Institution. Similarly, the Supreme Audit Institution must be able to mobilise its assigned duties, jurisdiction and powers, in practice as well as in theory (see section 12.2).

An ***effective audit approach*** requires the scrutiny of government revenue and expenditure applying internationally recognised auditing standards and methodologies, and the undertaking of audits on a timely basis (see section 12.3).

***Objective, qualified and resourced auditors*** are required to ensure rigorous audit testing and the development of audit observations that will result in improvements both in the individual case noted and on a systemic basis (see section 12.4).

***Timely and appropriate responses to audit observations.*** The effectiveness of auditing does not lie solely within the control of the Supreme Audit Institution. The government’s role is to ensure that arrangements are in place to ensure the prompt response to audit observations (see section 12.5).

***Follow up procedures ensure implementation of audit observations*** ensure that the audit process results in PFM improvements, both in the individual case noted and on a systemic basis (see section 12.7).

159 Audit is also undertaken by the State Audit Department. The latter audits the accounts of the local bodies, such as the Zilla Parishads, Mandal Parishads, Gram Panchayats, and Municipalities and is thus outside the scope of this SFAA.

160 National Commission to Review the Working of the Constitution (2001) ‘A Consultation Paper on Efficacy of Public Audit System In India: C&AG - Reforming the Institution’. The consultation paper was based on a paper prepared by Dr. B.P. Mathur, Former Deputy CAG, who is a member of the Commission alongwith a number of distinguished persons in the field of PFM and audit.

161 The Lima Declaration of Guidelines on Auditing Precepts issued by INTOSAI in 1977 remains the core text on principles for good practice in auditing, and was reissued in 1998 as such.

***Timely and accessible audit opinion and reporting*** by the Supreme Audit Institution must be to the widest possible audience (see section 12.7).

This chapter benchmarks the CAG, the AG and the institutional arrangements made by GoAP for responses to audit against the principles of good practice for external auditing. The CAG lies outside the jurisdiction of GoAP of course, therefore this analysis is for the purposes of assessment only.

## **12.2 Clearly established, sufficient and enforced independence, duties, jurisdiction and powers**

In this section, we examine the adequacy of the Constitutional and legal provisions, and institutional arrangements in practice, for the independence, duties, jurisdiction and powers of the CAG.

### **12.2.1 Independence of the CAG**

Independence is the most single important quality of any Supreme Audit Institution.<sup>162</sup> The establishment of the CAG as the Supreme Audit Institution of India, with the necessary degree of independence from the executive and the Legislative Assembly, is provided for in articles 148 to 151 of the Constitution, providing critical Constitutional protection to this important office.<sup>163</sup>

The independence of the CAG as an institution is inextricably linked with the independence of the CAG himself. The Constitution clearly sets out provisions for the CAG's appointment, tenure, salary and removal provisions that lay the foundation for his ability to express his views about PFM without fear or favour. In particular:

- He shall be appointed by the President under warrant;<sup>164</sup>
- He shall hold office for a term of six years, unless he reaches 65 years of age, at which time he shall vacate the office. He can only be removed from office by the President of India under warrant and prescribed procedures exist to govern the circumstances under which he can be removed, i.e. misconduct and incompetence;<sup>165</sup>
- His salary is determined by Parliament and charged on the Consolidated Fund (i.e. not voted), and neither his salary nor other rights shall be varied to his disadvantage after his appointment;
- He shall not be eligible for further office within the GoI or any State after he has ceased to hold office. In practice, the CAG tends to be an IAS officer in his last posting before retirement.

There are no specific provisions about the political neutrality of the CAG. The CAG pledges an oath on assumption of office that he will perform the duties of office "without fear or favour, affection, or ill-will", and that he will uphold the Constitution and Laws. None of these Constitutional or legal provisions apply specifically to the Principal AG, but this is not required as he is considered to be the CAG's representative in the State.<sup>166</sup>

<sup>162</sup> INTOSAI (1998) 'The Lima Declaration of Guidelines on Auditing Precepts'. The chief aim of the Lima Declaration is to call for independent government auditing.

<sup>163</sup> Article 149 of the Constitution of India lays down that there shall be a CAG of India to look after the accounting as well as auditing arrangements of the accounts of the GoI as well as the constituent governments of the States. Again, Article 151 of the Constitution lays down that the reports on the accounts and audit are to be submitted to the President of India and the Governor of the relevant State, for the purpose of placing them on the table of the respective legislatures.

<sup>164</sup> The issue surrounding the appointment of the CAG is analysed in: National Commission to Review the Working of the Constitution (2001) 'A Consultation Paper on Efficacy of Public Audit System In India: C&AG - Reforming the Institution'.

<sup>165</sup> Provisions for the removal of the CAG are identical to those for the Judge of the Supreme Court, see articles 124(2b), 124(4) and 124 (5) and 148 (1) of the Constitution.

<sup>166</sup> Reflecting this representation, the Audit Reports will be signed by the Principal AG/AG and the CAG himself.



In addition to legal and operational independence, Supreme Audit Institutions must have financial independence, so that government is not able to control their activities via restricting the level or allocation of their resources. The level of the CAG's budget is agreed by the Ministry of Finance, but the allocation of resources within the overall budget ceiling is determined by the CAG. This constitutes sufficient financial independence.

In AP, this independence from GoAP appears to be well established in practice. There is no evidence or indication that either the Principal AG or his officials come under any pressure from GoAP. Certainly, the content and tone of the Audit Reports are convincing evidence that the CAG is able to comment freely on the extent to which GoAP has spent funds on authorised or intended purposes.

The Constitution provides for the CAG to have a dual role, for both compilation and audit of the accounts. While accounts compilation is undertaken by the AG (Accounts Wing) and audit by the AG (Audit Wing), both wings fall within the overall responsibility of the CAG. And, as noted below, the CAG certifies both the Accounts and the Audit Reports. This is a highly unusual arrangement, divergent from international good practice.

### 12.2.2 Duties of the CAG

Details of the CAG's operational functions are set out in the legislation which supports the Constitution with regard to the CAG: the CAG (Duties, Powers and Conditions of Service) Act, 1971 (known as the DPC Act). The duties of the CAG are clearly stated in the DPC Act as:

*Sec. 13: "to audit all expenditure from the Consolidated Fund ... and to ascertain whether the moneys shown in the accounts as having been disbursed were legally available for and applicable to the service or purpose to which they have been applied or charged and whether the expenditure conforms to the authority which governs it"; "to audit all transactions ... relating to Contingency Funds and Public Accounts"; "to audit all trading, manufacturing, profit and loss account and balance sheets and other subsidiary accounts kept in any department";*

*Sec 14 & 15: "to audit Grants or loans from the Consolidated Fund of India or State in a financial year, excepting those specific purpose Grants whose audit was specifically exempted by the President or the Governor in public interest"*

*Sec 16 & 17: "to audit all receipts payable into the Consolidated Fund, and accounts of stores and stock kept in any office or department of union or of a state."*

The CAG Auditing Standards set out the CAG's role as to "safeguard the financial interests of the State within the statute and to uphold and promote financial accountability and sound financial and economic practices". The standards also clarify the definition of audit as "including both financial and performance audit", even though there is no legislative backing for performance audit.<sup>167</sup>

### 12.2.3 Jurisdiction of the CAG

The CAG's jurisdiction includes government departments, autonomous bodies, departmental commercial undertakings, statutory corporations and boards and government companies, as laid down in the respective statutes and Companies Act in respect of companies. But the audit of any Body or Authority can also be entrusted to the CAG, by the President of India or the Governor of the State in the public interest after consultation with the CAG, either suo moto or on the initiative of the CAG.<sup>168</sup>

<sup>167</sup> CAG of India: Auditing Standards.

<sup>168</sup> CAG (Duties, Powers and Conditions of Service) Act, 1971, section 19(3).

There are three sets of circumstances in which the CAG does not automatically undertake the audits. First, the CAG's jurisdiction does not cover the audits of bodies and authorities financed from the Consolidated Fund in all circumstances. Their audits are conducted as per the provisions set out in their incorporation or registration acts or by the State Local Fund Audit.<sup>169</sup> Where the government grants are substantial (exceeding Rs.1 crore annually) the CAG is entitled to undertake what are known as section 14 audits, with the prior approval of the Governor of the State.<sup>170</sup>

Secondly, the audit of Panchayat Raj institutions and Mandal Parishads is entrusted to the Director of State audit. Thirdly, as the National Commission to Review the Working of the Constitution highlights, there is increasing outsourcing or devolution of government activities to non-government organisations outside the CAG's area of jurisdiction, which are audited by Chartered Accountants. The Commission is reviewing whether or not the audits by the Chartered Accountants are adequate, and hence whether a Constitutional provision should be made for all bodies which receive public funding to fall within the CAG jurisdiction.<sup>171</sup>

#### 12.2.4 Powers of the CAG

With regards to the CAG's power to undertake its duties effectively, the CAG (Duties, Powers and Conditions of Service) Act, 1971 states that the CAG may:

“inspect any office of accounts under the control of the Union or of a State”,  
 “require that any accounts, books, papers or other documents ... shall be sent to such place as he may appoint for his inspection;  
*“put such questions or make such observations as he may consider necessary ... and to call for such information as he may require for the preparation of any account of report which it is his duty to prepare.”*<sup>172</sup>

Further, the Act states that the person in charge of the office being audited “shall afford all facilities for such inspection and comply with requests for information in as complete a form as possible and with all reasonable expedition.” However, there is no mention of any penalty or sanction available for the auditors to impose in the event of non-compliance.

The CAG has limited access to the premises, record and accounts of private sector concerns to the extent required for the audit of revenue, for example to audit the central excise receipts. However, authority is set out in departmental manuals, for example that of Central Excise Department. Similarly, the CAG can access the income tax files of individuals. The legislative power for this access is derived from section 16 of the DPC Act which concerns the audit of receipts. However, this section does not specifically provide the right of access. Furthermore, the CAG has no right of access to the premises, records or accounts of private sector concerns to whom payments are made for construction and supplies.

The CAG has no power to enforce the implementation of its audit findings.<sup>173</sup> This is a major concern of the National Commission, which is considering mechanisms by which the CAG might better be enabled to enforce that implementation.<sup>174</sup>

169 For example, the statutory audit of co-operative societies is undertaken by the Registrar of Co-operative Societies.

170 The limit is set at Rs. 5 lakhs in the DPC Act, but has subsequently been increased to Rs.25 lakhs and Rs.1 crore.

171 National Commission to Review the Working of the Constitution (2001) ‘A Consultation Paper on Efficacy of Public Audit System In India: C&AG - Reforming the Institution’, section 3.2.

172 CAG (Duties, Powers and Conditions of Service Act, 1971), section 18(1).

173 Note, in some countries non-compliance is a criminal offence. In others, such as France, Spain and much of Latin America, the Supreme Audit Institution has judicial powers. Even where Supreme Audit Institutions are modelled on the UK system, as in India, more enforcement powers are available. For example, the Australian Auditor General has the power of surcharge.

174 National Commission to Review the Working of the Constitution (2001) ‘A Consultation Paper on Efficacy of Public Audit System In India: C&AG - Reforming the Institution’, section 2.





The DPC Act provides the CAG with adequate powers to make regulations for carrying into effect the provisions of the DPC Act in so far as they relate to the scope and extent of the audit, for example laying down guidance with regard to the auditing of receipts and expenditure. However, the CAG has not yet issued such regulations.

The CAG has the requisite administrative powers required. Officers are recruited through the Union Public Service Commission, and subordinate staff through the Staff Selection Commission. The CAG is vested with the powers for lateral induction into all cadres through promotion through the lower cadres up to the level of senior audit officers/ senior accounts officers. This is the third level in the gazetted cadre of officers.

### 12.3 Effective audit approach

An effective audit approach requires the scrutiny of government revenue and expenditure applying internationally recognised auditing standards and methodologies, and the undertaking of audits on a timely basis. There are two components of an effective audit approach relevant to the CAG's role in containing fiduciary risk, being that:

- Auditing standards are laid down to prescribe the principles and practice governing and guide the work of the Supreme Audit Institution, and are complied with;
- Audit methodologies allow the Supreme Audit Institution to provide reasonable assurance in auditing the government's finances.

The CAG has been a member of INTOSAI since 1953, and the Asian Organisation of Supreme Audit Institutions (ASOSAI) since 1978 (in both cases since their inception). The CAG thus seeks to subscribe to the standards and methodologies prescribed by these institutions.

#### 12.3.1 Auditing standards

Audits are conducted as per standing instructions and audit standards prescribed by the CAG. These audit standards, which were updated in 2000, aspire to be in line with INTOSAI best practice. They comprise:

- General standards covering professional and quality assurance;
- Operational standards covering audit planning, regularity, legality audit, performance/Value for Money audit; audit of receipts; auditing in the Electronic Data Processing (EDP) environment; audit evidence;
- Reporting standards covering field audit reports and follow up audit reports.

Manuals are in place to guide the staff in their everyday work.

#### 12.3.2 Audit methodologies

The traditional task of audit in India is to examine the regularity of financial transactions and practice, i.e. the extent of compliance with law and rules. However, audit methodologies have developed significantly in recent years, and the basic audit methodology currently applied by CAG in AP has four main components, as shown in Figure 90 below. All audit undertaken is post-audit.<sup>175</sup>

**Figure 90: Audit methodologies in use in AP by the CAG**

**Central audit:** on receipt of the vouchers from AG (Accounts Wing) (see section 6.6.1), vouchers are audited by central audit teams based in AG (Audit Wing). The follow checks are undertaken: classification check; arithmetical accuracy; sanction of appropriate authority; check of invoices and vouchers. Objection books are maintained major head-wise and all audit objections are entered in the objection books. Any objections are pursued with the departmental offices.

<sup>175</sup> Pre-audit, which tends to blur the distinction of responsibility between government and audit, was discontinued as an AG function in AP in 1971.

**Local audit (financial audit):** AG Headquarters charts out a programme to select offices for local audit examination, depending on the importance of the office, but district offices are usually audited annually. Audit teams undertake test and systems audit. They randomly sample one month's expenditure for audit examination. Three weeks notification will be given. Having collected the vouchers from the AG for the marked month, the audit parties visit the departments (where they mainly work with the DDOs), and then to DTOs or STOs, where detailed checks are undertaken. On each of these annual visits, maybe two field offices (e.g. PHCs, primary schools) will be visited, and the records of a further 10% - 35% will be called for inspection at the district office. The records will be "generally examined and a test audit conducted". The month sampled and tested normally approximates to 8.5% of the annual expenditure. High value transactions above a certain value are also 100% tested. In the districts and offices tested, reports were received by the audited offices within six to eight weeks of completion of the audit.

**Efficiency-cum-performance audit (ECPA).** ECPA examines the performance, economy, efficiency and effectiveness of public administration. Key criteria include the social benefits, and effective and timely utilisation of funds for development activities. The Finance Department is given an opportunity to offer their suggestions about which areas should be selected for ECPA examination. It is during ECPA that areas of high risk are examined. The results of ECPA are fed into the overall financial audit results, rather than it being a separate area of examination, as in other countries. In India, ECPA has been undertaken since 1971.

**Non-regular audits:** undertaken to focus on key issues identified, for example systems audits and manpower audits. The AG is also planning a review of financial accountability for the 2003-04 audit report.

In those areas that the CAG does audit, the audit approach is generally adequate and yields a highly satisfactory standard of results, as evidenced from the Audit Reports. The approach could reasonably be expected to uncover many fiduciary risk factors, such as extra-budgetary activity and divergences from the budget. However, the further containment of fiduciary risk would benefit from a development of audit approach in the following areas.

- The focus of the approach is on an audit of documentation, rather than on physical verification. Auditors do not, for example, check the existence of an asset - everything from a road to a computer in a government office. They simply inspect the records about the existence of the asset. The usefulness of the audit would appear to be seriously undermined by this aspect of the audit approach.
- Similarly, auditors tend to examine records from, for example PHCs, at district headquarters rather than visiting the PHC itself. Clearly, the distances and time spent travelling impede widespread visits. However, the usefulness of the exercise must be questioned.
- As in most countries, auditors take a compliance-focused approach to audit, noting relatively minor aberrations, rather than the major systemic failures. Changing the balance of audit observations to those of a more value added and constructive nature should allow the CAG to play a greater role in enabling improvements to systems and controls across GoAP and increase departmental responsiveness to audit.
- The majority of the auditors' time is spent on the traditional financial audit. The relatively low application of a risk based approach to audit or more investigative approach means that major cases of waste and irregularity such as corruption, fraud, and misappropriation are more likely to go undetected and unreported. High risk areas might include functions with a higher inherent risk, such as procurement and large contracts, or offices where an assessment of controls has revealed a high level of control risk.



## 12.4 Objective, qualified and resourced auditors

In this section, we examine three important aspects of the auditors: their objectivity and integrity, their qualification to undertake effective audit, and resources available to them.

### 12.4.1 Objectivity and integrity

Audit staff must not come under the influence of the audited body or become dependent on such bodies in any way. On joining the CAG's organisation, each auditor takes an oath to uphold the Constitution and standards of integrity in the conduct of audit. This pledge is renewed each year. The broad parameters to establish this objectivity and integrity are also included in the CAG Auditing Standards. The conduct rules as well as the classification control and appeal rules also provide adequate provisions for taking action on the errant officials.

### 12.4.2 Proficiency

With regard to *audit and accounts*, training is given on the related topics and then officers will be inducted into the service. There are arrangements for continuous training programmes at various levels. Provisions have also been made to impart training to staff, equipping them to discharge their duties effectively. No problems have been reported in training provision. There is no professional qualification, such as is gained by auditors in other Supreme Audit Institutions worldwide. However, officers are required to go through an examination in audit and accounts at the end of their six month induction training. And, subordinate level officials are required to pass an all-India level examination. There is also a scheme for Continuing Professional Experience (CPE).

A challenge for auditors worldwide is to develop a proficiency in a number of technical subject areas, everything from health to construction of roads and bridges, to inform their audit, albeit largely financial audit.

### 12.4.3 Resources

No problems of lack of resources have been reported or noted.

## 12.5 Timely and appropriate responses to audit observations

If audit is to have an impact both in individual cases and as a general force promoting sound PFM and accountability, it is essential that departments provide timely and appropriate responses to audit observations. Neither the DPC Act nor any governmental rules set down the time period within which responses are required from departments at each stage of the audit process. However, executive instructions for the speedy settlement of audit observations and Inspection Reports are issued by Finance Department from time to time. The norms of responsiveness for which reliable aggregate data is available from the Audit Reports (i.e. prior to the introduction of GO 507) are shown for each type of audit observation in Figure 91 on the next page.

In most cases, no response is received. The quality of responses also tends to be poor. Both these observations appear to be shared with other States.<sup>176</sup> Often, the response will be that the department is investigating and will report further. Normally, the departments do not report again. A small number of departments have the worst record of responsiveness, being (starting with least responsive): Education; Panchayat Raj and Rural Development; Health, Medical and Family Welfare; Revenue departments; Social Welfare; and Finance and Planning.<sup>177</sup>

<sup>176</sup> This appears to be a nationwide phenomenon. An eminent writer on the subject of public finance, Mr S P Ganguly observed in *Control over Public Finance in India* (1997) that "unfortunately, in India ... audit continues to be considered as something alien, something extraneous and something of the nature of an impediment. A natural resistance has, thus, come to be developed in the administrative system to the absorption of the suggestions of Audit. This trend has become more pronounced in recent years."

<sup>177</sup> Categorisation done on the basis of data in Appendix XXVII of the Report of the CAG of India for the Year ended 31 March 2001 (Civil) GoAP. Criteria were: number of outstanding Inspection Reports and paras; earliest year of the outstanding Inspection Reports; number for which even first replies have not been received; earliest year of the report for which first replies have not been received.

**Figure 91: Data on departmental responsiveness to each type of audit observation**

***Audit objections are raised during the course of the audit*** and communicated to the respective departments for their response or rectification. The usual practice is to require a response within 3 days. The experience of audit is that there is little or no response to the audit objections.

***Inspection reports produced by audit teams containing audit paras.*** Following each audit visit, the audit party produces an Inspection Report, with audit paras covering financial and procedural issues. Auditors give the report to the DDO for discussion on the last day of the audit visit. The report is copied to the HoD or the designated officer who is above the auditee office. The usual practice is to require a response within six weeks. Districts offices visited had an average of 15 - 30 audit observations per AG audit; field offices had an average of three audit observations per AG audit visit. Controls testing of departments revealed no cases where responses had been submitted within the one to two months deadlines. Some replies had started to arrive in the fourth to sixth month following the audit visit. In most cases, the response had still not been received within one year. Those responses that are received are normally 'holding replies'. It is only notification of a subsequent audit visit that prompts a response. In aggregate, as at the end of June 2002, 21,286 Inspection Reports (issued up to end March 2002) containing 83,305 paras were pending.<sup>178</sup> Of the Inspection Reports and paras pending, even first (holding) replies had not been received in the case of 2,058 Inspection Reports and 13,792 paras. However, comparative figures of pendency below indicate that responsiveness is improving over time.

	At 30 June 2000	At 30 June 2001	At 30 June 2002
Numbers of Inspection Reports not settled	23,046	22,207	21,286
Numbers of paras not settled	91,246	85,256	83,305

***Draft audit paragraphs and reviews to be published in the Audit Reports*** are forwarded to the relevant Secretary so that the GoAP's comments might be incorporated in the Audit Reports before their presentation to the Legislative Assembly. The usual practice is to require a response within 6 weeks. The CAG reports that "in a large number of cases, however, the departments did not abide by the provision about furnishing the comments on the draft paragraphs within the stipulated time."<sup>179</sup>

***Audit paragraphs appearing in the Audit Reports published by CAG.*** Government departments are required to submit suo motu Action Taken Notes (ATNs) on all audit paragraphs and reviews to the PAC within three months of their presentation to the Legislative Assembly, as per instructions issued by the Finance Department in 1993. The CAG notes the rate of responsiveness in his annual Audit Report. Data as at August 2002 is provided below.<sup>180</sup>

Year of CAG Audit Report	Number of audit paras appearing in CAG Audit Reports	Number of audit paras for which ATNs had not been received as at August 2002
2000-01	63	47
1999-2000	69	49
1998-99	64	26

The lack of response and action can be attributed to a number of factors as follows.

178 Report of the CAG of India for the Year ended 31 March 2002 (Civil) GoAP, para 3.13 and appendix XXI and appendix XXII.

179 CAG 'Epitome of CAG's reports on the GoAP for the year ended 31 March 2001'.

180 Report of the CAG of India for the Year ended 31 March 2002 (Civil) GoAP, para 3.16 and appendix XXVI.



- The compliance/regularity nature of audit observations undermines their value in the eyes of departments. In the case of procedural breaches, issues raised might be viewed as minor and one-off or the rule could be seen as impractical (for example, the requirement to obtain three quotes during procurement). In the case of financial observations, the issues raised (for example excesses or surrenders) are seen as unavoidable for which no response is meaningful or worthwhile.<sup>181</sup>
- The audit observations are more of a “fault finding” nature, rather than aimed at systemic improvements by recommending corrective measures. The experience of other countries is that more positive comments (for example, about strengths or improvements noted) and constructive recommendations can substantially enhance the reputation of audit and responsiveness to it.
- Registers to monitor outstanding audit observations are not maintained adequately. The controls testing revealed that an Audit Objections Watch Register was maintained by the tested departments in all cases, but that, in most of the cases it was not kept up to date. As a result, departments will have difficulty keeping track of pending outstanding audit observations. However, in every case requested, officials were able to present the Inspection Reports. The Treasuries tested did not maintain the Watch Register, but were able to produce all Inspection Reports, with which was filed a summary of observations to enable tracking of responses.
- The requirement that the Secretary submits a collated response based on responses from across the department might explain another blockage in the system.
- Audit committees have not been established consistently across GoAP. Where they are operating, they may not be operating effectively. The objective of the Committee should be to review AG audit and internal audit observations, co-ordinate a timely and appropriate response to them, plan the implementation of action required, and oversee that implementation.
- Communication between the AG and the audited department tends to be by correspondence, which is a disincentive to responsiveness. A forum at which more senior officials and auditors can establish a more positive and constructive relationship - without compromising the objectivity of the auditors - may be helpful. It is important that each side learns to understand the other’s point of view.

It is tempting to assume that the lack of departmental response and action means that the CAG’s individual observations have no impact. However, there is still a potential for an overall impact. GoAP has specifically mentioned the AG’s observations as justification for the increased discipline introduced by GO 507. GO 507, and other GoAP efforts by GoAP to increase departmental responsiveness, are outlined in Figure 92 below.

**Figure 92: GoAP efforts to increase departmental responsiveness to audit observations**

As a matter of course, Finance Department monitors the line departments’ responsiveness to Inspection Reports, audit observations and paras, and requests action from departments. The Chief Secretary also reviews the pending audit paras with the concerned secretaries of the department.

GO 507, released in April 2002, sought to increase departmental responsiveness by setting down the following requirements.<sup>182</sup>

- Departments were directed to focus on most recent audit observations first;

181 Financial observations usually relate to excessive/unnecessary re-appropriation of funds, surrenders in excess of actual savings, diversion of funds, unreconciled expenditure, avoidable expenditure, wastage of funds, non-remittance of unspent balances, delayed/non surrenders, unnecessary supplementary Grants, non recouping of contingency fund, and rush of expenditure at the end of the year.

182 GOM 507, Finance (TFR) Department, dated 10 April 2002.

- As an one off initiative, DDOs were required to ensure that suitable replies were made to Inspection Reports/Audit Paras (and PAC paras) relating to schemes up to 2000-01. They were required to furnish a certificate by September 2002 stating that replies to at least 50% of the Inspection Reports/Audit Paras (and PAC paras) for 2000-01 had been sent pertaining to that particular scheme for which bills are being submitted to the Treasury/PAOs for the drawal of funds. Failing provision of this certificate, the DDOs were instructed to withhold BROs.
- On an ongoing basis, no further amounts could be drawn for that particular scheme until and unless the DDO submits a certificate that at least 50% of the pending audit paras for years up to and including 2000-01 had been replied to.

In practice, it is the payment of bills that is withheld rather than BROs. This approach at enforcing DDO compliance does appear to be having an effect on the departments' clearing of audit paras, as seen below. Data is categorised by the Treasury department from which the department is drawing funds. As noted previously, the Treasury department monitoring reports have not been subject to independent verification, but the data is consistent with the results noted during controls testing.

Treasury department	Audit paras pending at 31 March 2002	Audit paras cleared during March 2003	Cumulative audit paras cleared by 31 March 2003	Audit paras pending at 31 March 2003	Percentage of audit paras pending at 31 March 2003
DDOs	29,710	1,323	23,543	6,167	21%
PAOs (Works & Projects)	6,650 (Oct. 2002)	602	4,899	1,751	26%
PAO (Hyderabad)	3,824	108	1,262	2,562	67%

*Source: Treasury departments' monitoring reports*

## 12.6 Follow up procedures ensure implementation of audit observations

The assessment of the extent to which audit observations are implemented follows naturally from the assessment of the extent to which observations are responded to promptly and adequately: if they are not responded to, they will not be implemented. In this section, we consider follow up procedures from three perspectives, being:

- Procedures to ensure that audit observations are implemented. There are few if any systemic departmental processes for analysing audit observations to determine reforms or actions required. And, as noted, the CAG has no powers of enforcement of the observations;
- Procedures to ensure departments' implementation of audit observations is monitored. This monitoring is undertaken by the CAG audit party when visiting a department or office. Evidence of this monitoring has been consistently noted during controls testing;
- Procedures to ensure that audit observations lead to systemic improvements in financial management and accountability, or to improvements in performance, efficiency and effectiveness. Such follow up procedures would be the responsibility of the secretariat of the Legislative Assembly or the PAC and be operationalised by the executive, particularly the equivalent of the Finance Department. There are no such follow up procedures in AP.



The absence of systematic means of follow up and enforcement seriously undermines the effectiveness of the audit function.

## 12.7 Timely and accessible audit opinion and reporting

The CAG's main reporting mechanism is his annual Audit Report. The CAG issues the Audit Reports in three parts: Civil, covering GoAP expenditure; Revenue Receipts; and Commercial, covering PSUs. The CAG also issues a summary report called 'Epitome of CAG's Reports on the GoAP'.<sup>183</sup> In accordance with article 151 of the Constitution, the CAG forwards the Audit Reports to the Governor, who causes them to be laid on the Table of the Legislative Assembly.

### 12.7.1 Timing and timeliness of reporting

In the last six years prior to the 2001-02 year of reporting, the Audit Report (Civil) had been presented to the Legislative Assembly within one year of the financial year end, with the exception of 1996-1997 (on 29 April 1998) and 1998-1999 (on 3 April 2000). Presentation is therefore generally sufficiently timely, within one year of the financial year end as good practice requires. However, this is some four to five months after the presentation in November of the Finance Accounts and Appropriation Accounts on which the CAG is reporting. Ideally, the Accounts and Audit Reports should be read together. Whilst the Audit Report will have been finalised by the AG by end October each year, it typically takes five months for all Audit Reports to be cleared through the CAG himself, and pass them through the Governor for presentation by him to the Legislative Assembly.

### 12.7.2 Form of audit opinion

The format of the audit certificate is determined by the CAG, obtaining judicial opinion as necessary. Audit reporting in India differs from standard international practice in several important respects.

Firstly, the CAG signs off both the Accounts and the Audit Reports. Furthermore, the views expressed by the CAG in those Accounts and the Audit Reports can differ somewhat from each other. For example, the Appropriation and Finance Accounts for 2000-01 note the presence of what the AG considers major misclassifications, for Rs.761.59 crore grants-in-aid and Rs.1,667 crore in subsidies as Plan expenditure. (The case in question is a matter of disagreement between GoAP and the AG rather than a confirmed error (see section 6.3 for more details). The point being raised here is one of principle.) On the one hand, the amounts are footnoted in the Accounts and the "correct" certificate is signed off by the CAG. On the other hand, the Audit Report for 2000-01, also signed off by the CAG, mentions the "errors" as "serious distortion(s)", with a particularly serious impact on the calculation of the revenue deficit.

Secondly, the Audit Reports do not offer a standard audit opinion, such as is seen in the audit certificate pertaining to the Accounts of other governments and corporate entities. The Audit Reports do not contain a certificate which, in clear, unequivocal and generally accepted terms, expresses the CAG's opinion that, for example, the Accounts "properly present" financial transactions or are "true and fair". Rather, the CAG's "audit" certificate appears in the Accounts where it also serves as an accountant's certificate, thus reflecting the inherent conflict of his dual role. The exact wording for the certificate in the Appropriation Accounts is:

*"the Appropriation Accounts have been prepared and examined under my direction in accordance with the requirements of the Controller and Auditor General's (Duties, Powers and Conditions of Service) Act, 1971. On the basis of the information and explanation that my officers required and have obtained, I certify that these accounts are correct, subject to the observations in my Reports on the accounts of the Government of AP being presented separately for the year ..."*

183 CAG at the Union level also produces "What the reports of CAG say? A bird's eye view of the Audit Reports of the CAG of India (GoI)."

Similarly, the certificate for the Finance Accounts includes:

*“These accounts have been prepared and examined under my direction in accordance with the requirements of the Controller and Auditor General’s (Duties, Powers and Conditions of Service) Act, 1971. According to the best of my information, as a result of audit of these accounts, the accounts now presented read with the observations in this compilation, are correct statements of receipts and outgoings of the Government of Andhra Pradesh for the year ...”*

Thirdly, the presentation of the Audit Reports is four to five months following that of the Accounts in the previous November, whereas the two would ideally be read together to enable the reader to understand the CAG’s observations (subject to which the Accounts were considered to be correct).

These comments notwithstanding, the Audit Report’s standard of content, written in a clear and balanced manner, compares well to good practice internationally. The Audit Reports present facts, and the CAG’s assessment of these, in a clear and objective manner. The analysis is of a high quality. The CAG has gone to great efforts to increase the relevance and user friendliness of the Audit Reports. Overall, the reports are of a high standard.

## **12.8 Conclusion**

The CAG undertakes relatively high quality work in AP, and the Audit Reports ably reflect his insights and professionalism. The system of audit needs strengthening in some key areas, for example by encompassing physical verification and increasing risk based audits/investigations into areas of potentially major irregularity. The form of audit reporting warrants change to clarify the opinion of the CAG on the Accounts and PFM. The responsiveness of government departments to audit observations is now being improved, following the introduction of GO 507. These factors combine to limit the extent to which audits can act as a deterrent to financial irregularities or result in systemic improvements across government. Signs of improvement are to be seen only in GoAP’s rate of responsiveness to audit observations.





## 13. Legislative scrutiny

### 13.1 Principles of good practice

Legislative scrutiny should serve as a robust systemic ‘check and balance’, ensuring the accountability of the executive for the usage of public resources. Strong and capable committees can enable a legislature to develop its expertise and play a greater role in budget decision-making and scrutiny of executive performance than is possible in open session. In AP, there are two main legislative committees with responsibility for PFM issues: the Estimates Committee and the PAC.<sup>184</sup>

Figure 93 highlights those principles of good practice in legislative scrutiny that are key to minimising fiduciary risk.

#### Figure 93: Principles of good practice in legislative scrutiny to minimise fiduciary risk

**Clear roles, responsibilities and process for the approval of budgets and legislative scrutiny**, as establishment of clear fiduciary responsibility depends on all budgets being passed by the Legislative Assembly (see section 13.2).

**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 authorised or intended purposes, as expressed in the budget (see section 13.3).

**Transparency of legislative approval and scrutiny** can increase the accountability of the executive (see section 13.4).

This chapter evaluates practice in AP against these principles.

### 13.2 Clear roles, responsibilities and process for approval of budgets and legislative scrutiny

The role of the Legislative Assembly in budget approval is provided for in the Constitution.<sup>185</sup> The Constitution stipulates that prior authorisation of the Legislative Assembly is required for withdrawals from the Consolidated Fund.<sup>186</sup> The Legislative Assembly provides this authorisation through the Appropriation Act, which provides the approval to appropriate amounts for specified purposes.

The Budget is usually presented to the Legislative Assembly in February and passed in March. In the event of a delay in the passing of the Budget, article 206 of the Constitution provides for “Vote on Account” (via an Appropriation Act) or demands for advance grants in respect of the estimated expenditure for a part of the budget year. This enables spending before the regular Appropriation Act is passed for the Budget as a whole.

There are two main stages to the Legislative Assembly’s discussion of the Budget, as follows.

- In the first stage, general discussions take place mainly based on the budget speech of the Finance Minister, which indicates the economic policies, taxation proposals, principles followed in allocation of resources, past performance and most importantly future projections.
- In the second stage, the Demands for Grants are discussed in the Legislative Assembly. The Detailed Demand for Grants is available by then and the discussions centre around the details in the Detailed Demands for Grants. When the period fixed for discussions for Demands for Grants is over, no further discussion is allowed by the Speaker, and the Demands for Grants which are not discussed are also taken as approved by the Legislative Assembly. In this process, many of the Demands for Grants get approved without any discussions in the Legislative Assembly due to the limitation of time at its disposal.<sup>187</sup>

184 The Assembly also convenes the Committee on Public Undertakings (COPU), but this is outside the purview of the SFAA.

185 Article 203 and 204 of the Constitution.

186 Approval is only required for voted expenditure, it is not needed for charged expenditure, such as debt servicing.

187 Note that the Legislative Assembly only sits for 50 days a year. The Budget sitting is 20 days. There are 56 Demands for Grants.

An important recent reform in legislative scrutiny was, for the first time in AP and in India, the presentation of the draft Budget to the public (including their representatives) for comment before it is submitted to the Legislative Assembly for approval.

The Estimates Committee has been established to assist the Assembly during budget formulation and approval. The Committee's role is clearly laid down as to "suggest the form in which the estimates shall be presented in the Legislative Assembly".<sup>188</sup> Thus, the Estimates Committee does not analyse the budget appropriations. The Estimates Committee is chaired by a MLA from the ruling party, but with 15 members representing all the political parties represented in the Legislative Assembly. In the past, there had been significant breaks in the continuity of the Estimates Committee, but this has improved in recent years.<sup>189</sup> The tenure of the members of the Estimates Committee is for one year only.

Unlike at the Union level, there are no other standing committees in the AP Legislative Assembly, whose responsibility it would be to develop expertise in specific sectors or departments better to scrutinise their budgets (and to examine the performance during the year).

Supplementary or additional Grants are approved by subsequent Appropriation Acts. As noted at section 5.3.3, the Legislative Assembly's approval of Supplementary Estimates is ex post facto. Also as noted, at section 5.3.5, while excess expenditure over the authorised appropriations is required to be regularised by the Legislative Assembly, this is not done regularly. In total, Rs.1,976.35 crore, for the years 1997-98 to 2000-01, has not yet been regularised by the Legislative Assembly, and the 61 cases totalling Rs.427.69 crore of excess expenditure during 2001-02 will also require regularisation. These amounts have gone unregularised largely due to delays by the departments in submitting explanations to the PAC.

### 13.3 Timely and effective scrutiny of budget execution

The Assembly undertakes scrutiny of PFM at two main stages, being:

- Monitoring during budget execution, when the Assembly, including through its Estimates Committee, seeks to ensure that the budget is being implemented as passed;
- Ex post facto scrutiny, when the Members of the Legislative Assembly (MLAs) have the opportunity to determine the extent to which resources were used for the purposes intended and authorised. This scrutiny is enabled by the placing of the Appropriation Accounts, the Finance Accounts and the CAG's Audit Reports before the Assembly, which delegates responsibility for detailed scrutiny to the PAC.

#### 13.3.1 Monitoring during budget execution

There are two means by which the Legislative Assembly can monitor budget execution, to determine the extent to which the budget is being implemented as passed, and hold the Government to account: questions in the Assembly and through the Estimates Committee.

##### 13.3.1.1 Questions in the Legislative Assembly

Questions can be posed in two forms in the Assembly as follows:

- "Zero hour": open questions are allowed for one hour each day during session;
- Pre-submitted questions. Questions will be either 'starred' i.e. reply in writing is requested and supplementary questions are allowed, or 'unstarred' when an oral reply is given and no supplementary questions are allowed. The request as to whether the question should be starred or unstarred comes from the questioner, but the decision is that of the Speaker.

<sup>188</sup> AP Legislative Assembly: Committee on Estimates (2002 - 2003), Internal Working Rules, published under Rule 310 of the Rules of Procedure and Conduct of Business in the AP Legislative Assembly.

<sup>189</sup> The Estimates Committee did not sit in 1992-93, 1993-94, 1994-95, 1997-98, 1998-99 and 1999-2000.



### 13.3.1.2 Role of the Estimates Committee

The Estimates Committee assists the Assembly in its scrutiny role during budget execution. The role of the Estimates Committee during budget execution is outlined in Figure 94 below.

**Figure 94: Role of the Estimates Committee during budget execution**

- Report on what economies, improvements in organisation, efficiency or administrative reform, consistent with the policy underlying the estimates may be effected;
- Suggest alternative policies in order to bring about efficiency and economy in administration;
- Examine whether the value for money is well laid out within the limits of the policy implied in the estimates.

*Source: AP Legislative Assembly: Committee on Estimates (2002 - 2003), Internal Working Rules, Rule 310 of the Rules of Procedure and Conduct of Business in the AP Legislative Assembly.*

The Estimates Committee focuses more on its responsibilities at the budget formulation stage than on budget execution.

### 13.3.2 Ex post facto scrutiny

The PAC has a critical role to play in any assessment of fiduciary risk as it is in a unique position to ascertain the extent to which the funds granted by the Legislative Assembly have been spent by the Government on authorised or intended purposes. The PAC's role is set out in Figure 95 below.

**Figure 95: The role of the PAC**

The PAC's examines the extent to which:

- Money has been recorded as having been spent against the Grant does not exceed the amount granted;
- Expenditure which has been brought to account against a particular Grant must be of the nature as to justify its being recorded against the Grant and against no other;
- Each Grant has been spent for the purpose for which it is set out in the detailed demand and that it has not be spent on any new service not contemplated in the demand;
- In the case of excess Grants - i.e. where actual expenditure has exceeded the Grant - the PAC considers the circumstances and recommends to the Legislative Assembly whether or not to regularise the excess grant.<sup>190</sup> The PAC also examines cases of losses, nugatory expenditure and financial irregularities.

*Source: AP Legislative Assembly: Committee on Public Accounts (2002 - 2003), published under Rule 310 of the Rules of Procedure and Conduct of Business in the AP Legislative Assembly.*

To fulfil this role, the PAC has the authority to examine the Appropriation Accounts, the Finance Accounts, the Audit Reports (Civil and Revenue Receipts) of the CAG of India and such other accounts laid before the House, as the Committee thinks fit.<sup>191</sup> In practice, the PAC tends to examine the Audit Reports only. The PAC selects a number of the audit paragraphs and reviews for more detailed examination.

While the standard of PAC examination is high, the PAC has the potential to play an even greater role in containing fiduciary risk, maintaining high standards of financial accountability, and supporting Government-wide improvements in PFM. In this section, we consider four key factors, being:

<sup>190</sup> This requirement is in keeping with Articles 115 and 205 of the Constitution.

<sup>191</sup> The Audit Report (Commercial) is considered by COPU.

- Timeliness of PAC scrutiny;
- Standard of PAC examination;
- Enforcement powers and rate of implementation of PAC's recommendations;
- The composition of the PAC and the tenure of PAC members.

### ***13.3.2.1 Timeliness of PAC scrutiny***

The PAC meets regularly (approximately twice weekly during sittings of the Legislative Assembly) to examine Audit Reports, consider audit paragraphs, conduct hearings and make recommendations to the Government. There has been, hitherto, a significant timelag in PAC's scrutiny of Audit Reports. For example, in 2002-03, PAC has focused on examining audit paras from the year 1995-96, with examination of a small number of audit paras from the following two years. This does represent an improvement on previous years however as, in 2001-02, PAC was focused on examination of audit paras as far back as 1993-94.

There are many reasons for the timelag in scrutiny, including significant increases in the Government's expenditure resulting in more audit paras by the CAG. Hitherto, there has been no prioritisation of audit paragraphs and audit paragraphs are examined at random. The PAC has not taken up the option of convening sub-committees to speed up the examination process.

In recognition of the impact of these delays in scrutiny, the PAC Chairman has taken the decision to commit half of the PAC's time henceforth to considering the previous year's Audit Reports, and the remainder to working through the years chronologically. Examination on this basis has now started in early 2003. This should strengthen accountability significantly, with a positive impact on fiduciary risk.

### ***13.3.2.2 Standard of PAC examination***

Albeit delayed, the PAC does undertake a high standard of examination of officials: questioning is rigorous and detailed, and matters are pursued to their logical conclusion with great tenacity. Thus, whilst it will be the serving rather than the responsible official who is called for PAC examination, there are indications that appearance before the PAC does command an appropriate level of preparation and respect.

### ***13.3.2.3 Enforcement powers and rate of implementation***

The Government is required to take action on the recommendations of the PAC and keep it informed of the action taken or proposed to be taken within six months of the recommendations having been made, by way of Action Taken Reports (ATRs). However, this requirement is not established in law, but by a May 1995 Finance Department instruction to administrative departments and Heads of Departments. Nor does PAC have any powers of enforcement. Indeed, implementation of the PAC's recommendations depends largely on the co-operation of GoAP which is being held to account, for example for excess expenditure. The PAC Secretariat oversees the implementation of the PAC's recommendations. The PAC reviews the implementation of the recommendations and reviews GoAP's performance in implementation when it examines the particular department.

The rate of implementation of PAC's recommendations does not appear to be high. The CAG reports that, as at August 2002, 1,159 recommendations made between 1962-63 and 2000-01 were pending settlement. Of these, the PAC had received ATRs in respect of 313 recommendations. Of the remaining 846 for which ATRs had not been reviewed, no ATRs had been received from the concerned departments in 493 cases. Of these ATRs not received, 195 related to just one department, Irrigation and Command Area Development.<sup>192</sup> The PAC has stated that it had received confirmation of only four and three of its 52 and 25 recommendations made for 2000-01 and 2001-02 respectively having been implemented.

<sup>192</sup> Report of the CAG of India for the Year ended 31 March 2002 (Civil) GoAP, see para 3.17 and appendix XXVII.



**13.3.2.4 Composition of PAC and tenure of PAC members**

In line with international best practice, the chairman of the PAC is from the opposition party, although the majority of the members are from the ruling party. The members are selected on the basis of proportional representation of the Legislative Assembly. There are 15 members including the Chairman. The Committee is supported by a Secretariat, including a Secretary, Joint Secretary and Assistant Secretary. The tenure of the members of the PAC is for one year only.

**13.4 Transparency of legislative approval and scrutiny**

Sittings of the Legislative Assembly are televised. There are plans for live internet coverage.

The Estimates Committee is not open to public viewing or media coverage, as the evidence it hears is deemed highly confidential.

The PAC's sittings are open to neither the media nor public, although verbatim records are made available to the press.

**13.5 Conclusion**

The AP Legislative Assembly and its committees - the Estimates Committee and the PAC - have a long standing and well established role in scrutinising public finances.

Both the Estimates Committee and the PAC play their role with a high degree of application, with the assistance of the Principal Accountant General. Their scrutiny of individuals and issues is rigorous and detailed. However, the PAC itself has been feeling the need to improve the timeliness of their scrutiny, to be more effective and contribute to the improvement of the system of PFM and accountability. The recent decision of the PAC Chairman to divide the time of PAC between recent years and the previous year augurs well for holding the Government and its officials to account in a quick and effective manner.

## 14. Public access to information on public finances

### 14.1 Principles of good practice

Traditionally, worldwide, scrutiny has been undertaken solely by the legislature, and by the Supreme Audit Institution on its behalf. Ensuring public access to information on public finances supports scrutiny of the legislature to minimise fiduciary risk. Reforms that involve the public in public finance should, over time, empower civil society, enabling it to hold the government to account and yet become the government's ally in identifying areas of waste and mismanagement of resources. Figure 96 below highlights those principles of good practice in public access to information that are key to minimising fiduciary risk.

#### Figure 96: Principles of good practice in public access to information on public finances to minimise fiduciary risk

Increase *transparency of, and the public's access to, information* on public finances, so as to supplement legislative scrutiny (see section 14.2).

Provide *opportunities for public consultation or participation* throughout the budget process (see section 14.3).

Develop and maintain *avenues for filing, follow up and redressal of public complaints* to support identification of instances of waste and mismanagement of resources (see section 14.4).

This chapter examines GoAP practice against these principles.

### 14.2 Transparency and public access to information

The GoAP is committed to enhancing transparency and public access to financial information. For example GoAP:

- Has drafted a *Rights to Information Bill*. The bill was prepared on the basis of a draft provided by the non-government organisation, Lok Satta, and bills and acts of other Indian States. The bill was to have been introduced in the December 2002 session of the Assembly after having been amended in the light of comments of the GoI. However, now that the GoI has come out with its own bill, GoAP is considering adopting the GoI bill with appropriate modifications;<sup>193</sup>
- *Publishes* the Budget and makes key budget documents accessible through GoAP's web site;
- Publishes an AP *Budget in Brief* document which provides some useful summaries on the State's receipts and payments, and fiscal indicators (revenue and fiscal deficits);<sup>194</sup>
- Published a *draft 2002-03 Budget*, and subsequently a draft 2003-04 Budget, to facilitate public consultation on the budget.

The AG also publishes Accounts at a Glance, which contains useful summaries of the final accounts and some analysis.

While substantial progress has been made, there is still some scope to improve transparency and public access to information in AP. For example:

- The analysis that is included in budget and reporting documents aimed at a general audience, particularly the Budget in Brief and Accounts at a Glance, tends to just highlight key figures, with less explanation of the factors and trends underlying the figures.

<sup>193</sup> GoI introduced a Right to Information Bill in the winter session of Parliament.

<sup>194</sup> Publication of the Budget in Brief Document follows recommendations of the RBI Core Group on Voluntary Disclosures in State Governments.



- While the budget documentation is included on the internet, other key financial monitoring and reporting documents are not.<sup>195</sup> For example, the Accounts at a Glance is not released on the internet nor are the monthly monitoring accounts. The latter are not publicly available in any form. While publishing “high frequency data”, such as monthly monitoring reports, on the web would be cutting edge in terms of international good practice, it has been recommended by the Report of the State Finance Group of Secretaries (the Core Group) on Voluntary Disclosure Norms for State Governments, set up by the RBI.<sup>196</sup>

As noted in previous sections, there are Constitutional requirements for production and presentation of the Annual Financial Statement, the Accounts and the Audit Report to the Assembly. The publication of these documents is at the discretion of the Government, as is the publication of all other budget and financial documentation.

### **14.3 Opportunities for public consultation or participation throughout the budget process**

The GoAP is committed to creating opportunities for public consultation in budget formulation. In particular, GoAP began the process of producing a draft budget (the AFF) as a basis for public consultation in the 2002-03 budget process. The 2003-04 AFF was published on 22 January 2003. The 2003-04 AFF was also supplemented by the release of Group Reports on Departmental Performance Budgets by concerned Ministers from January 23-27 2003. These reports were used as the basis for a consultation process on departmental Draft Performance Budgets through State and district workshops. Public feedback was also received through print and electronic media comments, emails and letters, and ‘Dial Your CM’.<sup>197</sup>

The 2003-04 Budget Speech indicated that this reform responded to a review of the 2003-04 consultation exercise undertaken for GoAP by the CGG.<sup>198</sup> The review suggested that meaningful consultation needs to focus on GoAP’s key expenditure objectives and activities, set in the context of the resource constraints the Government faces. Therefore, the 2003-04 Draft Performance Budget Exercise sought the public’s response to departments’ strategy, plans, priorities, programmes, schemes and performance targets. The Finance Minister signalled the Government’s intention to further strengthen public participation in the future in the Budget Speech.

GoAP has also made efforts to expand the scope of consultation in the 2003-04 process, through the invitation of a larger number of NGOs and civil society organisations to the workshops, as it was recognised that the reach of consultation was limited in the initial exercise. However, the AFF document is still relatively technical and difficult for non-public finance experts/Government officials to understand. There is scope for increasing the accessibility of the document over time, or simultaneously producing a popular publication that fulfils a similar function to the Budget in Brief.

GoAP also recognises the need to begin consultation earlier in the budget formulation process, as the AFF exercise is currently very compressed. However, given the significant resources involved in running large scale consultation processes, GoAP has decided to focus initially on enhancing transparency, moving to a greater focus on public consultation and participation over time.

### **14.4 Avenues for filing, follow up and redressal of public complaints**

The Government sees its measures to establish grievance procedures as a critical element of its anti-poverty agenda. GoAP is implementing citizen’s charters and grievances procedures for government departments with a major public interface (completed already for seven departments). GoAP’s extensive e-governance initiatives will greatly improve the flow of data within government, and enable customers

195 While GoI provides information on major fiscal indicators on a monthly basis, no such high frequency data is presented by GoAP.

196 RBI (2001) ‘Report of the Core Group on Voluntary Disclosure Norms for State Governments’, section VI.

197 As outlined in the 2003-04 Budget Speech.

198 CGG (June 2002) ‘Report to Finance Department, GoAP: Review of AFF public consultation F001, Financial Management Workstream’.

to get better feedback on their queries and requests. GoAP also emphasises community mobilisation and formation of self-help groups to give a greater voice to the poor and marginalized communities (such as water user groups, school committees, and joint forestry management groups).

**Figure 97: Commission on People’s Empowerment**

COPE has been set up under the chairmanship of the former Chief Vigilance Commissioner of GoI. COPE has eight members, three of whom are from outside the public service.

COPE is an advisory body which can advise on a wide range of topics related to governance reform. It is empowered to “interface with citizens, business, government departments, etc and receive complaints/obtain feedbacks.”<sup>199</sup> Thus COPE has been established to advise GoAP on enhancing the effectiveness of its governance reform programme by inviting submission from the general public and public servants. It has also opened up a channel by which citizens can raise concerns and complaints with a high powered committee which will be reporting directly to Ministers and the Chief Secretary. To date, COPE has only met three times.

In December 2002, GoAP constituted a Commission on People’s Empowerment (COPE), to strengthen public access to grievance redressal, as set out in Figure 97.<sup>200</sup> While the establishment of COPE may support in engaging people in identifying and solving problems leading to poor governance, it is too early to judge its effectiveness.

**14.5 Conclusion**

GoAP is making excellent progress in increasing public access to budget information, particularly through increasing the accessibility of budget and financial information, and opportunities for public consultation. Budget documentation, including the Budget in Brief, is included on the internet. However, other key financial monitoring and reporting documents, such as Accounts at a Glance and monthly monitoring accounts, are not published on the internet. While publishing “high frequency data”, such as monthly monitoring reports, would be cutting edge in terms of international good practice, it has been recommended by the Core Group in its Voluntary Disclosure Norms for State Governments.

GoAP has also made commendable efforts to increase public consultation, with the publication of a draft budget for the last two years. Its initial focus is on transparency, with the aim to create greater scope for public consultation and participation in public finance issues over time.

<sup>199</sup> Ibid.

<sup>200</sup> GOM 507, Finance (TFR) Department, dated 10 April 2002.





## A1 The PFM legal framework

The Constitution is the premier source of financial management and accountability provisions, with relevant articles largely covering procedural matters. The only specific role allotted in the Constitution is to the CAG and Finance Commission. The Constitution deems budget activity to be generally within the realm of delegated legislation and to be part of the administrative process determined by each State, and thus delegated to State legislatures.<sup>1</sup>

AP Government Business Rules are issued by the AP State Governor, exercising powers conferred by the Constitution. The Business Rules detail, inter alia, the “powers and responsibilities” of the Finance Department.<sup>2</sup> In particular, they confer authority on the Finance Department for the development of the more detailed rules and procedures which guide the budget process and financial management.

The GoI Government Accounting Rules, Account Codes and General Financial Rules are the primary source of rules and regulations.

At the level of codes and manuals, there are four key generic reference documents, which contain the “instructions” which dictate day to day operations in PFM:

Budget Manual is issued by the Finance Department under the authority provided by the Business Rules. The first part of the manual outlines the process for formulation of the budget and within-year changes to Budget Estimates during execution. In particular, it outlines the responsibilities and accountabilities of line departments in the budget process. The second half of the manual provides a list of major and minor heads within the classification system.

AP Financial Code is for departmental use, particularly to guide the work of the Drawing and Disbursing Officers (DDOs) in the line departments. It sets out articles which govern procedures in all areas of departmental financial management, and contains the Delegation of Financial Powers.

AP Treasury Code is primarily a reference source for Treasury officials. Subject areas include: systems of control, procedures for custody, payment, withdrawal and transfer of monies, and responsibilities of officers. The Code also contains appendices (for example, listing banks, agents, classes of payments) and forms to be completed at various stages of the Treasury process.

AP Accounts Code sets out how all financial transactions should be accounted for. The AP Accounts Code comprises the CAG’s rules together with local rulings relating to local AP variations in accounts procedure. The Code sets out the General Principles and Methods of Accounts, the directions of CAG relating to the initial accounts kept by Treasuries and the forms in which the accounts are rendered to them, and specifics on initial and subsidiary accounts kept by the Public Works Accounts and Forest Accounts.

The codes and manuals are supplemented by a number of departmental and functionary manuals, which aim to emphasise integrity in financial matters and accountability for all financial transactions. They supplement the relevant Codes and Manuals, and are intended to guide and assist functionaries in the effective discharge of their duties. The manual for the Treasuries and Accounts Department was the first to be drawn up, and has been followed by another 35. Each of the Manuals is compiled by the relevant department and approved by a special committee convened by the Dr MCR HRD Institute.

1 Under Article 166(3) of the Constitution, “The Governor shall make rules for the more convenient transaction of the business of the Government of the State, and for allocation among Ministers of the said business, in so far as it is not business with respect to which the Governor is by or under this Constitution required to act in his discretion”.

2 Powers are conferred by clauses (2) and (3) of Article 166 of the Constitution.

Government orders (GOs) are issued by the Finance Department and line departments with the concurrence of Finance Department to supplement the Codes and Manuals, and have been used to facilitate the government's attempts to tighten up PFM and accountability. They thus play a critical role in creating the regulatory and procedural framework for finance and accounts (and, in general for managing the State Government as a whole). GOs are issued on a needs basis. One particular GO, GO 507, will be mentioned throughout this report as having been critical in the strengthening of financial accountability in departments.<sup>3</sup>

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3 GO 507, Finance (TFR) Department, dated 10 April 2002. GO 507 must be read with Memo No. 268/15154-A/TFR/2002, dated 18/5/2002 of the Finance Department.



**A2 The PFM institutional framework**

<i>Institution within PFM framework</i>	<i>PFM roles and responsibilities of institutions</i>
CAG, whose representative in the State is the “the AG” referring to the Accountant General	<p>Overseeing PFM: Management of the accounting as well as auditing arrangements of the accounts of the GoI as well as the constituent governments of the States (Article 149 of the Constitution).</p> <p>Accounting: The President determines the form of the accounts on the advice of the CAG (Article 150 of the Constitution); preparation and submission of the accounts (Article 10 of the CAG (Duties, Powers and Conditions of Service) Act, 1971), although provisions exist for him to be relieved of this duty.</p> <p>Auditing: audit the accounts of the government (article 13 to 20 of the CAG (Duties, Powers and Conditions of Service) Act, 1971).</p>
Legislative Assembly	<p>Budget formulation: prior authorisation of the Assembly is required for any withdrawal from the Consolidated Fund (Articles 203 and 204 of the Constitution).</p> <p>Legislative scrutiny (Rules of Procedure and Conduct of Business in the AP Legislative Assembly).</p>
Cabinet	Council of Ministers headed by the Chief Minister, to aid and advise the Governor of the State (Article 167 of the Constitution of India).
Finance Department	<p>AP Govt Business Rules Part I, section I, article 11 (3) and section III B sets out in detail the powers and responsibilities of the Finance Department. These include:</p> <ul style="list-style-type: none"> <li>● Budget formulation: preparation of estimates;</li> <li>● Budget execution: powers of re-appropriation; cash management; ways and means operations; ensuring budget is implemented as passed; Treasury management (“safety and employment of all funds belonging to, vesting in or under the management of the State Government”);</li> <li>● Reporting: “bringing to the notice of the PAC all expenditure which has not been duly authorised and any financial irregularities”; laying the Audit Report before the PAC;</li> <li>● PFM framework: “all matters relative to financial procedure and the application of the principles of sound finance”.</li> </ul>
Treasury departments	The Treasury and PAO systems form part of the Finance Department and ensure the exercise of control over the release of GoAP funds.
Line departments	<p>According to the Budget Manual, Heads of Departments (HoDs), in their role as Chief Controlling Officers (CCOs) - and therefore the line departments themselves - are responsible for:</p> <ul style="list-style-type: none"> <li>● Budget formulation: the submission of accurate departmental estimates; The administrative department of the Secretariat is responsible for scrutinising the revised estimate and budget estimate of each HoD</li> </ul>

<b><i>Institution within PFM framework</i></b>	<b><i>PFM roles and responsibilities of institutions</i></b>
	<ul style="list-style-type: none"><li data-bbox="603 383 1382 551">● Budget execution: keeping himself thoroughly acquainted with the progress of revenue and expenditure under his control; seeing that expenditure under each unit of appropriation is kept within the appropriation and seeking additional appropriation if needed; undertake timely reconciliation with Treasury records</li></ul>



### A3 Budget documentation

**Volume I: Annual Financial Statements and Statement of Demands for Grants.** This provides a statement of the overall demand for each grant (with a list of the associated major heads). It shows both the gross demand and expected net expenditure, distinguishing between plan and non-plan expenditure. It also provides a summary of the Government's financial results for the last year (actual), current year (budget and revised estimate) and ensuing budget year (budget estimate). This summary includes a Statement of Revenue, Statement of Receipts under Public Debt and Loans and Advances, Statement of Receipts under the Public Account, Statement of Expenditure on the Revenue Account, Statement of Capital Expenditure, a Statement of Disbursements under Public Debt and Loans and Advances and a Statement of Disbursement under Public Account.

**Volume II: Detailed Estimates of Revenue and Receipts.** This provides detailed information on revenue and capital receipts to the sub-head level. This is provided for the last year (actual), current year (budget and revised estimate) and Budget year (budget).

**Volume III: Demand for Grants.** Normally one Demand is presented in respect of each department. In respect of some of the large departments, however, more than one grant is presented. There are eighteen sub-volumes, labelled III/1 etc. The figures of budget for the current year, the revised estimate for the current year and the budget estimate for the ensuing year are shown. The figures for revenue expenditure are shown separately from capital, charged is shown separately from voted expenditure and plan is shown separately from non-plan.

Each Demand for Grants may include one or more Major Head. The same Major Head may appear in several Demands for Grants, if a number of departments undertake programmes under that Major Head. Thus, while the figure for expenditure under a Major Head is in one place under the Annual Financial Statement, the part of the same figure may appear under several Demand for Grants.

Subsequently, detailed demands for grants are submitted to state Legislative Assembly, before it starts discussions on Demands for Grants. While a Demand for Grant shows the figures of estimates by Major Heads only, the Detailed Demands for Grants shows the estimates up to detailed heads; i.e. standard objects for expenditure.

**Volume IV: Public Account.** This outlines the receipts and outgoings from the Public Account.

**Volume V: Explanatory Memorandum on the Budget** is a detailed memorandum explaining the figures in the Budget Estimates, in Telegu and English.

**Volume VI: Budget in Brief.** This provides summary tables and charts on the salient features of the Budget. It includes information on revenue, expenditure and debt levels, as well as information on the growth of expenditure in important development sectors.

Volume VII: Annual Plan

Volume VIII: Minor headwise estimates

**Volume IX:** Survey of Economic Trends, which is released by the Planning Department either on the day preceding, or the day of, the budget presentation. This includes analysis of the economic position of the state and of the budgetary position.

Volume X: Government Commercial Undertakings

Volume XI: Appendices to Budget Estimates

**Volume XII: Analysis of Demand for Grants by Ministers**

Each department, when its budget is submitted to the Legislative Assembly, also submits a Performance Budget. This provides information on the revised estimates for the previous year vs. budget and describes how the money was proposed to be used, and how it was.

#### A4 Budget classification

The expenditure classification system (sectors, major heads and minor heads) has been prescribed by GoI on the advice of the CAG of India. The State Governments have no power to prescribe such heads of classification. This ensures uniformity in the accounts of GoI and the State Governments. This makes it possible to prepare the Combined Finance and Revenue Accounts for each financial year showing the receipts and expenditures up to the level of Minor Heads for GoI, each of the State Governments, and the grand total for the entire country.

In particular, expenditure data is categorised according to:

- the broad *sectors* of general services, social services and economic services, with sub-sectors such as agriculture, education, health etc;
- *major heads (or functions)* under each sub-sector, for example under the education sub-sector are the major heads of general education and technical education;
- *sub-major heads (or sub functions)*, for example under the major head general education are the sub-major heads elementary education, secondary education, university and higher education;
- *minor heads (or programmes)*, for example under the sub-major head of elementary education are the minor heads direction and administration, Government primary schools, assistance to non-Government primary schools, assistance to local bodies for primary education, inspection, teachers training, scholarships and incentives, examinations and other expenditure;
- *sub-heads (or schemes)*, for example under the minor head Government primary schools is the sub-head of primary education;
- *detailed head (or object-head)*, for example under the sub-head government primary schools are salaries, wages, overtime allowance, domestic travel expenses, office expenses, rents, rates and taxes, supplies and materials, professional services, grants-in-aid, other charges and machinery and equipment; and
- *sub-detailed head*, for example under the sub-detailed head salaries are the sub-detailed heads of pay, allowances, dearness allowance etc.<sup>4</sup>

<sup>4</sup> The classification categories are prescribed by the Union Government to the minor-head level. The appropriation unit is sub-head. The annual Appropriation Accounts will only comment on variations up to sub-head level.



## A5 Re-appropriations

The powers delegated to HoDs to make re-appropriations are set out below.<sup>5</sup>

Powers are delegated to HoDs to make re-appropriations in the following cases:

- i. Re-appropriations between Revenue to Revenue, Capital to Capital and Loans to Loans within the same Grant.
- ii. Re-appropriation from one unit of appropriation to another except under recoveries Unit Heads.
- iii. Re-appropriations to the detailed Heads 050 Office Expenses/051 Service, Postage and Telegram Charges - 052 Telephone Charges - 053 Water Charges - 054 Electricity Charges or 131 Utility Payments in the Revised Classifications, from non-salary detailed heads but not vice-versa.
- iv. Re-appropriation from any other Heads to 010 Salaries and 030 Dearness Allowances but not vice versa.
- v. Re-appropriation within the non-salary O&M both under Plan and Non-Plan except '170 Minor Works', '180 Maintenance (i.e.270 Minor Works, 272 Maintenance in the revised classification).
- vi Re-appropriations from one detailed head to another under 'Salaries' and 'Travel Expenses' and from all the detailed heads under sub-heads other than 'Salaries' and 'Travel Expenses' to any detailed heads under another sub-head or within the same sub-head.

No re-appropriations are permitted in respect of the following cases:

- i From one Grant to another Grant.
- ii Between Revenue, Capital and Loans Section even in the same Grant.
- iii Expenditure constituting new services.
- iv From Lump sum provision to any other Head.
- v From or to 091 grants-in-aid towards salaries 092 Other grants-in-aid.
- vi When no provision has been made in the Appropriation Act or Appropriation Act pertaining to the Supplementary Statement or Expenditure for that year.
- vii From plan to non-plan.
- viii Non-plan salary heads to plan.
- ix From or to the detailed heads 050/055 Purchase of Motor Vehicles, 160 Major Works, 170 Minor Works, 180 Maintenance, 190 Machinery and Equipment, 240 Materials and Supplies.
- x From any Head to give loans and advances to the employee under the Section Loan Account.
- xi The HoDs are not authorised to make re-appropriations within the powers delegated to them under 'non-plan' for the 4th quarter provisions within the RE fixed in accordance with the orders issued at para 4(i) of the Govt. Memo.3rd cited.

<sup>5</sup> As per Government Circular Memo. No.6413-A/184/BG/A1/2002, dated 30-3-2001. This was reviewed and revised instructions issued in Memo. No. 6413-A/184/BG/A1/2002 dated 11-3-2002 of Fin (BG) department. The object heads (Detailed and sub-detailed heads) were further revised from 01-04-2002 vide GO Ms No.664, Fin (BG-I) Dept dated 27-10-2001.

## A6 Financial reporting disclosure

### A6.1 Appropriation Accounts

The Appropriation Accounts record the grant-wise expenditure against provision approved by the Legislative Assembly in and offer explanations for variations between the actual expenditure and the funds provided.

### A6.2 Finance Accounts

The Finance Accounts are statements of accounts under the Consolidated Fund, Contingency Fund and the Public Account. They present the accounts of receipts and disbursements of the government for the year together with the financial results disclosed by the revenue and capital accounts, the accounts of the public debt and the liabilities and assets as worked out from the balances recorded in the accounts. The statements in the Finance Accounts are summarised below.

#### *Contents of the Finance Accounts: Part I Summarised Statements*

**No.1: summary of transactions:** sets out actual revenue and expenditure for the current and previous FY. Disclosure is by sector and then sub-sector, down to the major head level. Figures are shown for Consolidated Fund, Contingency Fund and Public Account. Totals are shown for each sub-sector. There is a calculation of the revenue deficit/surplus.

*Explanatory notes* set out important information such as 1: cash flow statement; 2: breakdown of receipts from GOI; 3: changes in taxation policies during the FY; 4 and 5: reasons for revenue/expenditure increases/decreases between the two year actuals at the major head level. Mostly, these explanations (4) and (5) simply note the minor and sub-heads responsible for the increases/decreases, without any analysis of the reasons for the increases/decreases.

**No.2: Capital outlay - progressive capital outlay to the end of the FY:** sets out the capital expenditure up to the end of the previous FY (it does not say from when - formation of AP presumably?), and the equivalent expenditure in the current FY. Disclosure is by sector and then sub-sector, down to the major head level.

*Explanatory notes* disclose significant issues such as: capital expenditure from Contingency Fund not yet recouped to the Consolidated Fund; inclusions in progressive from periods prior to formation of AP; details on investments in government companies and co-operative societies, with cross reference to further detail.

**No.3: Financial results of irrigation works.** However, due to the fact that the relevant department has not provided details of irrigation revenue relating to individual works, no statement has actually been provided. <sup>6</sup> Statement no. 3 was last provided in 1990-91, covering the results for the years up to 1985-86 only. The Finance Accounts do not note the reasons of the Irrigation Department for the statement not having been furnished.

**No.8: summary of balances under Consolidated Fund, Contingency Fund and Public Account as at end FY.** This statement discloses the FY end debit or credit balance for each component of the three parts of the accounts of the state government. A more detailed breakdown is provided of the government account under the Consolidated Fund showing brought forward, total of revenue receipts, revenue/capital expenditure, miscellaneous transactions and closing balance. This allows the reader to track the constituent elements of the closing balance to other statements in the Finance Accounts and receive some reassurance.

**No.9: statement of revenue and expenditure for the current FY,** expressed as a percentage of total revenue/expenditure. Disclosure is by sector and then sub-sector, down to the major head level.

<sup>6</sup> The requirement for this proforma is as per Article 19 of the Accounts Code.





**No. 10: statement showing the distribution between charged and voted expenditure.** Disclosure is for the current FY by revenue expenditure (sectors A - D), capital expenditure (sectors A - C) and disbursements under public debt and loans and advances (sector E and F). An additional table shows a more detailed breakdown of disbursements under public debt and loans and advances.

**No.11: detailed account of revenue receipts by minor heads.** Disclosure is of amounts for the current FY, and down to minor head level, with totals at the major head, sub-sector and sector level.

**No.12: detailed account of expenditure by minor heads.** Disclosure is of amounts for the current FY, and down to minor head level, with totals at the sub-major head, major head, sub-sector and sector levels. Within each minor head, amounts are disclosed of non-plan, plan and centrally sponsored schemes. Within each of these are disclosed the charged and voted amounts.

**No.13: detailed statement of capital expenditure during and to the end of the year.** Disclosure is of amounts for the current FY and of the progressive amount up to and including the current FY. Both current FY and progressive are disclosed down to minor head level, with totals at the sub-major head, major head, sub-sector and sector levels. For the current FY only, amounts are disclosed of non-plan, plan and centrally sponsored schemes within each minor head.

**No.14: statement showing details of investment of government in statutory corporations, government companies, other joint stock companies, co-operative banks etc to the end of the current FY.** Under each type of institution is disclosed: name of institution, years of investment, types of shares (e.g. equity, preference, bonus), number of shares of each type and % govt investment is of total paid up capital, face value of each share, amount invested up to end current FY, and amount of dividend received/credited in year. A summary table shows the total investments and dividends received for each type of institution. An indication of other investments which could not be disclosed due to lack of information is also provided.

**No.15: statement showing capital and other expenditure (other than on the revenue account) to the end of the year and the principal sources from which the sources were provided for the expenditure.** Disclosure is of progressive amount up to the start of the current FY, amounts for the current FY and progressive total including the current FY. Disclosure is at the sub-sector level for capital expenditure. Sources of funds include internal debt of the state government, loans and advances, small savings, provident funds etc.

*Contents of the Finance Accounts: Part II Detailed Accounts and Other Statements for Revenue and Expenditure*

**No.9: statement of revenue and expenditure for the current FY, expressed as a percentage of total revenue/expenditure.** Disclosure is by sector and then sub-sector, down to the major head level.

**No. 10: statement showing the distribution between charged and voted expenditure.** Disclosure is for the current FY by revenue expenditure (sectors A - D), capital expenditure (sectors A - C) and disbursements under public debt and loans and advances (sector E and F). An additional table shows a more detailed breakdown of disbursements under public debt and loans and advances,

**No.11: detailed account of revenue receipts by minor heads.** Disclosure is of amounts for the current FY, and down to minor head level, with totals at the major head, sub-sector and sector level.

**No.12: detailed account of expenditure by minor heads.** Disclosure is of amounts for the current FY, and down to minor head level, with totals at the sub-major head, major head, sub-sector and sector levels. Within each minor head, amounts are disclosed of non-plan, plan and centrally sponsored schemes. Within each of these are disclosed the charged and voted amounts.

**No.13: detailed statement of capital expenditure during and to the end of the year.** Disclosure is of amounts for the current FY and of the progressive amount up to and including the current FY. Both current FY and progressive are disclosed down to minor head level, with totals at the sub-major head, major head, sub-sector and sector levels. For the current FY only, amounts are disclosed of non-plan, plan and centrally sponsored schemes within each minor head.

**No.14: statement showing details of investment of government in statutory corporations, government companies, other joint stock companies, co-operative banks etc to the end of the current FY.** Under each type of institution is disclosed: name of institution, years of investment, types of shares (e.g. equity, preference, bonus), number of shares of each type and % govt investment is of total paid up capital, face value of each share, amount invested up to end current FY, and amount of dividend received/credited in year. A summary table shows the total investments and dividends received for each type of institution. An indication of other investments which could not be disclosed due to lack of information is also provided.

**No.15: statement showing capital and other expenditure (other than on the revenue account) to the end of the year and the principal sources from which the sources were provided for the expenditure.** Disclosure is of progressive amount up to the start of the current FY, amounts for the current FY and progressive total including the current FY. Disclosure is at the sub-sector level for capital expenditure. Sources of funds include internal debt of the state government, loans and advances, small savings, provident funds etc.

**Contents of the Finance Accounts: Part III Detailed Accounts and Other Statements for Debt, Contingency Fund and Public Account statements**

**No.16: detailed statement of receipts, disbursements and balances under heads of account relating to Debt, Contingency Fund and Public Account.** This statement discloses the opening balance, receipts, disbursements and closing balance for the current FY for the Consolidated Fund, the Contingency Fund, and the Public Account, but receipt and expenditure in the Consolidated Fund is a one-line entry only i.e the detail being of CF debt, loans and advances; Contingency fund and the Public Account. Disclosure is down to the minor head level, with totals at the major head, sub-sector and sector levels.

**No.17: detailed statement of debt and other interest bearing obligations of government.** This statement discloses balance of debt brought forward, additions during year, discharges and closing balance for the current FY, at the sector, major head and minor head levels. 'Other interest bearing obligations' refers to sector I Small Savings, Provident Funds etc.

Annex to Statement No. 17 provides further detail about each loan taken by the state government.

**No.18: detailed statement of loans and advances made by government** The statement discloses balance brought forward, amounts advanced during the year, total loaned, amount repaid during the year, balance at end current FY, and interested received and credited. Disclosure is by sector of expenditure.

**No.19: statement showing details of earmarked balances, for sinking funds and famine relief funds**



### A6.3 Budget

The budget presented to the Legislative Assembly in February/March contains some information about actuals for the previous FY (i.e. FY 1), the Budget Estimate and Revised Estimate for the current FY (i.e. FY 2), and Budget Estimate for the ensuing year whose Demand for Grants is under consideration by the Legislative Assembly (i.e. FY 3). Actuals information is disclosed in the following budget documents.

#### *Volumes of the Budget containing information on actuals*

**Volume I: the Annual Financial Statement (AFS) and Statement for Demand for Grants** contains the actuals for the previous FY at sector, sub-sector and major head levels, i.e. at the same level of detail as in the summary statements in the Finance Accounts <sup>7</sup> Actuals are shown for: Revenue, Grants in Aid and Contribution; Receipts under Public Debt and Loans and Advances; Statement of Receipts under Public Account being Small savings, Reserve Funds, Suspense and Misc etc; Statement of Expenditure on Revenue Account; Capital expenditure outside the Revenue Account; Statements of Disbursements under Public debt and Loans and Advances; Statement of Disbursements under Public Account.

**Volume III: Budget Estimates.** Normally one Demand is presented in respect of each department. In respect of some of the large departments, however, more than one grant is presented. There are eighteen sub-volumes, labelled III/1 etc. The figures for revenue expenditure are shown separately from capital, charged is shown separately from voted expenditure and plan is shown separately from non-plan. The amounts shown are down to the detailed head or object head, for example grants in aid, salaries etc.

**Volume VI: Budget in Brief.** This provides summary tables and charts on the salient features of the Budget. It includes information on revenue, expenditure and debt levels, as well as information on the growth of expenditure in important development sectors. The Budget in Brief follows the standard timeline of disclosure as above (FY 1 - 3), but in some cases, such as its analysis of revenue receipts or plan outlays includes time series going as far back as 1993-94 and 1990 respectively. The tables and charts are too numerous to list here, but do provide a comprehensive yet accessible picture for the casual as well as the informed reader of the accounts.

### A6.4 Accounts at a Glance

**Accounts at a Glance** provides a broad overview of governmental activities, as reflected in the Finance Accounts and the Appropriation Accounts. The information is presented through brief explanations, statements and graphs.

### A6.5 AG Audit Report (Civil)

**CAG Audit Report:** The CAG's audit report also provides useful abridged accounts, being:

- Summarised Financial Position* of the GOAP at the year end, calculated on a cash basis;
- Abstract of Receipts and Disbursements* for the current year;
- Sources and Application of Funds*, essentially a cash flow statement;
- Time series* data on state government finances.

<sup>7</sup> Note that the 2002-03 AFS presented in February 2002 wrongly stated that the actuals included in statement A and B were for 1999-2000, when in fact they were for 2000-01.

## **A7 Note on fiscal responsibility legislation**

In its publication 'Finances of State Governments - 2002-03: a Summary of Major Features', the Reserve Bank of India (October 2002) notes:

"Fiscal reforms at the States' level have assumed critical importance in recent years. While measures towards fiscal reforms have been undertaken by many States, some States have initiated steps to provide statutory backing to the fiscal reform process.

Karnataka has enacted a fiscal responsibility act the main features of which are:

- Reduction in the revenue deficit to 'nil' within four financial years beginning April 2002 and ending March 31, 2006;
- Reduction in the fiscal deficit to not more than three per cent of the estimated gross state domestic product (GSDP) within four financial years beginning April 2002 and ending March 31, 2006;
- Reducing revenue and fiscal deficits as a percentage of GSDP in each of the financial years;
- Limiting the guarantees within the prescribed limits under the Guarantees Act;
- Ensuring that by end-March 2015, the total liabilities do not exceed 25 per cent of the estimated GSDP for that year.

In addition to the above-mentioned fiscal targets, the Act provides, inter alia, for a Medium-Term Fiscal Plan (MTFP) setting forth a four-year rolling target for prescribed fiscal indicators. This would also include an assessment of the sustainability relating to the balance between revenue receipts and revenue expenditures and the use of capital receipts including borrowings for generating productive assets. The MTFP would also contain an evaluation of the performance of the prescribed fiscal indicators in the previous year vis-à-vis the targets set out earlier and the likely performance in the current year as per revised estimates.

The Act enunciates certain fiscal management principles and measures for fiscal transparency. Accordingly, the Government would need to ensure that borrowings are used for productive purposes and for accumulation of capital assets and not for financing current expenditure. The Government would also need to ensure a reasonable degree of stability and predictability in the level of tax burden and maintain the integrity of the tax system by minimizing special incentives, concessions and exemptions. The non-tax revenue policies would be in due regard to cost recovery and equity.

In order to enforce compliance, the Act provides for half yearly review of receipts and expenditure in relation to budget estimates along with remedial measures to achieve the budget targets to be placed before both the Houses of Legislature.

Maharashtra Government has expressed its intention to introduce Fiscal Responsibility bill to contain the fiscal deficit. It also intends to set up an independent Fiscal Advisory Board to oversee the implementation of the fiscal responsibility legislation.

Similarly, Punjab Government has decided to enact Fiscal Responsibility and Budget Management Act in order to fix certain targets for fiscal correction. The objective of the proposed Bill in Punjab would be to contain the growth of fiscal deficit to 2 per cent per annum, reduce revenue deficit as a percentage of revenue receipts by 5 percentage points, cap debt to GSDP ratio at levels achieved in the previous year subject to an absolute ceiling of 40 per cent and cap outstanding guarantees on long-term debt to 80 per cent of the revenue receipts of the previous year. Kerala State has proposed to have Fiscal Accountability Bill to provide legal framework for fiscal reforms."



## 1. Introduction

As part of an ongoing fiscal reforms process, the Government of Andhra Pradesh (GoAP) decided to take a number of measures during 2002-03, including completion of a State Financial Accountability Assessment (SFAA) and related Action Programme covering the State Government. The SFAA is a GoAP exercise, undertaken by the Centre for Good Governance (CGG). This exercise has resulted in the development of:

- A Fiduciary Risk report that assesses the risk that government and donor funds might not be spent on authorised and intended purposes, as expressed in the Budget. It only considers issues of direct relevance to fiduciary risk and is structured around a series of principles of good practice;
- A Development report (this report) that supplements the Fiduciary Risk report by considering wider development issues that may not directly impact on fiduciary risk but are relevant to the wider effectiveness and efficiency of the public financial management (PFM) process and outcomes;
- SFAA recommendations and action plan which provides some high level recommendations on the sequencing of potential PFM reforms to address the issues raised in the Fiduciary Risk and Development reports.

This report is the Development report. In taking a wider development perspective to PFM in AP, it introduces both additional principles of good practice, as well as additional issues to be considered under the principles of good practice that are considered key to fiduciary risk. It does not generally repeat issues discussed in the Fiduciary Report except where the additional points can only be understood in the context of the section from the Fiduciary Risk report. Therefore, it is intended as a supplement to, and should be read in conjunction with, the Fiduciary Risk report.

This report follows the same broad structure as the Fiduciary Risk report.

## 2. PFM legal and institutional framework

This chapter discusses some additional development issues in relation to the PFM legal and institutional framework. These are in addition to the fiduciary risk issues raised in the Fiduciary Risk report and should be read in conjunction with it.

### 2.1 Comprehensive and relevant legal framework kept up to date

Section 3.4 of the Fiduciary Risk report noted the need to update the legal framework. Some additional areas, less closely related to fiduciary risk, which require updating are:

- Asset management. Strengthening is required of the Financial Code's coverage of the management of assets such as equipment and machinery, and the efficient and effective management of all assets;
- Efficiency and effectiveness. GoAP has implemented and continues to implement reforms in wide range of areas, but they are all underpinned by a running theme, being the enhancement of efficiency and effectiveness throughout government. However, policies and procedures to promote efficiency and effectiveness are generally absent from the formal PFM framework, which should be updated to ensure consistency.

### 2.2 Clear accountability framework for individual officials

Section 3.7 of the Fiduciary Risk report noted the need for a clear accountability framework for individual officials. Some additional points are as follows.

In other Commonwealth jurisdictions, a senior official would be designated as the Accounting Officer. The responsibilities of the Accounting Officer would be clearly laid down for all to see: propriety and regularity of the public finances; keeping proper accounts; prudent and economical administration; the avoidance of waste and extravagance; and the efficient and effective use of all available resources. And, as in AP, it would be the Accounting Officer who would be required to appear before the Public Accounts Committee (PAC) to provide answers to questions arising from these responsibilities.

In GoAP, it is the Secretary who is the equivalent of the Accounting Officer. Useful mechanisms and procedures may be prescribed to clarify and strengthen the Secretary's accountability.



### 3. Budget Formulation

This chapter discusses some additional development issues in relation to budget formulation. These are in addition to the fiduciary risk issues raised in the Fiduciary Risk report and should be read in conjunction with it. Some of the sections provide some analysis of GoAP against some additional principles of good practice, while others introduce additional issues to be considered under the principles of good practice that were included in the Fiduciary Risk report.

#### 3.1 Clear and optimal roles and responsibilities in budget formulation

Clarity of roles, responsibilities and processes in budget formulation is an additional principle to the Fiduciary Risk report. It is key to enabling financial accountability during budget execution. The distribution of responsibility in budget preparation should be clearly established in the budget rules or guidelines in order to establish unquestioned rules for compliance and accountability during budget execution.

The process for budget preparation, and the budget classification system, are outlined in the Budget Manual. The manual is issued by the Finance Department and updated periodically to reflect changes in the classification system by the Controller General of Accounts (CGA), Ministry of Finance.<sup>1</sup> Indeed, the manual has just been updated to reflect changes in the list of major and minor heads of account.<sup>2</sup>

However, there is also a need to update the manual's description of the budget process, and the associated roles and responsibilities, to reflect current practices, as amended by Government Orders (GOs). For example, the Budget Manual makes a distinction between the budget process for "Part I and Part II Estimates", which has not been used for around 20 years. As another example, the Budget Manual has not been updated to reflect increased delegation of powers of re-appropriation to Heads of Department (HoDs) or for the budget release reforms.<sup>3</sup> The Finance Department is aware of the need to update the Budget Manual, and has embarked on this task.<sup>4</sup>

The difficulties of maintaining an updated manual reflect the ongoing reforms in budget process, as GoAP seeks to strengthen budget formulation. These reforms are placing greater demands on line departments as GoAP strives to take a more strategic approach to budget formulation. As well as changes to the process, the time at which departments have been required to submit their initial budget requests have varied from October for Budget Estimates (BE) 2001-02, end January for BE 2002-03 and early December for BE 2003-04.<sup>5</sup>

Departments' ability to respond to new requirements and changing deadlines would be enhanced through more timely circulation of the budget circular or other GOs. For example, between receipt of the GO and submission of their initial Non-Plan estimates for the 2003-04 Budget, departments had only 17 days.<sup>6</sup> The letter from the Chief Minister requiring departments to prepare draft performance

1 These changes are made with the concurrence of the Comptroller and Auditor General (CAG).

2 The Budget Manual was updated in 1974 (to reflect the rationalisation of the heads of account) and in 1987 (when there was another revision to the heads of account). The last update, completed by December 2002, was to incorporate 'correction slips' or changes to the major and minor heads, issued by the CGA since the 1987 update. Of the 429 changes, 387 had reportedly already been incorporated before the updating exercise.

3 Memo. No.6413-A/184/BG/A1/2002.

4 The consultant responsible for updating the list of major and minor heads is now engaged in updating the first half of the budget manual, that covers the process for budget preparation and execution. However, there is no set date for completion of this work.

5 Memo no 6087/957/BG/A-1/2000 (2001-02 Budget Instructions); Memo.No.4836/993/BG/A1/2002 (Budget Estimate 2002-03 - Instructions for the Preparation of Budget Estimates) and Memo.No.34528-A/1137/BG/A12001 (Budget Estimates 2003-04 - Preparation of Non-Plan Budget Estimates).

6 Departments had 22 days formal warning through GOs of the deadline for the initial 2000-01 Budget Estimates and 7 days for the 2002-03 Budget Estimates.

reviews and budgets for the 2003-04 Budget was issued on 2 January 2003 and initial budget ceilings were communicated on 4 January. The draft performance reviews were to be finalised by 15 January.

Early development and circulation of an annual budget timetable would provide a mechanism for the Finance Department to provide timely communication of any changes to the budget process, clarify expectations to line departments and ensure that departments are well prepared to submit their budget proposals. Advance warning of key budget dates and line department requirements will become increasingly important as the process requires departments to think more strategically about the links between their activities and results, as signalled by the 2003-04 Performance Budget exercise (see section 4.3 in the Fiduciary Risk report).

There is also scope to provide more guidance and support to line departments in understanding the new requirements. For example, it may be helpful to provide departments with more guidance as to the format and content of the draft performance reviews and budgets, perhaps through the provision of a pro-forma. This would clarify expectations and support consistency across departments.

### **3.2 Political engagement in budget formulation**

Political engagement in setting the fiscal framework and broad strategic priorities is also an additional principle from those included in the Fiduciary Risk report. It contributes to the realism and credibility of the budget, which is central to minimising fiduciary risk. If the Government recognises and uses the budget as a tool for achieving their objectives, there will be greater political commitment to ensuring that budget plans are put into effect.

GoAP is taking key steps to facilitate more constructive political engagement in the budget process. For example, GoAP has now identified deficit and debt objectives in the Medium Term Fiscal Framework (MTFF). While the MTFF is developed by the Finance Department, it is approved by the Chief Minister and his Cabinet. The Strategy Paper on Fiscal Reforms identifies the MTFF as “a tool for establishing overall affordability of government spending within reasonable revenue forecasts, while identifying a broad path for expenditures that protects expenditure priorities”. It identifies that it intends to put the annual budget preparation in a multi-year context by formulating a medium-term rolling framework, updated annually and providing a guide for the annual budget preparation. Although the MTFF is not yet acting as a rolling framework as an additional year was not added to the framework in the 2002-03 and 2003-04 budget process, reducing the framework from a five to three year horizon.

To achieve these goals, Cabinet agrees to an overall expenditure ceiling before agreeing individual departmental ceilings. This overall expenditure ceiling is driven by the Government’s objectives for deficits and debt (taking into account constraints on borrowing) as well as revenue forecasts. There was still a tendency for overall expenditure to creep up at the various stages of finalising expenditure ceilings. There was a net increase in the expenditure ceilings of Rs.400 crore as a result of the initial departmental petitions to the Budget Committee in mid-January, further increases when Cabinet set the final budget ceilings for budget submission preparation and then further increases after the presentation of the Budget to the Assembly, on the basis of feedback from Members of the Legislative Assembly (MLAs). However, these increases are the Government’s prerogative and the Budget Estimates are still consistent with the Government’s MTFF objectives.

There is also increased political engagement in the setting of department ceilings. In particular, a Cabinet sub-committee, the Budget Committee, provided recommendations to Cabinet on expenditure ceilings in the 2003-04 Budget process.<sup>7</sup> The Budget Committee included the Minister of Finance, Home, Major Industries, Major Irrigation and Municipal Administration and Urban Development. While Finance Department actually set the initial ceilings that were circulated as a basis for preparation of performance budgets, the Budget Committee were involved in negotiations with HoDs in each

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7 G.O.Ms No.956 Constitution of Committee for re-assessing, re-prioritising the budget. Dated 28.11.2002.





group, and the relevant portfolio Ministers, to resolve perceived mis-matches between priorities and expenditure ceilings. The Budget Committee made the final decision on the expenditure ceilings to be included in the 2003-04 Annual Fiscal Framework (AFF) (draft budget) and the Cabinet as a whole approved the final expenditure ceilings as the basis for the preparation of detailed budget submissions. However, it should be noted that in the same way that salary and debt commitments limit the flexibility of line departments in budget formulation (see section 4.3 in the Fiduciary Risk report), they also limit the flexibility of politicians to direct resources to priority areas.

### **3.3 Budget realism**

#### **3.3.1 Revenue**

The Fiduciary Risk report noted that whilst revenue departments submit their forecasts to the Finance Department around December of each year, it is ultimately the Finance Department that determines the revenue forecasts to be included in the budget. These forecasts are then translated into targets for the revenue departments. Both the Finance and revenue departments acknowledge that these forecasts are typically higher than those initially provided by the revenue departments. They are based on anticipated growth rates in revenue in relation to the previous and current year trends.

As a wider development issue, it may be useful to distinguish between revenue targets given to Revenue Departments and the forecasts that are used as the basis for budgeting. While targets can be challenging, it is better to be conservative in the revenue forecasts that are used to set expenditure limits.

#### **3.3.2 Expenditure**

There are two additional issues to raise under the realism of expenditure provisions:

- The impact of under-provision for non-salary operations and maintenance (O&M) expenditure on the effectiveness and efficiency of expenditure;
- The need to move from expenditure provision on the basis of past trends to activity-based costing over time.

##### **3.3.2.1 Under-provision of non-salary O&M**

The Fiduciary Risk report recognised that there were signals of under-provision for non-salary O&M expenditure (see section 4.2.2 of this report). This means that Budget Estimates tend to under-estimate the full cost of funding ongoing government activities, creating pressures for increases in this expenditure relative to budget. However, this fiduciary risk does not materialise during budget execution as Treasury controls prevent expenditure exceeding budget. Indeed actual non-salary O&M expenditure is generally lower than budget, due to constraints facing departments in budget execution.

However, while under-provision for non-salary O&M expenditure may not impose a direct fiduciary risk, it does undermine the effectiveness and efficiency of expenditure. This is recognised by GoAP, who aims to increase the provision for non-salary O&M in the medium term. The Strategy Paper on Fiscal Reforms identifies “raising the efficiency of government expenditure, by a targeted focus on the more productive activities and thus more adequate funding of those activities”.<sup>8</sup> The issue was also recently noted as a general problem across India in a report of the Eleventh Finance Commission: “a major weakness of the budgeting process of governments in the States and also at the Centre is the practice of spreading resources over too many projects.”<sup>9</sup>

8 GoAP (2001) ‘Strategy Paper on Fiscal Reforms’, paragraph 87.

9 Report of the Eleventh Finance Commission (2003), para 3.62.

### 3.3.2.2 Activity based costing

Over the longer term, ensuring that Government activities are adequately funded will require building the capacity of line departments to define and cost their existing activities, and their scope to prioritise activities. The estimates of expenditure are currently based on trends in actual expenditure in the past years, the pace of actual expenditure during the current year and accumulated arrears. Budget realism will be enhanced by moving from budgeting on the basis of past trends to an activity-based approach that forecasts expenditure based on key economic, demographic and policy drivers. GoAP's Medium Term Expenditure Framework (MTEF) pilots provide an opportunity to identify the potential for, and challenges in, moving towards an activity-budgeting approach.

### 3.4 Line department ownership of budgets

In the Development report, there are some issues to highlight in terms of the discussion of the limitations on the flexibility of departments in developing realistic budgets that provide adequate funding for their activities. These are as follows.

- Departments are unable to free resources from salaries in order to more adequately provide for O&M expenditure. Departments can re-deploy staff to other activities, or surrender them and their budgets to the manpower cell. However, given that unfilled posts are not funded, this does not lead to a savings for departments. In terms of the surrender of "excess posts", as the salaries for these posts must still be paid, the salary is surrendered or transferred with the post. This limits the incentives for departments to identify surplus labour and their capacity to reallocate expenditure. Therefore, it makes it difficult for departments to address the issue of under-provision of non-salary O&M expenditure.
- The current annual focus to the budget makes it difficult for departments to reconcile activities with available resources. As noted by the Fiduciary Risk report, a medium term approach facilitates more fundamental shifts in expenditure priorities by enabling them to be planned over a time span of several years. Moving towards a medium term budgeting approach will require building the capacity of departments to develop medium term costed expenditure strategies on an activity basis (see section 3.3.2.2). It will, therefore, ultimately depend on the integration of the MTEF and MTEFF initiatives into the budget process.

### 3.5 Budget integration

This is the third additional principle to be added to budget formulation in the Development Report. Integration of the budget requires that all spending programmes compete for resources in the context of overall government priorities. A lack of integration can lead to governments taking on activities that they cannot afford to adequately fund.

Perceptions of Non-Plan expenditure as unproductive create pressures for all State Governments to maximise the size of Plan expenditure. As a consequence, there is a tendency to take on new activities in the Plan budget rather than maintain existing operations and assets within the Non-Plan budget.<sup>10</sup> The Eleventh Finance Commission has expressed concern that the dichotomy between Plan and Non-Plan expenditure, as mandated by the CGA, leads to the neglect of essential maintenance and the non-labour inputs needed for the effective delivery of "Government services."<sup>11</sup>

The Plan/Non-Plan classification approach is mandated by the CAG and is not at the discretion of GoAP. While the Finance Commission has suggested eliminating this distinction, it has not yet secured the agreement of the CAG, which is required for a change in the classification structure. However, there is scope for greater integration in budgeting for Plan and Non-Plan expenditure within departments. This would not prevent GoAP classifying expenditure in line with the CAG requirements. While the

<sup>10</sup> Although some Plan expenditure does provide for the ongoing costs of government operations.

<sup>11</sup> Report of the 11th Finance Commission (2003), para 3.64.



Chief Accounts Officer (CAO) wing of a department is responsible for the Non-Plan budget, the Planning Division prepares the Plan budget. Our case study departments advised us that there is no co-ordination in the preparation of the two budgets. While it has not been possible for us to assess the extent of co-ordination between the Accounts wing and Planning division across all departments, the separation of these roles poses a risk to integration. This lack of integration inhibits a comprehensive analysis of expenditure options if the relative priorities of new initiatives are not considered against the costs and benefits of existing expenditure commitments.

### **3.6 Budget comprehensiveness**

There is one additional issue in relation to budget comprehensiveness: disclosure of donor-funded schemes.

As all donor financing to GoAP is channelled through the Government of India (GoI), it is captured in the GoAP budget. Expenditure financed from the funds is channelled through the Treasury system. Donor financing is shown on both the revenue and expenditure sides of the budget.<sup>12</sup> Total donor financing (externally aided projects) is included as a source of receipts in the AFF. In addition, the Demand for Grants shows the amount that is externally financed under each scheme. However, it would enhance transparency if the Budget or the Finance Accounts included a summary table that captures externally aided project grants by donor and scheme. At present, it is not possible to get an overall picture of the type of donor funding from budget or financial reporting.

### **3.7 Comprehensive, accessible and timely budget documentation**

There are some additional development issues to raise under this principle:

- Reporting aggregate actual expenditure and revenue against budget;
- Scope to further increase the transparency around fiscal strategy;
- Simplification of classification system;
- Commitment to timely publication.

#### **3.7.1 Reporting aggregate actual expenditure and revenue against budget**

A number of budget documents do provide information on actuals for the previous year and the revised estimate for the current year. However, it should be noted that no budget reporting provides the budget estimate, revised estimate and actual for one complete year. It is necessary to go through at least two budgets to assemble this information. The process of compiling this information is further complicated by changes in the format of summary tables between budget documents and across years, for example between the 2002-03 and 2003-04 AFFs. While the Appropriation Act compares budget and actual expenditure at the end of the financial year, this is done at a detailed sub-head level and does not provide a summary comparison of the implications for fiscal aggregates.

#### **3.7.2 Transparency of the fiscal strategy**

As recognised in the Fiduciary Risk report, GoAP has taken a number of steps to enhance transparency of its fiscal strategy. The Government's medium term objectives, for the revenue deficit, fiscal deficit, debt and guarantees, are published in its fiscal strategy paper and were included in the 2003-04 Budget speech. There is also some discussion of recent progress against these indicators in the Budget speech. The AFF (draft budget) provides more detail on the Government's fiscal position for the budget year and GoAP now intends to publish an updated AFF, once the Assembly passes the Budget.

<sup>12</sup> Note that GoI provides funding for externally financed projects to States as 70% loan and 30% grant. Therefore, 70% would be shown in capital receipts and 30% would be shown in revenue receipts.

In the spirit of ongoing strengthening of transparency as signalled by GoAP, these reforms could be further extended by including 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. It should also explain any changes to these objectives over time and the policy steps GoAP intends to take to achieve these objectives in the short and medium term. While Budget indicators are currently consistent with the Government's objectives, in any situation where these deviate, the AFFs should explain the Government's strategy for "getting back on track" towards achievement of its medium term objectives. This type of publication would support the public, and Legislative Assembly, in reconciling the current Budget with the Government's medium term fiscal strategy.

### **3.7.3 Simplification of classification system**

As recognised in the Fiduciary Risk report, GoAP has made significant efforts to simplify the classification system below the Minor Head level (CAG standardised system is up to Minor Head only). There is still scope to continue this simplification process by continuing to reduce the classification levels below minor head and standardising the sub-heads. For example, for Non-Plan expenditure, the sub-heads could be limited to salaries, non-salary O&M, grants-in-aid, capital expenditure, loans and advances and other. This would help to avoid misclassifications and to create a more accessible Budget.

### **3.7.4 Commitment to timely publication**

GoAP meets all its legislated requirements for publication of budget and financial documents. However, these legal requirements are relatively limited and do not extend to recent innovations, such as the Budget in Brief and the AFF. GoAP may consider doing so to strengthen citizens' hands in obtaining information on revenue and expenditure issues.

Furthermore, GoAP does not announce advance release dates for fiscal or financial information. In contrast, India subscribes to the Special Data Dissemination Standards (SDDS) and have announced advance release calendar dates for release of data on GoI operations.



## 4. Budget execution

This chapter discusses some additional development issues in relation to budget execution. These are in addition to the fiduciary risk issues raised in the Fiduciary Risk report and should be read in conjunction with it. Note that no new principles for budget execution have been added in the Development Report.

### 4.1 Transparent and clear processes for within-year expenditure changes

The additional issues that the SFAA team wish to raise in the Development report relate to the reporting of divergences between budget and actual expenditure in respect of:

- The Contingency Fund;
- Authorised relaxation of Treasury controls in anticipation of Supplementary Estimates.

#### 4.1.1 Contingency Fund

As noted in the Fiduciary Risk report, the Contingency Fund is Rs.50 crore, less than 0.2% of total expenditure in 2001-02. However, there are two developmental issues that would become of increasing importance if the Fund was larger:

- The Finance Accounts do not show the transactions from the Contingency Fund that have already been provided for in the Supplementary Estimates, which represent the majority of transactions.<sup>13</sup> Neither is a summary of the funds recouped for the Contingency Fund, provided in the Supplementary or Budget Estimates. Therefore, at the present time, there is no published summary of all the Contingency Fund transactions. Given the special nature of Contingency Fund transactions, that is they are appropriated on an ex post basis, the SFAA team recommends that full accounts and balance sheet should be provided for the Fund.
- The criteria for “urgent expenditure” are not clearly specified. The development of well-defined criteria and rules for use of the Contingency Fund may permit the Government to put aside a larger contingency. This could potentially provide GoAP with greater flexibility in budget execution with less recourse to other within changes in expenditure, thereby providing departments with greater flexibility.

#### 4.1.2 Supplementary Estimates

The Fiduciary Risk report also noted that the Finance Department authorises Treasury departments to release some of the expenditure in anticipation of Supplementary Estimates, as “authorised relaxations of Treasury control”. There is scope to strengthen the monitoring and reporting of authorised relaxations. It is not possible to identify the total number or value of authorised relaxations from either the Appropriation Accounts or the Audit Report (Civil). Furthermore, while, some of the expenditure authorised in relaxation of Treasury control is not subsequently covered by supplementary appropriations, it is not possible to identify how much of “excess expenditure” is due to this cause.

### 4.2 Commitments and arrears

The Fiduciary Risk report noted that there was no reporting or control of commitments. The International Monetary Fund (IMF) Code on Fiscal Transparency recommends at least a memorandum reporting arrears, when the country does not use accrual or modified accrual accounting (which would systematically generate reports on overdue accounts). In countries that face arrears problems, the deficit on a cash basis plus net increase of arrears is also an important indicator, and is very similar (but not necessarily identical) to the deficit on a commitment basis, i.e. the difference between annual expenditure commitments and cash revenue and grants. GoAP may find this a useful indicator to track performance in this dimension.

<sup>13</sup> Expenditure under the Contingency Fund must be recouped from the Consolidated Fund once the expenditure has been authorised by the Legislative Assembly. Therefore, it is necessary to make provision either in the Supplementary Estimates or in the Main Budget Estimates for the next year for the amount to be recouped from the Consolidated Fund.

## 5. Accounting

No additional issues to be raised.



## 6. Monitoring and reporting

This chapter discusses some additional development issues in relation to monitoring and financial reporting.

### 6.1 Timely, relevant and reliable monitoring of budget execution

Section 7.2 of the Fiduciary Risk report noted the importance of timely, relevant and reliable monitoring of budget execution. The following are additional points, less closely related to fiduciary risk but nonetheless important for PFM.

#### 6.1.1 Timeliness of monitoring reports

The Fiduciary Risk report recognised that departmental and aggregate monitoring reports were prepared on a monthly basis in line with good practice. However, even the aggregate reports (such as the revenue monitoring statement and the monthly civil accounts) are considered internal monitoring reports and are not currently published in hard copy or on the internet. Publication is not required by law and it would be at the cutting edge of good practice to publish monthly monitoring reports. However, this has been recommended by the Core Group on Voluntary Disclosure Norms and may be a reform that GoAP could consider over the medium term. Pro-active use of monitoring information for within year management of the fiscal position

The Fiduciary Risk report noted that the overall result of the GoAP within-year monitoring is the production of Revised Estimates, which are presented to the Assembly for approval in January/February for the current year. The Revised Estimates represent an updated version of the originally approved estimates, which are revised to reflect changes to spending and revenue patterns which have occurred during the first six to ten months of the year.

While it has not been possible for the SFAA team to assess the extent to which changes in revised estimates reflect savings or enforced cuts, this Development report suggests that there may be some scope for more pro-active use of monitoring information to provide departments with earlier signals of within-year expenditure changes.

Any expenditure reductions made in the Revised Estimates are on the basis of actual financial performance until the date of Revised Estimates and, given that departments have generally underspent in the first nine months of the year, can often be absorbed within existing departmental savings. However, some departments have notified the SFAA team of instances when they have been required to achieve savings late in the financial year. For example, in December 2002 the Irrigation Department was informed of a cut in its state Plan allocation for the current financial year of nearly Rs.250 crore (equivalent to 14%). While these types of examples may be limited, the pro-active use of monitoring information can help to signal the need for some reductions early, thereby enabling departments in the effective management of their budget. This would also support the Finance Department in the management of the overall financial position.

It may also be helpful for within-year management of the fiscal position if the Finance Department was to produce a quarterly report that consolidated revenue and expenditure monitoring information. This would support the Cabinet in understanding the implications of within-year revenue and expenditure trends to its fiscal aggregates, such as the expected deficit for the year and expected debt levels at the end of the year. To be useful, this report would need to make some assessment of the extent to which revenue and expenditure patterns in the year-to-date would be sustained for the year as a whole and, therefore, an estimate of fiscal aggregates for the year as a whole.

## 6.2 Timely, relevant, understandable and comparable financial reporting

Section 7.3 of the Fiduciary Risk report noted the importance of timely, relevant, understandable and comparable financial reporting. The following are additional points, less closely related to fiduciary risk but nonetheless important for PFM.

- The interim accounts - monthly, quarterly, six monthly - are not publicly disclosed, although it is understood that GoAP does plan to start disclosing the six monthly accounts.<sup>14</sup>
- GoAP does not issue accounts with financial information disclosed by department or district. Such reporting would enhance the accountability of Secretaries, HoDs, and district officials.
- The Appropriation Accounts and Finance Accounts are published only in English, not in Telugu. They are not released on the internet. In the case of both sets of Accounts then, they are only likely to be read by those working within the Government, and then only for a specific purpose at a certain time. In both cases, minor cosmetic improvements would improve the user friendliness of the documents.
- Accounts at a Glance is now published in Telugu as well as English, but is not released on the internet.
- Budget in Brief is now published in Telugu as well as English, but is not released on the internet.

## 6.3 Linking financial and performance reporting

This is an additional principle from those included in the Fiduciary Risk report. GoAP has a clear commitment to upgrading its performance through performance management and reporting, as reflected by the performance budgets, administrative reports, performance indicators and GoAP's records of its achievements on its website. However, there does appear still to be a "disconnect" between the reporting of financial results and that of physical achievements. The accounting system and processes are not designed to produce information on GoAP's efficiency and effectiveness, only on its economy. And, the various performance reporting tools do not allow GoAP to demonstrate what has been achieved for a given amount of resources.

Experience worldwide has shown that a clearer link between financial and physical performance results, and accessible reporting on this basis, can bring a step change in accountability, specifically financial accountability.

Once again, AP is not alone in this dilemma as governments worldwide struggle with how to demonstrate what they have achieved for a given amount of money in a certain sector. Even more challenging, but rewarding, would be to demonstrate what has been achieved at a local level, in such a way that citizens could assess the extent to which they have received value for money.

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14 Note that Karnataka and GoI publish their six monthly accounts on the internet.





## 7. Asset management

This chapter discusses some additional development issues in relation to asset management. These are in addition to the fiduciary risk issues raised in the Fiduciary Risk report and should be read in conjunction with it. Some of the sections provide some analysis of GoAP against some additional principles of good practice, while others introduce additional issues to be considered under the principles of good practice that were included in the Fiduciary Risk report.

### 7.1 Clear roles, responsibilities and process

Section 8.1 of the Fiduciary Risk report raised some general issues about the roles, responsibilities and process for asset management, with respect to asset management guidelines. Additional points are as follows.

#### 7.1.1 Competence and training

The controls testing exercise revealed some concerns with regard to officials' professed awareness and understanding of the asset management requirements, for example:

- All of the officials questioned during controls testing claimed that they were unaware of the existence of any formal requirements or guidelines with regard to asset management;<sup>15</sup>
- This notwithstanding, officials were aware of the general requirement to maintain records of assets, and to have these records verified. However, they all professed to be unaware of the specific requirements with regard to the details, such as formats of registers or timing of verification;
- Where key documents, for example as an asset register, had been maintained, some officials admitted that they were only maintained and updated in anticipation of the Accountant General (AG) audit, rather than through a recognition of their benefits as a management tool, or from a sense of accountability for governments resources.

Some training programmes are conducted by GoAP in stores management in subjects such as stores procurement, stores accounting, safe custody, stores verification, stores maintenance, stores disposal and space management, periodicity of procurement and disposal. However, such training is rare and none of the officials questioned during district visits had received any form of training. Specifically, none of the Drawing and Disbursing Officers (DDOs) had received any form of training with regard to their responsibilities and how to comply with the codes and manuals.

#### 7.1.2 Clear accountability established and enforced

The Financial Code seems to attribute responsibility and accountability for the safeguarding and recording of assets to "the head of the office and any other Government servant who is entrusted (with assets)."<sup>16</sup> Within a department or office, the official who would manage the assets in practice would be either the Estate Office or the General Administration (Secretariat) or the Head of the Office.

The results of controls testing, outlined throughout this chapter, indicate that the Heads of Office are not fulfilling their responsibilities, either directly through verification or authentication of assets, or,

15 This claim should be treated with some scepticism as it is inconsistent with the fact that all officials required to pass, after three years, an exam which covers inter alia the AP Financial Code and the AP Accounts Code.

16 AP Financial Code Volume I Chapter VII, Article 133a: "The head of the office and any other Government servant who is entrusted with stores of any kind should take special care in arranging for the safe custody, and maintain suitable stock accounts or inventories with a view of preventing losses through theft, fraud, negligence or accident and to making it possible to check the actual balance with the book balances and expenditure on stores at any time."

more generally, for ensuring adequate asset management. Furthermore, there is no evidence that Heads of Offices are being held accountable for the low standards of asset management within their field of responsibility.

There is, however, a more far reaching issue with regards to responsibility for asset management, being that there is no clearly identified function with GoAP responsible for asset management with regard to:

- Developing, evaluating and revising the asset management legal and policy framework;
- Managing the training of officials in good practice asset management;
- Ensuring that asset management is integrated with or properly represented in other aspects of PFM, for example procurement regulations and practices, financial systems, internal audit, performance management, the accountability framework and disciplinary rules.

Clear responsibility and accountability for asset management within GoAP as a whole is a prerequisite for ensuring compliance with sound asset management at the field level.

## **7.2 Efficient and effective management of assets**

This is an additional principle of good practice to those included in the Fiduciary Risk report. There appear to be minimal provisions to ensure the efficient and effective management of assets.

First, as the CAG regularly reports, there is widespread non/under/mis-utilisation of assets and of stores, often leading to their obsolescence. Specifically, controls testing revealed that there are insufficient arrangements necessary to ensure proper maintenance and optimum utility of equipment and machinery, such as photocopying machines, fax machines, computers, and printers, but also for essential equipment such as refrigeration equipment and generators. For example:

- Machine cards or log books are very rarely, if ever, maintained to provide a record of acquisition date, usage, dates of required service / upgradation / replacement. Controls testing could find no instances of machine cards or log books being maintained;
- Maintenance contracts are not consistently entered into. As a result, breakdowns and repairs are handled by local contractors, who might not have the requisite skills;
- Centralised purchasing tends to mean that records of warranties and contracts with suppliers are not maintained locally, so local officials are unable to insist on repairs within the warranty period.

Secondly, it appears to be generally accepted that assets are not generally well maintained due to lack of funds applied for their upkeep.<sup>17</sup> Departments are required to ascertain the approximate maintenance cost every year for their assets' optimum utilisation and for projection in the budget estimates. However, there are no specific guidelines provided to enable this estimation. Any provision for maintenance tends to be made based on ad hoc "guesstimates" and incremental budgeting rather than on any rationale or formulae. Furthermore, as is often the case, there is an individual and institutional preference for new assets rather than for maintaining existing assets by proper repair and maintenance, and thus for Plan rather than Non-Plan expenditure. The result is that the provision for maintenance costs tends to be inadequate, and, hence, assets are often not properly maintained. The under-provision for maintenance costs is also noted at section 3.3.2.

Thirdly, there is no consistent valuation, or even estimates made, of departmental or State assets.<sup>18</sup> Rational decision making about where to invest, maintain and replace is impeded. This is likely to hinder the Government's ability to make rational decisions about resource allocation, resource management and service delivery. It also impedes accountability for the use of Government assets.

<sup>17</sup> One specific instance which requires mention is the facilities at Bhoopur PHC, in Mahabubnagar. Here, the equipment showed no sign of having been used for months.

<sup>18</sup> The Financial Code Article 136 gives minimal guidance on valuation, and does not require valuation.



## 8. Debt Management

This chapter discusses some additional development issues in relation to debt management. These are in addition to the fiduciary risk issues raised in the Fiduciary Risk report and should be read in conjunction with it. Note that no new principles for debt management have been added in the Development Report.

### 8.1 Pro-active approach to developing a debt policy

The Fiduciary Risk report commended GoAP for its steps towards a more pro-active approach to debt management, by setting out a medium term objective of keeping debt within sustainable levels. However, there are two additional issues that are appropriate to raise in this Development report.

Firstly, the SFAA team notes that, while the fiscal strategy paper talks of a rolling framework, the horizon over which debt objectives are set are not being extended a year in each budget. Given that GoAP started with a five-year horizon (coterminus with the Plan period), debt objectives are still set out to 2006. However, GoAP will need to extend its MTF horizon in the 2004-05 Budget process to maintain at least a three-year horizon.

Secondly, the Fiduciary Risk report did note that there is an issue over whether it would be appropriate for GoAP to entrench fiscal objectives and reporting for debt in legislation. In the Development report we would like to note that if it decided on this route, GoAP needs to consider whether legislation would set specific targets or focus on transparency issues. For example, in some countries such legislation does not enshrine particular debt targets, but simply outlines broad fiscal principles, while imposing requirements on Government to set more specific targets and reporting on progress against these principles and targets.

### 8.2 Pro-active approach to debt management

The Fiduciary Risk report also supports GoAP's intention to strengthen in-house institutional capacity for debt management by establishing a Debt Management Cell in the Finance Department. However, the SFAA team also encourages the Finance Department to consider the extent to which it can invest in building the capacity of this cell to ensure that it is well-equipped to undertake its tasks, either via training or selective recruitment.

A key focus should be on building the capacity of the new Debt Management Cell to monitor and forecast debt. Over the longer-term, an important capacity to develop would be the modelling of the debt implications of current and alternative fiscal positions in the medium to long-term.

### 8.3 Comprehensiveness and transparency in the reporting of debt

As recognised in the Fiduciary Risk report, GoAP has made significant improvements in the transparency of debt policy. There are two minor development points to note:

- It would be helpful to highlight the inclusion of off-budget borrowings into debt figures in the Budget and Accounts (since the Accounts of 2000-01), through a footnote or a memorandum item in the Accounts;
- The increased transparency has enabled greater scrutiny of GoAP's debt management. These gains could be further enhanced by including the Government's debt objectives in the AFF, and updated AFF, with an analysis of the consistency of the current year's budget (see section 3.7.1).

## **9. Contingent liabilities**

No additional issues to be raised.



## 10. Internal controls

This chapter discusses some additional development issues in relation to internal controls. These are in addition to the fiduciary risk issues raised in the Fiduciary Risk report and should be read in conjunction with it. Some of the sections provide some analysis of GoAP against some additional principles of good practice, while others introduce additional issues to be considered under the principles of good practice that were included in the Fiduciary Risk report.

### 10.1 Clear roles and responsibilities for internal controls

Clear roles and responsibilities for internal controls must be laid down, preferably by the Constitution or legislation, requiring a government-wide system of internal control. Clarity is required about who is responsible for developing and promulgating the government-wide framework, for establishing an effective control system in government, and for operating specific internal controls.

However, in India, there are no specific Constitutional or legislative provisions for designing, installing, and operating a system of internal control, and for monitoring compliance with internal controls. The concept of a system of internal control (as opposed to specific internal controls) has been a relatively recent development in PFM required by the increasing complexity of government, and hence has predated the most recent Constitutional amendments.<sup>19</sup>

In the absence of Constitutional or legislative requirements, the government should clearly establish roles and responsibilities for:

- Developing and promulgating the government-wide framework for internal control systems;
- Ensuring that the internal control system is installed, operated and complied throughout government and within each institution;
- Operating specific internal controls within each process and institution.

Each of these tasks is examined in turn.

#### 10.1.1 Developing and promulgating the government-wide framework

Good practice requires that a specific institution should be assigned responsibility for developing and promulgating:

- A government-wide definition of an internal control structure;
- The objectives to be achieved through the enforcement of that structure;
- The internal control standards to be followed when designing the structure.

This institution could be part of the executive, or could be independent, but should have jurisdiction across Government and be assigned specific responsibility by legislation. In many countries, this authority is the Supreme Audit Institution. Indeed, in a report on the effectiveness of internal control systems worldwide, the International Organization of Supreme Audit Institutions (INTOSAI) specifically notes the critical role of the Supreme Audit Institution in this respect, also highlighting the key role of the Supreme Audit Institution in working with internal auditors and evaluating internal controls as an integral part of both their financial and performance audits.<sup>20</sup>

<sup>19</sup> Although some individual governments developed internal control standards in the 1980s, they did not gain popular currency until the development of International Organization of Supreme Audit Institutions (INTOSAI)'s guidelines in 1992. The private sector was somewhat slower in adopting the concept of internal controls. Only in the 1990s did corporate scandals highlight the need for enhanced corporate governance, of which controls are a core component.

<sup>20</sup> INTOSAI: Guidelines for Reporting on the Effectiveness of Internal Controls: SAI Experiences in Implementing and Evaluating Internal Controls (1997).

In AP, however, neither the CAG nor any other named institution has been specifically charged with developing a system of effective control.

In practice, the Finance Department takes on the task of designing effective financial controls through its responsibility for “all matters relative to financial procedure and the application of the principles of sound finance”.<sup>21</sup> Finance Department is seeking to ensure that internal controls feature increasingly in manuals and procedures, and has implemented a number of reforms that seek to enforce stronger controls in high-risk areas. These are detailed in Fiduciary Risk report.

However, these reforms have not been designed within the framework of internal control standards. Good practice **would dictate that these standards should be designed and patterned after, or adopted from, those of INTOSAI.** *Finance Department has started an initiative to develop an internal audit manual, which it is suggested, may also contain internal control standards.*

### 10.1.2 Institutional system of control

Good practice requires that responsibility for each institution’s internal control system must be:

- Clearly and specifically assigned to each level within the bureaucratic hierarchy: including the DDO, subordinate Controlling Officer (CO), and HoD/Chief Controlling Officer (CCO) and, ultimately, the Secretary of the Department;
- Regularly and publicly accepted by the senior official concerned. Increasingly, good practice requires the senior official in an institution to make a formal statement as to his responsibilities for the control system and how he intends to ensure that a system of control is designed, installed, operated and complied with. Clearly, to be able to sign the statement, the senior official would need to take assurance from other officials that a system of control is in place and operating effectively.

Lack of clarity about responsibility for internal control will result in an increased risk of control failures and breaches, and the reduced likelihood that senior officials will be held accountable for these failures and breaches, and their repercussions.

Persuasive evidence was gathered which suggested that HoDs and other managers such as COs are not adequately fulfilling their responsibilities for internal controls, for example by not undertaking management verification. They must display a more positive attitude to controls, and set an example for their staff to follow. Mechanisms are required to strengthen HoDs’ and other managers’ sense of accountability. There are three issues to consider, as follows.

- While GoAP increasingly favours listing the duties of departmental officials, such as the CO at the district level, for example in the Functionary Manuals, internal controls do not yet feature in the implied ambit of their responsibilities. This notwithstanding, all officials questioned during controls testing were able to identify the Head of Office as being responsible for internal controls (albeit applying a narrow definition of internal controls). However, they were not able to point out where this was laid down specifically.
- HoDs and other managers are not required to make a formal statement as to their responsibilities for the control system and how they intend to ensure that a system of control is designed, installed, operated and complied with; nor do they report on the state of the internal control system.
- Managers, and COs in particular, do not receive adequate training to enable them to manage their fiduciary responsibilities, and supervise staff working in these areas.

21 AP Govt Business Rules: Part I, section III B sets out in detail the powers and responsibilities of the Finance Department.



Furthermore, there are no job descriptions in which to set out responsibilities for the operating of controls by all levels of departmental official. Lack of accountability for internal control in line departments will result in an increased risk of control failures and breaches.

In contrast, the Directorate of Treasury and Accounts (DTA) Functionary Manual sets out with clarity and in some detail the responsibilities of Treasury officials for internal controls.

### **10.1.3 Operating specific controls**

With regard to operating specific controls, responsibility should be assigned to specific officials.

In the main, the various codes and manuals do specify who should be operating each control, although this is not set down in a sufficiently clear manner. The weakness in the system is the absence of clear job descriptions, which set out the responsibilities of each official for the key controls. The functionary manuals are starting to fill that gap, but they do not cover the financial responsibilities of departmental officials (see section 2.2).

## **10.2 Common understanding and appreciation of internal controls**

This is an additional developmental principle of good practice, included in addition to the fiduciary risk principles included in the Fiduciary Risk report. Common understanding and appreciation of internal controls, from the most senior levels down to the field level is necessary. Without the commitment this understanding and appreciation engenders, any internal control system will fail to be effective.

Controls testing revealed a generally unsatisfactory understanding of, and attitude to, internal controls amongst official questioned. The general view of internal controls appears to be that they relate only to controls over financial transactions; are about external monitoring and “checks”, and therefore that they are someone else’s (usually the supervising officer’s) responsibility; and only have to be complied with if there is a possibility of your failure to comply being detected. There is a general failure to appreciate the role of internal controls as a valuable management tool.

On being asked how controls could be strengthened, the general response was that there is no time to think about these issues, that they do not have the training to undertake this exercise, and that there is no incentive to strengthen controls. There is a general failure to appreciate the role of internal controls as a valuable management tool.

## 11. External auditing

This chapter discusses some additional development issues in relation to external auditing. These are in addition to the fiduciary risk issues raised in the Fiduciary Risk report and should be read in conjunction with it. Some of the sections provide some analysis of GoAP against some additional principles of good practice, while others introduce additional issues to be considered under the principles of good practice that were included in the Fiduciary Risk report.

### 11.1 Effective audit approach

Section 12.3 of the Fiduciary Risk report addressed core issues of the CAG's audit approach, most directly to the minimisation of fiduciary risk. An additional point relates more to the efficiency of the audit approach.

As noted at section 10.1.1, good practice would expect the CAG to undertake an evaluation of internal audit to determine its effectiveness as a management control.<sup>22</sup> If internal audit was judged to be effective, efforts could be made to rely on the results of internal audit, as part of a risk based approach by the CAG. Liaison can reduce overlap and duplication of audit and allow internal audit to be more focused on controls and systems, and external audit to be more focused on issues of concern to the Assembly.

In AP, audit teams will examine internal audit reports and take cognisance of them, but will not rely on the reports or their evaluation of internal controls to reduce the extent of, or impact the focus, of their audit testing. There is no formal system of liaison between the AG auditors and internal audit.

### 11.2 Timely and accessible audit opinion and reporting

Section 12.7 of the Fiduciary Risk report addressed core issues of the CAG's formal annual reporting. An additional point relates to ad hoc reporting.

The Principal AG is empowered to communicate in writing to the Chief Minister, in the event of an issue of major concern. However, this rarely, if ever, happens. The Principal AG does write periodically to the Chief Secretary and/or the Finance Department. In recent years, subjects covered have included reconciliations between the AG's figures and departmental figures, and the selection of schemes for testing.

Furthermore, there is no hindrance to the CAG reporting on issues of major significance, such as excess expenditure, as soon as the audit is completed in September/October of each year.<sup>23</sup>

Prompt reporting of this kind would increase the profile of the CAG in his reporting to the Assembly, enhance the Assembly's scrutiny and would serve as a deterrent against excess expenditure by GoAP.

22 The Lima Declaration of Guidelines on Auditing Precepts specifically notes that "the Supreme Audit Institution has the task of examining the effectiveness of internal audit." (section 3)

23 The Constitutional Review Committee discussion paper raises the issue about the workload of the CAG as he seeks to approve audit reports on GoI and all the states. Ad hoc and more regular reporting would spread this workload during the year.





## 12. Legislative scrutiny

This chapter discusses some additional development issues in relation to legislative scrutiny. These are in addition to the fiduciary risk issues raised in the Fiduciary Risk report and should be read in conjunction with it. Note that no new principles for legislative scrutiny have been added in the Development Report.

### 12.1 Timely and effective scrutiny

Section 12.3 of the Fiduciary Risk report addressed core issues of the work of the Legislative Assembly. An additional point relates more to how the Assembly could be supported in its important scrutiny function.

In addition to facing some time constraints in its scrutiny role, the Legislative Assembly has only administrative support and has no access to technical assistance, either in general budgetary or specific sector policy issues. MLAs currently receive no training in budget or financial management issues, although they do receive a simple handbook on various concepts, terminologies and provisions relating to budget when a new Legislative Assembly is constituted. This is intended to provide information and increase the understanding of the MLAs.

## 13. Public access to information on public finances

This chapter discusses some additional development issues in relation to public access to information on public finances. Note that no new principles for debt management have been added in the Development Report.

### 13.1 Transparency and public access to information

The Fiduciary Risk report highlights the various measures that GoAP has taken to enhance transparency and public access to financial information. There are four additional development issues to note:

- GoAP is intending to amend the Rights to Information Bill it has drafted in light of the GoI Freedom of Information Act passed in December 2002. GoAP may consider framing regulations in accordance with those of GoI, with appropriate modifications;
- It would enhance public capacity to understand the Government's broad fiscal strategy if the medium term objectives were included in the AFF, and updated AFF, with an explicit discussion of the consistency of the budget indicators with these medium-term objectives (see section 3.7.1);
- GoAP does not announce advance release calendar dates for release of fiscal or financial reports (see section 3.7.4).

### 13.2 Opportunities for public consultation or participation throughout the budget process

The GoAP is committed to creating opportunities for public consultation in budget formulation. The Fiduciary Risk report recognised that GoAP has continued to build on its initial efforts to enable public participation in budget formulation through consultation around the Annual Fiscal Framework. For example, GoAP has made efforts to expand the scope of consultation in the 2003-04 process, through the invitation of a larger number of non-governmental organisations (NGOs) and civil society organisations to the workshops, as it was recognised that the reach of consultation was limited in the initial exercise. However, as an additional development point, this report notes that the participation of these groups was still limited. As GoAP moves towards greater public participation over time, it will need to build a greater understanding of the reasons for low participation by non-government or non-academic groups.



Recommendation	Action points and reference	Institution(s) responsible	Timetable
<b>Strengthen PFM legal framework and access to it</b>	<b>Codification and dissemination of requirements on key areas of PFM:</b> <ul style="list-style-type: none"> <li>● Review and updation of key areas of PFM e.g. (1) cash, receipts, cheques and demand drafts, cash book maintenance (FR 5.6.5) (2) asset management, particularly registers, tagging and efficient usage mechanisms such as machine cards, log books, locally held warranty agreements (FR 8.2, DR 7.2)) (3) update the budget manual to reflect the current and planned budget formulation process (DR 3.1)</li> <li>● Produce short and simple guide to each key area of PFM (with covering GO to lend authority) (FR 3.7.1)</li> <li>● Codify key fiduciary responsibilities of CCOs and COs (FR 3.7.1) and disseminate as short and simple guide, alongwith DDO manual (FR 3.7.2)</li> </ul>	Finance Dept.	Within 1 year
	<b>Increase access of officials to PFM legal framework:</b> <ul style="list-style-type: none"> <li>● Place all PFM texts and guides, and GOs, on the website allowing download (FR 3.5)</li> <li>● Send GOs directly to the District Collector for them to pass down the chain of district officials of all departments (FR 3.4)</li> </ul>	Finance Dept.	Within 1 year
<b>Enhance PFM reform effort</b>	<b>Institutional strengthening of Finance Dept:</b> <ul style="list-style-type: none"> <li>● 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)</li> </ul>	Finance Dept.	Within 1 year
	<ul style="list-style-type: none"> <li>● Undertake training in key areas (FR 3.2)</li> </ul>	Finance Dept.	1 - 2 years
<b>Build capacity of line departments to develop realistic expenditure estimates</b>	<b>Provide greater information and support to departments:</b> <ul style="list-style-type: none"> <li>● 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)</li> </ul>	Finance Dept.	Within 1 year

Recommendation	Action points and reference	Institution(s) responsible	Timetable
	<ul style="list-style-type: none"> <li>Provide line departments with pro-formas for draft Performance Budgets (with Budget Sections acting as point of a contact in Finance Department for departmental queries) (DR 3.1 and DR 3.4)</li> <li>Departments to provide consolidated liability statements to Finance Department with Budget Estimates</li> </ul>	Line Depts.	Within 1 year
	<p><b>First steps towards activity based costing approaches:</b></p> <ul style="list-style-type: none"> <li>Enforce requirement that all departments submit number statements at the beginning of the budget formulation process (DR 3.1)</li> <li>Prioritise 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)</li> </ul>	Finance Dept., Line Depts	Within 1 year
<p><b>Further steps to enhance revenue marksmanship</b></p>	<p><b>Continue to strengthen forecasting of State-Owned Revenue:</b></p> <ul style="list-style-type: none"> <li>Review recommendations of Dr. Sarma on revenue forecasting and develop a plan for implementation as appropriate (FR 4.2.1)</li> </ul>	Finance Dept.	Within 1 year
<p><b>Increase comprehensiveness, accessibility and transparency of budgetary and financial reporting</b></p>	<p><b>Build on recent gains in comprehensiveness:</b></p> <ul style="list-style-type: none"> <li>Include debt liabilities under the Public Account in the debt stock figures in Budget in Brief (FR 4.4.2)</li> <li>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)</li> <li>Once consultancy report on pension liability is received, publish it (or a summary) with outline of Government policy for addressing issue (FR 10.4)</li> <li>Include a summary of major subsidies provided by GoAP in Budget in Brief and Accounts (FR 7.3)</li> </ul>	Finance Dept.  Finance Dept.  Finance Dept.	2004-05 Budget  Within one year  2005-06 Budget onwards



	<p><b>Build on recent gains in accessibility:</b></p> <ul style="list-style-type: none"> <li>● Publish all financial reports in Telugu, particularly Accounts At A Glance, and place on the website (FR 7.3 and FR 14.2)</li> <li>● Announce approximate release dates for the AFF and for the public consultation process at least one month in advance (FR 14.2)</li> <li>● Finalise Right to Information Bill (identify scope for improving on GoI version) and submit to Legislative Assembly (FR 14.2 and DR 13.1)</li> </ul>	AG, Finance Dept.  Cabinet, Legislative Assembly	2004-05 Budget process  Within one year
	<ul style="list-style-type: none"> <li>● 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)</li> </ul> <p><b>Build on recent gains in transparency:</b></p> <ul style="list-style-type: none"> <li>● Simplify classification system by continuing to reduce the classification levels below minor head and standardising the sub-heads (FR 4.5.2.2 and DR 3.7);</li> <li>● Include a narrative with key fiscal indicators and expenditure priorities in Budget in Brief on the internet (FR 14.2);</li> <li>● Publish a quarterly or six monthly expenditure report that reveals key trends in within year revenue and expenditure (DR 6.1)</li> <li>● Show Budget Estimate, Revised Estimate and Actual for previous year in the Annual Fiscal Framework and Budget in Brief summary tables</li> <li>● Maintain consistency in the preparation of summary tables across budget documentation and years (if changes are required, explain these changes)</li> </ul>	Finance Dept.  Finance Dept., CGA	1 to 2 years  1 to 2 years
<b>Strengthen reporting on budget vs. actual expenditure</b>	<p><b>Improved reporting on within-year changes in expenditure:</b></p> <ul style="list-style-type: none"> <li>● Provide summary in Supplementary Estimates of funds recouped for the Contingency Fund (DR 4.2.1)</li> <li>● Provide table in Supplementary Estimates summarising these releases for which ex post authorisation is sought from the Legislative Assembly (DR 4.2.2)</li> </ul>	Finance Dept.	1 to 2 years

	<ul style="list-style-type: none"> <li>● 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)</li> <li>● Publish a list of all re-appropriations with the Appropriation Accounts (FR 5.3.1)</li> <li>● Produce full accounts and balance sheet for the Contingency Fund (DR 4.2.1)</li> <li>● Improve quantity and quality of analysis of reasons for major variances in Appropriation Accounts (based on work undertaken by Internal Audit to strengthen system of reporting)</li> </ul>	AG	1 to 2 years
<b>Enhance pro-active within-year expenditure management</b>	<p><b>Strengthen controls over expenditure relative to budget:</b></p> <ul style="list-style-type: none"> <li>● Clearly define the criteria for “urgent expenditure” for use of the Contingency Fund and for Supplementary Estimates</li> <li>● Ensure more timely regularisation of excess expenditure</li> </ul>	Finance Dept., Treasury, AG, CGA, CAG	1 to 2 years
	<p><b>Strengthen departmental monitoring:</b></p> <ul style="list-style-type: none"> <li>● Strengthen measures to ensure departments submit monthly expenditure statements to CCOs who should ensure suitable and timely follow-up action (FR 7.2.2.1)</li> <li>● Devise GoAP-wide expenditure monitoring report format that provides a stronger basis on which to manage within-year expenditure (FR 7.2.2.2)</li> </ul>	Finance Dept. to devise, line departments to implement Finance Dept to devise, line depts to implement	Within 1 year 1 to 2 years
	<p><b>Strengthen aggregate monitoring:</b></p> <ul style="list-style-type: none"> <li>● 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) 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)</li> </ul>	Finance Dept. and Revenue Depts	1 to 2 years



<b>Strengthen predictability of expenditure allocations and releases</b>	<p><b>Ensure that there are timely releases to COs and DDOs:</b></p> <ul style="list-style-type: none"> <li>Given that Finance Department now provides three-quarter releases to CCOs, CCOs should be required to also provide 1 distribution statement for first three-quarters as early as possible</li> </ul>	Line Depts, Finance Dept.	1 to 2 years
<b>Strengthen accountability of DDOs, COs and CCOs for PFM</b>	<p><b>Implement reporting mechanism, by DDO to CO, on fiduciary performance indicators as agreed but initially including:</b></p> <ul style="list-style-type: none"> <li>Assets within their department (six monthly) (FR 8.5)</li> <li>all bank accounts in the Public Account or outside the Government Account entirely (monthly) (FR 5.6.5.1)</li> <li>cash, maintenance of cash book and reconciliation of cash/cash book (monthly) (FR 5.6.5)</li> <li>Reconciliation with bank (monthly) (FR 5.6.5)</li> <li>reconciliations undertaken with Treasuries (monthly) (FR 6.6.4.1)</li> <li>UCs and recovery of specific purpose grants (monthly) (FR 5.7.1)</li> <li>Responses to audit observations (monthly) (FR12.5)</li> <li>AC/DC bills (monthly) (FR 5.7)</li> <li>Monthly expenditure statements (monthly) (FR 7.2.2.1)</li> </ul>	Finance Dept, Line Depts	Within 1 year
	<p><b>Implement reporting mechanism, by CO to CCO , on fiduciary performance indicators as agreed but initially including:</b></p> <ul style="list-style-type: none"> <li>Assets within their department (six monthly) (FR 8.5);</li> <li>all bank accounts in the Public Account or outside the Government Account entirely (monthly) (FR 5.6.5.1);</li> <li>cash, maintenance of cash book, reconciliation of cash/cash book (monthly) (FR 5.6.5);</li> </ul>	Finance Dept, Line Depts	Within 1 year

	<ul style="list-style-type: none"> <li>● Reconciliation with bank (monthly) (FR 5.6.5); reconciliations undertaken with Treasuries (monthly) (FR 6.6.4.1);</li> <li>● UCs and recovery of specific purpose grants (monthly) (FR 5.7.1);</li> <li>● Responses to audit observations (monthly) (FR12.5);</li> <li>● AC/DC bills (monthly) (FR 5.7);</li> <li>● Monthly expenditure statements (monthly) (FR 7.2.2.1)</li> </ul>		
	<p><b>Implement reporting mechanism, by CCO to concerned Secretary of department, copied to Finance Dept, on fiduciary performance indicators as agreed but initially including:</b></p> <ul style="list-style-type: none"> <li>● Assets within their department (six monthly) - eventually leading to GoAP reporting on assets on annual basis (FR 8.5);</li> <li>● all bank accounts in the Public Account or outside the Government Account entirely (monthly) (FR 5.6.5.1);</li> <li>● cash, maintenance of cash book and reconciliation of cash/cash book (monthly) (FR 5.6.5);</li> <li>● Reconciliation with bank (monthly) (FR 5.6.5);</li> <li>● reconciliations undertaken with AG (monthly) (FR 6.6.4.1);</li> <li>● UCs and recovery of specific purpose grants (monthly) (FR 5.7.1);</li> <li>● Responses to audit observations (monthly) (FR12.5);</li> <li>● AC/DC bills (monthly) (FR 5.7);</li> <li>● Monthly expenditure statements (monthly) (FR 7.2.2.1);</li> <li>● reconciliations between DDOs in twin cities and PAO (Hyderabad) (FR 6.6.4.1);</li> <li>● reconciliations between DDOs in the districts with PAOs (Works and Projects)</li> </ul>	Finance Dept, Line Depts	Within 1 year





	<p><b>Encourage financial accountability of senior officials</b></p> <ul style="list-style-type: none"> <li>● increase involvement of functional Head of Accounts Wing in the production of the final accounts by AG i.e. reconciliation statements (FR 6.2.1)</li> <li>● 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 (FR 6.2.1)</li> <li>● accounts should contain statement by HoDs, which sets out parameters of responsibility and how have fulfilled these (DR 10.1), with specific reference to internal control (FR 11.2)</li> </ul>	Finance Dept., line depts, AG	1 - 2 years
<b>Strengthen Treasury system</b>	<p><b>Standardise and widen Treasury control:</b></p> <ul style="list-style-type: none"> <li>● Implement uniform standard system of processing and payment through bank credit system through Treasuries/PAOs (FR 5.8)</li> <li>● No bank accounts to be maintained other than authorised accounts (FR 5.6.5.1)</li> <li>● Convert all non-banking treasuries into banking treasuries (using whatever banking facilities are available) to avoid cash handling by treasury personnel (FR 5.8.1)</li> <li>● Strengthen controls over schemes not using the Treasury system e.g. DPEP and seek to bring them into Treasury system (FR 5.8.4)</li> <li>● Each DDO to draw only at one Treasury/PAO (FR 5.8)</li> </ul>	Finance Dept and Treasury depts	Within 1 year
	<p><b>Strengthen key accounting controls in Treasury depts.</b></p> <ul style="list-style-type: none"> <li>● Ensure PAOs (Works and Projects) undertake reconciliation of cheques with DTOs (SSTs) and the AG (FR 5.8.3)</li> <li>● Clear the outstanding balance in cash settlement suspense (for inter-departmental transactions) by the PAOs/PWDs (FR 5.8)</li> <li>● Clear backlog of PAO (Hyderabad) cheque reconciliations with bank and devise system to ensure monthly reconciliations henceforth (FR 6.6.4.2)</li> <li>● Clear the arrears in reconciliation of paid cheques by PAO (Works and Projects)/ PWD (FR 6.6.4.2)</li> </ul>	Finance Dept and Treasury depts	Within 1 year

	<p><b>Enhance skills of Treasury officials</b></p> <ul style="list-style-type: none"> <li>• Functional and IT training to be provided to Treasury/PAO staff (FR 3.8)</li> </ul>	Finance Dept and Treasury depts	Within 1 year
<p><b>Increase transparency of the public account and ensure timely accounting of transactions</b></p>	<p><b>Enhance co-operation between Finance Dept and AG:</b></p> <ul style="list-style-type: none"> <li>• Quarterly meetings of Finance Dept and AG to resolve key issues</li> </ul> <p><b>Clear long outstanding balances and seek to minimise build up of large balances in the future:</b></p> <ul style="list-style-type: none"> <li>• Review and clear unreconciled 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)</li> <li>• Analyse 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)</li> <li>• In the case of reconciliations, the focus should be on fully reconciling current balances and work backwards</li> </ul>	<p>Finance Dept., AG</p> <p>Finance Dept., AG</p>	<p>Within 1 year</p> <p>1 - 2 years</p>
	<p><b>Ensure the AG has sufficient information to enable financial reporting</b></p> <ul style="list-style-type: none"> <li>• Ensure AG has sufficient information about institutional loans and advances to enable proper reporting (FR 5.7.3)</li> </ul>	Finance Dept., AG	Within 1 year
	<p><b>Strengthen management of select funds on the public account</b></p> <ul style="list-style-type: none"> <li>• Thorough review of APGLI and AP State Government Employees Group Insurance Scheme to be undertaken (FR 6.7.1)</li> <li>• Thorough clearing of unposted items in APGLI and Class IV employees’ Provident Fund (FR 6.7.1 and 6.7.2)</li> <li>• Reform of management of APGLI and AP State Government Employees Group Insurance Scheme (FR 6.7.1)</li> <li>• Class IV employees’ Provident Fund to be restructured as a single accounting unit with unified control (FR 6.7.2)</li> </ul>	Finance Dept., Director of Insurance	Within 1 year



<b>Pro-active approach to debt policy and management</b>	<b>Provide supporting mechanisms to achievement of debt objectives:</b> <ul style="list-style-type: none"> <li>Ensure that the revenue and expenditure policies to achieve GoAP's medium term debt objectives are well developed and internally consistent (FR 9.2)</li> <li>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)</li> <li>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</li> </ul>	Finance Dept., Cabinet	1 to 2 years
<b>Enhance management of contingent liabilities</b>	<b>Clarify procedures for issuing of guarantees:</b> <ul style="list-style-type: none"> <li>Finance Department to strictly enforce the requirement for adequate scrutiny of guarantee proposals, including an assessment of risk (FR 10.2)</li> </ul>	Finance Dept.	With 1 year
	<b>Continue with policy to estimate and provide for pensions:</b> <ul style="list-style-type: none"> <li>Set up proposed Pension Fund (FR 10.3)</li> <li>Assign responsibility within Dept. of Finance for keeping actuarial projections of future pension costs updated to ensure adequate funding of these future liabilities (FR 10.3)</li> </ul>	Finance Dept.	1 to 2 years
<b>Strengthen internal audit as a mechanism for monitoring and evaluation of internal controls</b>	<b>Develop internal audit expertise in GoAP to guide the long term development of internal audit:</b> <ul style="list-style-type: none"> <li>Establish specialist internal audit cell in Finance Dept (FR 11.4.2)</li> </ul> <b>Establish internal audit function in GoAP:</b> Establish internal audit wing in Finance Dept. with reports copied to HoD (FR 11.4.2). Internal audit wing to undertake audits in departments targeting: <ul style="list-style-type: none"> <li>compliance with key fiduciary controls/Pis (e.g. AC/DC bills, cash, reconciliations, responses to audit observations)</li> <li>departments to provide explanations for any excess expenditure or savings from their revised estimates (FR 5.3.4)</li> </ul>	Finance Dept.  Finance Dept.. line depts	Within 1 year  Within 1 year

	<ul style="list-style-type: none"> <li>• a higher standard of explanations for both savings and excess expenditure by departments in the Appropriation Accounts (FR 5.2)</li> <li>• departmental explanations for actual expenditure relative to budget (as well as total appropriations, which includes Supplementary Estimates) in Appropriation Accounts (FR 5.3.4)</li> <li>• reasons for significant divergences between revised estimates and actual expenditure (FR 5.3.4)</li> <li>• proper monitoring and timely surrender of unutilised amounts that are expected not to be used by end of year</li> </ul>		
	<p><b>Enforce responsiveness to internal audit observations</b></p> <ul style="list-style-type: none"> <li>• Finance Dept to set down timeframe required for response to internal audit observations and link non-response to non-release of payments (per GO 507) (FR 11.4.2)</li> </ul>	Finance Dept	Within 1 year
<p><b>Increase effectiveness of AG (Audit) and PAC scrutiny</b></p>	<p><b>Increase timeliness/quality of responses to AG audit observations</b></p> <ul style="list-style-type: none"> <li>• Re-activate State level audit committees in pilot departments. Audit committees to meet frequently to resolve Inspection Report and audit paras issues to avoid their escalating and becoming audit paras in the Audit Reports</li> </ul>	FD, AG (Audit Wing)	Within 1 year
	<p><b>Build on expected increases in timeliness of PAC scrutiny</b></p> <ul style="list-style-type: none"> <li>• PAC may consider establishing sub-committees, possibly specialising in key sectors to undertake the speedy clearing of outstanding audit paras (FR 13.3.2.1)</li> </ul>	Recommendation by FD to Legislative Secretariat and GAD	Within 1 year
	<p><b>Ensure excess expenditure examined and regularised</b></p> <ul style="list-style-type: none"> <li>• PAC to focus its immediate attention on the numerous cases of excess and unregularised expenditure in recent years, seeking explanation for the excesses, recommending regularisation where appropriate, and taking appropriate action in other cases (FR 13.3.2.1)</li> </ul>	Recommendation by FD to Legislative Secretariat and GAD	Within 1 year



Recommendation	Action points and reference	Institution(s) responsible	Timetable
<b>Develop comprehensive PFM legal framework</b>	<ul style="list-style-type: none"> <li>● Provide legislative cover for accountability framework, key principles underpinning PFM (FR 3.4)</li> <li>● Public finance legislation (or revision of existing Codes and Rules) should specifically include requirement for GoAP-wide system of internal control, and assign specific roles and responsibility for developing internal control standards on which system should be based (DR 10.1)</li> <li>● Review and selective revision of all Codes and Manuals on an ongoing basis (FR 3.4)</li> </ul>	Finance Dept.	2 - 5 years
<b>Upgrade departmental PFM expertise</b>	<ul style="list-style-type: none"> <li>● Seek flexibility in pay and conditions to attract/retain professional finance staff (FR 3.8)</li> <li>● Review and reform provisions for training, both to finance function staff and to DDOs, COs, CCOs and other key officials (FR 3.8)</li> </ul>	Finance Dept., GAD and HRD Institute	6 months to 2 years
<b>Build capacity of line departments to develop realistic expenditure estimates</b>	<p><b>Provide greater information and support to departments:</b></p> <ul style="list-style-type: none"> <li>● Develop a plan to build the capacity of district offices to participate in budget formulation (FR 4.3.2)</li> <li>● Develop consultation guidelines to support Depts and District Collectors in the consultation exercise around performance budgets and the AFF</li> </ul>	Finance Dept. in consultation with key line departments	2 to 5 years
	<p><b>First steps towards activity based costing approaches:</b></p> <ul style="list-style-type: none"> <li>● 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)</li> <li>● As policy of recruitment control generates savings on salary costs, use these resources to provide more adequate funding for non-salary O&amp;M expenditure (FR 4.2.2)</li> <li>● Develop training programme to build the capacity of departments to develop MTEFs and undertake activity-based costing (FR 4.3.1)</li> </ul>	Finance Dept., Line Depts	2 to 5 years

	<ul style="list-style-type: none"> <li>• Develop MTEFs for all line departments that define and cost both non-plan and plan activities (FR 4.3.1)</li> <li>• Integrate the MTFE and MTEF processes as a framework for developing multi-year departmental baselines (i.e. moving to medium term budgeting) (DR 3.4)</li> <li>• Adopt a rolling term MTFE rather than being co-terminus with the plan period, so that the MTFE will always cover 5 years (DR 3.2)</li> </ul>	Finance Dept., Line Depts	2 to 5 years (or possibly even longer-term)
<b>Further steps to enhance revenue marksmanship</b>	<p><b>Continue to strengthen forecasting of State-Owned Revenue:</b></p> <ul style="list-style-type: none"> <li>• 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)</li> </ul>	Finance Dept., Revenue Depts	2 to 5 years
<b>Enhance political engagement in budget process</b>	<p><b>Provide technical support to Cabinet Budget Committee:</b></p> <ul style="list-style-type: none"> <li>• 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)</li> <li>• If above recommendation accepted, Official Committee to hold meetings with each department and provide accompanying recommendations with each budget submission to Budget Committee (DR 3.2)</li> <li>• Undertake a review of recent reforms to increase political engagement in budget process to identify opportunities to build on gains made (DR 3.2)</li> </ul>	Finance Dept.	2 to 5 years
<b>Increase comprehensiveness, accessibility and transparency of budgetary and financial reporting</b>	<p><b>Build on recent gains in comprehensiveness:</b></p> <ul style="list-style-type: none"> <li>• Include a statement of GoAP equity in PSUs in the Budget and the Budget in Brief (DR 3.7)</li> <li>• Include details of the amounts devolved to districts and local bodies in the Annual Financial Statement</li> <li>• Disclose details of gross transactions of the Contingency Fund (FR 11.3)</li> <li>• Disclosure of * loans and advances by institution (FR 11.3)</li> <li>• Disclosure of cash flow in more useful cash flow statement form (FR 11.3)</li> </ul>	Finance Dept. (and AG for the Accounts)	2 to 5 years









<p><b>Enhance the accuracy of the accounts</b></p>	<ul style="list-style-type: none"> <li>● AG to ensure that supporting documentation for variations of budget are verified (FR 6.6.4.1)</li> <li>● AG to submit RBI Deposits discrepancy statement with accounts to Finance Dept. (FR 6.6.4.2)</li> <li>● Work towards implementing double entry system of accounting (FR 6.6.3)</li> </ul>	<p>AG</p> <p>Finance Dept.</p>	<p>Within 1 year</p> <p>2 - 5 years</p>
<p><b>Strengthen asset management</b></p>	<p><b>Increase accountability for asset management</b></p> <ul style="list-style-type: none"> <li>● Assign named individual in each district office to be responsible for providing training, ongoing guidance, 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)</li> </ul> <p><b>Increase knowledge of, and control over, government assets</b></p> <ul style="list-style-type: none"> <li>● Undertake a GoAP-wide stocktake of government owned and held assets, in order to facilitate proper recording, monitoring, security and control of these assets (FR 8.3)</li> <li>● 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)</li> <li>● Develop asset management computerised 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 computerised inventory systems (FR 8.3)</li> </ul> <p><b>Improve efficient and effective management of assets</b></p> <ul style="list-style-type: none"> <li>● Introduce system of asset valuation (DR 7.2)</li> </ul>	<p>Finance Dept.</p> <p>Finance Dept.</p>	<p>2 to 5 years</p> <p>5 - 7 years</p>

<p>Enhance management of contingent liabilities</p>	<p><b>Clarify procedures for issuing of guarantees:</b></p> <ul style="list-style-type: none"> <li>● Consider the relevance of a statutory limit on guarantees (FR 10.2)</li> <li>● Establish an annual procedure to assess the mix of guarantees and the continued relevance of the flat guarantee fee policy (FR 10.2)</li> </ul>	<p>Finance Dept.</p>	<p>2 to 5 years</p>
<p><b>Pro-active approach to debt policy and management</b></p>	<p><b>Provide supporting mechanisms to achievement of debt objectives:</b></p> <ul style="list-style-type: none"> <li>● Continue to petition GoI to transfer funding for CSSs direct to state governments, rather than requiring GoAP to take loan from GoI in order to get the grant funding (FR 9.2)</li> <li>● 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)</li> </ul>	<p>Finance Dept., Legislative Assembly, Estimates Committee</p>	<p>2 to 5 years</p>
	<p><b>Build debt policy and management capacity:</b></p> <ul style="list-style-type: none"> <li>● Develop modelling skills of Debt Management Unit to model alternative fiscal scenarios and assess their consistency with medium term objectives (FR 9.4)</li> </ul>	<p>Finance Dept.</p>	<p>2 to 5 years</p>
<p><b>Strengthen system of internal controls</b></p>	<p><b>Enhance accountability for internal controls</b></p> <ul style="list-style-type: none"> <li>● GoAP should assign specific roles and responsibility for (1) Developing and promulgating the government-wide framework to Finance Dept. with assistance of CAG (2) Ensuring that the internal control system installed, operated and complied throughout government and within each institution to Finance Dept. and Secretaries/HoDs (3) specific controls in all Codes and Manuals</li> </ul> <p><b>Increase understanding and appreciation for internal controls</b></p> <ul style="list-style-type: none"> <li>● Establish formal system of risk and self assessments throughout GoAP (FR 11.4.1)</li> <li>● Increase training of officials in internal controls (DR 10.2)</li> </ul> <p><b>Strengthen records management</b></p> <ul style="list-style-type: none"> <li>● Issue policies regarding maintenance, backup, movement of data, hardware and software and implement in each department (FR 11.3.1)</li> <li>● Ensure backup and Disaster Recovery Plan (DRP)/arrangements for alternative activity continuity made in each IT site (FR 11.3.1)</li> </ul>	<p>Finance Dept.</p>	<p>1 - 2 years</p>



<p><b>Strengthen internal audit as a mechanism for monitoring and evaluation of internal controls</b></p>	<p><b>Create government-wide internal audit functions</b></p> <ul style="list-style-type: none"> <li>● Build on success of Finance Dept internal audit to set up internal audit functions throughout key departments, reporting to HoD (FR 11.4.2)</li> <li>● Create exclusive internal audit cadres with individuals of previous record of proven honesty and integrity and impeccable record (FR 11.4.2)</li> </ul>	<p>Finance dept., line depts</p>	<p>5 - 7 years</p>
<p><b>Increase effectiveness of CAG and PAC scrutiny</b></p>	<p><b>Enhance audit approach</b></p> <ul style="list-style-type: none"> <li>● Petition CAG to include physical verification of assets as a core part of audit methodology (FR 12.3.2)</li> <li>● Petition CAG to 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)</li> <li>● Petition CAG to adopt risk-based audit methodologies and undertake more special risk based audits (FR 12.3.2)</li> <li>● Petition CAG to integrate the evaluation of, and liaison with, internal audit into its audit methodology and regular practice (DR 11.1)</li> <li>● Petition CAG to contract in 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)</li> </ul>	<p>Finance Dept. to petition CAG</p>	<p>Within 1 year</p>
	<p><b>Enhance responsiveness to audit observations</b></p> <ul style="list-style-type: none"> <li>● GoAP to issue deadlines for responsiveness to audit observations (FR 12.5)</li> <li>● Petition CAG to complement audit observations with more positive and constructive comments/recommendations as to how to strengthen systems and procedures (FR 12.5)</li> </ul>	<p>Finance Dept, CAG</p>	<p>Within 1 year</p>
	<p><b>Increase accessibility of audit opinion and reporting</b></p> <ul style="list-style-type: none"> <li>● 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)</li> </ul>	<p>Finance Dept. to petition CAG</p>	<p>6 months to 2 years</p>

	<ul style="list-style-type: none"> <li>● Petition CAG to issue department-wise audit opinions once department-wise accounts issued (FR 12.7.2)</li> <li>● Petition CAG to 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)</li> </ul>		
	<p><b>Enhance Assembly monitoring of budget estimates and budget execution</b></p> <ul style="list-style-type: none"> <li>● Expand role of Estimates Committee to scrutinise estimates or establish standing committees for key sectors (FR 13.2)</li> <li>● Expand role of Estimates Committee in scrutiny of budget execution (FR 13.2)</li> </ul>	Recommendation by FD to Legislative Secretariat and GAD	6 months to 2 years
	<p><b>Build on expected increases in timeliness of PAC scrutiny</b></p> <ul style="list-style-type: none"> <li>● PAC to issue an annual plan stating: planned timetable, paras to be covered, issues to be prioritised, recommendations to be enforced. This plan should be made widely available and released to the media in summary form (FR 13.3.2.1)</li> <li>● PAC to issue an annual report reporting on: its performance against plan, main achievements. Again, this report should be made widely available and released to the media in summary form FR 13.3.2.1)</li> </ul> <p><b>Strengthen support to Assembly and Committees</b></p> <ul style="list-style-type: none"> <li>● PFM and technical/sector policy support for Assembly and Committees (DR 12.1)</li> <li>● Training for MLAs in PFM issues (DR 12.1)</li> <li>● Life of the Committees to be made 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)</li> </ul>	Recommendation by FD to Legislative Secretariat and GAD	6 months to 2 years
	<p><b>Strengthen support to Assembly and Committees</b></p> <ul style="list-style-type: none"> <li>● PFM and technical/sector policy support for Assembly and Committees (DR 12.1)</li> <li>● Training for MLAs in PFM issues (DR 12.1)</li> <li>● Life of the Committees to be made 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)</li> </ul>	Recommendation by FD to Legislative Secretariat and GAD	Within 1 year
<b>Enhance accessibility of Legislative Assembly</b>	Sittings of the Legislative Assembly to be broadcast on the radio/Television (FR 13.4)	Recommendation by FD to Legislative Secretariat and GAD	Within 1 year

