



An Institute for Civil Services

IAS MAINS

**GIST OF**  
**2**  
**ARC**  
**REPORT**

**STRENGTHENING FINANCIAL  
MANAGEMENT SYSTEM**

📍 Office No. 6, 1<sup>st</sup> Floor, Apsara Arcade, Karol Bagh, New Delhi-110005  
(Karol Bagh Metro Station Gate No. 5)

☎ 011 - 47058253, 8448496262    ✉ info@iasscore.in    🌐 /iasscore

[www.iasscore.in](http://www.iasscore.in)



# GS SCORE

An Institute for Civil Services

## Target PT 2019

Complete Revision *through*  
4000<sup>+</sup> MCQs

**60 DAYS**

Classroom & Online  
Programme

45 Days Concept cum Revision  
Classes with Daily Test

15 Days Prelims Current Affairs  
Classes + Tests

Special Classes on Economic  
Survey & Budget

Special Classes on India Year  
Book & Mapping

Prelims  
Mock Test Series

Prelims  
Study Material

  
**Batch-2  
Starts**

**11 February, 2019**

Test Timings: 1:30 PM to 2:30 PM  
Class Timings: 2:30 PM onwards

**Fee** ₹ 17,000/- (+GST)

Off. No. 6, 1<sup>st</sup> Floor, Apsara Arcade, Karol Bagh, New Delhi-110005 (Karol Bagh Metro Gate No. 5)

 011 47058253  9953595114, 9873870114  info@iasscore.in  /iasscore



[www.iasscore.in](http://www.iasscore.in)

**STRENGTHENING FINANCIAL  
MANAGEMENT SYSTEM***Index*

1. Public Finance Management - Concepts and Core Principles
2. Evolution of Budgeting
3. Weaknesses in the Budgetary Process
4. Core Principles of Reforms
5. Overview of the Existing Financial Management System in India
6. Budgetary Process
7. Appropriation Act
8. Form of Accounts
9. Preparation of Accounts
10. Audit
11. Internal Audit
12. Flow of Funds Related to Union Government Programmes
13. Analysis of the Budgetary Process
14. Weaknesses in the Budgetary System and Implementation
15. How to overcome these weaknesses
16. Outcome Budget
17. Irrational 'Plan - Non-Plan' Distinction Leads to Inefficiency in Resource Utilization
18. Flow of Funds from the Union to the States - Centrally Sponsored Schemes
19. Absence of a System for Managing the Flow of Financial Information
20. Development of Financial Information System
21. Capacity Building
22. Internal control and audit
23. External audit and parliamentary control
24. Financial Management in State Governments

# **STRENGTHENING FINANCIAL MANAGEMENT SYSTEM**

## **Public Finance Management - Concepts and Core Principles**

Public Finance Management (PFM) basically deals with all aspects of resource mobilization and expenditure management in government. Just as managing finances is a critical function of management in any organization, similarly public finance management is an essential part of the governance process. Public finance management includes resource mobilization, prioritization of programmes, the budgetary process, efficient management of resources and exercising controls. Rising aspirations of people are placing more demands on financial resources. At the same time, the emphasis of the citizenry is on value for money, thus making public finance management increasingly vital.

For a long time, financial management in developing countries was viewed as a process that enabled central agencies like the Ministry/Department of Finance to keep “spending agencies under control through continuous review and specification of inputs and verification of documents, submitted for payment. As an extension of this approach, financial management was viewed as being restricted to budget implementation, administration of payment systems, accounting and reporting in the states of funds received and spent. This approach with a long lineage continues to be prevalent even now, through a declining scale”.

Reforms in financial management have concentrated on taxation reforms, the use of government budget as a vehicle for economic development, through improved budget classification system, accounting system reforms etc. Cost-benefit analysis techniques were also applied. From the 1970s, the need for containment of fiscal deficits through tightened fiscal management, pre-occupied the economists. In the 1980s, the management approach came to be prevalent which included a corporate type of financial management within an overall framework of accountability. The overall assessment is that the system of financial management in developing countries has generally been slow in adapting itself to changing requirements. Basically, there has been a segmented approach to reforms.

Public Finance Management also includes taxation and other resource mobilization, debt and cash management, budgetary process, accounting systems, information systems and internal and external audit. Thus, reforming the public finance system would entail several measures:

- Improving the collection of revenue is critical. No country can be run properly without revenue. Moreover, tax can help to establish a government’s authority. Tax policy itself is increasingly limited by external forces: in a globalised world, governments’ choices are less about the tax rate than about the efficiency with which tax is collected and the reach of the tax net. Thus, the revenue services must be properly resourced and motivated to collect tax more efficiently.
- Debt and cash must be managed efficiently. In particular, sound principles for deficit funding should be established, efficiencies sought and proper risk management procedures introduced. Proper management of the government’s borrowing program will reduce the cost of funding.
- Effective planning and allocation of resources is key and government should develop and institutionalise planning processes at all levels of government. The budgeting process must be transparent and inclusive. There should be focus on outputs rather than on mere expenditure and related inputs, with strong accounting and reporting procedures. The office of the accountant-general must be properly resourced and funded to fulfil this function.

- Effective oversight and monitoring are crucial to sound governance and PFM reform. A well-functioning PFM system must have clear rules on transparency and reporting, as well as enforceable sanctions for failure. Oversight should be established by internal mechanisms in the national treasury as well as external oversight by bodies like independent parliamentary committees, a public ombudsman, a free media and civil society, and an independent auditor-general.

## Evolution of Budgeting

### A. The line item Budget

The line item budget is defined as “the budget in which the individual financial statement items are grouped by cost centers or departments. It shows the comparison between the financial data for the past accounting or budgeting periods and estimated figures for the current or a future period”.

In a line-item system, expenditures for the budgeted period are listed according to objects of expenditure, or “line-items.” These line items include detailed ceilings on the amount a unit would spend on salaries, travelling allowances, office expenses, etc. The focus is on ensuring that the agencies or units do not exceed the ceilings prescribed. A central authority or the Ministry of Finance keeps a watch on the spending of various units to ensure that the ceilings are not violated.

The line item budget approach is easy to understand and implement. It also facilitates centralized control and fixing of authority and responsibility of the spending units. Its major disadvantage is that it does not provide enough information to the top levels about the activities and achievements of individual units.

### B. Performance Budgeting

Unlike the traditional line item budget, a performance budget reflects the goal/objectives of the organization and spells out performance targets. These targets are sought to be achieved through a strategy(s). unit costs are associated with the strategy and allocations are accordingly made for achievement of the objectives. A Performance Budget gives an indication of how the funds spent are expected to give outputs and ultimately the outcomes. However, performance budgeting has a limitation - it is not easy to arrive at standard unit costs especially in social programmes which require a multi-pronged approach.

### C. Zero-based Budgeting (ZBB)

The concept of zero-based budgeting was introduced in the 1970s. As the name suggests, every budgeting cycle starts from scratch. Unlike the earlier systems where only incremental changes were made in the allocation, under zero-based budgeting every activity is evaluated each time a budget is made and only if it is established that the activity is necessary, are funds allocated to it. The basic purpose of ZBB is phasing out of programmes/activities which do not have relevance anymore. However, because of the efforts involved in preparing a zero-based budget and institutional resistance related to personnel issues, no government ever implemented a full zero-based budget, but in modified forms the basic principles of ZBB are often used.

### D. Programme Budgeting and Performance Budgeting

Programme budgeting aimed at a system in which expenditure would be planned and controlled by the objective. The basic building block of the system was classification of expenditure into programmes, which meant objective-oriented classification so that programmes with common objectives are considered together.

PPBS went much beyond the core elements of programme budgeting and was much more than the budgeting system. It aimed at an integrated expenditure management system, in which systematic policy and expenditure planning would be developed and closely integrated with the budget. Thus, it was too ambitious in scope.

## Weaknesses in the Budgetary Process

The World Bank after analyzing the budgetary processes of several countries came to the conclusion that government budgets generally have the following shortcomings:

Weaknesses that undermine public sector performance include:

- Poor planning;
- No links between policy making, planning and budgeting;
- Poor expenditure control;
- Inadequate funding of operations and maintenance;
- Little relationship between budget as formulated and budget as executed;
- Inadequate accounting systems;
- Unreliability in the flow of budgeted funds to agencies and to lower levels of government;
- Poor management of external aid;
- Poor cash management;
- Inadequate reporting of financial performance; and
- Poorly motivated staff.”

Many of the weaknesses in budgeting reflect the failure to address linkages between the various functions of budgeting. The following factors contribute to budget systems and processes that create a disabling environment for performance in the public sector, both by commission and by omission:

- Almost exclusive focus on inputs, with performance judged largely in terms of spending no more, or less, than appropriated in the budget;
- Input focus takes a short-term approach to budget decision making; failure to adequately take account of longer-term costs (potential and real), and biases in the choice of policy instruments (e.g., between capital and current spending and between spending, doing, and regulation) because of the short-term horizon;
- A bottom-up approach to budgeting that means that even if the ultimate stance of fiscal policy was appropriate (and increasingly after 1973 it was not) game playing by bids into the appropriate fiscal policy box;
- A tendency to budget in real terms, leading either to pressure on aggregate spending where inflation is significant (which was often validated through supplementary appropriations) or arbitrary cuts during budget execution with adverse consequences at the agency level;
- Cabinet decision making focused on distributing the gains from fiscal drag across new spending proposals;
- Cabinet and/or central agencies extensively involved in micro-decision making on all aspects of funding for ongoing policy;
- Last minute, across-the-board cuts, including during budget execution;
- Weak decision making and last-minute cuts cause unpredictability of funding for existing government policy; this is highlighted to the centre by central budget agencies on the alert to identify and rake back “fortuitous savings;”

- Strong incentives to spend everything in the budget early in the year and as quickly as possible, since the current year's spending is the starting point for the annual budget haggles and the fear of across-the-board cuts during execution;
- Existing policy itself (as opposed to its funding) subject to very little scrutiny from one year to the next. (This and previous point epitomize the worst dimension of incremental budgeting);
- Poor linkages between policy and resources at the centre, between the center and line agencies, and within line agencies because of incremental budgeting;
- A lack of clarity as to purpose and task and therefore poor information on the performance of policies, programmes and services, and their cost because of poor linkages;
- The linking together (in association with the point above) within government departments of policy advising, regulation, service delivery and funding and an aversion to user charging; and
- Overall, few incentives to improve the performance of resources provided.

The common elements of the budgetary reforms in OECD member countries are:

**a) “Medium-term budget frameworks:**

Medium-term budget frameworks form the basis for achieving fiscal consolidation. They need to clearly state the government's medium term fiscal objectives in terms of high-level targets such as the level of aggregate revenue, expenditure, deficit/surplus, and debt. They then need to operationalise these high-level targets by establishing hard budget constraints for individual ministries and programmes over a number of years. This lends stability and credibility to the government's fiscal objectives.

By their very nature, high-level fiscal targets are set in a medium-term context. They aim to achieve a certain fiscal outcome over a number of years. Budgets are however enacted for a time period of one year, and are notorious for their short-term focus. This short-term time horizon is often criticised for impeding effective expenditure management; decisions on resource allocation are said to be made on an ad hoc or piecemeal basis with the implications of past and present decisions beyond the next year being neglected. This is not

a new criticism. Medium-term budget frameworks aim to bridge this gap. Their successful implementation has been nothing short of a “cultural revolution” in governments.

**b) Prudent economic assumptions**

Deviations from the forecast of the key economic assumption underlying the budget are the government's key fiscal risk. There is no single factor more responsible for “derailing” fiscal consolidation programmes than the use of incorrect economic assumptions.

Great care must be taken in making them and all key economic assumptions should be disclosed explicitly. Sensitivity analysis should be made of what impact changes in the key economic assumptions would have on the budget. Furthermore, a comparison should be made between the economic assumptions used in the budget and what private sector forecasters are applying for the same time period where practicable. The establishment of an independent body to recommend the economic assumptions to be used in the budget may be considered as well. All this serves to place safeguards against the use of unrealistic, or “optimistic,” economic assumptions.

**c) Top-down budgeting techniques**

Budgeting has traditionally operated on a bottom-up principle. This means that all agencies and all ministries send requests for funding to the finance ministry. These requests greatly exceed what they realistically believe they will get. Budgeting then consists of the Finance Ministry negotiating with these ministries and agencies until some common point is found.

This bottom-up system has several disadvantages to it. First, it is very time consuming and it is essentially a game; all participants know that the initial requests are not realistic.

Second, this process has an inherent bias for increasing expenditures; all new programmes, or expansion of existing programs, are financed by new requests; there was no system for reallocation within spending ministries and there were no pre-set spending limits.

Third, it was difficult to reflect political priorities in this system as it was a bottom-up exercise with the budget “emerging” at the end of this process. This manner of budgeting is now being abandoned and replaced with a new top-down approach to budget formulation.

This has been of great assistance in achieving fiscal consolidation. The key point is that each ministry has a pre-set limit on how much it can spend.

Once this decision is taken, the Finance Ministry largely withdraws from the details of budgetary allocations for each ministry. The Finance Ministry concerns itself only with the level of aggregate expenditure for each ministry; not the internal allocations.

#### **d) Relaxing central input controls**

Relaxing central input controls is another feature of successful fiscal consolidation strategies in Member-countries. This is based on the simple premise that the heads of individual agencies are in the best position to choose the most efficient mix of inputs to carry out the agency’s activities. The end-result is that an agency can produce the same services at less cost, or more services at the same cost. This greatly facilitates fiscal consolidation strategies by mitigating their effects on services.

Relaxing central input controls operates at three levels. First, the consolidation of various budget lines into a single appropriation for all operating costs (salaries, travel, supplies, etc.). Second, the decentralisation of the personnel management function. Third, the decentralisation of other common service provisions, notably accommodations (buildings). The can be seen as the public sector’s version of “deregulation.”

#### **e) An increased focus on results**

An increased focus on results is a direct quid pro quo for relaxing input controls as described above. Accountability in the public sector has traditionally been based on compliance with rules and procedures. It didn’t matter what you did as long as you observed the rules. Now, when the public sector is deregulated, a new results-based system is needed to hold managers accountable. This is a fundamental change: holding managers accountable for what they do, not how they do it. Effectively implementing this is, however, very difficult in practice.

#### **f) Budget transparency**

The most effective manner for achieving that was simply to throw open the books and say to the public: “Look, things are really as bad as we told you, we’re not hiding anything.” This may sound a bit sinister at first, but in actuality it is government at its best: Being honest with citizens, explaining the problem to them in order for an understanding to emerge as to the best course of action to take.

This time period also coincided with increased attention being paid to good governance in general. The budget is the principal policy document of government, where the government’s policy objectives are reconciled and implemented in concrete terms. Budget transparency – openness about policy intentions, formulation and implementation – is therefore at the core of good governance agenda.

If we take a look at fiscal transparency in concrete terms, we can say that it has three essential elements:

- The first is the release of budget data. The systematic and timely release of all relevant fiscal information is what we typically associate with budget transparency. It is an absolute pre-requisite, but it is not enough.

- The second element is an effective role for the legislature. It must be able to scrutinise the budget reports and independently review them. It must be able to debate and influence budget policy and be in a position to effectively hold the government to account. This is both in terms of the constitutional role of the legislature and the level of resources that the legislature has at its disposal.
- The third element is an effective role for civil society, through the media and nongovernmental organisations. Citizens, directly or through these vehicles, must be in a position to influence budget policy and must be in a position to hold the government to account. In many ways, it is a similar role to that of the legislature albeit only indirectly.

These three elements work together. The scrutiny of fiscal information by the legislature and by civil society can only take place if the information is released in the first place. Similarly, released budget information is only of value if it is effectively scrutinised by the legislature and by civil society. The legislature and civil society have a very similar function, one is responsible for shaping budget policy and for holding government directly to account while the other performs this role indirectly.

## Core Principles of Reforms

These core principles are described below:

- Reforms in Financial Management System are part of overall governance reforms:** Governance reforms to bring about improved transparency, greater accountability, streamlining the structure of the Government, elimination of corruption, and fiscal and environment sustainability have to be backed by reforms in the financial management system in order to deliver the desired results. At the same time, it needs to be understood that reforms in the management system are not an end in itself but a means to achieving good governance.
- Sound financial management is the responsibility of all government departments/ agencies:** Maintaining financial prudence, discipline and accountability, while achieving organizational goals is the responsibility of all government agencies/ organizations and not only of the Finance wing/Finance Ministry.
- Medium-term plan/budget frameworks and aligning plan budgets and accounts:** Medium-term plan/ budget frameworks attempt to bridge the gap between the short-term time horizon of annual budgets with the medium-term objectives of the schemes and programmes of government. Even when there are medium term frameworks like five-year development plans, there is need for aligning the annual budgets explicitly with the plans and with the accounting mechanisms so that there is a clear 'line of sight' between the medium term developmental plan and the annual budget exercise.
- Prudent economic assumptions:** The economic assumptions that underline the budget have to be prudent and accurate in order to ensure that the budgetary estimates do not go haywire. The tendency to be overly optimistic has to be avoided.
- Top-down budgeting techniques:** There is need to shift from the traditional bottom up approach to budgeting to a top-down framework where the desired outcomes should point to the resources required which should be allocated thereafter at the macro level sector-wise. This in turn would lead to focus on outputs and outcomes rather than on inputs and processes.
- Transparency and simplicity:** The budget documents should be simple and easy to comprehend and be available in the public domain. Also the procedures involved in operating the budget and release of funds should be simple. Suitable financial management information systems need to be developed in order to ensure that all transactions are captured and ultimately made available for public scrutiny.
- Relaxing central input controls:** Government agencies need to be given greater operational autonomy and flexibility by consolidating budget items and decentralization of administrative and financial powers.

- viii. Focus on results:** Accountability in government needs to shift from compliance with rules and procedures to achievement of results. This is all the more necessary with relaxed central input controls. There should be emphasis on 'value for money'.
- ix. Adopting modern financial management practices:** Modern financial management tools like accrual accounting, information technology, financial information systems etc. need to be used to improve decision making and accountability. However, care needs to be exercised to ensure that a congenial environment is created and adequate capacity is developed before adopting new practices.
- x. Budgeting to be realistic:** Unless the projections made in the budget are reasonably accurate, the budgetary exercise loses credibility.

## Overview of the Existing Financial Management System in India

The basic framework of the financial management system in India is provided in the Constitution.

The Constitution of India provides that in respect of every financial year, a statement of the estimated receipts and expenditure of the Government of India or the Government of any State for that year, is to be laid down before both the Houses of Parliament/ State Legislature. This is referred to as the "annual financial statement" of the concerned Government (Articles 112 & 202). As per Article 112, this statement should show, inter alia, the following:

- "112. (2) The estimates of expenditure embodied in the annual financial statement shall show separately-*
- (a) the sums required to meet expenditure described by this Constitution as expenditure charged upon the Consolidated Fund of India; and*
  - (b) the sums required to meet other expenditure proposed to be made from the Consolidated Fund of India, and shall distinguish expenditure on revenue account from other expenditure.*

Article 202 contains similar provisions with regard to annual financial statement of a State Government.

To meet such expenditure, appropriations have to be made out of the Consolidated Fund of India (or of the respective States). The appropriations are required to be made in the manner provided in the Constitution. The procedure in these matters in relation to the Parliament is provided in Articles 113 to 117 and 119. These pertain to the procedure in Parliament with respect to estimates, Appropriation Bills, supplementary, additional or excess grants, votes on account, votes to credit and exceptional grants, special provisions as to financial Bills and regulation by law of procedure in Parliament in relation to financial business. These provisions are mentioned below:

*"113. Procedure in Parliament with respect to estimates.-*

- (1) So much of the estimates as relates to expenditure charged upon the Consolidated Fund of India shall not be submitted to the vote of Parliament, but nothing in this clause shall be construed as preventing the discussion in either House of Parliament of any of those estimates.*
- (2) So much of the said estimates as relates to other expenditure shall be submitted in the form of demands for grants to the House of the People, and the House of the People shall have power to assent, or to refuse to assent, to any demand, or to assent to any demand subject to a reduction of the amount specified therein.*
- (3) No demand for a grant shall be made except on the recommendation of the President.*

## 114. Appropriation Bills –

- (1) *As soon as, may be after the grants under Article 113 have been made by the House of the People, there shall be introduced a Bill to provide for the appropriation out of the Consolidated Fund of India of all moneys required to meet-*
  - (a) *the grants so made by the House of the People; and*
  - (b) *the expenditure charged on the Consolidated Fund of India but not exceeding in any case the amount shown in the statement previously laid before Parliament.*
- (2) *No amendment shall be proposed to any such Bill in either House of Parliament which will have the effect of varying the amount or altering the destination of any grant so made or of varying the amount of any expenditure charged on the Consolidated Fund of India, and the decision of the person presiding as to whether an amendment is inadmissible under this clause shall be final.*
- (3) *Subject to the provisions of Articles 115 and 116, no money shall be withdrawn from the Consolidated Fund of India except under appropriation made by law passed in accordance with the provisions of this article.*

## 115. Supplementary, additional or excess grants.-

- (1) *The President shall-*
  - (a) *if the amount authorised by any law made in accordance with the provisions of Article 114 to be expended for a particular service for the current financial year is found to be insufficient for the purposes of that year or when a need has arisen during the current financial year for supplementary or additional expenditure upon some new service not contemplated in the annual financial statement for that year, or*
  - (b) *if any money has been spent on any service during a financial year in excess of the amount granted for that service and for that year, cause to be laid before both the Houses of Parliament another statement showing the estimated amount of that expenditure or cause to be presented to the House of the People a demand for such excess, as the case may be.*
- (2) *The provisions of Articles 112, 113 and 114 shall have effect in relation to any such statement and expenditure or demand and also to any law to be made authorising the appropriation of moneys out of the Consolidated Fund of India to meet such expenditure or the grant in respect of such demand as they have effect in relation to the annual financial statement and the expenditure mentioned therein or to a demand for a grant and the law to be made for the authorisation of appropriation of moneys out of the Consolidated Fund of India to meet such expenditure or grant.*

## 116. Votes on account, votes of credit and exceptional grants.-

- (1) *Notwithstanding anything in the foregoing provisions of this Chapter, the House of the People shall have power-*
  - (a) *to make any grant in advance in respect of the estimated expenditure for a part of any financial year pending the completion of the procedure prescribed in Article 113 for the voting of such grant and the passing of the law in accordance with the provisions of Article 114 in relation to that expenditure;*
  - (b) *to make a grant for meeting an unexpected demand upon the resources of India when on account of the magnitude or the indefinite character of the service the demand cannot be stated with the details ordinarily given in an annual financial statement;*
  - (c) *to make an exceptional grant which forms no part of the current service of any financial year; and Parliament shall have power to authorise by law the withdrawal of moneys from the Consolidated Fund of India for the purposes for which the said grants are made; and*

- (2) *The provisions of Articles 113 and 114 shall have effect in relation to the making of any grant under clause (1) and to any law to be made under that clause as they have effect in relation to the making of a grant with regard to any expenditure mentioned in the annual financial statement and the law to be made for the authorisation of appropriation of moneys out of the Consolidated Fund of India to meet such expenditure.*

Provisions contained in Chapter I, Part XII of the Constitution of India necessitate the maintenance of government accounts in three parts with regard to receipts – (1) the Consolidated Fund of India / separate Consolidated Funds of the States, (2) the public account of India/public accounts of the States and (3) the Contingency Fund of India/ Consolidated Funds of the States. This is based on the provisions of Articles 266 and 267. Thus, Article 266 provides for the Consolidated Funds and Public Accounts of India and of the States in the following manner:

*“266. Consolidated Funds and public accounts of India and of the States.- (1) Subject to the provisions of Article 267 and to the provisions of this Chapter with respect to the assignment of the whole or part of the net proceeds of certain taxes and duties to States, all revenues received by the Government of India, all loans raised by that Government by the issue of treasury bills, loans or ways and means advances and all moneys received by that Government in repayment of loans shall form one consolidated fund to be entitled “the Consolidated Fund of India”, and all revenues received by the Government of a State, all loans raised by that Government by the issue of treasury bills, loans or ways and means advances and all moneys received by that Government in repayment of loans shall form one consolidated fund to be entitled “the Consolidated Fund of the State”.*

- (2) *All other public moneys received by or on behalf of the Government of India or the Government of a State shall be credited to the public account of India or the public account of the State, as the case may be.*
- (3) *No moneys out of the Consolidated Fund of India or the Consolidated Fund of a State shall be appropriated except in accordance with law and for the purposes and in the manner provided in this Constitution.”*

The provisions regarding the Contingency Funds of India and of the States are contained in Article 267 of the Constitution:

*“267. Contingency Fund.-*

- (1) *Parliament may by law establish a Contingency Fund in the nature of an imprest to be entitled “the Contingency Fund of India” into which shall be paid from time to time such sums as may be determined by such law, and the said Fund shall be placed at the disposal of the President to enable advances to be made by him out of such Fund for the purposes of meeting unforeseen expenditure pending authorisation of such expenditure by Parliament by law under Article 115 or Article 116.*
- (2) *The Legislature of a State may by law establish a Contingency Fund in the nature of an imprest to be entitled “the Contingency Fund of the State” into which shall be paid from time to time such sums as may be determined by such law, and the said Fund shall be placed at the disposal of the Governor of the State to enable advances to be made by him out of such Fund for the purposes of meeting unforeseen expenditure pending authorisation of such expenditure by the Legislature of the State by law under Article 205 or Article 206.”*

## **Budgetary Process**

### • **Annual Financial Statement**

Based on the Constitutional provisions and provisions contained in the General Financial Rules (GFR), General Accounting Rules (GAR), Budget Manual (in the States) etc, a statement of its estimated annual receipts and expenditure is prepared by each Government and presented to its Legislature. This “Annual Financial Statement” is commonly known as the Budget. In this statement, the sums required to meet the expenditure charged upon the Consolidated Fund of India or the Consolidated Fund of the State or the Consolidated Fund of the

Union Territory and the sums required to meet other expenditure proposed to be met from the Fund are shown separately. Further, the expenditure on revenue accounts is distinguished from other expenditure (Articles 112 & 202 of the Constitution and Section 27 of the Government of Union Territories Act, 1963). As stated earlier the Annual Financial Statement shows the receipts and expenditure of Government in three separate parts under which Government accounts are maintained viz. (i) Consolidated Fund of India (ii) Contingency Fund of India and the (iii) Public Account.

The part of the estimates pertaining to expenditure charged upon the Consolidated Fund is not submitted to the vote of the Legislature (although it is open to discussion in the Legislature). The part of the estimate which is concerned with other expenditures is submitted to the Legislature concerned in the form of Demands for Grants on the recommendation of the President or the Governor of the State or the Administrator of the Union Territory with legislature, as the case may be.

Normally, a separate demand is presented for each Department or the major services under the control of a Ministry/Department. The number of Demands for Grants and their coverage is decided by the Ministry of Finance. Each demand generally includes the total provisions required for a service, that is, provisions on account of revenue expenditure, capital expenditure, Grants to States and Union Territories and also loans and advances relating to that service. The estimated expenditure included in the Demands for Grants are for gross amounts. The receipts and recoveries taken in reduction of expenditure are shown by way of footnotes.

The Finance Bill containing the annual taxation proposals is considered and passed by the Legislature only after the Demands for Grants have been voted and the total expenditure is known. Then it enters the statute as the Finance Act.

The House of the People (and the Legislative Assemblies) also has the power to authorize by law the withdrawal of moneys from the Consolidated Fund of India for the following purposes (Article 116/206):

- **Vote on Account** – for making any grant in advance in respect of the estimated expenditure for a part of any financial year pending the completion of the parliamentary procedure;
- **Vote of Credit** – for making a grant for meeting an unexpected demand upon the resources of India when on account of the magnitude or the indefinite character of the service the demand cannot be stated with the details ordinarily given in an annual financial statement; and
- **Exceptional Grant** – for making provision for an exceptional grant that does not form part of the current service of any financial year.

As per the requirements of the Fiscal Responsibility and Budget Management Act, 2003 three Statements are to be presented to the Parliament, which form a part of the budget documents: (a) the Macro-economic Framework Statement, (b) the Medium term Fiscal Policy Statement, and (c) the Fiscal Policy Strategy Statement. The Macro-economic Framework Statement contains an assessment of the growth prospects of the economy. The Medium term Fiscal Policy Statement indicates the three-year rolling targets for four specific fiscal indicators in relation to GDP at market prices, namely, (i) Revenue Deficit, (ii) Fiscal Deficit, (iii) Tax to GDP Ratio, and (iv) Total Out-Standing Debt at the end of the year, while the Fiscal Policy Strategy Statement seeks to outline the strategic priorities of the Government in the fiscal area for the ensuing year.

## Appropriation Act

After the Demands have been passed by the Legislature, an Appropriation Bill is introduced to provide for the appropriation out of the Consolidated Fund of India or of the State or of the Union Territory with Legislature for all moneys required to meet: a. The Grants made by the Legislature and b. The expenditure charged on the Consolidated Fund, but not exceeding in any case the amount shown in the statement previously laid before the Legislature. (This charged expenditure is referred to as Appropriation).

No money can be withdrawn from the Consolidated Fund until this Bill is passed by the Legislature. Once this Bill is passed, it becomes the Appropriation Act.

## Form of Accounts

Article 150 of the Constitution states the following regarding the form of Accounts:

“150. Form of the accounts of the Union and of the States. – The accounts of the Union and of the States shall be kept in such form as the President may, on the advice of the Comptroller and Auditor General of India, prescribe.”

The general principles of government accounting are presently prescribed by the Government Accounting Rules, 1990 (GAR). Rule 21 of GAR provides for cash system of accounting in the government in the following way:

“21. Cash basis of Accounts With the exception of such book adjustments as may be authorized by these rules or by any general or special orders issued by the Central Government on the advice of the Comptroller and Auditor General of India, the transactions in Government accounts shall represent the actual cash receipts and disbursements during a financial year as distinguished from amounts due to or by the Government during the same period.”

In case of Part I of the accounts, there are two main divisions:

(i) Revenue - consisting of sections for ‘Receipt heads (Revenue Account)’ and ‘Expenditure heads (Revenue Account)’. (ii) Capital, Public Debt, Loans - consisting of sections for ‘Receipt heads (Capital Account)’, ‘Expenditure heads (Capital Account)’, and ‘Public Debt’, ‘Loans’, and ‘Advances’.

The second division comprises the following sections:–

- The section ‘Receipt heads (Capital Account)’ dealing with receipts of a Capital nature which cannot be applied as a set off to Capital Expenditure.
- The section ‘Expenditure heads (Capital Account)’ dealing with expenditure met usually from borrowed funds with the object of increasing concrete assets of a material and permanent character. It also includes receipts of a Capital nature intended to be applied as set off to Capital expenditure.
- The section ‘Public Debt’, ‘Loans’ and ‘Advances’, comprises loans raised and their repayments by Government such as, Internal Debt, External Debt of the Union Government and loans and advances made by Governments and their recoveries; transactions relating to ‘Appropriation to Contingency Fund’ and ‘Inter-State Settlement’.

In the case of the Public Account, the transactions are again grouped into sectors and sub-sectors, which are further sub-divided into Major Heads of Account.

**Major, Minor and Detailed Heads:** The main unit of classification in accounts is the major head which is divided into minor heads, each of which has a number of subordinate heads, generally known as subheads. The sub-heads are further divided into detailed heads. Sometimes major heads may be divided into sub-major heads before their further division, into minor heads. Thus, the Sectors, Major heads, Sub-heads and Detailed heads together constitute a five-tier arrangement of the classification structure of Government Accounts.

The Major Heads of Account falling within the Consolidated Fund generally correspond to ‘Functions’ of Government, such as different services like ‘Crop Husbandry’, ‘Defence’ etc being provided by Government, while minor heads subordinate to them identify the ‘Programmes’ undertaken to achieve the objectives of the function represented by the major head. A programme may consist of a number of schemes or activities and

these generally, correspond to sub-heads below the minor head represented by the programme. In certain cases, especially in regard to non-developmental expenditure or expenditure of an administrative nature, the sub-heads may denote the components of a programme, such as 'Organizations' or the different 'Wings of Administration'.

A 'detailed head', is termed as an object classification. On the expenditure side of the accounts particularly in respect of heads of accounts within the Consolidated Fund, detailed heads are primarily meant for itemized control over expenditure and indicate the object or nature of expenditure on a scheme or activity or organization in terms of inputs such as 'Salaries', 'Office Expenses', 'Grants-in-Aid', 'Loans', 'Investments'.

## Preparation of Accounts

### • Appropriation Accounts

Appropriation Accounts are accounts of the expenditure, voted and charged of the government for each financial year compared with the amounts of the voted grants and charged appropriation for different purposes as specified in the schedules appended to the Appropriation Acts passed by the Parliament or Legislature, to exhibit the excess or savings as the case may be, over the final grant or appropriation. These accounts are complementary to the accounts of the annual receipts and disbursements of Government otherwise known as Finance Accounts.

### • Finance Accounts

As soon as the accounts of a year are closed, the Finance Accounts of each Government of a State or Union Territory with Legislature for the year are prepared by the Accountant General concerned and submitted to the Comptroller and Auditor General for approval and the transmission to the Governor of the State/Administrator of the Union Territory to be laid before the respective Legislature. The Finance Accounts of the Union Government which comprise transactions of Civil as well as Railways, Defence, Posts and Telecommunication are prepared by Controller General of Accounts and submitted to the Comptroller and Auditor General for certification and transmission to the President for being laid on the table of the Parliament.

The Finance Accounts present the accounts of the receipts and outgoings 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 liability and assets of the Government concerned as worked out from the balances recorded in the accounts

## Audit

Article 148 of the Constitution provides that there shall be a Comptroller and Auditor-General of India (CAG) who shall be appointed by 'the President by warrant under his hand and seal and shall only be removed from office in like manner and on the like grounds as a judge of the Supreme Court'.

Article 149 of the Constitution provides that the Comptroller and Auditor-General of India (CAG) shall perform such duties and exercise such powers in relation to the accounts of the Union, the States and of any other authority / body as may be prescribed under law by Parliament. It also provides that until such law is passed, the Auditor-General of India would continue to perform such functions as were exercised by him before the commencement of the Constitution. Accordingly, the Parliament passed The Comptroller and Auditor General's (Duties, Powers and Conditions of Service) Act, 1971.

Article 151 of the Constitution provides that the CAG shall submit his/her reports, in case of the Union, to the President who shall cause them to be laid before each House of Parliament. Similar provisions exist in case of the States. Under Sections 13, 16 and 17 of the Comptroller and Auditor General's (Duties, Powers and Conditions of Service) Act, 1971, it is the responsibility of the CAG:

- a. To audit all receipts which are payable into the Consolidated Fund of India and of each State and each Union Territory having a Legislative Assembly and to satisfy himself that the rules and procedures in that behalf are designed to secure an effective check on the assessment, collection and proper allocation of revenue and are being duly observed and to make for this purpose such examination of the accounts as he thinks fit;
- b. To audit all expenditure from the Consolidated Fund of India and of each State and of each Union Territory having a Legislative Assembly and to ascertain whether the money shown in the accounts as having been disbursed was 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;
- c. To audit all transactions of the Union and of the States relating to Contingency Funds and Public Accounts;
- d. To audit all trading, manufacturing, profit and loss accounts and balance sheets and other subsidiary accounts kept in any department of the Union or of a State; and
- e. To audit the accounts of stores and stock kept in any office or department of the Union or of a State and in each case to report on the expenditure, transactions or accounts so audited by him.

### **Internal Audit**

Presently, 'internal audit' is recognized as an aid to the management for monitoring the financial performance and effectiveness of various programmes, schemes and activities. In Government of India, internal audit is conducted through the Internal Audit Wings in the Principal Accounts Offices of various Ministries/Departments.

The scheme of departmentalization of Union Government Accounts provided for setting up an internal audit organization. Accordingly, these were set up in most Union Government Ministries under the Chief Controller of Accounts/Controller of Accounts. The Secretary of the Ministry/Department acts as the Chief Accounting Authority. However, it is the Financial Adviser who, for and on behalf of the Secretary, is responsible for internal audit of payments and accounts from the records maintained by the various secretariat and field formations and Pay and Accounts Offices of the Ministry/Department.

### **Flow of Funds Related to Union Government Programmes**

Transfer of funds from the Union to the States due to the inadequacy of sources of generation of revenue takes place through various means. The first and foremost is by way of devolution as per the recommendations made by the Finance Commission (in terms of Articles 280 and 281 of the Constitution). The second channel is through the Planning Commission. In this case, the States receive Plan funds from the Planning Commission in the form of 'Central Assistance' under the 'Scheme of Financing of States' Annual Plan. They also receive Plan Funds through various Union Government Ministries/Departments in respect of certain schemes implemented by State Governments. These schemes are known as 'Centrally Sponsored Schemes' (CSS). The mechanisms of transfer of funds in case of the CSS are as contemplated in the design of the respective schemes.

The flow of funds from the Union Government to the ultimate implementing agencies for any scheme is through one of these two channels.

- i) Funds are transferred to the Consolidated Fund of the State Governments which spend the money through the implementing agencies.
- ii) The Union Government transfers funds directly to implementing agencies in the States through normal banking channels.

Actual expenditure under the CSS is incurred only when payment is made either to a beneficiary of the scheme or to the supplier of goods and services. However, due to lack of a proper information system, the tracking of fund flow and correlation between the amount released and expenditure made could not be determined without a degree of uncertainty. Further, when funds are transferred directly to the implementing agencies in the States, it has to be done in advance which results in a substantial accumulation of funds in the pipe line.

## Analysis of the Budgetary Process

In an input-based budget system the linkages of budget outlays with productivity of public expenditure and delivery of public services generally remain nebulous. In the conventional line-item budgeting, the major focus is on ensuring that agencies do not exceed the specified allocation. Financial compliance is sought to be achieved in this system through a detailed budgetary specification of inputs and to achieve this, detailed procedures are designed for expenditure control. The budgeting system in India, both at the Union and State levels, continues to be conventional and inputs based though the recently introduced outcome budgeting is a major reform towards achieving results.

As per Rule 204(1) of the Rules of Procedure and Conduct of Business in the Lok Sabha, the Budget is presented to the Parliament on such date as is fixed by the President. The present convention is to present the Budget at 11.00 am on the last working day of February i.e. about a month before the commencement of the financial year except in the year when General Elections to the Lok Sabha are held. In an election year, the Budget may be presented twice, first to secure a Vote on Account for a few months and later in full.

The General Discussion on the Budget is held on a day appointed by the Speaker, subsequent to the day of presentation of the Budget and for such period of time as the Speaker may decide. During the general discussions, the House is at liberty to discuss the budget as a whole or any question of principle involved therein, but no motion can be moved nor can the budget be submitted to the vote of the House. The Finance Minister has a right to reply at the end of the discussions. The scope of discussions at this stage is confined to general examination of budget, policy of taxation as expressed in the Budget speech of the Finance Minister and general schemes and structures etc. Specific points or grievances can be discussed on the floor of the House when it takes up relevant Demands for Grants or the Finance Bill.

After the conclusion of the General Discussion, the Demands for Grants of individual Ministries/Departments are taken up in the Lok Sabha for discussion as per the time table decided by the Business Advisory Committee of the House and is subjected to vote. In order to facilitate proper examination of different Demands for Grants, different Departmentally related Standing Committees of the Parliament are constituted every year to consider the concerned Demands for Grants and make a report on them to the House. However, these Committees are not empowered to suggest anything in the nature of 'cut motions' and they have only persuasive value.

When a Demand is taken up for discussion, any Member may seek reduction in the amount of the Demand by moving any of the following types of Cut Motions:

- **Disapproval of Policy Cut** (by moving "that the amount of the Demand be reduced to Re. 1", thereby representing a disapproval of the policy underlying the demand);
- **Economy Cut** (by moving "that the amount of the demand be reduced by a specified amount", thereby representing the economy that can be effected); and
- **Token Cut** (by moving "that the amount of the demand be reduced by Rs. 100", in order to ventilate a specific grievance).

At the end of the period allotted for discussion on the Demands for Grants, the Speaker puts all the outstanding Demands for Grants to the vote of the House. This process is known as 'Guillotine' which acts as a device

for bringing the debate on financial proposals to an end within a specified time with the result that several Demands have to be voted by the House without discussions. At the same time, Cut Motions which have been moved are also put to vote and disposed of. The Appropriation Bill for withdrawal from the Consolidated Fund of India is introduced in the Lok Sabha with the prior approval of the President. For its introduction, consideration and passing on the same day, special permission has to be sought from the Speaker. The scope of debate on an Appropriation Bill relating to Demands for Grants for the financial year after the remaining demands have been guillotined is restricted to matters of public importance or administrative policy implied in the grants covered by the Bill which have not already been raised while relevant Demands for Grants were under consideration.

## Weaknesses in the Budgetary System and Implementation

### a) Unrealistic budget estimates:

The amounts budgeted are often not realistic. Weakness in preparing proper estimates leads to frequent revisions and supplementaries. On the other hand, there are major unspent provisions at the end of the year.

### b) Delay in implementation of projects:

Resources are being spread thinly with only token provisions in some cases, often leading to inordinate delays in execution of projects.

### c) Skewed expenditure pattern:

The expenditure pattern is skewed, with a major portion getting spent in the last quarter of the financial year, especially in the last month.

### d) Inadequate adherence to the multi-year perspective and missing 'line of sight' between plan and budget

Though the Five year Plan provides the basis for multi-year perspective, often ad hoc deviations from it distort the long-term plan objectives. The Plan schemes get dispersed into line-items in the budget estimates and there is no consolidation afterwards – both in the estimates and the final accounts. There is need for alignment between the plan, budgets and accounts.

### e) No correlation between expenditure and actual implementation:

The expenditure figures do not reflect actual expenditure made towards receipt of goods and services.

### f) Mis-stating of financial position:

Parking of funds by implementing agencies, outside the government accounts portrays an incorrect picture of the financial position of government. This also means that the Government's financial position is not known with reasonable accuracy at any given point of time.

### g) Ad hoc project announcements:

Indiscriminate announcement of projects/schemes not included in the plan/budget is regularly made, often without proper consideration and detailing.

## How to overcome these weaknesses

- The assumptions made while formulating estimates must be realistic. At the end of each year the reasons for the gap between the 'estimates' and 'actuals' must be ascertained and efforts made to minimize them. These assumptions should also be subject to audit.

- The method of formulation of the annual budget by getting details from different organizations/units/agencies and fitting them into a predetermined aggregate amount leads to unrealistic budget estimates. This method should be given up along with the method of budgeting on the basis of 'analysis of trends'. This should be replaced by a 'top-down' method by indicating aggregate limits to expenditure to each organization/agency.
- Projects and schemes should be included in the budget only after detailed consideration. The norms for formulating the budget should be strictly adhered to in order to avoid making token provisions and spreading resources thinly over a large number of projects/schemes.
- The practice of announcing projects and schemes on an ad-hoc basis in budgets and on important National Days, and during visits of dignitaries/ functionaries to States needs to be stopped. Projects/schemes which are considered absolutely essential may be considered in the annual plans or at the time of mid-term appraisal.

## Outcome Budget

Due to the realisation that 'certain weaknesses have crept in the performance budget documents such as lack of clear one to-one relationship between the Financial Budget and the Performance Budget and inadequate target-setting in physical terms for ensuing years'...it was felt that there was need for tracking 'outcomes' and not the readily measurable 'outputs'. This found mention in the Budget speech of the Finance Minister (Budget 2005-06) which was re-emphasised by the Prime Minister in his letter to all Union Ministers in March 2005. The first outcome budget was passed in the Parliament on August 25, 2005. The guidelines for the 2006-07 outcome budget provided that each Ministry/Department will separately prepare the outcome budget documents in respect of 'all Demands/ Appropriations controlled by them'.

These contained:

- i. Details about the mandate, goals and objectives as well as the policy framework and vision statement of the Ministry/Department
- ii. Details in indicated tabular format comprising financial outlays, projected physical outputs and projected/ budgeted outcomes.

The key words used here are 'Outlays', 'Outputs' and 'Outcomes'. It has been recognised in the guidelines that converting 'outlays' into 'outcomes' is a complex process addressing "value for money" concerns; being more a management process than merely a financial process and admitting possibilities of different approaches and modalities, which may differ from Ministry to Ministry and programme to programme. It has also been stated that preparation of the Outcome Budget is an evolving and dynamic process, which will require detailed scrutiny and examination on yearly basis, with value addition based on the preceding year's experience. The guidelines have prescribed the following steps in this conversion process:

- Defining intermediate and final outcomes specifically in measurable and monitorable terms;
- Standardizing unit cost of delivery;
- Benchmarking the standards/quality of outcomes and services;
- Capacity building for requisite efficiency at all levels, in terms of equipment, technology, knowledge and skills;
- Ensuring adequate flow of funds at the appropriate time to the appropriate level, avoiding both delay and 'parking' of funds;

- Setting up effective monitoring and evaluation systems, to indicate the directions for further calibration and honing the processes, to deliver the intended outcomes; and
- Involving the community/target groups/recipients of the service, with easy access and feedback systems.

The guidelines have defined the three terms used in the performance budget. Thus, 'outlays' imply total financial resources deployed for achieving certain outcomes. Part of this money may come directly from the Government budget and part may be contributed by other stakeholders such as the State Governments, Public Sector Undertakings or even private parties in the growing area of Public Private Partnerships. It has been mentioned that the outlays should be segregated scheme-wise, covering both Plan / Non-Plan budget (as shown in the Expenditure Budget Vol II) for the financial year in monetary terms. In case of projects (whether Government or parastatal) spanning multi-year time frames, total sanctioned cost of the project and the planned annual expenditure both should be brought out as both are relevant 'outlays' for effecting linkage with outcomes.

'Outputs' have been defined as the 'measure of the physical quantity of the goods or services produced through an activity under a scheme or programme'. They are identified as an intermediate stage between 'outlays' and 'outcomes'. For example, in case of a social sector programme/scheme, the intermediate results before identifying, measuring and arriving at the 'final outcome' as per the objectives of the said programme/scheme, may be treated as 'output'. The purpose is to capture intermediate 'outputs' before identifying and measuring the 'final outcome'.

'Outcomes' are the end product/results of various Government initiatives and interventions, including those involving partnership with the State Governments, Public Sector Undertakings, Autonomous Bodies, private sector and the community. They involve much more than mere 'outputs', since they cover the quality and effectiveness of the goods or services produced as a consequence of an activity under a scheme or programme. The 'outcomes' are required to be measured keeping in mind the objectives of the programme/ scheme by following appropriate methodology.

### Second ARC recommendations

*Outcome budgeting is a complex process and a number of steps are involved before it can be attempted with any degree of usefulness. A beginning may be made with proper preparation and training in case of the Flagship Schemes and certain national priorities.*

## Irrational 'Plan – Non-Plan' Distinction Leads to Inefficiency in Resource Utilization

Since the country follows a Planbased model of economy, the expenditure of Government is divided into Plan and Non-Plan. As the name suggests, Plan expenditure is directly related to expenditure on schemes and programmes envisaged in the Five Year Plans. Non-Plan expenditure is the expenditure incurred on establishment and maintenance activities. Thus, 'Plan' in this context includes what is provided by the Planning Commission and is included in the Five-Year Plan. Non-Plan expenditure covers expenditure on security, interest payments and subsidies etc. The Plan and Non-Plan divide runs too deep to give a comprehensive idea about resource availability to the departments at an early stage of budget development. The dichotomy between plan and non-plan in expenditures has been commented upon as an unnecessary development that has adverse effects on the quality of public services. Moreover, in order to find funds for the plans, over the years, a tendency has developed to view non-plan expenditure as far less important and subject it to cuts and economy measures, although many of them are vital in nature.

This distinction, however, undermines the budget formulation process of the departments by bringing in complexity. The Five Year Plans prepared by the Planning Commission are indicative in nature and are

operationalised through Annual plans. The schemes/projects to be undertaken in the Plan are indicated in the Plan documents and resources are made available in the annual budgets. However, if any new scheme/project is proposed by any Department, it requires 'in principle' approval from the Planning Commission and then financial resources are tied up in consultation with the Planning Commission. This requires detailed analysis of resource requirements and availability of funds for the existing schemes and if fund requirement exceeds the availability reprioritization exercise needs to be undertaken. The procedures are elaborate and time consuming thus leaving the individual Department with less flexibility in proposing new schemes. From the budgeting point of view the relevant distinctions are in terms of revenue and capital expenditures with sufficient disclosures relating to new expenditure proposals.

The plan versus non-plan distinction in expenditures needs to be abolished keeping in view its impact on budget development and public service delivery. The Departments should have the flexibility in formulating their budgets with prior indication of resource availability. Though this has been considered by many Committees over the last forty years and repeated recommendations have been made to do away this division, this has not been done so far. Just as Public Undertakings, Autonomous Bodies, Societies etc. are required to consider their resources as a whole and plan accordingly, the Departments should also be allowed to work out the committed resources and plan within overall allocations.

## **Flow of Funds from the Union to the States - Centrally Sponsored Schemes**

The Centrally Sponsored Schemes (CSS) do not fall within the subjects allocated to the Union Government in List I of the Seventh Schedule of the Constitution. However, they are funded by the Union Government to achieve certain national objectives. The CSS have formed an important part of successive Five Year Plans. The flow of funds from the Union Government to the ultimate implementing agencies for any scheme is through one of these two channels:

- i. Funds are transferred to the Consolidated Fund of the State Governments which spend the money through the implementing agencies. In such cases, the agency banks at the field level, honour the payment claims made by authorized officers of the State Government and, in return, place the claim on the State Government through the RBI office at the State Headquarters.
- ii. The Union Government transfers funds directly to implementing agencies in the States through normal banking channels. These agencies distribute funds progressively to lower level field formations through banking channels. The banks honour cheques up to the amount lying as credit in their respective bank accounts.

Actual expenditure under the CSS is incurred only when payment is made either to a beneficiary of the scheme or to the supplier of goods and services. However, due to the lack of a proper information system, the tracking of fund flow and correlation between the amount released and expenditure made could not be determined without a degree of uncertainty. Further, when funds are transferred directly to the implementing agencies in the States, it has to be done in advance which results in a substantial accumulation of funds in the pipeline.

The basic issues here are:

- i. whether the simple release of funds by Union Government Ministries/ Departments to State Governments/ other implementing agencies, NGOs, societies etc in the States for implementing various centrally sponsored schemes could be termed as expenditure in their accounts,
- ii. whether real time information about the use of funds so transferred is available,
- iii. whether such use of funds gets adequately reflected in government accounts, and
- iv. how to minimize the costs of raising the financial resources which are lying unutilized.

Thus, it was pointed out that in case of expenditure incurred on Centrally Sponsored Schemes through the State Budget, the Accountants General (Accounts & Entitlements) in the States would not be able to link such expenditure unless the expenditure incurred on a scheme can be ascertained across all functional Major Heads of Accounts involved. Further, even the accounts compiled by Accountants General (A&E) would not capture the data distinctly under each Centrally Sponsored Schemes in the absence of uniform plan-budget link and a distinct sub-head for the each of the Centrally Sponsored Schemes. Moreover, the expenditure booked in the State Accounts consists of expenditure for the end-use as well as advances to implementing agencies without any distinction between them. There is no coding or accounting rules prescribing coding of the expenditure by their type (enduse, advance etc.)

Further, in many cases, transfers are recorded in registers and not made through account books. This further aggravates the position and the link to end use gets lost in transition. In case of transfers to societies, NGOs etc., their accounts do not get reflected in the governmental accounts. The problem of absence of coding by the type of expenditure exists here also, in the same manner as with the State Government.

It was, therefore, suggested that the following aspects, inter alia, would need to be taken care of:

- i. As in the case of funds from the State Budget, a provision / system should be mandatory for autonomous bodies and NGOs to capture their expenditure that can be identified to the particular Centrally Sponsored Schemes and the type of expenditure.
- ii. A system may be put in place to track the amount in transit to the end-use through accounts / subsidiary accounts rather than through registers.

### **Absence of a System for Managing the Flow of Financial Information**

There exists a hierarchical chain of implementing agencies through which GOI funds flow to the grass roots level. A bulk of the actual expenditure is carried out at the block/ panchayat level in most schemes. The current system does not facilitate tracking of fund flow from the point of release in GOI to final expenditure at the spending unit level. The current system lacks a reliable reporting system for utilization of plan scheme funds. Moreover, it does not generate (i) agency-wise (ii) geographical location-wise and (iii) scheme-wise information on flow of funds. Huge funds are lying unutilized in the banking system parked in different accounts of different implementing agencies across several schemes.

The present Chart of Accounts allows 'releases' to be treated as 'expenditure'. Further, the Chart of Accounts followed by the Civil Ministries, State Governments, NGOs and other agencies is not uniform and each agency adopts its own Chart of Accounts for maintaining accounts pertaining to plan schemes. There is thus a need for a common Chart of Accounts (COA) so as to ensure a seamless flow on information from all stakeholders.

The existing system of expenditure classification is one-dimensional as it flows only in the direction namely from the fund to the sector/sub-sector. It does not permit an integration and consolidation with regard to functions, programmes and economic categories in a single hierarchy. Presently, budget classification focuses on compliance rather than on government policies and priorities and the two main dimensions (functions/ programmes and objects) are clubbed together with a 15-digit accounting code, which has limited flexibility and scope for segregating and correlating various budget dimensions. Thus, it does not allow capture of information regarding:

- Schemes as defined by Planning Commission (Schemes defined in Chart of Accounts are often not the same as defined by Planning Commission)
- Recipient agency identification

# GS SCORE

An Institute for Civil Services

**IAS 2019**

## Prelims Test Series

### PT MAXIMA

**SCORE MAX WITH DAILY TEST**

**DAILY TESTS**

**DAILY REVISIONS**

**MAXIMUM SCORE**

Total **55 Tests**

**10**

NCERT

**16**

Sub Sectional

**6**

Sectional

**7**

Current Affairs

**13**

Mock Tests

**3**

CSAT

&

**5000<sup>+</sup> Topics** covered through **Smart Solution**

**Batch-8**  
Starts

**25**

February, 2019

🕒 11:00 AM to 1:00 PM

Fee:

Rs. 8,000/-  
(including GST)

Off. No. 6, 1<sup>st</sup> Floor, Apsara Arcade, Karol Bagh, New Delhi-5, (Karol Bagh Metro Gate No. 5)

☎ 011-47058253 | 8448496262    ✉ info@iasscore.in    📱 /iasscore



[www.iasscore.in](http://www.iasscore.in)

- Geographical location identification

Moreover, the classification system between the Union and State Governments is uniform only till the programme level - at the scheme level there is no uniformity of classification.

In consultation with the Controller General of Accounts (CGA), it has now been planned that the Government should shift over to a system of transfer of debits in respect of the CSS. The Core Banking Systems (CBS) which most banks have now rolled out is sought to be linked with a Core Accounting System (CAS), which is to be set by the CGA. Under the proposed CAS, only the sanctions will move down the line to the final implementing authority. These sanctions, through the proposed linkage between the CAS and the CBS, would also move in parallel down the CBS to the bank branch that will make the payment upon the authorisation of the field level implementing agency.

In order to implement this, the CGA have proposed the use of an IT-based platform which would address the following concerns:

- Identifying the entities involved in fund devolution,
- Identifying schemes under which funds are devolved to the agencies/spending units,
- Identifying geographical location of the entities receiving funds, and
- Using the extensive banking network for reducing float in the system.

The objective here is to build a comprehensive centralized database from the source for enhanced financial reporting for monitoring plan schemes implementation by including sanction ID with the current system of classification of accounts. This will facilitate complete information base for Plan Schemes about:

- Funds released under a scheme of Planning Commission
- Funds received by an agency
- Funds received geographical location-wise

Thus, sanctions pending release of funds under Plan schemes can be monitored more effectively and recipient agencies/States can also use the sanction ID for referencing purposes. A sanction in such cases would include both actual expenditure and transfer. This will create a system in which only “authorization to spend” and not “funds to spend” flows through the system. This will use the existing banking networks to transfer these “authorizations” instead of real funds. A system of authorizations also implies that all these entities become a part of the preparation process of national accounts.

It is expected that the proposed CAS will solve two major problems being faced at present. First, it will provide a platform for consolidating accounting data relating to all plan schemes on a uniform basis, irrespective of the agency that is actually charged with the receipt of funds and with programme implementation. Secondly, the CAS will have the advantage of ensuring that expenditure is booked in the accounts of the Union Government only at the time when the actual payment at the field level takes place.

### **Second ARC Recommendations**

The Controller General of Accounts, in consultation with the C&AG, should lay down the principles for implementing the system of flow of sanctions/ approvals from the Union Ministries/Departments to implementing agencies in the States to facilitate release of fund at the time of payment. After taking into account the available technology and infrastructure for electronic flow of information and funds, especially under the NeGP, and putting in place a new Chart of Accounts, the scheme should be implemented in a time bound manner.

## Development of Financial Information System

A robust financial information system is necessary as it helps in:

- Providing timely and reliable information to the decision makers
- Providing inputs to control systems
- Monitoring financial and physical progress
- Ensuring proper utilization of resources

The Commission is of the view that a robust financial information system needs to be created in the government. This system should also make accessible to the public real time data on government expenditure at all levels and should be available in the public domain. This would also be honouring the spirit of the Right to Information which mandates that government organizations should attempt to provide maximum information through voluntary disclosures.

## Capacity Building

The changes in the accounting and financial management system discussed above would necessitate capability building in not only the accounts and finance personnel but also non-finance personnel. Better skills would allow better preparation of estimates and better management of expenditure. A lot would require to be done for improving the estimating and forecasting capabilities within Ministries/Departments and implementing agencies. Specially designed and periodic training modules for personnel at different levels need to be designed to meet these needs.

The Commission is of the view that major reforms in financial management can only be undertaken if capacity of both - individuals and institutions – is improved. For this to happen, a proper programme of training needs to be devised and implemented in a time bound manner.

## Internal Control and Audit

Internal control systems are basically management control systems with a view to ensuring compliance with rules and regulations, reliability of financial data and reports, and to facilitate efficiency of government operations. A sound internal control framework, of which internal audit is an important element, is required to assure that government operations attain some basic fiduciary standards in guarding against misuse and inefficient use of resources; for safeguarding government assets; countering fraud and error; checking maintenance of satisfactory accounting records; and whether budgetary objectives set out in the government policies are being achieved. Thus, “Internal controls can be regarded as one of the foundations of good governance and the first line of defense against improprieties. They also provide the public with ‘reasonable assurances’ that if improprieties do occur, they will be made transparent and made appropriately addressed.”

Though internal audit is also a part of internal control system, it has a distinct role in that it is one of the tools for evaluating and improving the internal control system. Internal audit in government also involves audit on the basis of standards of financial propriety (as does the external audit) and, therefore, is required to observe upon cases of improprieties in financial operations.

The present scope of internal audit is as follows:

The Internal Audit Unit will work directly under the Pr.CCAs/CCAs/CAs, with overall responsibility remaining with the concerned Financial Adviser and the Secretary of the Ministry/Department. The Principal Accounts

Office, the Pay and Accounts Offices as well as the offices of the D.D.Os in Ministries/Departments, Indian Missions and other Govt. of India offices abroad, shall be within the jurisdiction of internal audit. In addition to these offices, internal audit shall be required to audit the implementing agencies for various schemes and programmes of the Ministry/Department.

Internal Audit shall also check the initial accounts maintained in the executive offices to ascertain the extent of following of the rules and regulations, system and procedures in accounting and financial matters. The scrutiny would cover checking of all accounting records including those relating to fund accounts, loans and advances, disposal of confiscated stores (in CBEC), review of the installation and operating efficiency of expensive equipments and machinery and examination of records relating to physical verification of stores, equipments, tools and plant. The accounts of all grantee Institutions or Organizations shall be open to inspection by the sanctioning authority and audit, both by the Comptroller and Auditor General of India under the provision of CAG (DPC) Act 1971 and internal audit by the Principal Accounts Office of the Ministry or Department, whenever the Institution or Organization is called upon to do so and a provision to this effect should invariably be incorporated in all orders sanctioning grant in aid.”

As per the new charter of duties and responsibilities of Chief Controllers of Accounts issued by the Secretary, Department of Expenditure, Ministry of Finance, the following functions will be carried out as per the guidelines issued by the Controller General of Accounts from time to time.

- (i) The appraisal, monitoring and evaluation of individual schemes;
- (ii) Assessment of adequacy and effectiveness of internal controls in general, and soundness of financial systems and reliability of financial and accounting reports in particular;
- (iii) Identification and monitoring of risk factors including those contained in the Outcome Budget;
- (iv) Critical assessment of economy, efficiency and effectiveness of service delivery mechanism to ensure value for money; and
- (v) Providing an effective monitoring system to facilitate mid course corrections.”

Observation of the C&AG on the functioning of Internal Audit indicates that there are serious deficiencies in the existing internal audit system making it inadequate and ineffective. The internal audit guidelines are outdated and there are no manuals in many cases. There are also no prescribed internal auditing standards. Because of the acknowledged problem of under-resourcing of the internal audit service and shortage of manpower, including that of qualified professional staff, internal audit is not being conducted in many departments. The limited staff of the internal audit is also sometimes diverted for accounting and budgeting purposes. In cases where internal audits have been conducted, there is often lack of response to their reports by auditee units. As a result action is not taken to rectify the deficiencies and irregularities and the deficiencies pointed out persist. A large number of Central and State scheme and programmes as well as Public Sector Undertakings and Autonomous Bodies have also been kept out of the purview of internal audit. At the supervisory level, there is no segregation of duties relating to internal audit and other accounting functions. The reports of internal audit are of a routine nature. It is largely a faultfinding exercise with no positive recommendations. Extremely low priority is accorded to internal audit and to resource allocation for internal audit both in terms of manpower and finances.

### Second ARC recommendations

- a. *An Office of the Chief Internal Auditor (CIA) should be established in select Ministries/departments to carry out the functions related to internal audit. Its independence, duties, functions, mechanism of coordination with the CAG etc. should be provided by a statute.*
- b. *CIA should be directly responsible to the Secretary of the Department.*

- c. *In the initial stages, personnel may be inducted from existing accounts cadres. Norms for recruitment and utilizing private sector expertise in select tasks may also be devised. Capacity building needs for proper functioning of this Office should be identified in advance.*
- d. *The modalities for ensuring non-duplication of work vis-à-vis the C&AG should be formalized. This should be aimed at assisting the C&AG in concentrating on carrying out specialized audit/tasks.*
- e. *Standards for internal audit should be prescribed by the Office of the C&AG.*
- f. *The Accounting functions should be completely separated from Internal Audit.*
- g. *The functioning and effectiveness of this new system may be examined after allowing a suitable period of operation. Based on the results of this examination, such offices may also be instituted in other Ministries/ departments/ organisations.*
- h. *An Audit Committee should be constituted in each Ministry/Department. It should consist of a Chairperson and two members to be appointed by the Minister in charge of that Ministry/Department. The Chairperson should be a person of eminence in public life. The two members should be from outside the government. The Audit Committee should look after matters related to both internal and external audit including implementation of their recommendations and report annually to the respective Departmentally related Standing Committee of Parliament.*

## External Audit and Parliamentary Control

External audit has a very important role to play in financial management, because it :

- (a) provides assurance to Parliament/Legislature that public money has been spent for the purpose for which it was sanctioned by the Parliament/Legislature and that it has not only been properly spent but has achieved the purpose/ outcome for which it was sanctioned.
- (b) is a crucial element of public accountability as it is an independent external scrutiny. External audit is, therefore, deemed to be a key element in ensuring proper accountability of the executive both to the Parliament/Legislature who provide/ sanction resources and to the community including tax payers, consumers and beneficiaries.
- (c) is a deterrent against careless decision-making and irresponsible attitude towards public expenditure and project management.
- (d) is expected to establish public confidence that public money is being properly spent.
- (e) is expected to help in achieving full value for money. External audit includes examination of the economy, efficiency and effectiveness in the use of public resources including the evaluation of service quality and measurement of performance.
- (f) adds value not merely by analysing and reporting what has happened after the event but also by looking ahead and identifying lessons to be learnt and by disseminating good practices.

### Types of Audit

The role of audit in India has been constantly evolving. Initially, in the pre-Independence period, audit was an integral organ of the Government keeping track of its expenditure and receipts, checking and exercising control over expenditure incurred by various Departments in accordance with rules, norms and instructions. In Independent India, planning and development changed the audit perspective. It was realized that Regularity (Compliance) Audit and Financial Audit were not enough to evaluate the results of expenditure out of public funds.

Performance Audit, slowly developed as an attempt to measure the economy, efficiency and effectiveness of the Government expenditure.

The following types of audit are undertaken by the CAG:

- Performance Audit
- Regularity (Financial) Audit
- Regularity (Compliance) Audit
- IT Audit

### **Strengths of External Audit in India**

The external audit by the CAG of India has many inherent strengths.

- (i) The CAG has a high status enshrined in the Constitution, upheld by long traditions of public audit in India. The institution of audit under the CAG is often regarded as the fourth pillar in the democratic setup and an essential instrument of financial control and accountability.
- (ii) The Constitution of India ensures independence and autonomy of the public audit.
- (iii) The expression 'Audit' or scope of the audit has not been defined either in the Constitution or the CAG's DPC Act, 1971. The scope of external audit is, therefore, wide. Audit can respond to changes, reforms, new initiatives, changing patterns of Government activities, international developments in the profession and rising expectations of the stakeholders regarding public accountability.
- (iv) The CAG has the power to determine the nature and extent of audit and related access to records and to relevant information.
- (v) The CAG has the inherent right to determine what should be included in the Audit Reports.
- (vi) There is a requirement that Audit Reports should be tabled in the Parliament/ Legislature and thereafter these become public documents.
- (vii) There are well documented Audit Manuals and audit guidelines for the Auditors to follow.
- (viii) Auditing Standards framed on lines of INTOSAI (International Organization of Supreme Audit Institutions) guidelines are available.
- (ix) There are discussions in the Public Accounts Committee of the Parliament/ Legislature on the important observations contained in the Audit Reports.

### **Challenges before the External Audit**

There is no doubt that external audit by the CAG has contributed a great deal in improving the financial management in the country keeping in view the large number of Inspection Reports issued, Audit Reports presented to the Parliament/Legislature and the recoveries made at the instance of audit. In its Reports, Audit raises many important issues relating inter-alia to weak budgetary controls, deficiencies in revenue collection, wastage of public resources, inappropriate accounting, poor returns on investments, diversion of funds, system deficiencies and numerous instances of poor management of public resources, etc.

There is, however, a feeling that the impact/effectiveness of external audit could be further enhanced. Some of the factors and perceptions, which are impeding the effectiveness of external audit are given below.

- (i) Detailed examination of paras included in the Audit Reports by Public Accounts Committee is barely about 15-20 against the total number of 1000 to 1500 paras included in the CAG's reports submitted to

the Parliament every year. The Ministries/Departments take only those audit paras seriously which come up for discussions in the PAC.

- (ii) The Ministeries/Departments are supposed to submit Action Taken Notes on the paras not discussed. Such Action taken Notes are largely formal rather than substantive.
- (iii) In the State Legislatures, there is a huge pendency of Audit Paras to be examined by State PACs. Some of the pending paras are 10 to 20 years old. Delay in examination of matters brought out in the Reports reduces their relevance.
- (iv) Thousands of inspection reports containing a huge number of observations are lying unattended in the State and Union Government Departments. Many of these paras have revenue implications. There is hardly any accountability for not taking timely action on audit observations.
- (v) There is a feeling that the CAG's reports are sometimes not timely because there is substantial time gap between occurrence of an irregularity and its reporting by Audit. It reviews programmes after these have run for a few years. CAG's audit itself is post facto and by the time, the process of auditing and reporting is completed, its findings and recommendations may be too late for corrective action. Many transaction audit comments relate to earlier years and not to the year of the Audit Report.
- (vi) Audit findings are based exclusively on documents and files. Many a times, the situation on the ground is quite different from what is reflected in the papers. There is practically no physical verification to supplement or validate the audit findings.
- (vii) There is a feeling that external audit reports tend to be unduly negative and their focus is on irregularities and faultfinding. Audit does not always recognize the practical constraints under which the Government/ Government Agencies function.
  - Audit often does not discriminate between errors arising out of bonafide intentions/malafide intentions. § Government Agencies are handicapped by unknown/ unforeseen problems, delays beyond their control and unexpected hurdles. The auditors on the other hand have the benefit of hindsight. Audit as such could act as a dampner against new initiatives and risk taking.
- (viii) Audit Reports are not always presented in a sufficiently constructive manner, as they often do not delve into the causes of the problems and how to address them.
  - Reporting each year a large number of problems which are already known and which are not being addressed does not add value. Audit must therefore identify systemic problems.
  - Findings are at times not focused and are in the nature of scattered observations. A macro level view of the functioning of a department is seldom available.
  - Audit does not give due credit for good performance.
- (ix) The relationship between the auditor and auditee is not always harmonious. Generally interaction is confined mainly to the lower levels.
  - Audit is viewed as a system for policing Government Organisations. The view that audit is a valuable aid to management is normally missing.
  - There is poor/inadequate response to external audit bordering sometimes on indifference on the part of Government officials, which seriously reduces the effectiveness of audit.
- (x) Though Audit Committees comprising representatives of audit and government agencies have been set up to review the departmental action taken on inspection reports/recommendation, their functioning is not satisfactory.

- (xi) There is lack of informed media coverage of CAG's reports on Union/ State Governments.
  - The extent of public interface between the auditors and civil society is poor. Inspection reports are not in the public domain.
- (xii) There is inadequate synergy/coordination between external audit and internal audit.
- (xiii) External audit does not provide audit assurance on the fair presentation of financial statements of the Government in accordance with stated accounting principles and policies.
- (xiv) There is rarely any audit of grants and loans to NGOs.

### **Relationship between Audit and the Government/Government Agencies**

Due to the very nature of its role as watchdog, independent audit is sometimes perceived by government agencies and auditees as a mere fault finding exercise. This perception has, on occasions, led to lack of adequate cooperation by the auditees which results in tardy response to audit observations. In such cases, external audit does not have the desired impact.

There is need for better understanding and synergy between government agencies and audit so that there is proper accountability and timely oversight and consequently better audit impact. The information provided by the external audit is useful only if the executive acts upon it. How to encourage a more collaborative approach to public audit is the real challenge. This calls for a more positive approach by both auditors and auditees.

Another area of concern is that audit is often perceived by the auditees as discouragement to innovate, change and reform. This is because departments associate risk taking or innovations with the increased possibility of something going wrong leading to financial loss and consequently their censure by the audit. Because of this apprehension officers prefer to play it safe and continue with the traditional time tested methods of functioning even when need for innovations or reforms is obvious because unlike audit, they do not have the benefit of hindsight. Therefore, before indicting an officer for an innovation or reform which may have caused a financial loss, the audit should carefully examine whether the department had taken adequate steps to identify the risks and planned suitably before carrying out the reforms/innovations. If this had been done and no malafide is indicated then audit should not be hasty to draw adverse conclusions.

There is a need for deepening and enhancing the level of interaction between audit and the executive at senior levels. They should discuss important issues, recommendations and what needs to be done arising out of audit. Audit should not remain isolated; While independence of audit is crucial to objectivity, it should not mean isolation. There should be increasing coordination with the executive. There should be a quarterly communication from the Accountant General to each Administrative Secretary informing the latter of significant points and systems deficiencies noticed during audit inspections. Additionally there should be quarterly meetings relating to pending inspection reports, audit observations and clearance during the quarter and various issues of common interest including audit recommendations for improvements. Audit should consider their views with an open mind and appreciate their constraints. A concern has been that the public audit reporting is unduly negative. While it is true that audit has a major role in ensuring accountability, this does not mean a negative or only faultfinding approach.

The Commission is of the view that there is paramount need to sensitize the executive towards the role and findings of audit so that the two sides realize that they are not working at cross purposes but for the same objective of delivery of the programmes in a manner which leads to achievement of objectives, outcomes and also promotes accountability. Further, the Auditing Standards require Auditors to be careful to avoid offering implied criticism in cases where although the original anticipations have not been realized, there are no strong indications, significant or substantive of inefficiency or waste on the part of the administrative authorities.

Audit organizations in all the developed countries have been moving towards positivism while still maintaining their key role. Everybody is sensitive to criticism but amenable to reason and logic and ready to take corrective action. Rather than focus exclusively on irregularities, external audit should conduct studies and evaluation of systems e.g. accounting, financial management, internal control, risk management, contracting, procurement, etc. and offer constructive suggestions for strengthening Government operations and reforms oriented towards best practices. Audit should look at itself as an agency for change and improvement rather than primarily detection of irregularities.

### Second ARC recommendations

- a. *There is need for better understanding and synergy between the audit and auditees for enhanced public accountability and consequently better audit impact.*
- b. *There should be balanced reporting by the audit. Audit reports should not focus on criticism alone but contain a fair assessment or evaluation, which would mean that good performance is also acknowledged.*
- c. *There is need for increasing interaction as well as coordination between the executive and the audit, including at senior levels. These should include regular and meaningful meetings where important issues could be discussed and conclusions reached on what needs to be done arising out of the recommendations made by the audit. There should also be quarterly communication from the Accountant General to Administrative Secretaries informing them about significant points and areas of improvement noted by Audit during their inspections.*

## Financial Management in State Governments

Some of the issues which need to be addressed by the State Governments are briefly analysed below.

- **Integrated Financial Advisers**

The extent of delegation of financial powers to Departments varies from State to State. It has generally been observed that since this delegation is quite limited, most of the financial proposals get referred to the Finance Department. Some States have created the mechanism of Financial Advisers in some major Departments, but their powers are also rather inadequate. The same compulsion that made the Union Government implement the scheme of Integrated Financial Adviser for assisting administrative ministries in planning, programming and budgeting should now be the reason for State Governments to introduce the system of FA in various departments where FAs would be the representatives of the Finance Department. This should be coupled with greater delegation of financial powers to the Departments. But all these need to be preceded by capacity building of the Departments in financial administration.

- **Multi-year Budgeting**

Along with the introduction of the FA system, multi-year budgeting would help in bringing about better fiscal discipline and financial management. The present system of budgeting in the States for a year at a time suffers from a number of weaknesses. The most important is that full financial implications of projects, which are to be implemented over a number of years, are not brought out fully. A government decision may entail only a nominal expenditure in year one, but may call for sizable expenditure in the following years. With one year budgeting system, the full implications of incomplete work are not realized. It is, therefore, necessary that State Governments shift to multi-year budgeting and give the estimates of revenue and expenditure for a period of four years in addition to the year which the budget pertains. This should be done on a roll-on basis. This will enable better estimation of the fund requirements of on-going schemes, programmes and projects. It will also ensure realistic budgeting.

- **Realistic Estimates and Proper Assumptions while Preparing Budget**

There is need to have economic assumptions which are prudent and realistic in order to formulate budget estimates which are accurate and not overly optimistic. At the end of every financial year, the gap between

the estimates and the actuals should be analysed so that the underlying economic assumptions could be suitably calibrated for the future.

- **Avoiding Ad hoc Announcements Token Provisions**

As stated earlier in the case of Government of India, in States also, in spite of detailed instructions and guidelines in budget manuals, projects and schemes are announced on an ad-hoc basis during visits of high-level functionaries. Such announcements of large sums seriously distort plan allocations and disturb the faithful implementation of schemes already approved under the budget. This could also lead to announcements not being followed by formal approvals thereby resulting in discontent among people and financial indiscipline.

The proper method would be to include projects that may be considered absolutely essential at the time of preparing the annual plans and budgets. The practice of announcing projects and schemes on an ad-hoc basis needs to be abandoned.

A related practice is to make token provisions in the budget. This is resorted to facilitate announcement of a large number of projects. This can result in spreading limited resources thinly over a large number of projects and starvation of projects already under execution. Cost and time over-runs are consequences of this practice. It is therefore necessary that norms for sanction of projects should be rigidly adhered to.

- **Skewed Expenditure Pattern**

As in the case of Union government, the expenditure pattern of the State Governments is also highly skewed with the bulk of expenditure taking place in the last quarter and particularly in the month of March. Government of India has tried to overcome this problem by introducing the Monthly Expenditure Plan (MEP). A similar system should be adopted by the States.

- **External Audit**

The Public Accounts Committees in some States have a practice of examining all paragraphs and performance audit reports included in the CAG's Audit Reports, while others have adopted a more selective approach. In the former case, due to the volume of work involved, the Reports of the CAG are sometimes not discussed for years together, often upto 10-15 years and the arrears keep mounting. The approach of discussing all the paragraphs in the order of the year of their presentation often results in examination of matters as old as 10-20 years many of which may have lost their relevance due to the lapse of time. In other State Legislatures, where selective approach is adopted, the status on effectiveness is similar to the one in the case of the Central PAC/ COPU discussed above.

The PACs and COPUs in all States may accord priority to the consideration of the latest Audit Report, selecting matters for detailed discussions in such a manner that they can complete scrutiny of that Report within one year.

As regards the clearance of arrears, the PACs/ COPUs may simultaneously take up the outstanding past Audit Reports for selective scrutiny in a phased programme, so that the arrears would be cleared within a period of say two to three years.

The implementation of the aforesaid recommendations did result in some improvements but a large number of paras are still pending. As per the status paper of the CAG on the detailed examination of Audit Reports by the State PACs/COPUs, 14,715 paras/reviews were pending for discussion as on 31st March 2006 and some of the paras date back to 1983-84. This would indicate that the examination of CAG paras included in the Reports is still in heavy arrears in almost all States.

To overcome the situation, the Legislative Committees may like to adopt a time frame within which they would complete examination of audit reports also and submit their reports to the Legislature. The State

Governments may also specify a time frame for the Departments for necessary follow up action on the recommendations of Audit and forwarding of the ATNs for vetting to the Accountant General before their final submission to the State PAC/ COPU. It is also necessary to ensure that all Departments adhere to the prescribed time limits.

GS SCORE

# IAS 2020-21

“  
DON'T WAIT FOR IT TO  
HAPPEN.  
MAKE IT HAPPEN.”

# IAS FOUNDATION 2020-21

## 1 Yr. & 2 Yrs. GS FOUNDATION COURSE

Regular Classroom & Live Online Courses

Programmes

<b>OPTIONAL</b>	→ Political Science → History	→ Public Administration → Geography		
<b>MODULAR</b>	→ GS Mains Advance → Ethics	→ Essay Writing → Indian Economy		
<b>TEST SERIES</b>	→ Prelims → GS Mains	→ Essay → Ethics	→ Pol. Science → Pub. Admn.	→ History → Geography

# GS SCORE

An Institute for Civil Services

**PIONEER** in **Assessment Based Learning**

**ADMISSIONS OPEN** | Download detailed schedule at [www.iasscore.in](http://www.iasscore.in)

Office No. 6, 1st Floor, Apsara Arcade, Karol Bagh, New Delhi-110005, (Karol Bagh Metro Station Gate No. 5)

☎ 011-47058253, 8448496262 ✉ info@iasscore.in 🌐 iasscore