INDIA: PUBLIC EXPENDITURE AND FINANCIAL ACCOUNTABILITY

Public Financial Management Performance Assessment Report

Pratap Ranjan Jena

NIPFP
NATIONAL INSTITUTE OF PUBLIC FINANCE & POLICY

India: Public Expenditure and Financial Accountability

Public Financial Management Performance Assessment Report

India: Public Expenditure and Financial Accountability

Public Financial Management Performance Assessment Report

Pratap Ranjan Jena

With assistance from
Satadru Sikdar

National Institute of Public Finance and Policy
New Delhi

Email: nipfp@nipfp.org.in

ISBN 978-81-88035-11-3
Price Rs. 150/-
US $ 10/-

Published by
National Institute of Public Finance and Policy
18/2, Satsang Vihar Marg
Special Institutional Area, (Near JNU),
New Delhi – 110 067

Printed by:
VAP Enterprises
H-24, Green Park Extn.
New Delhi – 110 016
Email: info@vaponline.com;vap_enterprises@yahoo.co.in

Preface

The National Institute of Public Finance and Policy undertook this study in response to the request of the World Bank. Opinions expressed are those of the authors and the Members of the Governing Body of the Institute are in no way responsible for these.

M. Govinda Rao
Director

New Delhi
March 19, 2010

Acknowledgement

The authors gratefully acknowledge the help and co-operation of officials in the various departments of Government of India and senior faculty members at the National Institute of Public Finance and Policy (NIPFP) for providing information and insights into the functioning of the PFM system in the country. Special thanks are due to M. Govinda Rao, Director, NIPFP, R. Kavita Rao, Professor, NIPFP, and Amiya K. Ghosh, Distinguished Fellow, Centre for Air Power Studies for their valuable comments and suggestions. The authors would like to thank A. K. Thakur, Director General of Audit, Central Revenue, V. Sivasubramanian, Director, Budget, Ministry of Finance, Anuradha Prasad, Financial Manager (Maritime System) and JS, Ministry of Defence, S. M. Kumar, Additional Controller General Accounts, Department of Expenditure, J. K. Mishra, Deputy Controller General Accounts, Department of Expenditure, Sanjay Kumar, Commissioner, Income Tax, Central Board of Direct Taxes, and Vijay Singh Chauhan, Additional Director, Directorate of Revenue Intelligence for their help and cooperation. Thanks are due to P. K. Subramanian, Lead Financial Management Specialist, World Bank, who continuously helped and guided the authors throughout the course of this study. The authors would like to thank the PEFA Secretariat, Washington, and experts from the World Bank, particularly, Leslie I. Kojima, Senior Financial Management Specialist, Manoj Jain, Senior Financial Management Specialist, Amadou Tidiane Toure, Lead Procurement Specialist, Sushil Kumar Bahl, Senior Procurement Specialist, A.K. Kalesh Kumar, Senior Procurement Specialist, Mohan Nagarajan, Senior Economist, Puneet Kapoor, E T Consultant, and Michael Jacobs, Consultant, for providing substantial feedbacks on the draft version of the assessment report. The authors are indebted to M. Govinda Rao, Director, NIPFP, for his constant support and guidance during the course of the study. The authors thank Kavita Issar for her assistance in bringing the report to this book form. While expressing indebtedness to all who have contributed to this study, any remaining errors of omission are solely the responsibility of the authors.

Table of Contents

List of Tables

List of Acronyms

APM	:	Administered Pricing Mechanism
ARC	:	Administrative Reform Commission
BIA	:	Board of International Audit
BPE	:	Bureau of Public Enterprises
CAA&A	:	Controller of Aid Accounts and Audit
CAG	:	Comptroller and Auditor General
CBDT	:	Central Board of Direct Taxes
CBEC	:	Central Board of Excise and Customs
CCA	:	Chief Controller of Accounts
CGA	:	Controller General of Accounts
COFOG	:	Classification of Functions of Government
COPU	:	Committee on Public Undertakings
CPSE	:	Central Public Sector Enterprises
CSO	:	Central of Statistical Organisation
CSS	:	Centrally Sponsored Scheme
CVC	:	Central Vigilance Commission
DDOs	:	Drawing and Disbursing Officers
DFPRs	:	Delegation of Financial Power Rules
DGS&D	:	Director General of Supply & Disposal
DMO	:	Debt Management Office
DOPT	:	Department of Personnel & Training
DPE	:	Department of Public Enterprises
DSA	:	Debt Sustainability analysis
EDMU	:	External Debt Management Unit
FA	:	Financial Advisor
FC	:	Finance Commission
FD	:	Financed Department
FRBM	:	Fiscal Responsibility and Budget Management
GASAB	:	Government Accounting Standards Advisory Board
GDP	:	Gross Domestic Product
GFR	:	General Financial Rules
GFS	:	Government Finance Statistics
GoI	:	Government of India
IAS	:	Indian Administrative Service
IFA	:	Integrated Financial Advisor
IFAC	:	International Federation of Accounts
IFMIS	:	Integrated Financial Management Information System
IGAS	:	Indian Government Accounting Standards
IIA	:	Institution of Internal Auditors
IMF	:	International Monetary Fund
INTOSAI	:	International Organization of Supreme Audit Institution
IPSAS	:	International Public Sector Accounting Standards
ITAT	:	Income Tax Appellate Tribunal

ITJ	:	Indian Trade Journal
LTU	:	Large Taxpayers Unit
MEP	:	Monthly Expenditure Plan
MoF	:	Ministry of Finance
MSS	:	Market Stabilization Scheme
MTFP	:	Medium-Term Fiscal Policy
NCA	:	Normal Central Assistance
NRHM	:	National Rural Health Mission
NSDL	:	National Securities Depository Ltd
PAC	:	Public Accounts Committee
PAN	:	Permanent Account Number
PAO	:	Pay and Account Officer
PEFA	:	Public Expenditure and Financial Accountability
PEs	:	Public Enterprises
PESB	:	Public Enterprises Selection Board
PFM	:	Public Financial Management
PI	:	Performance Indicator
PSU	:	Public Sector Units
QEA	:	Quarterly Expenditure Allocation
QEDS	:	Quarterly External Debt Statistics
RBI	:	Reserve Bank of India
RTI	:	Right to Information
SAI	:	Supreme Audit Institution
SBE	:	Statement of Budget Estimates
SDDS	:	Special Data Dissemination Standard
SNG	:	Sub National Government
SSA	:	Sarva Shiksha Abhiyan
SSC	:	Staff Selection Committee
TFC	:	Twelfth Finance Commission
TIN	:	Tax Information Network
UPSC	:	Union Public Service Commission
UTIISL	:	UTI Investors Service Ltd.
WPI	:	Wholesale Price Index
ZBB	:	Zero Based Budgeting

Summary Assessment

The objective of this PFM performance report is to assess the current status of the PFM system in India at the Central Government level. The assessment is expected to contribute towards identifying priorities for PFM reform, and informing efforts to formulate and implement a PFM reform strategy. It will serve as a baseline against which progress on PFM performance can be measured over time. The assessment indicates both the strengths and weaknesses of the existing PFM system. The approach of the performance report is based upon careful analysis of existing PFM systems, procedures and practices in India in recent years as determined through interactions with government officials related to financial management systems, and reviews of official documents and reports. The report also draws from the contemporary literature on the subject relating to India.

It needs to be noted that the coverage of the assessment is limited to Central Government and leaves out the sub-national governments in the Indian Union. These governments are entrusted with substantial functional responsibilities spanning both social and economic sectors. In India both the central and state governments play crucial roles in undertaking mandated functional responsibilities for key areas of policy regulation, oversight, revenue administration, debt and cash management, budget management, and monitoring and evaluation. The sub-national governments have a wider service delivery role in the Indian Union and the information on resource availability at field level in the front line service delivery units is limited for the central level. However, the PFM system at both levels of government is largely similar and in some areas a unitary institutional set-up exists that caters to both levels with a similar set of financial rules and institutional machinery.

The PFM performance review for India at the central level presents an assessment of the 28 high level indicators of the PEFA Performance Measurement Framework. The report, however, is not intended to provide recommendations to improve the PFM system in the country in terms of an action plan. The report also does not provide any specific fiscal policy inputs relating to revenues or expenditures. It is a diagnostic assessment only. It is expected that the assessments of the PFM system through the various indicators will assist policy makers in determining subsequent reform efforts.

Integrated Assessment of PFM Performance

The summary of the performance of PFM systems, procedures and practices as measured through the PEFA indicators is described in the following sections. The six critical dimensions of PFM performance assessment provided by the PEFA framework are credibility of the budget, comprehensiveness and transparency, policy-based budgeting, predictability and control in budget execution, accounting, recording and reporting, and external scrutiny and audit.

Credibility of the Budget

The credibility of the budget was assessed mainly through two critical indicators of expenditure and revenue out-turn as compared to the budget estimates. At the aggregate level the expenditure out-turn (expenditures net of debt repayments and the donor funded project expenditure) was substantially higher than the budget estimates for all the three years reviewed (12.95% in 2006-07, 10.62% in 2007-08 and 36.95% estimated in 2008-09). Internal policy interventions to increase subsidies and to a lesser degree to raise grants to states were important causes. Scheme-specific grants transferred to the states by the departments and ministries have been included within the sector expenditures. The increased level of expenditures was made available through the mechanism of supplementary demands, used for in-year budget adjustments, the primary objective of which is intended to be to meet unforeseen expenditures. Through the supplementary demands funds for under budgeted central schemes and fiscal stimulus packages in the difficult year of 2008-09, when the growth of the national economy plummeted below the target level, were also provided. The higher expenditure out-turn as against the budget estimates, largely in the revenue expenditure rather than the capital expenditure, certainly adversely affects budget credibility, as it indicates poor planning and implementation of expenditures and non-regard for the sanctity of the budget estimates. Favorable revenue out-turns as compared to the budget estimates during the first two of these years mitigated the effects of these higher expenditures. This was due to the high growth of the economy and some timely improvements in tax administration. The pattern of revenue out-turn as against the budget estimates, however, shows that revenue projections have remained a challenge depending upon the growth of the economy and the global market situation. This was evident when the revenue out-turn as against the budget estimates turned negative in the year 2008-09 following the international economic crisis and consequent slow down in the growth rate of the economy. Overall budget credibility is affected by the absence of a hard budget constraint, thereby allowing substantial adjustments in the budget during the year through supplementary grants, and the absence of an accurate revenue projection mechanism by which the movement of economy and changes in tax administration determine the actual revenue collection.

Comprehensiveness and Transparency

India has achieved a reasonably high level of fiscal transparency and the comprehensiveness of the fiscal information publicly available has improved in recent years. Transparency is viewed here as reflecting the aims of government and the financial results of its operation at the end of the year. The major objective of fiscal transparency is to inform the common citizen about the policy choices available, the implications of each choice, and the reasons as to why a particular choice is preferred. Some progress has been made in this direction. After the adoption of the Fiscal Responsibility and Budget Management Act (FRBM), the government started presenting fiscal policy strategy documents and projected major fiscal indicators in the medium term. This has provided better understanding of government fiscal policies

relating to revenue generation and expenditure prioritization. The budget documents also contain relevant information on macroeconomic forecasts, fiscal deficit indicators, deficit financing sources, government borrowings and debt stock, prior year budget out-turns, and outlines of new tax polices and fiscal data. The extent of unreported government operations is limited and the financial operations of extra-budgetary funds are reported in the budget. However, these are not accounted for in the estimation of the fiscal deficit.

The budget classification system in India which takes into account the COFOG functional classification system is consistent with the GFS manual of 1986 based on the cash accounting system. However, the GFS manual of 2001, which presents advanced standards for compilation and presentation of fiscal statistics, follows the principle of accrual accounting and its coverage of events is broader than the earlier version representing cash based transactions. Efforts are now being made to introduce an accrual based accounting system for government transactions.

The intergovernmental fiscal transfer system is complex due to the existence of various sources of funding to state governments. In the system of transfer of resources to the state governments, the discretionary elements have increased over the years. The tax devolutions recommended by the Finance Commission are transparent and based on a formula devised by taking into account various indicators and their weights. However, in the actual plan transfers, the relative share of formula based transfers have declined and discretionary components in the form of scheme based transfers have increased. Under many of these scheme based transfers, the funds are routed to the implementing agencies out of the state budget. While a considerable amount of information on the likely flow of resources to the state governments becomes available to assist their budget estimates, uncertainties remain because of changes in central tax collections during the year.

More attention needs to be paid to providing public access to key fiscal information, and to reporting on Central Government oversight on the public sector enterprises and the details of fiscal risks arising from the activities of these enterprises. Although the Central Government has a formal oversight and monitoring mechanism, the aggregate fiscal risk is not generated and reported in budget documents, except that of the loan guarantees.

Policy Based Budgeting

The budget preparation in India is guided by a budget calendar, which is generally indicated in the budget circular issued by the Ministry of Finance for the year. The budget circular is issued in the month of September and it provides sufficient time to the ministries/departments to complete their budget preparation before the budget is presented in February. The budget preparation involves participation of ministries/departments when they submit their initial budget estimates followed by interactions with the Ministry of Finance, where the budget ceilings are communicated to departments. The

departments finalize their budget estimates after taking into account the expenditure ceilings communicated by the Ministry of Finance and the plan allocations from the Planning Commission, which determines the size of funding for new schemes.

A multi-year perspective in expenditure planning and budgeting has been lacking in India. While attempts were made in past to initiate medium term fiscal policy, they were given up in latter years. The enactment of the FRBM Act and stipulation of presenting a Medium Term Fiscal Policy (MTFP) along with the budget brought back the issues once again into the budgeting system. However, while the MTFP mandates presentation of three year rolling targets relating to major fiscal indicators such as revenue deficit, fiscal deficit, tax revenue and outstanding liabilities as percent to GDP, a detailed medium term expenditure framework for various sectors is not worked out by projecting expenditure implications of programmes undertaken for outward years. The budgeting thus remains strictly annual without a multi-year perspective relating to expenditure commitments of various sectors.

It is maintained that the five year plans in India provide the basis for a multi-year perspective for resource allocation. However, the economic planning and budget differ in their scope and time span. While plans provide a conceptual framework by focusing on various sectors in the economy, the budget is more concerned with systems of control over the use of funds by government and pays more attention to financial aspects. It is not uncommon to initiate major projects and schemes which are not provided for in the plan. Further, in the context of current budgetary practice, the link between the plan and the budget is weak. In the process of budget preparation the plan allocations are dispersed over various heads and sub-heads of expenditure. While the debt information including both from external and internal sources are regularly reported by the government and Reserve Bank of India, debt sustainability analysis in a multi-year framework is not carried out; nor are costed sector strategies prepared.

Predictability and Control in Budget Execution

The predictability and control systems in budget execution is assessed taking into account performance of indicators such as effectiveness of tax administration in providing a transparent mechanism with regard to taxpayer obligation, registration and assessment, and effectiveness of collecting tax arrears; predictability of availability of resources; reporting practices relating to cash balances and debt; payroll controls; transparency in procurement; and effectiveness of internal control and internal audit.

The central taxes are administered based on explicit legal provisions, which are subject to procedural and legal safeguards. However, in the Indian tax system the scope for administrative discretion is considerable in practice due to large numbers of exemptions and reliefs, and frequent changes in tax provisions, making the tax laws relatively complex. The internal audit system is not strengthened to ensure accountability of tax collection staff and adherence to established tax administration policies and procedures in their

dealings with taxpayers. Despite various efforts of the government, taxpayers face difficulties in accessing information on tax liabilities and administrative procedures. A structured taxpayer education programme covering various aspects of tax payment is absent, which adds to the compliance cost.

The Indian tax system is, however, marked by a well structured tax appeal mechanism through which the tax disputes arising out of various provisions relating to tax assessments and penalties are taken up. Despite a well laid out appeal mechanism, the time taken to dispose of the appeals is long, and a large number of cases remain pending. The taxpayer registration is maintained by allotting a Permanent Account Number (PAN) to individuals. The PAN is the key element of maintaining a taxpayer registry and it is linked with other government registration system. While tax administration in India has adequate legal provisions to take action against delinquent taxpayers, its ability to collect the taxes assessed is obstructed by the taxes remaining under dispute, and arrears both in dispute and not in dispute are only slowly cleared.

Efforts were made to improve the predictability in the availability of funds for commitment of expenditure through efficient cash management and planning of market borrowing calendar by stipulating monthly and quarterly ceilings of expenditure for the departments. However, in practice the unevenness of expenditure and rush of expenditure towards the end of the financial year still remains a problem due to weak adherence to the cash management programme.

Recording and Management of Cash Balances, Debt and Guarantees by the government of India have improved significantly and a comprehensive report on Central Government liabilities is provided in the budget documents. Over the years, the coverage and compilation procedures of external debt statistics have become more comprehensive and the dissemination of external debt statistics too has improved; India has also been able to comply with both IMF's Special Data Dissemination Standard (SDDS) and World Bank's Quarterly External Debt Statistics (QEDS). As regards financial assets, the budget provides information on the government’s opening cash balance, which is maintained by the Reserve Bank of India (RBI). The RBI maintains the cash balance of the Government and invests in government securities held in its portfolio for the purpose. While loan guarantees given by the Central Government are reported in the budget, complete information on implicit guarantees is absent.

An Integrated Financial Management Information System (IFMIS) incorporating systems for management of personnel database and payroll records at Central Government level in India does not exist. The management of personnel, maintenance of the personnel database, and preparation of payroll are the prime responsibility of departments and ministries. The personnel database of government employees in terms of their number, staffing pattern as against approved posts, salary bill are maintained by each department and ministry. While a direct link between personnel database and the payroll for each month is not established, the payroll is prepared after

reconciling with the previous month's payroll. Ministries and departments maintain a service book for each employee where all the personnel details and payroll data are recorded. Any change in personnel records and the payroll are recorded in the service books of the Government employees, which are updated regularly. The Budget section of Ministry of Finance collects the information from every ministry, which is part of their expenditure proposals shown in demand for grants, and this information enters into the budget estimates of the government.

There is no law exclusively governing public procurement of goods by the departments and ministries. Rules and directives in this regard provided in the General Financial Rules (GFR), 2005 and manual on procedures for purchase of goods guides the procurement process. An important number of instructions, issued by the Central Vigilance Commission (CVC), supplement these regulations. With the exception of certain control and oversight functions carried out by central authorities such as the Comptroller and Auditor General and the CVC, no central authority exists that is exclusively responsible for defining procurement policies and for overseeing compliance with the established procedures. As per the rules and procedures on procurement stipulated in the GFR the Ministries or Departments have been delegated full powers to make their own arrangements for procurement of goods. Tenders for contracts above a threshold size are issued and are reported by the respective departments. In the absence of required expertise, a Ministry or Department can procure goods through the Central Purchase Organization, Directorate General of Supplies and Disposals (DGS&D). While rules and principles governing procurement are published, the data on actual procurement by various departments and ministries of the Government is not publicly available.

Despite the existence of the financial rules for effective internal expenditure control, the actual practice falls short of the standard. The unevenness of expenditures during the year that spikes during the last quarter of the financial year still remains a problem in expenditure control. The surrender of unspent amounts, 'savings', from various grants to the Finance Ministry and excess expenditures not regularized are witnessed regularly as brought out by the CAG in their audit reports. These deviations indicate inadequate programme management and internal control through the year. There is also the prevalence of personal ledger accounts, a device intended to facilitate the designated officer to credit receipts into and effect withdrawals directly from the account to avoid losing it at the end of the year. Lack of comprehensive data base limits the ability to manage the assets efficiently. The internal audit, a useful management tool to control misuse and mismanagement of public funds, has not been effective to serve the objectives of an effective internal control system.

The expenditure commitment controls are not effective in India. The Appropriation Act, meant for authorizing withdrawals from the Consolidated Fund for incurring expenditure based on the approved budget estimates, do not distinguish between commitment and expenditures. The budget preparation exercises faults on overlooking expenditure arrears as there is no

provision in the budget for the ensuing year to discharge the expenditure arrears of the previous year(s). The year end financial statement, Appropriation Accounts, is prepared on a cash basis reporting cash execution of the expenditure plans approved by parliament and do not report on commitments. The statutory requirements for budget implementation focus exclusively on controlling expenditures with respect to budget appropriations. The cash management system is not integrated with control over commitments. Lack of an effective cash management mechanism in the line Ministries and Departments is a stumbling block to implement commitment control system. The expenditure ceiling, which is communicated to the departments during their pre-budget meeting with the Ministry of Finance, mostly relate to the line item control. There is no instrument to assist and guide the Head of the Accounts to know that sufficient unencumbered funds are available at the time of entering into obligations.

Internal audit has remained a weak link in the financial management system. Internal audit in India is conducted in a routine manner and the result of this audit on improving the financial management system is insignificant. The internal audit system has not been updated over several decades and due importance has not been given to securing 'value for money' and accountability. The Task Force on Internal Audit, constituted by the CAG observed that the internal audit in India has a restricted mandate, does not have the ability to evaluate risks. It was also noted that that no standards have been evolved for internal audit in India and it did not have the required independence for its effective functioning.

Accounting, Recording and Reporting

Central Government accounts are reconciled with those of the accounts kept by the Reserve Bank of India (RBI), the banker to the government, on a monthly basis. The general banking business of the Central Government (which includes the receipt, collection, payment and remittance of moneys on behalf of the Government) is carried on and transacted by the RBI. The Controller General of Accounts (CGA) in the Ministry of Finance compiles the aggregate accounts of the ministries/departments from the compiled accounts received from the departmental accounts sections and these accounts are reconciled with the cash balance of the ministries/departments maintained by the RBI in its Central Accounts Section.

While there are no provisions for presenting a mid-year budget report to the Parliament, the aggregate monthly accounts prepared by the Controller General of Accounts (CGA), compiled from the departmental accounts, provide monthly accounts of budget implementation. The monthly accounts of the Central Government are important in-year budget reports that are accessible to the general public through the website of the CGA. These monthly accounts are reviewed and a critical analysis of expenditure, revenue collection, borrowings and deficit is prepared for Finance Minister. The Finance Accounts and Appropriation Accounts prepared by the CGA are the consolidated year-end financial statements of the Government of India. These documents are based on the detailed information for all the

ministries/departments and decentralized units. The year-end financial statements are accessible to the general public. The accounts for the government sector in India are prepared on a cash basis and the year-end financial statement reflects this accounting system. However, the year-end financial statements in the form of Finance Accounts and Appropriation Accounts are presented with a time lag of 8 to 10 months.

External Scrutiny and Audit

The preparation of budget and its approval in the Parliament, provisions for which are enshrined in the Constitution of India, goes through legislative scrutiny and the Parliament exercises full control over the annual budgetary system through this mechanism. Without the approval of the parliament no tax measures can be introduced (barring executive ordinances for temporary measures) and no expenditures can be incurred by the executive. The process of preparing the budget, discussing it in Parliament, and its subsequent approval is considered as an effective instrument of financial control of government activities. To facilitate proper examination of different Demands for Grants leading to more meaningful discussion in the Parliament departmentally related Standing Committees are constituted drawing members from both the houses of the Parliament. The Standing Committees consider the demands for Grants of the concerned ministries/departments and make a report to the House. The Parliament also exercises its control over the provision of supplementary or additional funds required in a particular year and for regularizing any excess expenditure over the approved appropriations.

A unitary audit in federal setup is designed to play a significant role in effective financial administration of the country. The Constitution of India has provided the Comptroller and Auditor General of India (CAG) as a high independent statutory authority. The Constitution prescribes exhaustive safeguards for the independent functioning of CAG. The range of audit performed by the CAG includes regularity (financial) audit, regularity (compliance) audit, IT audit and performance audit. The audit assists Parliament in exercising financial control over the executive to ensure that funds approved have been utilized with due regard to economy and efficiency, and the funds authorized to be raised through taxation and other measures have been assessed, calculated and credited to the government properly. The audit reports of CAG are examined by a Parliamentary committee, Public Accounts Committee (PAC), which makes recommendations to Parliament on various issues involved. However, the PAC's examination of the audit report is not comprehensive, as the committee over the years has scrutinized only a limited portion of the audit reports. While the recommendations made by the PAC were taken seriously by the executive, its scope was limited as the PAC considers only a small portion of the audit reports. The Action Taken Notes submitted by the departments and units audited by the CAG relating to other audit observations not examined by the PAC were largely formal rather than substantive. CAG's reports are sometimes not timely because there can be a substantial time gap between

the occurrence of an irregularity and it's reporting by CAG. It reviews programmes after these have run for a few years.

Assessment of Impact of PFM Weakness

When judged from the perspective of the three main objectives of an effective public financial management system—namely, aggregate fiscal discipline, strategic allocation and the efficient delivery of services—many problems exist in India. While efforts of the government and the role of legal and institutional mechanisms in strengthening the financial management systems are evident in many areas, the actual practice leaves much to be desired. The adoption of rule based fiscal management by enacting the Fiscal Responsibility and Budget Management Act helped in monitoring aggregate fiscal indicators, but its impact on the actual practice of financial management is not clear. The budgeting system in India is conventional input-based and more concerned with basic financial compliance; but this has not resulted in establishing effective fiscal discipline. Absence of a multi-year perspective in expenditure planning, lack of robust macro-economic forecasting on which to base the budget, and inherent weaknesses in adhering to the procedures laid down in Constitutional and legal provisions have negatively affected PFM outcomes. The assessment of PFM practices at central level provides little opportunity to measure service delivery as these are the responsibilities of sub-national government. While the PFM practice at both central and state government are largely similar the information on actual service delivery and resource availability to implementing agencies at field levels is limited at the central level leaving few flagship programmes.

Aggregate Fiscal Discipline

With respect to aggregate fiscal discipline, an elaborate expenditure control mechanism exists in India; debt strategy and debt management practices are reasonably well developed; rules and regulations are developed for procurement system; rule based fiscal management is adopted through the FRBM to monitor and adhere to stipulated deficit indicators; and Parliamentary control over budgetary practice and expenditure control is established following the Constitutional provisions. At the same time, the absence of a multi-year perspective in the expenditure planning that indicates future year commitments, a lack of effective fiscal risk assessment at an aggregate level, the unevenness and the late spike in the annual spending pattern, surrender of money at the end of the fiscal year in an annual lapsable budget cycle due to a lack of effective programme management in budget implementation, an absence of a hard budget constraint, and weak internal control and internal audit system are important weaknesses of the PFM system that limit fiscal discipline. While external audit in the country is well established and facilitates the legislative in exercising control over the executive, the process of scrutiny of the audit reports has deteriorated, adversely affecting its effectiveness.

Strategic Allocation of Resources

Strategic resource allocation in India is affected by the lack of well developed sector strategies based on government objectives, developing and costing of programmes to achieve those objectives and linking the resource allocation to the priorities specified in sector strategies. Although the five year economic plans provide strategic resource allocations at an aggregate level, the five year plans and budgeting differ looking at their scope and time span. While plans provide a conceptual framework by focusing on various sectors in the economy, there are divergences between plan and budget in the resource mobilization and allocation and organizational structure. In the existing budgetary practice, the programmes referred to as schemes in Indian practice are diffused and do not provide a comprehensive perspective as to their link with government policy objectives. The cash basis of accounting followed by the government does not have the capacity to reveal the full outlays either on a programme or a project. In the existing budgeting system performance information is not included to improve strategic resource allocation.

Efficient Service Delivery

In the federal arrangement the sub-national governments have wide ranging responsibilities with regard to service delivery. The Central Government, however, intervenes in the state subjects through specially designed central schemes to improve the front line service delivery. The role of Central Government in contributing to efficient service delivery through effective monitoring of transfers to implementing agencies, providing guidance through policy measures and evaluating the performance in these services become important. The overall financial management system including the efficient revenue collection, expenditure control, cash and debt management to address liquidity problems, efficient intergovernmental transfer system are all important elements to facilitate better programme management and service delivery.

Prospects for Reform Planning and Implementation

The institutional arrangement within the government provides support to initiate reform planning and implementation processes. The initiatives taken by the government in recent years has put PFM issues at the forefront. The role of PFM systems in contributing to fiscal discipline, strategic resource allocation through better programme management and improving service delivery has gained attention in recent years. The government policies in expanding social sector spending has made it necessary to look at ways to improve programme management and actual service delivery. Attention is being given to improve the PFM systems and processes including planning for budgeting, budgeting process, resource management, internal control and audit, accounting and reporting and external audit. The government has appointed important study groups to examine various aspects of PFM systems and to recommend reform measures. A comprehensive view needs to be taken to strengthen the financial management systems in the country as it will be difficult to deliver through isolated reform initiatives.

PFM Performance Measurement Framework Indicators Summary

Table 0.1: Overall Summary of PFM Performance Scores

		Scoring Method	Dimension Ratings				Overall Rating
			i	ii	iii	iv	
A.PFM-OUT-TURNS: Credibility of the budget							
PI-1	Aggregate expenditure out-turn compared to original approved budget	M1	C				C
PI-2	Composition of expenditure out-turn compared to original approved budget	M1	C				C
PI-3	Aggregate revenue out-turn compared to original approved budget	M1	A				A
PI-4	Stock and monitoring of expenditure payment arrears	M1	NR	D			NR
B. KEY CROSS-CUTTING ISSUES: Comprehensiveness and Transparency							
PI-5	Classification of the budget	M1	A				A
PI-6	Comprehensiveness of information included in budget documentation	M1	A				A
PI-7	Extent of unreported government operations	M1	A	A			A
PI-8	Transparency of inter-governmental fiscal relations	M2	B	B	A		B+
PI-9	Oversight of aggregate fiscal risk from other public sector entities	M1	C	C			C
PI-10	Public access to key fiscal information	M1	A				A
C. BUDGET CYCLE							
C(i) Policy-Based Budgeting							
PI-11	Orderliness and participation in the annual budget process	M2	A	D	C		C+
PI-12	Multi-year perspective in fiscal planning, expenditure policy and budgeting	M2	D	D	D	D	D
C(ii) Predictability and Control in Budget Execution							
PI-13	Transparency of taxpayer obligations and liabilities	M2	C	C	B		C+
PI-14	Effectiveness of measures for taxpayer registration and tax assessment	M2	A	B	B		B+
PI-15	Effectiveness in collection of tax payments	M1	D	A	A		D+
PI-16	Predictability in the in the availability of funds for commitment of expenditure	M1	C	B	C		C+
PI-17	Recording and management of cash balances, debt and guarantees	M2	A	A	A		A
PI-18	Effectiveness of payroll controls	M1	B	B	B	C	C+
PI-19	Competition, value for money and controls in procurement	M2	NR	NR	D		NR
PI-20	Effectiveness of internal controls for non-salary expenditure	M1	D	B	D		D+
PI-21	Effectiveness of internal audit	M1	D	C	D		D+

		Scoring Method	Dimension Ratings				Overall Rating
			i	ii	iii	iv	
C(iii) Accounting, Recording and Reporting							
PI-22	Timeliness and regularity of accounts reconciliation	M2	B	B			B
PI-23	Availability of information on resources received by service delivery units	M1	A				A
PI-24	Quality and timeliness of in-year budget reports	M1	C	A	A		C+
PI-25	Quality and timeliness of annual financial statements	M1	A	B	C		C+
C(iv) External Scrutiny and Audit							
PI-26	Scope, nature and follow-up of external audit	M1	B	D	C		D+
PI-27	Legislative scrutiny of the annual budget law	M1	A	A	A		A
PI-28	Legislative scrutiny of external audit reports	M1	D	C	A		D+

Note: NR - Not rated

I. Introduction

1.1 The PFM Performance Assessment: Objective and Context

The objective of this Public Financial Management (PFM) performance assessment is to assess the Government of India's PFM systems, procedures and practices at the union level using the Public Expenditure and Financial Accountability (PEFA) PFM performance measurement framework. The assessment is expected to provide a baseline relating to the PFM system at the Union level which can be referred to in any future assessment. The PEFA PFM performance measurement framework provides a scoring system on a scale from A to D based on qualitative and quantitative assessments of various features of the performance of the PFM system. In this study the performance indicators are scored in accordance with the dimensions to be assessed and scoring methodologies prescribed by the framework. Background features, procedures and processes of the relevant indicators are described to explain and support the scoring. While emphasizing the need to carry out an indicator based assessment, a review of economic and fiscal developments is done and the institutional arrangements, legal and regulatory frameworks are elaborated to provide a setting in which the PFM system operates.

Although the PFM systems at the state level (SNGs) are similar to those of the Central Government and at an operational level extensive administrative and financial interface exist, the states have considerable financial and functional independence based on Constitutional provisions relating to division of expenditure responsibilities and resource raising powers. The states in India are at different level of fiscal capacity and development trajectory and these factors are recognized in the scheme of devolution of resources from the Central Government. Below the state government a third tier of local governments was created following a Constitutional amendment with defined financial and functional responsibilities.

The government of India has initiated many innovations in the PFM systems over the years. The reform measures span over many areas and include important components of the system such as budget management, accounts and audit, institutional strengthening for financial management, and capacity building.

In this context it needs to be emphasized that the purpose of this PFM performance assessment is not to evaluate government offices or individuals responsible for financial management based on the scores. The assessment relates to providing a basis for measurement and monitoring of public financial management systems at the union level. The study makes no attempt to analyze fiscal or expenditure policy to determine its sustainability, desired effect of the

resource allocation, and policy impact on service delivery and also does not set any reform agenda. The performance measurement framework does not measure the factors impacting the performance. The study through performance indicators focuses on the operational performance of the key elements of the PFM system.

1.2 Approach, Methodology and Scope of PFM Assessment

The PFM assessment of the country at the union level is carried out using the PEFA framework and rating for each of the performance measurement indicators indicated using the scoring methodology. The assessment framework based on the 28 indicators is structured into three main categories: PFM system out-turns, crosscutting features of the PFM system, and the budget cycle. Although the study does not set a reform agenda, the assessment will provide information useful for the government in its reform initiatives by ascertaining potential areas for improvement and identifying possible priorities and areas requiring attention.

The PFM performance measurement framework is an integrated monitoring framework that allows measurement of country PFM performance over time (PEFA Report, World Bank, 2005). The PFM performance measurement framework is designed to measure PFM performance of countries across a wide range of development over time. In this framework a set of indicators is designed to measure and monitor performance of PFM system, processes and institutions. The assessment is based on review of published macro and fiscal data of the Central Government, government documents relating to operation of PFM systems, research studies on various aspects of fiscal and financial management, and interviews with government officials in relevant departments to collect information for basing the Performance Indicators (PIs) ratings. Wide ranging discussion were held with Central Government officials in the departments of Budget, Expenditure, Revenue Administration, Aids Accounts and Statistics, Controller General of Accounts and Comptroller and Auditor General of India, which is the Supreme Audit Institution in the country to examine the functioning of the various components of the PFM system and collect information and data.

The PFM assessment is conducted against 28 Public Financial Management (PFM) performance measurement indicators, PI-1 to PI-28, in accordance with the Public Expenditure and Financial Accountability (PEFA) framework. The performance indicators relating to donor practices which impact the performance of country PFM system, D-1, D-2 and D-3, are not assessed in this report as the external assistance at Central level has been very low. The share of external assistance in the gross revenue of the Central Government has remained less than one percent in recent years. However, the external donor agencies support the State Governments in India through loans and grants for

various projects. As per the recommendations of the Twelfth Finance Commission, the Central Government has been transferring or onlending external assistance to states without acting as a financial intermediary. That is, the states avail such assistance, on the terms and conditions of the lending agencies including foreign exchange risk, which was earlier the responsibility of the Central Government.

The PFM assessment was carried out during the period March 2009 to June 2009. The draft report was revised after receiving comments from the experts at World Bank and PEFA Secretariat during November to December 2009. The PFM Assessment Report for Government of India at Union level, following the PEFA framework, is an independent research activity carried out by designated researchers at National Institute of Public Finance and Policy, New Delhi. The researchers at the Institute benefited from the discussions held with some of the Government officials in understanding the operation of PFM system at Union level. The assessment report, thus, does not involve direct participation of any department or official of the Government of India. The assessment in the report also does not represent any official view of the Institute. The budgetary data, published government documents and information collected from relevant departments were used to describe the operational aspect of PFM system and scoring the performance indicators. The performance of the PFM system as assessed in the report was supported with the relevant published data and information from the Government reports depending upon their availability. Information was not gathered from the private sector or civil society to verify the government information sources. Where the data and information were not available or insufficient, the performance indicators are reported as 'Not Rated' in the report. The following areas of PFM system are examined for performance assessment following the PEFA framework.

i. **Credibility of the budget –** The extent of budget realism in terms of being implemented as planned.

ii. **Transparency and comprehensiveness –** The extent to which coverage of the budget, including the determination of overall fiscal risk, is adequate, and the public has unfettered access to budget and outcomes information.

iii. **Policy-based budgeting –** The extent that budget formulation is in line with the policies of the government.

iv. **Predictability and control in budget execution –** The extent of systematic and predictable budget implementation and the effectiveness and efficiency of expenditure and revenue management and controls.

v. **Accounting, recording and reporting –** The effectiveness and transparency in maintaining and reporting on the public finances

and the reliability and adequacy of financial information for management decision-making.

vi. **External scrutiny and audit –** The arrangement for, extent and scope of scrutiny of public finances as well as the timeliness and the strength of corrective measures taken.

The study involved following activities:

1. Reviewing PFM institutional structure through legal and regulatory documents, budgetary documents and financial auditing reports.
2. Analysis of budgetary data to prepare the performance indicators to assess the PFM-Out-turns (credibility of the budget).
3. The information on budget classification, budget documents, unreported government operations, arrears, fiscal risks and transparency related issues such as public access to fiscal information were collected and analyzed to provide ratings on Key Cross-Cutting Issues. The entire budget cycle was analyzed to provide rating on performance indicators relating to budgetary policy, and predictability and control in budget execution.
4. The financial accounting and reporting system and audit and control system were analyzed and relevant information were collected to assess the performance in these areas.
5. Discussions were held with relevant government officials to examine the institutional set up and working of PFM system at the union level. Discussions with key government officials in relevant departments included the scope of various reform measures undertaken to strengthen the PFM system and results of such reform.
6. The report was prepared as per the guidelines given in the PEFA Secretariat - PFM Performance Measurement Framework. The report includes required supporting data to facilitate the review of the report.

The structure of the rest of the evaluation report is as follows:

- Chapter 2 provides background information and the economic and fiscal context for the evaluation;
- Chapter 3 explains the scores for the 31 individual performance indicators;
- Chapter 4 describes the government's reform programme; and
- A series of appendices provides more detailed reference information

1.3 Structure of the Public Sector

India is a Sovereign Democratic Republic, containing a federal system with Parliamentary form of Government in the Union and the States, an independent judiciary, guaranteed Fundamental Rights and Directive Principles

of State Policy containing objectives which though not enforceable in law are fundamental to the governance of the nation. There are 28 States and seven centrally administered Union Territories in the Indian Union. After the country attained independence on 15 August 1947, the Constitution of the Republic came into effect on 26 January 1950. The union government, as India's Central Government is known, is divided into three distinct but interrelated branches: legislative, executive, and judicial. The parliamentary model as enshrined in the Constitution ensures that the leadership of the executive is drawn from and responsible to the legislative body. Although Article 50 of the Constitutions stipulates the separation of the judiciary from the executive, the executive controls judicial appointments and many of the conditions of work.

The Legislature: India has a parliamentary form of government based on universal adult franchise. The executive authority is responsible to the elected representatives of the people in the Parliament for all its decisions and actions. Parliament consists of a bicameral legislature, the Lok Sabha (House of the People - the lower house) and the Rajya Sabha (Council of States - the upper house). Rajya Sabha (The Council of States) consists of not more than 250 members, of whom 12 are nominated by the President of India and the rest elected. It is not subject to dissolution; rather, one-third of its members retire at the end of every second year. The elections to the Council are indirect. The Rajya Sabha is presided over by the Vice- President of India. The House of the People consists of 552 members. Of these, 530 are directly elected from the 28 States and 20 from the seven Union Territories. Two members are nominated by the President to represent the Anglo-Indian community. Unless dissolved sooner, the term of the House is five years from the date appointed for its first meeting. The Lok Sabha elects its own presiding officer, the Speaker.

The Executive: The President of India is the Head of the State and the Commander-in-Chief of the Armed Forces. He is elected by an electoral college composed of members of both the Houses of Parliament (Rajya Sabha and Lok Sabha) and the legislatures of the constituent States. The President holds office for five years and can be re-elected. The Executive Power of the union vests in the President and is exercised by him either directly or through officers subordinate to him in accordance with the constitution (Article 53). The President does not normally exercise any constitutional powers on his own initiative. These are exercised by the Council of Ministers, headed by the Prime Minister, which is responsible to the elected Parliament. The Vice-President is elected jointly by the members of both the Houses of Parliament. The person enjoying majority support in the Lok Sabha is appointed Prime Minister by the President. The President then appoints other ministers on the advice of the Prime Minister. The Prime Minister can remain in office only as long as he or she enjoys majority support in the Parliament.

The Judiciary: The judiciary is independent of the executive. It is the guardian and interpreter of the Constitution. The Supreme Court is the highest judicial

tribunal, positioned at the apex of a single unified system for the whole country. Each State has its own High Court. A uniform code of civil and criminal laws applies to the whole country.

The States: The States have their own Legislative Assemblies and in certain case a second Chamber. All members of the Legislative Assemblies are elected by universal adult franchise. The Head of the States are called Governors, appointed by the President. They normally exercise the same powers in the States as the President does at the Union government level. As in the Central Government, each State has a Cabinet headed by the Chief Minister responsible to the elected State Legislature.

Election Commission: The electoral machinery is centralized in an independent statutory body called the Election Commission. The Commission is responsible for the 'superintendence, direction and control' of the electoral rolls for all elections to Parliament and to the State Legislatures and also for conducting the elections.

1.4 The Conduct of Government Business

The Constitution has provided a detailed framework for the governance system in India, which deals with the Union Executive, the Parliament and Union Judiciary. The executive power of the Union vests in the President. The Council of Ministers headed by the Prime Minister aids and advises the President who acts in accordance with such advice in exercising these functions. As per the "The Government of India (Allocation of Business) Rules", the business of the Government of India is transacted in the Ministries, Departments, Secretariats and Offices specified in the First Schedule to these rules (hereinafter "departments"). The distribution of subjects among the departments and the manner in which the officers are required to help the Minister in discharge of his/her executive functions are specified. The Minister-in-charge has the responsibility to dispose all business allotted to a Department under his general or special directions, subject to certain limitations where consultation is required with other departments or where cases have to be submitted to the Prime Minister, the Cabinet and its Committees or the President. These Rules provide for the constitution of some Standing Committees of the Cabinet to help in decision making.

The work of Government of India is distributed into different Ministries/Departments. A department is responsible for formulation of policies of the government in relation to business allocated to it and also for the execution and review of those policies. For the efficient disposal of business allotted to it, a department is divided into wings, divisions, branches and sections. A department is normally headed by a secretary to the Government of India who acts as the administrative head of the department and principal adviser of the Minister on all matters of policy and administration within the department. As per the General

Financial Rules (GFR) the secretary is the Chief Accounting Authority of the department responsible for administrative and financial management.

The work in a department is normally divided into wings with a Special Secretary/Additional Secretary/Joint Secretary in charge of each wing. Such a functionary is normally vested with the maximum measure of independent functioning and responsibility in respect of the business falling within his wing subject, to the overall responsibility of the Secretary for the administration of the department as a whole. The functions of each of these are spelt out in the Central Secretariat Manual of Office Procedure. Each Department may have one or more attached or subordinate offices where the execution of the policies of the government requires decentralization of executive action and direction. Attached offices are generally responsible for providing executive direction required in the implementation of the policies laid down by the department to which they are attached. They also serve as repository of technical information and advise the department on technical aspects of question dealt with by them. Subordinate offices generally function as field establishments or as agencies responsible for the detailed execution of the policies of government.

The existing structure of the Government of India evolved over a long period of time has its strengths and weaknesses. According to the Administrative Reform Commission of India (ARC, 2009), the existing system has adhered to rules and established norms, provided continuity and stability, politically neutral and committed to the Constitution, provided link between policy making and its implementation, and has a national outlook. At the same time, according to the ARC, the system has given undue emphasis to routine functions, facilitated proliferation of Ministries/Departments resulting in weak integration and coordination, emphasized hierarchical structure, increased tendency of avoidance of risk in decision making, and avoided team work.

II. Country Background Information

2.1 Description of the Country Economic Situation

2.1.1 Economic Growth

The Indian economy has remained buoyant in recent years. The pace of growth of GDP has averaged 8.7 percent during the last four years, making the country one of the fastest growing economies in the world. However, there has been a moderation in growth in 2008-09 due to the fallout of the global economic crisis The Indian economy moved past the 'Hindu growth rate' of around 3.5 to 5.5 percent in the early 1980s and following the introduction of broad based economic reforms, the growth had started accelerating since the mid 1990s and achieved 7.8 percent growth of GDP during the 10th Five Year Plan (2002-03 to 2006-07). The accelerating domestic investment and savings rates supported the growth path. The high growth in the economy helped in improving government revenues which provided fiscal space to both central and state governments and led to achieving the fiscal targets led down by the Fiscal Responsibility and Budget Management Act (FRBM).

GDP at factor cost at constant prices grew at the rate of 9 percent in 2007-08 and the growth rate was more than 9 percent in the previous two years (*Table 2.1*). The impressive performance of the Indian economy in recent years was driven by the industrial and service sectors. Manufacturing activities, the largest component of the industrials sector, contributed heavily to the overall growth of GDP. Besides manufacturing, the construction sector provided momentum to growth. The growth of the service sector continued to be broad based although the transport and communication sector showed the fastest growth. Agricultural growth, which depends heavily on the monsoon, showed a fluctuating trend.

Impressive growth in savings and investment played a key role in recent growth in the economy. The reform process initiated during the 1990s was considered to have improved business confidence with entrepreneurial activities contributing to a rise in competitiveness of the economy and a growth of manufacturing thus accelerating the rate of investment. The gross domestic savings continued to rise and reached 36 percent in 2007-08. Both the private and public savings have contributed to higher overall savings. One notable feature of resurgence in savings and investment in recent years is the emergence of a negative savings-investment balance implying an improved demand situation in the economy. The savings-investment gap in the national income accounts is represented by the current account deficit and reflects the utilization of foreign savings.

The rise in the inflation rate in 2006-07 was contained in 2007-08 by monitoring prices and adopting other policy interventions. Inflationary pressure, however, started rising in 2008-09. Average annual WPI inflation

changed from 6.5 per cent in 2004-05 to 4.4 per cent in 2005-06, 5.4 per cent in 2006-07 and 4.7 per cent in 2007-08. Inflationary pressures were exacerbated during 2008-09 by the hardening of international prices of crude oil, minerals and metal related products. With prices of these items shooting up in world markets, imported inflation played a crucial role in domestic inflation in 2008-09. However, because of the higher inflation in the early part of the year, the average inflation of 52 weeks reached 9.2 per cent on January 24, 2009. This was considerably higher than the 52-weeks average of 4.6 per cent in the corresponding period of the previous year. In respect of primary articles, the average 52-weeks inflation at 10.6 per cent as on January 24, 2009 was higher than the average 52-weeks inflation of 8.0 per cent in the previous year.

Table 2.1: Growth of Indian Economy: Sectoral Composition, Investment and Savings Rates

Per cent

	2004-05	**2005-06**	**2006-07**	**2007-08**	**2008-09(A)**	
Agriculture & Allied Activities	-0.2	5.9	3.8	4.5	2.6	
Mining & quarrying	8.2	4.9	5.7	4.7	4.7	
Manufacturing	8.7	9.0	12.1	8.8	4.1	
Electricity, gas & water supply	7.5	4.7	6.0	6.3	4.3	
Construction	16.1	16.5	12.0	9.8	6.5	
Trade, hotels, transport, communications	10.9	11.5	11.8	12.0	10.3	
Finance, insurance, real estate & business services	8.7	11.4	13.9	11.8	8.6	
Community, social & personal services	6.8	7.2	6.9	7.3	9.3	
GDP at factor cost	**7.5**	**9.4**	**9.6**	**9.0**	**7.1**	
Industrial sector	10.3	10.1	11.0	8.5	4.8	
Services sector	9.2	10.3	11.1	10.8	9.6	
Per Capita GDP	5.8	7.8	8.1	7.5	5.6	
					July 08	**Jan 09**
Investment Rate	32.2	35.5	35.9	37.4	37.5	35.0
Savings Rate	31.8	34.3	34.8	36.0	34.5	33.1
Average WPI Inflation	6.5	4.4	5.4	4.7	10.5	8.7
Current Account Balance as ratio to GDP	(-)0.4	(-)1.1	(-)1.1	(-)1.5	(-)3.2	(-)1.9

Source: Central Statistical Organisation, GOI, Review of the Economy 2008-09 EAC to the PM, Macro-Economic Framework Statement (Budget 2009-10) GOI

The year 2008-09 remained a difficult year due to the international economic crisis and the pace of economic growth in the country was adversely affected. The Central Statistical Organization (CSO) in its advance estimates has predicted growth of 7.1 per cent for GDP during 2008-09 as compared to 9 per cent in 2007-08. The moderation in growth for 2008-09 is mainly attributed to a sharp slowdown in growth in industry to 4.8 per cent from 8.1 per cent in 2007-08. Within industry, the manufacturing and construction activities are expected to moderate sharply. Growth in agriculture, forestry and fisheries is estimated to decline to 2.6 per cent in

2008-09 as against a growth of 4.9 per cent in 2007-08. Services is slated to grow at 9.6 per cent in 2008-09 as compared to a growth of 10.9 per cent in 2007-08, with growth in financing, real estate, insurance and business services declining, and growth in community, social and personnel services increasing. The fiscal situation in the country has worsened partly because of the global financial crisis and partly because of internal developments such as the rises in government expenditures and liabilities. The deficit position of the Government has increased significantly beyond its FRBM targets.

Building on the growing strength of Indian economy and impressive growth in recent years the Eleventh Five Year Plan sets a target for 9% growth in the five year period 2007–08 to 2011–12 with acceleration during the period to reach 10% by the end of the Plan. The five year plan intends to make the growth inclusive by benefiting the poor and marginal section of the society, improving education and health standards, reducing poverty and expanding employment for all sections, reducing the gap between urban and rural sectors, and reducing the interstate disparity. While the country has made strides on many fronts, basic problems of poverty, unemployment and inequality remain as major drawbacks. The Eleventh Plan document points out that despite the decline in the poverty level, more than 300 million people remain below the poverty line. The proportion of the population deprived of a minimum level of living is much higher. While steady improvement was made in human development such as literacy and education, and maternal and infant mortality rates, the progress is slow and the country lags behind several other Asian countries (UNDP, Human Development Report, 2007-08).

The economic crisis, which had a negative impact on the pace of economic development during the last year, will definitely put pressure on the five year development plan of the country. However, it has been argued that the fundamentals of the economy have grown stronger over the years. The economy has undergone a process of modernization post economic reforms of 1991 and the economic institutions and enterprise are in a much better shape to face the crisis. Even as the economy is growing below its potential rate, the possibility of revival is very strong.

2.2. Description of Budgetary Outcomes

2.2.1 Fiscal Situation

The fiscal adjustment programme initiated in India in the aftermath of macroeconomic crisis in 1990-91 comprising tax and non-tax reforms, expenditure management and institutional reforms resulted in significant fiscal corrections in terms of reducing the fiscal deficit and the debt to GDP ratio up to the mid 1990s. The finances of Central Government, however, started deteriorating towards the end of the 1990s on account of rising revenue expenditure, a fall in tax buoyancy, a slow down in PSU restructuring, and upward revision of staff salaries on the basis of recommendations of the Fifth Pay Commission. The fiscal deficit of the Central Government reached a peak of 6.2 percent of GDP and the revenue deficit was over 4 percent of GDP in 2001-02. Towards the end of the nineties finances of the state

governments also deteriorated, taking the combined deficit to more than 10 percent of GDP in 2001-02.

There has been an appreciable turnaround in the fiscal situation in the country from 2001-02 to 2007-08. Central and State governments contributed to this turnaround in equal measure. According to the fiscal restructuring plan recommended by the Twelfth Finance Commission, Central and State governments taken together were required to phase out revenue deficits and bring down the consolidated fiscal deficit to 6 percent of GDP. The plan envisaged Central Government compressing the deficit to 3 percent of GDP and the consolidated deficit of the states to be reduced to 3 percent. It was seen that although the performance of the Centre in reducing the revenue deficit has lagged behind the plan, both Central and State governments have been successful in reducing their fiscal deficits to less than 3 percent of GDP in 2007-08, one year before the target date.

The Central Government enacted the Fiscal Responsibility and Budget Management Act (FRBM) in 2003 to provide a legal and institutional framework to bring down the fiscal deficit, contain the growth of public debt, and stabilize debt as a proportion of GDP over the medium term. There was a steady reduction in both the revenue and fiscal deficits of the Central Government and the reduction was sharper after the enactment of the FRBM Act. The fiscal deficit relative to GDP was reduced from 6.2 percent in 2001-02 to 4.5 per cent in 2003-04 and further to 2.7 per cent in 2007-08. Similarly, the revenue deficit was reduced from 4.4 per cent in 2001-02 to 3.6 per cent in 2003-04 and sharply thereafter to 1.1 per cent in 2007-08. It is expected to be a 4.7 per cent deficit for 2008-09 rather than the Fiscal Responsibility and Budget Management Act plan for a surplus.

Closer analysis of the fiscal variables at central level shows that the rise in revenue generation was the main contributor to the fiscal consolidation process. Sustained economic growth and improved performance of manufacturing and services and the improvement in tax administration contributed to the rise in tax revenues. The improvement in the revenue deficit was due to very sharp increase in the Central tax revenues, particularly in direct taxes. The gross tax revenues of the Centre as a ratio of GDP increased by 4.4 percentage points between 2001-02 and 2007-08 of which 3.4 percentage points increase was after 2003-04 (*Table 2.2*). The compression in expenditures is rather low.

Table 2.2: Trends in Central Finances

(Percent to GDP)

	2001-02	2003-04	2006-07	2007-08	2008-09 (RE)
Net Revenue Receipts	**8.83**	**9.58**	**10.48**	**11.55**	**10.36**
Tax Revenue (Net)	5.86	6.79	8.47	9.36	8.59
Non-tax Revenue	2.97	2.79	2.01	2.18	1.77
Gross Revenue Receipts	**11.18**	**12.02**	**13.38**	**14.82**	**13.35**
Gross Tax Revenue	8.21	9.23	11.37	12.64	11.57
Personal Income Tax	1.40	1.50	2.06	2.53	2.26
Corporation Tax	1.61	2.31	3.48	4.11	4.09
Customs	1.77	1.77	2.08	2.22	1.99
Excise	3.18	3.30	2.84	2.63	2.00
Service Tax	0.14	0.29	0.91	1.09	1.20
Others	0.10	0.08	0.00	0.05	0.04
Revenue Expenditure	**13.23**	**13.14**	**12.41**	**12.67**	**14.81**
of which					
Interest Payments	4.72	4.50	3.62	3.64	3.55
Major Subsidies	1.34	1.58	1.28	1.49	2.38
Defence Expenditure	1.67	1.57	1.25	1.22	1.42
Capital Outlay	**2.67**	**3.96**	**1.66**	**2.52**	**1.80**
Total Expenditure	15.90	17.11	14.07	15.19	16.60
Fiscal Deficit	**6.19**	**4.48**	**3.44**	**2.70**	**6.02**
Revenue Deficit	**4.40**	**3.57**	**1.94**	**1.12**	**4.45**
Oil/Fertilizer/Food Corp /Other Bonds	0.46	0.09	0.98	0.81	1.76

Source: Budget Documents, Government of India, Economic Outlook for 2009-10, Economic Advisory Council, Government of India

RE: Revised Estimates

The slow down in the economy in 2008-09 has resulted in a sharp reversal of the trend (*Table 2.2*). The revenue deficit deteriorated to 4.45 percent and fiscal deficit was estimated at over 6 percent of GDP, which were far more than the FRBM targets of achieving surplus after March 31, 2008. The fiscal deficit does not include government's off budget liabilities by way of bonds issued to oil companies and fertilizer companies to compensate their losses in the administrated price regime. The projected deficits would be much higher if these budget liabilities are accounted for. This magnitude of fiscal deficit is unprecedented and is considered to have surpassed the previously highest level of deficit incurred in 2001-02. The government has undertaken a number of measures and put forward three fiscal stimulus packages to combat economic slowdown in India, besides initiating a number of measures on the monetary policy side.

2.2.2 Budgetary Developments

Following a tax reform programme in the country after the economic crisis of 1991 that focused on simplifying the tax system, reducing exemptions and tax rates with the objective of providing incentive for better tax compliance, the direct taxes – personal and corporate income tax - showed impressive growth. The composition of gross tax revenue changed in favour of the direct taxes as their relative share increased from about 40 percent in 2002-03 to over 50 percent in 2007-08 (*Table 2.3*). The personal and corporate income taxes demonstrated remarkable growth rates of 25 and 32 percent during this period. The direct tax reform gave importance to expansion of the tax base, strengthening tax administration, and improving tax compliance. In the case of indirect taxes, the effort was to bring in a moderate and simplified tax structure with reduced tax rates. To widen the tax net and to provide non-distortionary treatment to goods and services, a service tax was introduced in 1994-95 and its ambit has been continuously expanded since then. The service tax proved to be a buoyant source of revenue for the government. Efforts were being made to introduce a comprehensive Goods and Services Tax replacing existing taxes on production and sale of goods and services collected by both the central and state governments. Strengthening of tax administration and adoption of information technology to create computerized information system has brought about significant changes in the direct tax compliance in recent years. The growth of tax revenue, however, remained subdued in 2008-09 due to decline in growth of manufacturing activities and services.

The composition of government expenditure reveals that the general services comprising interest payments, retirement benefits, administrative services and other administrative services remained the major component of the total expenditure (*Table 2.4*). The interest payment which was about 28 percent of total expenditure has declined to below 20 percent in 2008-09. The interest payments have declined in recent years due to softening of interest rates thus reducing the average cost of borrowing. The relative share of defence expenditure after registering an increase till 2004-05 has declined. The Central Government expenditure on social service shows a rising trend. This is due to rise in central funding of various schemes called Centrally Sponsored Schemes (CSS) implemented at state level. The CSS are largely implemented by specially created implementing agencies and elected local bodies. The CSS are meant to provide additional resources to the states for implementing programmes that are considered by the Government of India to be of national/regional importance. There are large numbers of such schemes run by various Central Government ministries and expenditures under CSS are contained in sector expenditures. The share of social sector expenditures in total expenditure for Central Government is relatively low as the expenditure responsibilities in social sector are mostly borne by the state governments as provided in the Constitution.

Table 2.3: Central Revenue Receipts

(Rs.Million)

	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09 (RE)
Revenue Receipts (Net)	2308340	2638130	3059910	3474620	4343870	5419250	5621730
Tax Revenue (Net)	1585440	1869820	2247980	2702640	3511820	4395470	4659700
Non-tax Revenue	722900	768310	811930	771980	832050	1023780	962030
Gross Tax Revenue	2162660	2543480	3049580	3661520	4715120	5931471	6279490
Direct Tax							
Personal Income Tax	368660	413870	492680	636290	855610	1189115	1226000
Corporation Tax	461720	635620	826800	1012770	1443060	1929108	2220000
Indirect Tax							
Customs	448520	486290	576110	650670	863270	1041189	1080000
Excise	823100	907740	991250	1112260	1176120	1236110	1083590
Service Tax	41220	78910	142000	230550	375970	513009.3	650000
Others	19440	21050	20740	18980	1090	22939	19900
Percent to Gross Tax Revenue							
Direct Tax							
Personal Income Tax	17.05	16.27	16.16	17.38	18.15	20.05	19.52
Corporation Tax	21.35	24.99	27.11	27.66	30.60	32.52	35.35
Indirect Tax							
Customs	20.74	19.12	18.89	17.77	18.31	17.55	17.20
Excise	38.06	35.69	32.50	30.38	24.94	20.84	17.26
Service Tax	1.91	3.10	4.66	6.30	7.97	8.65	10.35
Others	0.90	0.83	0.68	0.52	0.02	0.39	0.32
Percent to GDP							
Revenue Receipts	9.40	9.58	9.72	9.70	10.48	11.55	10.36
Tax Revenue (Net)	6.46	6.79	7.14	7.55	8.47	9.36	8.59
Non-tax Revenue	2.95	2.79	2.58	2.16	2.01	2.18	1.77
Gross Tax Revenue	8.81	9.23	9.68	10.23	11.37	12.64	11.57
Direct Tax							
Personal Income Tax	1.50	1.50	1.56	1.78	2.06	2.53	2.26
Corporation Tax	1.88	2.31	2.63	2.83	3.48	4.11	4.09
Indirect Tax							
Customs	1.83	1.77	1.83	1.82	2.08	2.22	1.99
Excise	3.35	3.30	3.15	3.11	2.84	2.63	2.00
Service Tax	0.17	0.29	0.45	0.64	0.91	1.09	1.20
Others	0.08	0.08	0.07	0.05	0.00	0.05	0.04

Source: Budget Documents, Government of India
RE: Revised Estimates
Note: Net revenue receipt is derived by deducting the share of state governments in central taxes

The grants provided to state governments are an important item of Central Government expenditure. The vertical imbalance that exists in the finances of central and state governments due to the Constitutional assignment of tax sources is addressed through the transfer of a share in central taxes based on the recommendations of the Central Finance Commission and grants to the states. The tax revenue available to the Central Government is shown as 'net tax revenue' after deducting the portion shared with the states (*Table 2.3*). The Central Finance Commission also recommends for state specific Central grants that includes grants to fill the gap in the non-plan revenue account after taking into account the share of central taxes to be devolved and some special purposes grants. The Central Government provides support to state plans in the form of block/unconditional grants under a devised framework called the Gadgil Formula.

Table 2.4: Composition of Expenditure

(Percent)

	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09 (RE)
General Services	**49.95**	**49.41**	**50.38**	**46.01**	**42.94**	**40.03**	**36.85**
Interest Payment	28.31	26.94	25.72	23.69	21.50	21.13	18.07
Pensions	3.40	3.45	3.59	3.39	3.08	2.85	2.95
Defence Services	13.10	13.07	15.39	13.97	12.32	11.13	10.65
Other Services	5.14	5.95	5.68	4.95	6.04	4.92	5.18
Social Services	**4.80**	**5.02**	**5.96**	**6.35**	**6.30**	**7.26**	**7.65**
Education, Sports, & Art	2.16	2.24	2.68	2.76	3.17	2.95	3.08
Health and Family Welfare	0.69	0.79	0.85	1.12	1.16	1.26	1.16
Water Supply, Sanitation	0.88	0.94	1.16	1.00	0.87	1.04	1.25
Information and publicity	0.27	0.26	0.24	0.22	0.19	0.16	0.15
Welfare of SC/ST	0.07	0.05	0.06	0.04	0.06	0.07	0.07
Social Welfare & Nutrition	0.17	0.21	0.23	0.48	0.25	1.35	1.54
Other Social Services	0.57	0.54	0.74	0.72	0.59	0.43	0.39
Economic Services	**34.75**	**34.67**	**32.32**	**34.51**	**37.50**	**39.34**	**43.62**
Agri. & Allied Activities	7.04	6.90	7.12	6.28	6.72	8.06	12.68
Rural Development	2.66	2.55	1.85	2.62	4.54	2.31	3.68
Special Areas Programme	0.45	0.43	0.33	0.31	0.26	0.23	1.43
Irrigation & Flood Control	0.08	0.08	0.07	0.07	0.06	0.05	0.05
Energy	2.65	2.77	1.84	4.26	4.83	3.49	7.90
Industry & Minerals	3.17	3.52	3.47	3.33	3.45	3.45	3.19
Transport	13.62	13.42	13.55	13.86	13.49	12.68	10.94
Communication	2.02	1.85	1.87	1.56	1.23	1.08	1.14
Science & Environment	1.18	1.20	1.41	1.32	1.21	1.16	1.12
General Economic Services	1.88	1.94	0.81	0.91	1.71	6.83	1.48
Grants -in Aid to States	**10.03**	**10.43**	**10.86**	**12.62**	**12.77**	**12.91**	**11.39**
Grants to UTs	0.47	0.47	0.48	0.51	0.49	0.46	0.49

Source: Budget Documents, Government of India

Both the functional and economic classification of government expenditure is carried out and the summary budget figures are presented according to the functional classification. The government expenditure is classified under two headings; revenue expenditure and capital expenditure. Broadly, there is a correspondence between revenue expenditure and 'current' expenditure, as they are generally understood, and between capital expenditure

and investment. However, this correspondence is not exact as some elements of investment expenditure remains on revenue account (for instance, capital expenditure required for carrying out general administration); and likewise, some elements of current expenditure show up on the capital account. The revenue expenditure which is expenditure incurred for purposes other than creation of assets, constitutes more than 80 percent of total expenditure net of debt repayments. Major components of this are payment of salaries and pensions to government employees, interest payments, subsidies. Its relative share has increased as shown by a higher growth rate than that of the capital expenditure, which comprises expenditure towards assets creation and loans and advances. The growth of revenue expenditure in 2008-09 is by far the highest in recent years due to additional provisions for the fiscal stimulus packages. The existence of the revenue deficit, the gap between current expenditure and revenue receipts, implies the use of borrowed funds meant for public investment for the financing of the revenue deficits.

Since the introduction of a planning process in the country, budget heads have come to be divided under ‘plan’ and ‘non-plan’ and the distinction runs through all items of expenditure on revenue as well as capital accounts. The plan expenditure encompasses all new expenditures envisaged in the Five Year Plans, which are included in the budget through the annual plans. Non-plan expenditure is the expenditure incurred on establishment and maintenance of existing assets. Further the recurrent expenditure in maintaining the assets created under plan schemes enters into non-plan expenditure when the schemes are completed at the end of the Plan. Thus the plan and non-plan expenditure shown in the *Table 2.5* include both revenue and capital expenditures. This classification of expenditures has been used essentially to evaluate the performance of functions included in the five year plans (Planning Commission, Government of India, (2008), Eleventh Five Year Plan 2007-12). The dichotomy between plan and non-plan expenditure has been commented upon as an unnecessary development that has adverse effect on the quality of public service (Government of India (2000), Report of the Eleventh Finance Commission; Government of India (2008), Economic Survey). The distinction has led to an ever increasing tendency to start new schemes while neglecting the maintenance of existing capacity and service levels. The plan and non-plan distinction has also resulted in a fragmented view of resource allocation to various sectors.

Table 2.5: Central Government Expenditures

(Rs. Million)

	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09 (RE)
Revenue Expenditure	3387130	3620740	3843290	4397610	5146080	5944940	8034460
of which							
Interest Payments	1178040	1240880	1269340	1326300	1502720	1710300	1926940
Major Subsidies	407160	435350	447530	444800	529350	697420	1292430
Defence Expenditure	407090	432030	438620	482110	516810	573583.8	769484
Capital Expenditure	745350	1091290	1139230	663620	687780	1182380	975070
Total Expenditure	4132480	4712030	4982520	5061230	5833860	7127320	9009530
of which							
Plan Expenditure	1114700	1222800	1322920	1406380	1698600	2050820	2829570
Non-plan Expenditure	3017780	3489230	3659600	3654850	4135260	5076500	6179960
Percent to GDP							
Revenue Expenditure	13.80	13.14	12.20	12.28	12.41	12.67	14.81
of which							
Interest Payments	4.80	4.50	4.03	3.70	3.62	3.64	3.55
Major Subsidies	1.66	1.58	1.42	1.24	1.28	1.49	2.38
Defence Expenditure	1.66	1.57	1.39	1.35	1.25	1.22	1.42
Capital Expenditure	3.04	3.96	3.62	1.85	1.66	2.52	1.80
Total Expenditure	16.84	17.11	15.82	14.14	14.07	15.19	16.60
of which						0.00	0.00
Plan Expenditure	4.54	4.44	4.20	3.93	4.10	4.37	5.21
Non-plan Expenditure	12.29	12.67	11.62	10.21	9.97	10.82	11.39
Growth Rate							
Revenue Expenditure	12.35	6.90	6.15	14.42	17.02	15.52	35.15
of which							
Interest Payments	9.63	5.33	2.29	4.49	13.30	13.81	12.67
Major Subsidies	33.73	6.92	2.80	-0.61	19.01	31.75	85.32
Defence Expenditure	6.96	6.13	1.53	9.92	7.20	10.99	34.15
Capital Expenditure	22.51	46.41	4.39	-41.75	3.64	71.91	-17.53
Total Expenditure	14.06	14.02	5.74	1.58	15.27	22.17	26.41
of which							
Plan Expenditure	10.15	9.70	8.19	6.31	20.78	20.74	37.97
Non-plan Expenditure	15.57	15.62	4.88	-0.13	13.14	22.76	21.74

Source: Budget Documents, Government of India
RE: Revised Estimates
Note: Expenditures are net of matching receipts

The objective of the provision of government subsidies was to reduce the prices of essential commodities like food, fertilizers and petroleum products and increasing the affordability and consequent consumption of these commodities. The subsidies as a percentage to GDP remained flat in recent years before rising in 2008-09. However, the budgetary figures of subsidies do not include compensation provided through the issue of special securities to oil marketing companies, Food Corporation of India and fertilizer units for which the deficit figures remain understated. The liabilities in the form of bonds issued to fertilizer companies, oil marketing companies, Food Corporation of India, and other bonds as percent to GDP are shown in *Table 2.2.* The Central Government has asked the Thirteenth Central Finance Commission to provide a roadmap to bring these liabilities into fiscal accounting.

Table 2.6: Economic Classification of Government Expenditure

(Rs. Million)

	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08 (RE)	2008-09 (BE)
Govt. Consumption Expenditure	**853890**	**871700**	**1056920**	**1163050**	**1216090**	**1322200**	**1497470**
Wages and Salaries	388813	391577	428035	464728	493433	542166	565672
Commodities and Services	465078	480121	628883	698325	722654	780030	931794
Gross Capital Formation	**216970**	**239970**	**273960**	**344500**	**364860**	**475030**	**638660**
Gross Fixed capital formation	209630	228280	265080	331820	348970	464450	618500
Increase in works stores	7340	11690	8880	12680	15890	10580	20160
Transfer payments	**2579070**	**2804740**	**2963510**	**3389480**	**4023180**	**4703770**	**5300940**
Current transfers	2285010	2484360	2595290	2972670	3565600	4207360	4713840
Capital Transfers	294060	320380	368220	416810	457580	496410	587100
Financial investments and loans	**338860**	**344910**	**343930**	**113800**	**97710**	**526820**	**165570**
Total Expenditure (1+2+3)	**3988790**	**4261320**	**4638320**	**5010830**	**5701840**	**7027820**	**7602640**

Source: Department of Economic Affairs, Ministry of Finance, Govt. of India

Central Government liabilities are composed of internal liabilities, which include internal debt, small savings and provident funds, other deposits, and external liabilities. Internal Debt comprises loans raised in the open market, special securities issued to Reserve Bank, compensation and other bonds, etc. It also includes borrowings through treasury bills including 14 day Treasury Bills issued to State Governments, commercial banks and other parties, as well as non-negotiable, non-interest bearing rupee securities issued to international financial institutions. The Reserve Bank of India (RBI), the central bank, is the debt manager of the Central Government and has the responsibility for fixing the indicative issuance calendar for the government borrowings. Outstanding liabilities of the Central Government as percent to GDP have declined after 2005-06 after remaining almost constant at 63 percent (*Table 2.7*). The internal debt as percent to GDP has declined from about 42 percent in 2002-03 to less than 40

percent in 2007-08. The external liabilities of the Central Government have remained flat in recent years. One of the objectives of the rule based fiscal framework adopted in India is the levels of and sustainability of public debt. While the Fiscal Responsibility and Budget Management Act did not have any explicit target with respect to debt GDP ratio, there was a stipulation to progressively reduce the incremental liabilities as a proportion of GDP. The reduction in debt to GDP ratio, despite the sharp increase in deficits and increased recourse to extra-budgetary liabilities, was enabled by a higher nominal GDP growth relative to the growth in domestic liabilities and a sharp reduction in government's liabilities under the Market Stabilization Scheme (MSS). Government of India launched MSS in consultation with Reserve Bank of India in 2004, to issue treasury bills and/or dated securities to absorb excess liquidity arising largely from significant foreign exchange inflows.

Table 2.7: Outstanding Liabilities of the Central Government

Year	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09 (RE)
Internal Debt	10206890	11417060	12759710	13897580	15449750	18083590	20144510
Small Savings, Provident Funds, Special Deposits, and Other Items	3987740	4564720	5645840	6666820	7596100	7899930	8772310
Reserve Fund and Deposits	801260	923760	929890	1094620	1312950	1270430	1227590
Total Internal Liabilities	14995890	16905540	19335440	21659020	24358800	27253950	30144410
External Liabilities	596120	461240	608780	942430	1027160	1120310	1216340
Total Liabilities	15592010	17366780	19944220	22601450	25385960	28374260	31360750
Percent to GDP							
Internal Debt	41.58	41.45	40.51	38.75	37.42	38.29	37.85
Small Savings, Provident Funds, Special Deposits, and Other Items	16.25	16.57	17.93	18.59	18.40	16.73	16.48
Reserve Fund and Deposits	3.26	3.35	2.95	3.05	3.18	2.69	2.31
Total Internal Liabilities	61.09	61.37	61.39	60.39	58.99	57.70	56.64
External Liabilities	2.43	1.67	1.93	2.63	2.49	2.37	2.29
Total Liabilities	63.52	63.05	63.33	63.01	61.48	60.07	58.93

Source: Reserve Bank of India

2.3. Description of the Legal and Institutional Framework for PFM

2.3.1 Legal Framework for PFM

In the Indian federation, where there are 28 states and 7 Union Territories, the functional responsibilities and financial powers of the Union and states, and the relationship between them, are set out in the Constitution. According to the Constitutional provisions (Seventh Schedule, Article 246), the legislative powers and consequent expenditure responsibilities of both levels of governments are demarcated in three lists – Union, State and Concurrent. Matters of national interest such as foreign affairs, defence, railways, posts and telegraphs, currency and coinage, and inter-state trade and commerce are contained in the union list. The state list contains matters of regional interest such as law and order, education, health, agriculture, irrigation, power, and rural and community development. Certain matters of common interest, such as economic and social planning have been placed under the concurrent list, where the residual power rests with the Central Government. Following a separation principle, the Constitution demarcated the taxation powers of both the levels of government. The division of taxation power is based on the economic and administrative rationale. The borrowing and foreign exchange entitlements are controlled by the Central Government. While Article 293 of the Constitution allows the states to borrow, they need permission from the Centre if indebted to it. The Constitution also recognizes that the States' tax powers are inadequate to meet their expenditure needs and therefore, provides for the sharing of revenues from central taxes (Article 270, Article 272). The States in need of additional assistance can also be given grants-in-aid (Article 275). The tax devolution and grants in aid are determined by the Finance Commission, an independent body appointed by the President (Article 280).

The financial year of the Government is from 1st April to 31st of March of the following year. The budgetary process is carried out in accordance with the provisions of Article 112 of the Constitution. The annual financial statement of receipts and expenditure of the Government is placed before the Parliament, which confers specific authority for raising revenue through taxation and incurring expenditure. A system of 'Vote on Account' is provided by the Constitution to enable Parliament to consider the estimates more carefully over an extended period. The legislative control over government finances is exercised first when the annual budget showing the estimated receipts and proposed expenditures of the government is presented as without the approval of the parliament no tax can be levied or collected and no moneys can be appropriated from the Consolidated Fund. The legislature also controls the implementation of the government policies by ensuring proper use of the money voted for the purposes and in the manner that the legislature wanted through parliamentary procedures and a system of committees.

Following the Constitutional provisions for the budgetary process a Finance bill is introduced in the Parliament during the budget session that contains tax proposal for the ensuing year. The tax proposals when considered and passed by Parliament becomes the Finance Act. The Finance Act provides the legal status to the revenue raising authority of the Government for the year.

There is no law exclusively governing public procurement of goods by the departments and ministries. Rules and directives in this regard are available in the General Financial Rules (GFR), 2005. Guidelines for public procurement are provided by the Ministry of Finance through a 'Manual on Polices and Procedures for Purchase of Goods'. An important number of instructions, issued by the Central Vigilance Commission (CVC), supplement these regulations. Specific sectoral procurement regulations exist in some areas, such as defense procurement. While, certain control and oversight functions are carried out by central authorities such as the Comptroller and Auditor General and the CVC, no central authority exists that is exclusively responsible for defining procurement policies and for overseeing compliance with the established procedures. Article 299 of the Constitution, which stipulates that contracts legally binding on the Government have to be executed in writing by officers specifically authorized to do so, provides some legal framework relating to procurement. Further, the Indian Contract Act, 1872 and the Sale of Goods Act, 1930 are major legislations governing contracts of sale/ purchase of goods in general.

The Central Public Sector Enterprises (CPSEs) comprise enterprises established by the Government of India (GOI) as Government companies under Section 617 of the Companies Act, and wherein the equity holding of the GOI is more than 50 per cent. It also includes statutory corporations constituted under specific statutes of the Parliament. Following a report of the Estimates Committee of the 3rd Lok Sabha (1962-67), which stressed the need for setting up a centralized coordinating unit to make continuous appraisal of the performance of public enterprises, the Government set a Bureau of Public Enterprises (BPE) in 1965. In 1990 the BPE was made a full-fledged Department, the Department of Public Enterprises (DPE) operating under the Ministry of Heavy Industries & Public Enterprises. The Department of Public Enterprises is the nodal department for all Central Public Sector Enterprises (CPSEs) and formulates policy pertaining to the role of CPSEs in the economy as also in laying down policy guidelines for performance improvement (and evaluation), autonomy and financial delegation, personnel management and other related areas. It also collects, evaluates and maintains information on several areas in respect of CPSEs. The DPE acts as the interface between the administrative Ministries and the CPSEs.

The Constitution of India called for the creation of a Consolidated Fund to which all revenues received and all loans raised by the issue of treasury bills and all moneys received in repayment of loans have to be credited. A Contingency Fund is provided for meeting unforeseen expenditure pending subsequent

authorization of the expenditure by Parliament. A third account called the Public Account is created in which all transactions relating to debt, deposits, advances, and remittances are accounted for.

The audit of the accounts of the Union and of the States is a Union responsibility. A unitary audit in a federal set up is intended to play a significant role in effective financial administration in the country. The Comptroller and Auditor General of India (CAG) is entrusted with the responsibility of auditing the accounts of both the levels of the government on behalf of the legislature to ascertain that the expenditures voted are not exceeded or varied, and that the money expended was legally available for and applicable to the purposes for which it was applied. The accounts of the Union and of the States are also kept in the format prescribed on the advice of the CAG. There is thus a unified system of auditing and accounting, facilitated by Parliament enacting a law governing the duties, powers and conditions of service of the CAG known as the Comptroller and Auditor General's (Duties, Powers and Conditions of Service) Act 1971.

The Government of India enacted the Fiscal Responsibility and Budget Management Act (FRBM) in 2003 to bring rule based fiscal management to the country. The objective of the FRBM was to ensure a sustainable fiscal policy and prudent debt management through limits on the Central Government borrowing, limits on debt and deficits, greater transparency in fiscal operation, and conducting fiscal policy in a medium term framework. The FRBM requires the Government to place before the Parliament statements of fiscal policy, namely the Medium Term Fiscal Policy Statement, the Fiscal Policy Strategy Statement and the Macro-economic Framework Statement, in addition to other budgetary documents. These documents are expected to detail the policy stance of the government in fiscal management to enhance transparency and accountability.

A compendium of general provisions relating to rules and procedures to be followed in Government offices in India while dealing with financial management is provided by General Financial Rules (GFR). The GFR, first issued in 1947, has gone through many rounds of modification, the latest version of which is of 2005. The GFR provides rules and procedures relating to expenditure and payment of money, budget formulation and implementation, government accounts, procurement, contract management, grants and loans, budgeting and accounting for externally aided projects, and government guarantees.

2.3.2 The Executive in Financial Management

The executive in India are responsible to carry out polices framed by the legislature and remain accountable to the Parliament. The Prime Minister heads the Council of Ministers, which is collectively responsible to the Parliament. Each Minister holds a portfolio for formulating departmental policies and oversees their

implementation and ensures the efficient working of the administrative machinery.

The Ministry of Finance traditionally controls the finances of Government. Although several financial powers have been delegated to Administrative Ministries, the Ministry of Finance continues to have the overall responsibility of co-ordination and control. For speedy and effective discharge of their functions in financial matters which include planning, programming, budgeting, internal control, monitoring and evaluation, an Integrated Financial Adviser is attached to each Administrative Ministry under the Delegation of Financial Power Rules. The Integrated Financial Adviser acts as internal financial adviser in the exercise of powers delegated to the Ministries, and acts as an external financial adviser on behalf of the Ministry of Finance in respect of matters outside the delegated financial powers of the Administrative Ministry. The Ministry of Finance helps the departments by issuing detailed regulations on financial management and control to be followed uniformly in the Government of India.

The Head of the department (Secretary), who is designated as the Chief Accounting Authority for that Ministry has the basic responsibility for the administration of each department's activities. Besides departmental planning and administrative responsibilities, the head of the department is responsible for the collection of revenue and control of expenditure pertaining to his department, the receipt and disbursement of which are usually effected at various places and through various persons and exercises financial control over public enterprises set up under each of them. The Controller of Accounts and the Financial Adviser assist the Head of the Department in discharging the financial responsibilities.

2.3.3 The Budgetary Process

The budgetary process in India involves preparation of budget, adoption of the budget by Parliament, implementation of budget proposals, and post-evaluation of budget achievements. The administrative departments frame their estimates of receipts and expenditure proposals keeping in view the existing government programmes and new schemes approved by the Planning Commission. These estimates constitute the budget of the government after being consolidated by the Ministry of Finance. After the budget gets approved in the Parliament, the administrative ministries are authorized to spend the funds in the schemes approved by the Parliament. The legislature exercises its control over the post-budget evaluation of the budget implementation through various committees.

The budgetary process starts with issuing of the Budget Circular by the Budget Division of Ministry of Finance normally during September each year for preparation of the Revised Estimates of the current financial year and the budget estimates of the ensuing financial year. This circular gives detailed instructions about the preparation of estimates of receipts and expenditure, the required

formats and the various statements that are to be appended to the estimates. It also specifies the processes to be followed and their scheduled dates. The GFR also prescribes the broad guidelines, procedures and forms for the preparation of budget estimates of receipts and expenditure by the ministries.

The ministries/departments prepare their estimates and receipts and expenditures following the prescribed accounting practice. The estimates of expenditure are furnished to the Budget Division in stages. The initial Statement of Budget Estimates is submitted by the departments by 31st October after which pre-budget meetings are held between the Ministry of Finance and the departments. After the pre-budget meetings are over, the approved ceilings for expenditure, as finalized in these meetings, are communicated including ceilings for revenue and Capital Expenditures. The final SBE is submitted by the departments after finalizing the expenditure proposals taking into account the ceilings fixed by the Finance department relating to non-plan expenditure and the annual plan allocations determined by the Planning Commission. While finalizing the budget proposals, the Ministry of Finance has to keep in view the amount of resources available and the acceptable levels of budgetary deficits. The respective Ministries/Departments prepare the detailed demand for grants containing the details of proposed expenditures following budget classification. The budget proposals are placed before the Parliament by the end of February. The Financial Advisers of the departments play a crucial role all through the budgetary preparation process as they submit the SBEs, finalize them and ensure the correctness of accounts classification, make modifications in the context of economy and other considerations, consolidate the estimates for each programme/organization to present a complete picture of their financial costs, and obtain approval of the Secretary (Expenditure) in the Ministry of Finance, wherever necessary.

After the finalization of the budget by the Ministry of Finance, it is placed in the parliament for its consideration and adoption. Parliamentary discussion of the budgetary proposals affords an opportunity to members to review the working of Government in general. As per the provision of the Constitution, a statement of estimated annual receipts and expenditure prepared by the Government is presented in the Parliament. This annual financial statement is commonly known as the Budget. The budget shows receipts and payments of the government under three heads: Consolidated Fund, Contingency Fund, and Public Accounts. The budget includes the Revenue Budget and Capital Budget. The estimates relating to expenditure are in the form of ‘charged’, which is not submitted for voting and ‘voted’, which are submitted as demand for grants. Each ministry/department proposes a demand for grants, which contains the amount required and detailed estimates under each demand divided into items. After the demands are passed by the legislature, a bill called is introduced to provide for the appropriation out of the Consolidated Fund. The bill when passed becomes the Appropriation Act. The Finance bill containing the annual tax proposal is considered and passed by Parliament only after the demands for grants have

been voted and the total expenditure is known, after which it becomes the Finance Act.

While the expenditures voted by Parliament are immediately available to the Administrative Ministries, the release of these funds to field agencies is based on periodic review of the expenditure profiles projected by them. The review is carried out with a view to controlling and monitoring expenditure as it shows the variations, budgetary lags, expenditure patterns, and relationship between physical and financial progress. The Finance Ministry has the responsibility of managing the cash management and the borrowing schedule efficiently depending upon the spending pattern of the administrative departments.

2.3.4 Parliamentary Committees

The Parliament exercises supervision over executive action in various ways through a system of committees. The post budget evaluation is carried out through the operation of various parliamentary committees, such as the Public Accounts Committee, the Estimates Committee, and the committee of Public Undertakings. The Estimates Committee is entrusted with responsibility of undertaking a detailed examination of budget estimates put forth by the Government in respect of each administrative department. The other two committees examine the expenditures incurred by the executive to ensure that the moneys disbursed were available and applicable to the service to which they had been applied, that the expenditures confirmed to the authority that governed it, and that the rules of financial propriety and economy in expenditure were duly observed. These committees also examine efficiency of implementation of projects and schemes and whether its objectives were attained or not. The Public Accounts Committee examines the Appropriation Accounts of the Government of India and the Report of the Comptroller and Auditor General thereon and the annual finance accounts of the Government and any other accounts placed before the House. The Committees on Public Undertakings consider the audit reports relating to commercial enterprises.

2.3.5 Role of Reserve Bank of India

The Reserve Bank of India (RBI), the Central bank of the country, is the banker to the Government and is the repository of all cash balances of the Government of India. It plays a vital role in assisting the Government in the economic management of the country, particularly the monetary system. The Central Government borrows through the issue of treasury bills for replenishing its cash balances from time to time. The Reserve Bank has been entrusted with the responsibility of management of public debt raised by the Government of India including maintenance of detailed accounts of all the loans floated. The RBI has also been entrusted with the complete control of foreign exchange of the country.

2.3.6 The Role of the Comptroller and Auditor General of India (CAG)

The Comptroller and Auditor General of India (CAG), the supreme audit institution in India has a crucial role in assisting the parliament in financial control. The jurisdiction of the CAG includes auditing the accounts of Central, State and local governments, Government commercial enterprises, authorities substantially financed from Government revenues, and any other bodies or authorities with the approval of, or at the request of, the President of India. The CAG also examines the accounts relating to grants and loans given by the Government to other bodies. The CAG audits the Appropriation and Finance Accounts and submits them along with the audit reports to the President of India, following which they are laid before the Parliament. The reports are then passed on to the Public Accounts Committee, which examines them and makes recommendations to Parliament on the various issues involved.

The primary function of the audit by the CAG is to verify the accounts to ascertain (1) whether the moneys shown in the accounts as having been disbursed were legally available for and applicable to the service or purpose to which they have been applied or charged and whether the expenditure conforms to the authority which governs it and (2) whether the assessment, collection and allocation of revenue have been properly done. The Appropriation and Finance Accounts are accordingly examined under the directions of the CAG and certified as to their correctness subject to his observations in his Reports on the Accounts submitted under Article 151 of the Constitution. The CAG has the authority to make regulations on the scope of audit. Apart from the traditional forms of audit, commonly known as the appropriation audit and regularity audit, the discretionary forms of audit (the propriety audit and the efficiency-cum-performance audit) developed by the CAG have assumed significance from the viewpoint of 'accountability' in a comprehensive sense. The audit looks beyond the mere regularity of expenditure to its prudence and economy and to a general examination of the efficiency and effectiveness with which an organization is discharging its financial responsibilities.

2.3.7 Accounting and Reporting

The government accounts in India are kept on a cash basis. Therefore, only actual receipts and payments during the financial year are taken into account with no outstanding liabilities or accrued income included. All cash appropriations lapse at the close of the financial year. One of the most distinctive features of the system of Government Accounts in India is the minute elaboration of the financial transactions of Government. Both receipts and payments are differentiated and classified in detail. Further, the uniform classification of transactions enables financial comparisons between Union and State governments.

The conventional pattern of classification followed organizational lines, consisting mainly of the listing of receipts by various types of taxes, and expenditures by reference to the spending department rather than to its objects or purposes. With the phenomenal growth and diversity in the functions of governments involving huge outlays, accounts acquired a new dimension. Accordingly the necessity for a more meaningful classification of transactions for presentation of government operations in terms of functions, programmes and activities became increasingly apparent. A study team went into the question of accounting reforms and made recommendations to reform the structure of budget and accounts. The study team investigated the feasibility of devising a uniform classification for the budget, accounts and plan, and of presenting the objectives and purposes of government expenditure clearly in terms of functions, programmes and activities. Following the recommendations, the classification of transactions on a function-cum-programme basis was introduced from 1 April 1974.

While a functional approach to classification was established, the emerging requirements such as bringing closer correlation between plan schemes and Accounts Heads, led the government to constitute a committee to review the existing classification and rationalize the Account Heads where required. As a result of this review, the new accounting classification came into force from 1 April 1987. While the basic principles and broad structure of accounts were retained, certain new sub-sectors were introduced and a new coding pattern was devised. The list of Major and Minor Heads of Accounts of Union and States published by the Government of India gives the relevant details. The changes in the accounting system envisaged improving accountability and provided opportunity to review performance with reference to objectives of economic and social development as visualized under Plan programmes.

Initially the CAG had the responsibility of compiling and maintaining the accounts of the Union and the States. In a major exercise of departmentalization of accounts covering all the ministries and departments of the Union Government was undertaken in 1976, with the main objective of integrating accounts with the administrative ministries and departments. Under this scheme, accounts and finance form an integral part of the overall management. Administrative ministries have been entrusted with the responsibility of arranging payments and the timely compilation and rendering of accounts. The secretary to the ministry/department is the chief accounting authority and discharges this responsibility through and with the assistance of the integrated financial advisor of the ministry/department. The payment and accounting functions of the ministries/departments are discharged through departmental pay and accounts offices.

The payment as well as receipt transactions relating to the ministry/department and attached and subordinate offices is transacted at the branches of the Reserve Bank of India and the State bank of India or its

subsidiaries, or at specified branches of public sector banks accredited to the department without intervention of the treasury.

With the separation of audit and accounts at the union level, an organization headed by the Controller General of Accounts was created in the Department of Expenditure of the Ministry of Finance. It was entrusted with the responsibility of establishing and maintaining a technically sound departmentalized accounting system, laying down the form of accounts relating to the Union and the State Governments, administrating the rules relating to the custody of the Consolidated fund, the Contingency Fund, and the Public Account of India, and consolidating the monthly accounts of the Union Government from the monthly accounts prepared by various central pay and accounts offices and the state accountants general of audit

The Controller General of Accounts prepares the annual accounts (known as Finance Accounts) showing under the respective heads the annual receipts and disbursements for the Union Government and also summarized civil appropriation accounts, comparing the actual expenditure under various grants/appropriations with the grants voted/appropriation charged as specified in the scheduled appended to the Appropriation Act passed by Parliament.

2.3.8 Role of Judiciary

One of the unique features of the Indian Constitution is that, notwithstanding the adoption of a federal system and existence of Central Acts and State Acts in their respective spheres, it has generally provided for a single integrated system of Courts to administer both Union and State laws. At the apex of the entire judicial system, there exists the Supreme Court of India below which are the High Courts in each State or group of States. Below the High Courts lies a hierarchy of Subordinate Courts. Different State laws provide for different kinds of jurisdiction of courts. Each State is divided into judicial districts presided over by a District and Sessions Judge, which is the principal civil court of original jurisdiction and can try all offences including those punishable with death. The Sessions Judge is the highest judicial authority in a district. Below him, there are Courts of civil jurisdiction, known in different States as Munsifs, Sub-Judges, Civil Judges and the like. Similarly, the criminal judiciary comprises the Chief Judicial Magistrates and Judicial Magistrates of First and Second Class.

The Constitution of India is the original source of law in India, which, in turn, gives due recognition to statutes, case law and customary law consistent with its dispensations. Statutes are enacted by Parliament, State Legislatures and Union Territory Legislatures. There is also a vast body of laws known as subordinate legislation in the form of rules, regulations as well as by-laws made by Central and State Governments and local authorities like Municipal Corporations, Municipalities, Gram Panchayats and other local bodies. This subordinate legislation is made under the authority conferred or delegated either

by Parliament or State or Union Territory Legislature concerned. The decisions of the Supreme Court are binding on all Courts within the territory of India. While the Indian Parliament can make laws on matters enumerated in the Union List, the State Legislatures are competent to make laws on matters enumerated in the State List. Both the Union and the States have power to legislate on matters enumerated in the Concurrent List. Laws made by Parliament may extend throughout or in any part of the territory of India and those made by State Legislatures may generally apply only within the territory of the State concerned. Hence, variations are likely to exist from State to State in provisions of law relating to matters falling in the State and Concurrent Lists.

The Supreme Court of India comprises the Chief Justice and not more than 25 other Judges appointed by the President of India. The Constitution seeks to ensure the independence of Supreme Court Judges in various ways. A Judge of the Supreme Court cannot be removed from office except by an order of the President passed after an address in each House of Parliament supported by a majority of the total membership of that House and by a majority of not less than two-thirds of members present and voting, and presented to the President in the same Session for such removal. A person who has been a Judge of the Supreme Court is debarred from practicing in any court of law or before any other authority in India.

The Supreme Court has original, appellate and advisory jurisdiction. Its exclusive original jurisdiction extends to any dispute between the Government of India and one or more States. The Constitution gives an extensive original jurisdiction to the Supreme Court in regard to enforcement of Fundamental Rights. Under the Arbitration and Conciliation Act, 1996, International Commercial Arbitration can also be initiated in the Supreme Court. The appellate jurisdiction of the Supreme Court involves any judgment, decree or final order of a High Court in both civil and criminal cases, involving substantial questions of law as to the interpretation of the Constitution. The Supreme Court has also a very wide appellate jurisdiction over all Courts and Tribunals in India. The Supreme Court has special advisory jurisdiction in matters which may specifically be referred to it by the President of India under the provisions of the Constitution.

Although the proceedings in the Supreme Court arise out of the judgments or orders made by the Subordinate Courts including the High Courts, but of late the Supreme Court has started entertaining matters in which interest of the public at large is involved and the Court can be moved by any individual or group of persons either by filing a Writ Petition at the Filing Counter of the Court or by addressing a letter to the Chief Justice of India highlighting the question of public importance for invoking this jurisdiction. Such concept is popularly known as 'Public Interest Litigation' and several matters of public importance have become landmark cases.

The High Court stands at the head of a State's judicial administration. There are 18 High Courts in the country, three having jurisdiction over more than one State. Among the Union Territories Delhi alone has a High Court of its own. Other six Union Territories come under the jurisdiction of different State High Courts. Each High Court comprises of a Chief Justice and such other Judges as the President may, from time to time, appoint. Each High Court has power to issue to any person within its jurisdiction directions, orders, or writs for enforcement of Fundamental Rights and for any other purpose. Each High Court has powers of superintendence over all Courts within its jurisdiction. It can call for returns from such Courts, make and issue general rules and prescribe forms to regulate their practice and proceedings and determine the manner and form in which book entries and accounts shall be kept.

There are also various tribunals that have been set up in India that look into various matters of grave concern. The tribunals that need a special mention are as follows:

- Income Tax Appellate Tribunal
- Central Administrative Tribunal
- Intellectual Property Appellate Tribunal
- Railways Claims Tribunal
- Appellate Tribunal for Electricity
- Debts Recovery Tribunal
- Central Excise Service Tax Appellate Tribunal

The Ministry of Law and Justice looks after the judicial set up of the country. There are also many legal committees and commissions that are set up in India so that the judiciary can run smoothly and render all possible help to the general masses of India in solving their legal problems.

The Right to Information Act (RTI) is a law enacted by the Parliament of India in 2005 allowing citizens of India to access to records of the Central Government and State Governments. The Act applies to all States and Union Territories of India, except the State of Jammu and Kashmir - which is covered under a State-level law. Under the provisions of the Act, any citizen (excluding the citizens within J&K) may request information from a "public authority" (a body of Government or "instrumentality of State") which is required to reply expeditiously or within thirty days. The Act also requires every public authority to computerize their records for wide dissemination and to proactively publish certain categories of information so that the citizens need minimum recourse to request for information formally. The RTI assumes significance on information disclosure in India, which was hitherto restricted by the Official Secrets Act of 1923.

III. Assessment of the PFM Systems, Processes and Institutions

3.1 Budget Credibility

3.1.1 PI-1 Aggregate Expenditure Out-turn Compared to Original Approved Budget

The PI-1 compares the aggregate actual expenditure with the budgeted expenditure to examine the ability of the Government in implementing the expenditures voted by the legislature and to deliver the public services based on the Government policy statements and programmes outlined by the administrative ministries/departments in their budget proposals. The total expenditure figure used for the indicator is net of debt repayments and the donor funded project expenditure.

The aggregate expenditure out-turn assessment is carried out for the last three fiscal years 2006-07, 2007-08 and 2008-09. The expenditure figures for the year 2008-09 are revised estimates as the final accounts figures (audited figures) are not available. The budget documents clearly identify the debt repayment obligations of the government, which was deducted from the total expenditure to arrive at the net expenditure. While the budget documents show the funds received through external assistance and the sources of such funds, projects funded exclusively through donor funds are not reported in these documents. The total expenditure net of donor funded project support is derived by taking the utilization figures relating to externally funded projects reported by the division of Aid Accounts and Statistics, of the Department of Economic Affairs of the Ministry of Finance.

The government accounts in India are kept on a cash basis. Only actual receipts and payments during the financial year, which is defined from April 1 to March 31, are taken into account with no outstanding liabilities or accrued income included. All cash appropriations lapse at the close of the financial year with no provision of rolling over of unspent amounts to the next fiscal year. Thus departments have to return the unspent balance to the treasury.

The budgeted total expenditure and the actual expenditure, net of debt repayment obligation and donor funded project expenditure, during the last three years are presented in *Table 3.1*. The aggregate expenditure out-turns for all the three years reviewed were substantially higher than that of the budget estimates, the difference in 2008-09 crossing 27 percent. Following the broad classification of expenditure into revenue and capital expenditures, for revenue expenditure the actual expenditure exceeded the budgeted estimates to an even greater extent as per *Table 3.2*. Capital expenditure is more volatile over the three years as it bears the impact of the fiscal adjustment in the face of downward rigidities for revenue expenditure.

Table 3.1: Aggregate Budgeted and Actual Expenditure

(Rs. Million)

	2006-07	2007-08	2008-09 (RE)
Budget Estimates	5053570	6155983	6720302
Actual Expenditure	5707877	6809820	9203301
Difference	654307	653837	2482999
Difference % of Budget Estimates	12.95	10.62	36.95

Table 3.2: Deviation in Actual Revenue and Capital Expenditures Compared to Budget estimates

(Per cent)

	2006-07	2007-08	2008-09 (RE)
Deviation in Revenue Expenditure	17.16	12.38	41.96
Deviation in Capital Expenditure	-10.37	3.64	6.24

The budget presented to the parliament often is not final for the year as it is augmented by supplementary demands for additional expenditures during the year. Article 115 of the Constitution of India provides for supplementary demands. Although, the objective of presenting supplementary demands is to meet unforeseen factors, in practice, a large part of them has become a routine affair. While part of the supplementary expenditures is met from anticipated savings of various departments, there are substantial amounts of net cash outgoings in these supplementary proposals. This practice has raised questions relating to the sanctity of the annual budget as a policy instrument and the absence of a concept of a hard budget constraint in observing fiscal discipline.

In each of the three years reviewed, the actual expenditures were higher as compared to the budget estimates mainly due to internal policy interventions during the year. The rise in explicit subsidies on food, fertilizer and oil due to price rises in international markets, and the increased level of grants to states on various centrally sponsored schemes were the important factors that raised actual expenditure. For 2008-09 in response to the declining growth of the national economy following the international financial crisis, the government extended two fiscal stimulus packages to revive the economy. As expenditures under these packages were accounted for through the supplementary demands during the year, the actual expenditure was significantly higher than the budgeted estimates. Detailed analysis of the supplementary demands, however, indicate that there was significant under budgeting of expenditure proposals adopted in the budget estimates for which during the course of the year, adequate expenditures had to be made available through the two Supplementary Demands for Grants. This includes provision for pay revision of government employees, additional funds for food and fertilizer subsidies, funding of a loan waiver scheme for farmers and additional allocation to various flagship programmes including the National Rural Employment Guarantee. Lower provision in the budget estimates relating to already announced programmes results in poor planning and implementation of expenditures and contributes to low productivity of public spending. The provisioning of additional funds during the course of the year was possible to some extent due to higher revenue collection. The prevailing

large expenditure commitments and significant deceleration in revenues due to the economic slowdown in 2008-09 contributed to higher fiscal deficits as against the budget estimates.

Indicator	Credibility of Budget	Score	Justification
PI-1	Aggregate Expenditure Out-turn Compared to Original Approved Budget	C	Actual expenditure deviated from budgeted expenditure by more than 10% of budgeted expenditure in all the years considered. The deviation in at least one year, i.e. 2008-09 was more than 15 percent.

3.1.2 PI-2 Composition of Expenditure Out-turn Compared to Original Approved Budget

The objective of PI-2 is to carry out an empirical assessment of expenditure out-turn against the original budget at a sub-aggregate level to examine how these variations contribute to the deviations in the overall level of expenditure. The rationale behind such assessment is that to have discipline in budget implementation and the budget to be a useful statement of policy intent the amount of variation in composition of expenditure from original budget should be limited. This indicator measures the extent to which reallocations between budget lines have contributed to variances in expenditure composition beyond the variance resulting from changes in the overall level of expenditure. Following the PEFA methodology, the variance in the expenditure composition is calculated and compared to the overall deviation in primary expenditure for each of the last three years. A functional classification of expenditure is followed for this assessment and the composition of expenditure was obtained from the Annual Financial Statements of the relevant years.

The actual expenditure and the budgeted estimates of expenditure at a dis-aggregated level are shown in *Table 3.3* and the expenditure deviation is shown in *Table 3.4*. The total expenditure variance calculated from the disaggregated expenditure follows closely to the aggregate deviation as per the PI-1 that explains the variation between budget estimates and the actual implementation. It shows that the actual expenditures at functional level vary considerably from the budget estimates and budget outcomes are not in line with the budgetary intents.

Table 3.3: Comparison of Actual and Budgeted Expenditures

(Rs. Million)

	2006-07		2007-08		2008-09	
	Budget	**Actual**	**Budget**	**Actual**	**Budget**	**Revised**
Total Expenditure	5053570	5707877	6155983	6809820	6720302	9203301
Social Services						
Education	216703	227716	263980	251167	337903	341409
Health and Family Welfare	81276	83257	106597	107268	118478	128763
Water Supply, Sanitation & Urban	65467	62338	87649	89010	103663	138569
Information and publicity	15345	13841	13666	13501	14771	16456
Welfare of SS/STs	4279	4653	6664	5589	8355	7568
Social Welfare & Nutrition	13611	17866	15524	114652	24426	171051
Other Social Services	31955	42527	37012	36954	39136	43527
Economic Services						
Agriculture & Allied Activities	400859	482231	883466	686208	688560	1404412
Rural Development	155085	325869	165786	197158	185619	407985
Special Areas Programme	125071	18623	147014	19641	166200	158851
Irrigation & Flood Control	4461	4189	4242	4045	5668	5788
Energy	121069	346293	111525	297510	116004	874866
Industry & Minerals	203768	247653	233147	293765	238755	352785
Transport	896087	967676	1043996	1080332	1172388	1211887
Communication	87985	88392	97508	91949	103280	126057
Science Technology & Environment	101649	87053	109601	98776	117524	123529
General Economic Services	90664	122886	74467	581651	101267	164446
General Services						
Pensions	213125	221038	234879	242610	250855	326901
Defence Services	917428	883879	986702	948201	1086697	1179484
Other General Services	330011	433326	396749	419220	498421	573266
Other Grants and Advances						
Grants -in Aid and Contributions	837432	891356	1008889	1073719	1205916	1234638
Disbursements of UTs	36327	35026	36637	39129	39041	54097
Loans and Advances	103914	100190	90283	117766	97375	156969

Table 3.4 shows the results of the expenditure variance at disaggregated level and its comparison with the aggregate deviation. As per the details shown in the tables below the average weighted variance calculated on the basis of the PEFA PFM framework shows the compositional variance exceeded 10 percent in one of the three years.

Table 3.4: Expenditure Comparison Variance in Excess of Total Expenditure Deviation

(Per cent)

Year	For PI-1 total expenditure deviation	Total expenditure variance	For PI-2 variance in excess of total deviation
2006-07	12.95	19.46	6.51
2007-08	10.62	23.42	12.79
2008-09	36.95	37.19	0.24

Indicator	Credibility of Budget	Score	Justification
PI-2	Composition of Expenditure Out-turn Compared to Original Budget	C	Variance in expenditure composition exceeded overall deviation in primary expenditure by 10 percentage points in no more than one of the last three years.

3.1.3 PI-3 Aggregate Revenue Out-turn Compared to Original Approved Budget

The major sources of revenue of the Union Government are the taxes constitutionally assigned to it that constitutes about three fourths of the total revenue. The remainder is revenue from non-tax sources, which are principally from departmental sources. Major central taxes comprises income tax on individuals and corporations, custom duty, and union excise duty, which form nearly 90 percent of the gross central tax revenue, with the income tax accounting for half of it. Among others the service tax, introduced in 2004, has been emerging as an important source of central tax revenue due to expansion of its base.

An unbiased revenue projection is crucial in effective budget implementation, since expenditure allocation across the sectors is based upon the revenue forecast. Further, the states in the Indian Union depend heavily on the central devolution of resources. A share of central taxes is transferred to the

states based on the recommendation of the Finance Commission, a statutory body established to determine the share of central taxes and quantum of grants to be transferred to the states. Share of central taxes is one of major sources of revenue for the state governments. As revenue projection in the state budget is based on the Central Government budget estimates, the budget performance of the states also depends on the realization of the revenue projected in central budget.

In India two boards, namely, the Central Board for Direct Taxes (CBDT) and Central Board for Excise and Customs (CBEC) are entrusted with tax planning, administration and collection of taxes. The budget division in the Department of Economic Affairs of the Ministry of Finance, which prepares the budget estimates, takes into account the revenue projections prepared by these boards and incorporates them in the budget. The revenue projections are carried out on a quarterly basis and the adjustments in the budget estimates during the course of the year through supplementary demands takes note of these projections. The revenue projections have remained a challenge in the face of a surging economy and the global market situation.

The budget estimates and actual revenue out turn for the last three years are presented in *Table 3.5*, which indicate that during the first two years the revenue achievements outperformed the budget estimates. Due to significant improvement in income tax, both on individuals and corporate, and customs duty the actual realization was more than the budget estimates (*Table 3.6*). The improvement in revenue performance was mainly due to high growth experienced in Indian economy and strengthening of tax administration that resulted in higher tax compliance. The increase in compliance of personal and corporate income taxes arising from networking of the tax information - institution of Tax Information Network (TIN) significantly improved tax collection. The robust revenue performance of the Central Government helped both central and state governments in fiscal consolidation after a prolonged period of imbalance and lowering the deficit level to the targets stipulated in FRBM Act.

Table 3.5: Comparison of Budgeted and Actual Revenue Receipts

(Rs. Million)

	2006-07	**2007-08**	**2008-09**
Revenue Estimates	6009863	7239626	9073695
Revenue Outturns	6431932	7985038	8416519
Deviation	422070	745412	-657176
Deviation % of Estimates	7.02	10.30	-7.24

Table 3.6: Major Taxes: Comparison of Budgeted and Actual Receipts

(Percent)

	2006-07	2007-08	2008-09
Corporation tax	8.50	14.55	-1.93
Taxes on income other than corporation taxes	2.28	18.21	-10.45
Customs	12.02	5.42	-9.19
Union Excise Duties	-1.17	-5.08	-21.41

The revenue realization over the projection, however, turned negative in the year 2008-09 due to slowdown in the growth rate of the economy following the international economic crisis. The falling manufacturing activities and the decline in the service sector in 2008-09 resulted in a reduced growth rate for the central taxes. The low growth of central taxes impacted on the fiscal situation of both the central and state governments. The significant level of expenditure commitments coupled with the decline in revenue growth has increased the deficit level above the FRBM target.

Indicator	Credibility of Budget	Score	Justification
PI-3	Aggregate Revenue Out-turn Compared to Original Approved Budget	A	Aggregate revenue collection exceeded 97% of the budget estimates in two of the three year period reviewed.

3.1.4 PI–4 Stock and Monitoring of Expenditure Payment Arrears

The expenditure arrears, expenditure obligations incurred by the government for which payment is overdue, is difficult to measure in cash based accounting system. The consolidated expenditure payment arrears across the departments do not exist. The government system of accounting does not allow distinguishing between payment for current expenditure and arrears as it follows the cash basis of accounting. However, expenditure obligation in respect of payments to employees is recorded and monitored at departmental level. In the case of payment of salary and debt obligation, government generally does not default. The budget manual provides detailed guidelines for assessment, reporting and consolidation of liabilities to facilitate the exercise of exchequer control over progressive expenditure and preparation of correct budget estimates and excess/savings over the budget. As there is no information available on stock of arrears, the level of stock in arrears as percentage of total expenditure cannot be examined.

Indicator	Credibility of Budget	Score	Justification
PI-4	Stock and Monitoring of Expenditure Payment Arrears	Not Rated	
(i)	The stock of arrears as percent to total expenditure	Not rated	As there is no information available on stock of arrears, the level of stock in arrears as percentage of total expenditure is not assessed.
(ii)	Reliable and complete data on stock of arrears	D	There is no reliable data on the stock of arrears

3.2 Comprehensiveness and Transparency

3.2.1 PI-5 Classification of the Budget

The budgetary classification generates meaningful information on the features of government transactions, their composition and impact in assisting policy analysis and decision making. Classification of revenue receipts is relatively simple identifying the sources of revenue, the activities generating the revenue and the organizations collecting it. Classification of government expenditure, however, has a wider range in providing information on the processes of taking policy decisions on resource allocation, monitoring of performance of government programmes, ensuring accountability for budgetary compliance and evaluating the overall impact of policy decisions. While the budget classification system specific to a country is designed to meet the requirement of budget management and reporting on policy decisions taken and efficiency in use of public resources, the system can be compared with the international standards Government Finance Statistics (GFS) and the UN-supported Classification of Functions of Government (COFOG) which provides the functional classification applied to GFS.

The budget classification system in India has improved over the years responding to phenomenal growth and diversity in government functions and outlays from an organizational structure based classification prior to 1974 to a more meaningful classification of transactions for presentation and reporting of government operation in terms of functions, programmes and activities. The salient features of the reforms were to establish a uniform classification for the budget accounts and plan, clear presentation of objectives and purposes of government expenditure in terms of functions, programmes and activities, bringing together all expenditures under appropriate functional (major),

programme (minor), and activity (subhead) irrespective of the organization administering it, and generating timely data for monitoring expenditure on programmes and activities. The rationalization of the list of major and minor heads of accounts was based on the classification suggested in COFOG.

In 1987 a revised coding pattern was introduced that facilitated computer-based financial information systems. All budgetary transaction in India are classified into three funds; Consolidated fund of India, Contingency Fund, and Public Accounts. The Consolidated Fund consists of Revenue and Capital Accounts, which are further disaggregated into sectors and sub-sectors, which broadly follows the major classification groups of COFOG. The structure of budget classification is presented in Figure 1.

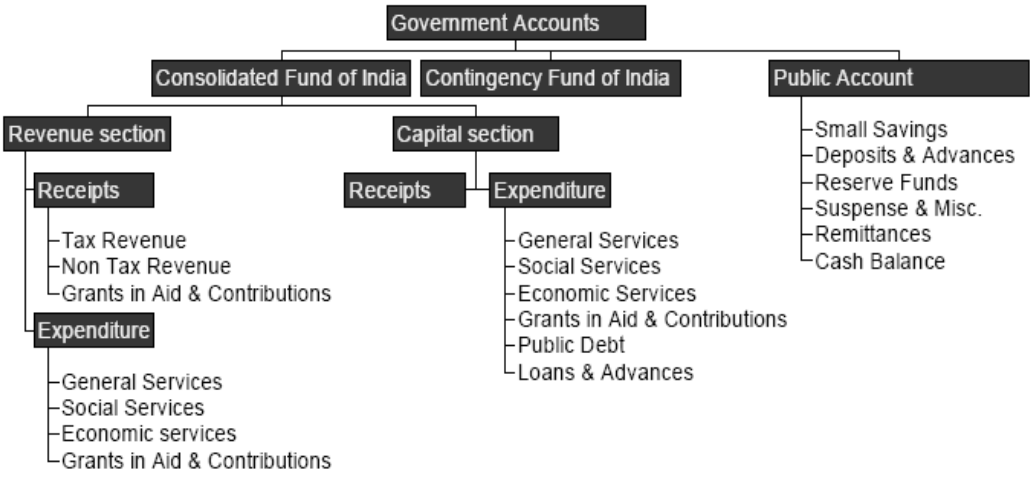
A six-tier hierarchical structure of classification is designed for the sub-sectors. The major functions of the government are presented as Major Heads with a four digit numerical code, followed by a two digit code for the sub-major heads, and followed further by a three-digit minor head representing a programme of the government. Below minor head there are sub heads showing a scheme, detailed head representing a sub-scheme and the sixth one is the object head representing the type and object of expenditure. The major heads correspond to 'Functions' of Government, such as different services like 'Crop Husbandry' 'Defence' etc being provided by the Government. Minor heads subordinate to them identify the 'Programmes' undertaken to achieve the objectives of the functions 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 in regard to expenditure of an administrative nature, the sub-heads may denote the components of a programme, such as 'Organization' or the different 'Wings of Administration'. The classification system is uniform for all stages of financial administration – preparation of budget estimates, voting of demands, implementation, accounting review, and audit – providing a comprehensive picture of various government activities across sectors and helps the government in reviewing its performance.

While this classification was expected to give correspondence between plan heads of allocation and account heads of classification to link plan allocations with the budgetary figures, considerable effort is still required to translate accounting information into Plan formats. This is due to the divergence between Major Heads and the Plan Heads of development. Down at the programme level, if a plan scheme has components of revenue and capital expenditure incurred by the government and also has transfers to sub-national governments, the data in the accounting books will be scattered under a number of heads that needs to be aggregated to generate plan scheme wise information.

The budget classification system in India which takes into account the COFOG functional classification system into account is consistent with the GFS

manual of 1986 based on cash accounting system. The budget classification in India was evolved over the years and reforms were introduced keeping in mind the emerging requirement and international standards. The GFS manual of 2001, which presents advanced standards for compilation and presentation of fiscal statistics, follows the principle of accrual accounting and its coverage of events is broader than the earlier version representing cash based transactions. The government accounts in India are kept on a cash basis. However, efforts are now being made to introduce the accrual system of accounting in government transactions.

Figure 1: Structure of Budget Classification



An Expert Group constituted by the Government of India in 2004 reviewed the classification system of government transactions, particularly relating to the distinction between capital and revenue expenditure. The expert group opined that, while current norms of classification are based on sound accounting principles and are in line with international standards, one major area of concern has been the transfers to the states which are bunched together without assignment to any function or programme. The transfers are treated as revenue expenditures, irrespective of utilization of such funds for asset creation or not. The group recommended for better disclosures for such payments as capital transfers under revenue expenditure. The expert group also suggested a multidimensional classification system to harmonize budgetary, accounting and economic classification.

Indicator	Credibility of Budget	Score	Justification
PI-5	Classification of the Budget	A	The budget classification system is uniform for all stages of financial administration and is based on economic, administrative, programme classification that can produce consistent documentation according to GFS/COFOG standards. The budget classification system is consistent with COFOG and GFS manual of 1986.

3.2.2 PI-6 Comprehensiveness of Information Included in Budget Documentation

During the budget session of the Parliament an 'Annual Financial Statement' comprising of annual receipts and expenditure prepared by the Government, commonly known as the Budget is presented in the Parliament. The budget shows receipts and payments of the government under three heads: Consolidated Fund, Contingency Fund, and Public Accounts and includes the Revenue Budget and Capital Budget. Each ministry/department proposes a demand for grants, which contains amount required and detailed estimate under each demand divided into items. After the demands are passed by the legislature, a bill is introduced to provide for the appropriation out of the Consolidated Fund. The bill when passed becomes the Appropriation Act. The Finance bill containing the annual tax proposal is considered and passed by Parliament only after the demands for grants have been voted and the total expenditure is known, after which it becomes Finance Act. The budget for the Railways is presented before the main budget is presented.

Before the budget is introduced, the Government presents the Economic Survey and Public Enterprise Survey to the Parliament as part of the overall budgetary process. The Economic Survey gives a background to the economic trends prevailing in the country. It also gives an analysis of various sectors of the economy comprising agricultural and industrial production, money supply, imports and exports, public finance and social sectors which have a bearing on the framing of the budget so that the Parliament may have a better appreciation of the efforts made by the Government for mobilizing resources and their allocation in terms of development priorities. The Public Enterprises Survey contains a detailed report on the operations of commercial public enterprises. The reports of the Comptroller and Auditor General of India on the operation of various public sector enterprises are also presented to Parliament during the budget session.

The budgetary process provides a comprehensive set of documents and are accessible to the public after its introduction. The budget documents consist of the following components;

- The budget speech of the Finance Minister, in which all new tax initiatives for the year and their impact on revenues are outlined' expenditure proposals in the various sectors consistent with overall government policies and the required financing pattern is placed before the Parliament. Following the budget speech the financial bill is introduced in the parliament.
- The 'Annual Financial Statement' comprising annual receipts and expenditures prepared by the Government, commonly known as the Budget shows the receipts and payments of the government under three heads: Consolidated Fund, Contingency Fund, and Public Accounts and includes the Revenue Budget and Capital Budget.
- A receipt budget is prepared which details the revenue estimates included in the Annual Finance Statement. The document also gives details of revenue and capital receipts, the trend of receipts over the years and, more importantly the details of external assistance received by the Government.
- The expenditure budget, part of the budget documents, gives expenditure estimates in terms of revenue and capital under Plan and Non-plan heads in relation to each administrative unit, and describes expenditure in terms of major programmes. The expenditure budget is distinct from 'Demands for Grants' presented by the departments.
- Budget at a Glance is prepared which provides summary information regarding the total expenditure and resources, and devolution of financial resources to State Governments.
- Each ministry/department proposes a demand for grants, which contains the amount required and detailed estimates under each demand divided into items. The demand for grants is a detailed document that elaborates the expenditure proposals of the department under different expenditure items.
- To facilitate understanding of the taxation proposals contained in the Finance Bill, the provisions of the Bills are explained in a separate document called the 'Memorandum Explaining the Provisions of the Finance Bill'.
- Following the adoption of the Fiscal Responsibility and Budget Management Act (FRBM) in 2004, the Government presents three statements of fiscal policy along with the budget, namely the Medium-term Fiscal Policy Statement (MTFP), Fiscal Policy Strategy statement, and Macro-economic Framework Statement. The Macro-economic Framework Statement contains an assessment of the growth prospects of the economy in terms of GDP growth, external sector balance as reflected in current account balance and the balance of payments, money banking and capital market movements, fiscal balance of the government. The MTFP sets forth a three-year rolling target for prescribed fiscal indicators and include assessment of sustainability relating to the balance between revenue receipts and revenue expenditures, use of capital receipts including borrowing for generating productive assets. The Fiscal Policy Strategy statement contains the policies of the government for the ensuing financial year relating to taxation, expenditure, market borrowings and other liabilities, lending and investments, pricing of administered goods and services, strategic priorities of the government, and an evaluation of the conformity of the current policies with the fiscal

management principles and objectives set out in the MTFP of the government.

- In order to ensure greater transparency in the fiscal operation of the Government, the FRBM Act stipulates for disclosure of assets and government guarantees in specified formats. Accordingly a statement of Asset Register of the Government and guarantees given by the Government for the previous year (for instance in 2009-10 budget the information was provided up to March 31, 2008) are included in the budget. However, the accounts of the Government are cash based in which deriving a complete record of assets and liabilities is not possible. Statement of Assets shows the extent to which the money raised by Government has been utilized for asset formation purposes. These assets do not take into account depreciation/appreciation in the value of assets and are shown at book value as per current market rates. The financial assets in these includes equity investments in shares, loans and advances to state governments, companies, foreign governments, and staff and other financial investments met from the general revenue. This disclosure statement does not include assets of Cabinet Secretariat, Central Police Organizations, Ministry of Defence, Departments of Space and Atomic Energy. This statement includes only those assets the ownership of which vests in Central Government, and it excludes assets created by State Governments and non-Government bodies from grant assistance from Central Government.

Later in the budgetary process, the Ministry of Finance produces a document known as 'The Economic and Functional Classification of the Central Government Budget'. This gives an appreciation of the impact of Government receipts and expenditure on the other sectors of the economy by regrouping the budgetary aggregates in terms of economic magnitudes-for example, the amount spent on capital formation directly by the Government and transferred to other sectors of economy.

Elements of Budget Documentation	Availability	Notes
Macro-economic assumptions, including. at least estimates of aggregate growth, inflation and exchange rate	Yes	Estimates for GDP growth, inflation, interest rates, the exchange rate, and balance of payments position among a host of other assumptions are presented in the macro-economic framework
Fiscal deficit, defined according to GFS or other internationally recognized standard	Yes	Fiscal deficit defined according to GFS is presented in the Macro-economic Framework. The summary fiscal statement in Budget at a Glance contains the fiscal variables such as revenue receipts and expenditures and consequent deficit indicators.
Deficit financing, describing anticipated composition	Yes	The composition by way of domestic versus foreign debt is presented and further the breakdown of domestic debt

Elements of Budget Documentation	Availability	Notes
		instruments to be used for financing the debt is described.
Debt stock, incl. details at least for the beginning of the current year	Yes	The Finance Account, audited financial statement of the government, provides a statement of outstanding public debt segregated between foreign and domestic debt which details type of debt for the last year, which can be updated with the annual borrowing details available in the budget.
Financial assets, including details at least for the beginning of the current year	Partially	The accounts of the Government are cash based in which deriving complete record of assets and liabilities are not possible. As per the FRBM Rules, the Government makes disclosures regarding the assets in a specified format called Asset Register. The Asset Register includes financial assets, such as equity investments in shares, loans and advances to state governments, companies, foreign governments, and staff and other financial investments met from the general revenue.
Prior year's budget out-turn, presented in the same format as the budget proposal	Yes	Prior year's budget outturn is included.
Current year's budget (revised budget or estimated out-turn), presented in the same format	Yes	The estimates of expenditure show the current year's revised budget in the same format as the budget proposal.
Summarized budget data for both revenue and expenditure according to the main heads of the classification used, including data for current and previous year	Yes	The budget includes summarized data according to the main heads of classification for both revenue and expenditure.
Explanation of budget implications of new policy initiatives, with estimates of the budgetary impact of all major revenue policy changes and/or some major changes to expenditure programs	Yes	The Budget Speech outlines all new tax policy initiatives and an explanation of their impacts on revenues as well as proposed policies along with the explanation of allocation shifts and expenditure consequences.

Indicator	Comprehensiveness and Transparency	Score	Justification
PI-6	Comprehensiveness of Information Included in Budget Documentation	A	Budget documentation fulfills all 9 benchmarks. The budget documents are comprehensive.

3.2.3 PI-7 Extent of Unreported Government Operations

Unreported expenditures in the financial transactions of the government tend to affect the fiscal discipline and efficient allocation of resources. One of the distinctive features of the government accounting system in India is the minute detail into which the financial transactions under receipts and payments are classified and reported. The available budgetary information suggests that the scope for unreported government operations is minimal and financial operations of extra budgetary funds are reported in budgetary documents.

All revenues received by the Government are accounted for in the Consolidated Fund of India. The fees and charges levied by the government departments engaged in the provision of services (revenue receipts for Telecommunication, user fees for health services) are shown as receipts in the budget and credited to the Consolidated Fund of India. The Government spends money from this account with prior approval of the Parliament through a process of legal appropriation. Grants in aid to any special purpose vehicles at the Union level such as Registered Societies are all accounted for in the expenditure budget. Unforeseen expenditures or expenditure in excess of approved appropriations are met from the Contingency Fund. Revenue inflows to some extra budgetary funds are held as deposits in the Public Accounts. However, transactions in these funds are fully accounted for in the budget. The transactions are shown in the aggregate in the budget and in detail in the Finance Accounts and the final audited accounts.

Extra-budgetary Funds refer to sets of budgetary transactions that are not included in the annual budget presentation and that therefore may not be subject to the same level of scrutiny. In Indian practice, the term is used to refer to funds which receive earmarked revenues for specific purposes. Although described as extra-budgetary, these funds are not necessarily outside the budget. The extra-budgetary funds include the National Small Savings Fund, Central Road Fund, Sugar Development Fund, Steel Development Fund, Railway Reserve Fund, and Telecommunications Reserve Funds. All the above funds receive revenues which are accounted for in the budget in aggregate terms. Some of the funds are relatively small, e.g., the Steel Development Fund or the Sugar Development Fund while others such as the recently created National Savings Fund is very large. However, in all cases, transactions are fully recorded in the budget.

The most important extra-budgetary arrangement which had a significant fiscal impact but which was not included in the budget was the Oil Pool Account operated by the Oil Coordination Committee. It was originally meant to be a self-balancing account, created to manage the administered pricing mechanism (APM) in the petroleum sector. The oil pool account was abolished and the deficit had been transferred to the general budget. The government has repaid most of the oil companies through the payment of oil bonds.

The Government subsidies on account of food, fertilizer, oil and others are reported in the budget. The government guarantees on borrowing of public sector undertakings are also reported and guidelines are issued to such undertakings on guarantees. However, the off budget liabilities of the government by way of bonds issued to oil companies and fertilizer companies, which formed significant liabilities, remained out of fiscal accounting and the fiscal and revenue deficits are understated to that extent. Starting from the year 2008-09, these off-budget liabilities were shown in the budget documents.

External assistance to the Government for financing development projects and programmes is routed through the budget and recorded as an inflow in budget documents with corresponding expenditure items reflecting the use of resources. Thus the external assistance both in the form of loans and grants are all accounted for in the budget accounts. The Aid Accounts and Statistics Division of the Department of Economic Affairs under Ministry of Finance manages the disbursement of loans and grants from multilateral/ bilateral donor agencies, debt servicing of loans to multilateral/ bilateral donors, accounting of external assistance, and reports the information.

One other arrangement which merits mention is the Prime Minister's Relief Fund. This fund receives contributions from individuals and others and is used for providing humanitarian assistance and relief. The fund consists entirely of public contributions and does not get any budgetary support. The corpus of the fund is invested with banks in fixed deposits. Disbursements are made with the approval of the Prime Minister. Since the inflows into the fund are purely voluntary and not based on a cess or on earmarked taxes, it is not really an extra budgetary fund performing a government function.

Indicator	Comprehensiveness and Transparency	Score	Justification
PI-7	Extent of Unreported Government Operations	A	
(i)	The level of unreported extra-budgetary expenditure	A	The financial operations of the extra budgetary funds are reported in the budget documents. The available budgetary information suggests that the scope for unreported government operations is minimal.
(ii)	Complete income/expenditure information of donor-funded projects reported in fiscal reports	A	The external assistance to the Government for financing development projects and programmes is routed through the budget and recorded as an inflow in budget documents with corresponding expenditure items reflecting the use of resources

3.2.4 PI-8 Transparency of Inter-Governmental Fiscal Relations

The states, 28 in number, form the second tier of governments in the Indian federation. There are 7 Union Territories, which are directly administered by the Central Government, two of which have legislatures. The functional responsibilities and financial powers of the Union and states, and the relationship between them, are set out in the Constitution. The state governments have wide ranging expenditure responsibilities for which central devolution of resources are mandated by the Constitutional provisions. The Finance Commission, a statutory body, is entrusted with the responsibility of recommending the share of central taxes and grants to be devolved to the states. Another important conduit of central resources for the states is the Planning Commission of India, which supports state plans. Central Government ministries also funds schemes in social and economic sectors, implemented by the state governments, which are called Centrally Sponsored schemes (CSS). The CSS form part of the Central Plan as they are meant to provide additional resources to the states for implementing programmes that are considered by the Government of India to be of national/regional importance. Funds transferred by the Central Government form significant part of total revenue receipts of the state Governments.

Table 3.7: Central Transfers to States

(Rs. Million)

	2005-06	**2006-07**	**2007-08 (RE)**	**2008-09 (BE)**
Total Revenue Receipts of the States	4238970	5240827	6233315	7138373
Total Central Transfers	1707744	2147441	2727725	3161769
Transfers % to Revenue Receipts	40.29	40.98	43.76	44.29

Source: State Finances: A Study of Budgets, RBI
Note: The revenue receipt includes net income from lottery transactions by some states

Below the state government, there exists a third tier of local governments both in rural and urban areas, which were established through Constitutional amendments. The State Governments are empowered to devolve functional and financial responsibility, although the areas to be devolved are indicated in the amendment (11^{th} schedule of the Constitution). The state governments are mandated to appoint State Finance Commissions, similar to the Union Finance Commission, to recommend devolution of resources from the state government to these local bodies. Central Government support to these local bodies is limited to transfer of funds to the States with the objective of augmenting the Consolidated Fund of a States to supplement the resources of the local bodies in the States. The quantum of central assistance to states meant for local bodies is determined by the Union Finance Commission. The local bodies, however, are chosen as implementing agencies for some of the Centrally Sponsored Schemes under which funds are routed directly to them.

The PFM system at the state levels is similar to that of the Central Government and there is a significant financial and administrative interface between the two tiers. The legal and regulatory framework relating to the PFM systems compares favorably with good international and Indian practice. The state budgets are prepared with the participation of relevant stakeholders and the state budget manual clearly enunciates the role of all the parties in framing the budget and implementing it. The legislative scrutiny and approval system is established as is the case of Central Government and budget classification is similar to that of the Central Government. The accounting and reporting practice is largely uniform in the country as the rules and standards of accounting practice are prescribed by the CAG of India. While the CAG audits the accounts of the Central Government, it continues with the responsibility of compiling the accounts as well as audit for the state governments. The budget documents, audit reports and reports of financial transactions of the state governments are published and accessible. The flow of funds through various sources at central levels can be comprehended from the sate accounts.

The composition of central transfers through various channels is presented in *Table 3.8*. The transfers based on the recommendations of the Finance Commission comprising tax devolutions and grants to the states constitute about 63 percent (Average over 2005-06 to 2008-09) of total transfers. The tax devolution recommended by the Finance Commission to be distributed among the states is transparent and is based on formula which is devised taking into account various indicators and their weights. The grants recommended by the Finance Commission are intended to assist the states which are in need and the principles of determining the grants and the quantum of the grants for the next five years are clearly indicated. The finance commission transfers constituting substantial portion of the total transfers are transparent and rule based.

State Plan assistance was initially designed to provide formula based block assistance or untied resources to the states to finance their own Plans. The plan grants are given to the states following the Gadgil formula, which contained broad state specific indicators with weights. However, over the years, several distortions have crept in for which the discretionary component has increased in the plan grants. Specific purpose schemes have been increasingly included as part of the state plans diluting the block resource transfers character of the Plan assistance. Further purely discretionary outlays are being included in Plan assistance in the name of state specific economic packages in the form of plan assistance or special central assistance. It was also noted that some of the schematic outlays of some of the central ministries/departments, which could otherwise be considered as CSS as shown as plan assistance to states. In the total plan grants to states, leaving the component known as Normal Central Assistance (NCA), which remains block assistance to states based on the Gadgil Formula, all other components have discretionary elements while determining the states share. The NCA to State Plans given under the Gadgil formula has declined

from 85 percent of State Plan assistance in 1991-92 to 27.5 percent in the 2008-09 budget (The average over 2005-06 to 2008-09 is about 30 per cent).

The CSS are meant to provide the states additional resources for expenditure which the GoI considers of national/regional priority although being within the states' domain. The CSS are specific purpose grants that form part of the central Plan and part of the central budget, as distinct from the state Plan assistance in the central budget. Although the states prefer unlinked, untied or block assistance, over the years the CSS have proliferated. Consequently, the NCA component has come down sharply in total central assistance to states and the schematic component has gone up. While normal central assistance is routed through state budgets, the CSS funds to states are channeled in two forms. Some CSS are budgeted and accounted for as being routed only through state budgets. Many other CSSs are routed to special state or district level agencies or local bodies directly from the Central Government bypassing the state budgets.

Table 3.8: Composition of Central Transfers to the States

(Rs. Million)

	2005-06	**2006-07**	**2007-08 (RE)**	**2008-09 (BE)**
Finance Commission Transfers	1120732	1380119	1650074	1896717
Tax Devolution	940242	1202929	1481343	1731469
Grants	180490	177190	168731	165248
Plan Grants	446171	600450	895568	1057212
State Plan Schemes	287477	402149	552364	666243
Central Schemes	158694	198301	343204	390969
Other Grants	140841	166871	182084	207840
Percent to Total Transfers				
Finance Commission Transfers	65.63	64.27	60.49	59.99
Tax Devolution	55.06	56.02	54.31	54.76
Grants	10.57	8.25	6.19	5.23
Plan Grants	26.13	27.96	32.83	33.44
State Plan Schemes	16.83	18.73	20.25	21.07
Central Schemes	9.29	9.23	12.58	12.37
Other Grants	8.25	7.77	6.68	6.57

Source: State Finances: A Study of Budgets, RBI

The fiscal year for the state government is similar to the Central Government, i.e., 1st April to 31st March. The budget presented by the state governments is consistent, in terms of its format and classification, with the Central Government. The state budget is presented after about a month of presentation of the central budget, which provides some time to base their budget estimates relating to central assistance on Central Government budget

proposals. The grant component determined by the Finance Commission is fixed for duration of five years. Although individual states' share in central taxes was already determined by the Finance Commission, the quantum of likely flow during the ensuing year depends upon the central revenue projections given in the budget. If the central tax collection falls short of the budget estimates, the tax devolution during the years is reduced. The central tax collection during the year 2008-09 has declined due to the slow down of the economy, which will be reflected in the actual receipts of tax devolution of the states. However, during the up-swing years, the states received more tax devolution which helped them consolidating their finances and meet the FRBM targets. The Plan grants to the states are decided through a negotiation between the central and state governments, which are then incorporated in the state plans. Thus, while the state governments have considerable knowledge about the likely availability of the central assistance before finalizing their budget estimates, elements of uncertainty remain.

After the state budgets are presented in March, the budget estimates for the ensuing year, the revised estimates for the current year and the audited figures for the last year all become available. The Reserve Bank of India brings out a volume on state finances in December that gives a detailed analysis of finances of all the individual states together with data on state finances in a format consistent with the budget classification. The Reserve Bank of India, being the banker to the state governments, monitors the fiscal position of the states and advises the states in various fiscal matters. After the presentation of state budgets, the data on state finances become available to the general public through state specific web sites and published budget documents. The economic Survey prepared by the Central Government and presented to the Parliament during the budget session contains analysis and summarized data on state finances.

Indicator	Comprehensiveness and Transparency	Score	Justification
PI-8	Transparency of Inter-Governmental Fiscal Relations	B+	
(i)	Transparency and objectivity in the horizontal allocation among SN governments	B	The transfers based on the recommendations of FC, constituting 63 % (Average over 2005-06 to 2008-09) of total transfers are rule based and transparent. The plan transfers constituting about 30 % (Average over 2005-06 to 2008-09) of total transfers are a mix of rule based and discretionary schematic transfers. The rule based transfer in the Plan transfers is about 30 percent.

Indicator	Comprehensiveness and Transparency	Score	Justification
(ii)	Timeliness of reliable information to SN governments on their allocations	B	The share of individual states in central taxes depends upon the tax realization of the Central Government. The grant recommended by the FC is fixed for whole of the five years. The state governments finalize their plans after deliberation with central Planning Commission. Thus before the state budget is presented the states get to know about the likely flow of funds under these heads. The CSS flow for the year is known and the actual release depends on the stipulated utilization of funds during the year.
(iii)	Extent of consolidation of fiscal data for general government according to sectoral categories	A	Fiscal information (ex-ante and ex-post) that is consistent with Central Government fiscal reporting is collected for 90% (by value) of SN government expenditure and consolidated into annual reports within 10 months of the end of the fiscal year.

3.2.5 PI-9 Oversight of Aggregate Fiscal Risk from Other Public Sector Entities

In India the fiscal risk arising from activities of other public sector entities has to emphasize upon on the public sector enterprises as autonomous government agencies (AGA) are not significant in terms of their budgetary support. The details of fiscal risks arising from the activities of public sector enterprises are not provided in the budget documents except in the form of contingent liabilities, i.e., loan guarantees. In the budgetary system the quasi-fiscal-activities conducted by various public sector entities are not reflected in the conventional measure of the overall balance. The size of public sector entities is large in India and these entities are engaged in commercial activity operating in a competitive environment. While a part of the deficit of such enterprises is due to the implicit loss of revenue arising from social objectives, large part of it arises from their commercial activity. In view of these operational features, the deficits of public sectors entities are not included in Central Government fiscal deficit.

The Central Public Sector Enterprises (CPSEs) comprise enterprises established by the Government of India (GOI) as Government companies under Section 617 of the Companies Act, and wherein the equity holding of the GOI is more than 50 per cent. It also includes statutory corporations constituted under specific statutes of the Parliament. The CPSEs do not, however, include

departmental undertakings, banking institutions and enterprises where equity holding of the GOI is 50 per cent or less. The central ministries under which the public enterprises are established have the primary responsibility relating to these enterprises. The Ministry of Heavy Industries and Public Enterprises is the nodal ministry with the responsibility of policy making and appraisal of the public enterprises. The Ministry comprises of two Departments.

The Department of Heavy Industry is concerned with the development of the engineering industry *viz*. machine tool industry, heavy electrical industry, industrial machinery and auto industry and administers 48 CPSEs. The Ministry focuses on promoting the development and growth of capital goods and engineering industry in the country, framing of policy guidelines for Central Public Sector Enterprises (CPSEs) and administratively dealing with 48 CPSEs.

The Department of Public Enterprises is the nodal department for all Central Public Sector Enterprises (CPSEs) and formulates policy pertaining to the role of CPSEs in the economy as also in laying down policy guidelines for performance improvement (and evaluation), autonomy and financial delegation, personnel management and other related areas. It also collects, evaluates and maintains information on several areas in respect of CPSEs. The DPE is also the interface between the administrative Ministries and the CPSEs. In fulfilling its role, the Department coordinates with other Ministries, CPSEs and concerned organizations. The DPE Publishes the annual survey of CPSEs known as the Public Enterprises Survey, which is laid before the Parliament. The basic data for the Survey is compiled from the Annual Reports and Balance Sheets provided by CPSEs to this department.

The Central Government has a formal oversight and monitoring mechanism in relation to the public sector entities. Financial reports and audited statements of these entities are presented to the Parliament regularly. Individual annual report of each enterprise is laid on the Table of both the Houses of Parliament. A separate comprehensive report called Public Enterprises Survey prepared by the Department of Public Enterprises (DPE) is also submitted to the Parliament indicating Government's total appraisal of the working of public enterprises. This report contains an overview of the financial and physical Performance of Central Public Sector Enterprises (CPSEs) in the country. The Ministry of Heavy Industries and Public Enterprises also presents a mid-year review on the financial and physical progress of the PSEs. The Comptroller and Auditor General of India (CAG) have the responsibility to audit the accounts of the public sector enterprises, which is also laid before the Parliament.

The legislative control over the operation of the Public sector enterprises exercised through a parliamentary body called Committee on Public Undertakings (COPU), which examines the reports and accounts of the public undertakings including the audit reports of the CAG thereon. The report of the COPU is submitted to the Parliament and the government is required to inform

the committee within six months of the action taken by it on the recommendations of the Committee. The COPU considers the government actions and presents another report known as the 'Action Taken Report' incorporating their views on the action taken by the Government.

Macro-economic risks in terms of the likely impact of changes in the underlying macro-economic forecast taking combined accounts of central and state governments are not generally quantified. The combined fiscal indicators in the form of revenue or fiscal deficits and combined fiscal data involving both the tiers of the government are prepared by the Finance department in a document known as 'Public Finance Statistics'. However, there is considerable time lag in presentation of this document. The finances of state governments are reviewed by the Union Finance Commission and grants are recommended to the states that are in need after taking into account the state resources and tax devolution from the Central Government. The state government plans are finalized after deliberation with the central planning commission and the level of borrowing by the state governments is determined through these negotiations. The Central Government has considerable control over borrowings of the state governments. Thus the ability of the state governments to generate fiscal liability for the Central Government is limited. Further under the individual Fiscal Responsibility and Budget Management Act (FRBM), the state governments are required to limit their debt stock to an agreed limit considered to be sustainable and the states have also put cap on their contingent liabilities. However, the Central Government intervenes in the areas constitutionally allotted to the state governments through the CSS to provide assistance in the regional or national interest. Special packages are also provides to states with special needs. These interventions are based on policy designs of the Central Government and are not as a result of fiscal risk arising from fiscal management of state governments.

The state finances are audited by the CAG, which is the supreme auditing authority in the country, and the budget statistics are consolidated at central level in the reports of Reserve Bank of India (RBI) and in the Economic Survey of the Central Government. The budget data including the relevant fiscal indicators and information of state government outstanding liabilities comprising of their borrowings and other contingent liabilities are published in these reports and in the respective state financial reports.

Indicator	Comprehensiveness and Transparency	Score	Justification
PI-9	Oversight of Aggregate Fiscal Risk from Other Public Sector Entities	C	
(i)	Extent of Central Government monitoring of AGAs/PEs	C	All major AGAs/PEs submit fiscal reports to Central Governments annually and audited accounts are also presented. The Ministry of Heavy Industries and Public Enterprises presents consolidated 'Annual Survey of Industries' including their financial and physical progress. The CAG audits the accounts of the PSEs, which are presented in the Parliament. The Parliament exercises legislative control over the functioning of the PSEs through a parliamentary committee. However, a consolidated fiscal risk report is not prepared and the fiscal risk arising from the functioning of the PSEs does not form part of the central budget.
(ii)	Extent of Central Government monitoring of SN governments' fiscal position	C	The ability of SN governments to generate fiscal liabilities for Central Government is limited. The net fiscal position of SN governments is monitored is reported by the RBI through its publications annually for all levels of SN government. The CAG audits the accounts of the SN governments and its reports are presented to the state legislature. However, macro-economic risks in terms of the likely impact of changes in the underlying macro-economic forecast taking combined accounts of central and state governments are not generally quantified.

3.2.6 PI-10 Public Access to Key Fiscal Information

An important element of fiscal transparency is easy availability of information on budget and its implementation to the general public. This requires that the government makes relevant information widely available in a comprehensive, understandable and timely manner. India has achieved a reasonably high level of fiscal transparency, especially as regards the amount of

fiscal information that is made available to the public. However, concerns remain as regards the time taken to make the key fiscal information considered under PI-10 accessible to the public.

The publication of fiscal information in India is not based on any legal obligation arising out of a budget law, but it is an established tradition for the Central Government to make the budgetary data available to the general public. The Fiscal Responsibility and Budget Management Act (FRBM) enacted in 2004, however, has mandated the government to present three documents, the Medium-term Fiscal Policy Statement, Fiscal Policy Strategy Statement and Macro-economic Framework Statement before the Parliament, along with the annual budget. The FRBM Act does not stipulate disclosure of all relevant aspects of fiscal obligation of the government.

Considerable amounts of data and information are made available to the public covering the entire budget cycle starting from the budget presentation, in-year budget execution information, audit reports, and government accounts. The Central Government budget documents cover all Central Government transactions. The budget documents report the Budget Estimates for the year, the year preceding the budget and the actual outcome of the previous year. The *Annual Financial Statement*, which is constitutionally the budget, provides aggregated information. Detailed information on allocation for individual Ministries is provided in the *Demand for Grants*, and the *Expenditure budgets*. The *Receipts Budget* provides information on revenue receipts. A summary *Budget at a Glance* provides a concise overview of the net fiscal position of the Central Government. The central budget provides the fiscal outcome of the two years preceding the budget. Information in both Budget Estimates and Revised Estimates is provided for the year immediately preceding the budget year. For the previous year only the Actual estimates are provided. No forecasts are provided for years following the budget. The lack of forward projection is a major weakness in current practice

After the budget is tabled the budget documents are made available through the web site of the Ministry of Finance and are also published. The budget presentation is broadcasted by TV channels and radio and gets widely published in print media along with budget analysis. The level of information dissemination on budget presentation is usually high.

The year-end financial statements of the government comprises of two documents, Finance Account and Appropriation Accounts, which are published by the Controller General of Accounts (CGA). These documents contain comprehensive information on the finances of the government including debt, contingent liabilities and information on extra-budgetary funds and utilization of government funds. While major extra-budgetary funds are shown in the budget, the details are accounted for in the Annual Finance Accounts. These documents are first placed in the Parliament after which these become available to the

public. The CGA places these documents in its web-site. The quality and timeliness of Government financial statements are discussed in PI-25. The year-end financial statements placed in the Parliament are audited and certified by the Comptroller and Auditor General of India (CAG). The Finance Accounts and the Appropriation Accounts are made available to the public within 6 months of the completed audit.

The in-year budget execution reports are in the form of monthly data on budget execution prepared by the CGA by consolidating the monthly execution accounts of various ministries and departments prepared by the respective chief accounts officers. This monthly review of the Central Government revenues and expenditures, containing analysis of key fiscal performance parameters, is submitted by the CGA to the Ministry of Finance and other key decision makers. This monthly information is published in a format that reflects the accounting practice of the government. The monthly review of government finances is made available on the website of CGA before the end of the following month.

The Comptroller and Auditor General of India (CAG), a statutory body, have the responsibility of auditing the accounts of the Central Government and Public Sector Undertakings (PSU) in addition to the accounts of the state governments. The details of the scope of the external audit, legislative examination and follow up actions by the executive are discussed in PI 26 and 28. The CAG submits the completed audit reports on Central Government consolidated operations to the legislature about 12 months after the end of the financial year. However, the length of time duration between completion of the audit process (which is some time after the final date of fieldwork, in order to clear draft audit paras and otherwise complete the reporting phase of the audit) and the presentation of audit reports to the Parliament is usually less than six months. The audit reports become available to the public through the website of the CAG and in print version as soon as the reports are tabled.

A comprehensive report on Central Government liabilities is provided in the *Economic Survey* which is traditionally presented to Parliament in February, a few days before the budget, and can be treated as a budget related document. The information given in the *Survey* distinguishes between internal debt and external debt of the Central Government. Internal debt in turn is broken down into "market borrowings" (securities issued by the Government of India as part of its market borrowing programme), "other internal debt" (mainly small savings certificates) and other internal liabilities (deposits in the public account). The budget documents also provide a comprehensive statement on liabilities in the *Receipts Budget*.

In the present cash based accounting system it is not possible to present an aggregate balance sheet of the government covering financial liabilities and assets and also non-financial assets. However, following the provisions of the FRBM Act, the Government provides a statement of Assets for the previous year

(for instance in 2009-10 budget the information was provided up to March 31, 2008). Statement of Assets shows the extent to which the money raised by Government has been utilized for asset formation purposes. The financial assets in these includes equity investments in shares, loans and advances to state governments, companies, foreign governments, and staff and other financial investments met from the general revenue. Government holdings of equity in public sector companies are not given in the budget but this information is incorporated in the Public Enterprises Survey brought out annually with a lag of about two years by the Department of Public Enterprises. Total outstanding loans to public enterprises is also not given in the budget but is available in the Public Enterprises Survey.

Element of Information for Public Access	Availability and Means
Annual budget documents after the presentation of budget in the Parliament	Yes – these are made available to the public in the form of published documents and through web site of the Ministry of Finance immediately after the budget is tabled in the Parliament.
In-year budget execution reports within one month of their completion	Yes – Monthly accounts of ministries/ departments are compiled by the CGA and published in its web site before the end of the following month.
Year-end financial statements within 6 months of completed audit	Yes – The year-end financial statement is prepared by the CGA in the form of Finance Accounts and Appropriation Accounts. These statements are made available to the public within 6 months of completed audit.
External audit reports within 6 months of completed audit	Yes – The external audit reports are made available to the public within 6 months completed audit.
Contract awards (app. USD 100,000 equivalent) published at least quarterly	No - The tenders inviting bids of the departments are only provided in the department websites
Resource available to primary service unit at least quarterly	Yes The financial position of primary service delivery units that includes their resource position and utilization of funds are provided in a consolidated quarterly report prepared by the State level implementing agency.

Indicator	Comprehensiveness and Transparency	Score	Justification
PI-10	Public Access to Key Fiscal Information	A	The government makes available to the public 5 of the 6 listed types of information

3.3 Policy Based Budgeting

3.3.1 PI-11 Orderliness and Participation in the Annual Budget Process

Budget preparation in India is guided by a budget calendar which is generally indicated in the budget circular issued by the Ministry of Finance for the year. The General Financial Rules (GFR), which provides the rules and procedures for financial management in the government, contains the provisions that govern the budget preparation process. Both the Ministry of Finance and the Planning Commission issue guidelines and instructions and the Ministries/Departments prepare their budgetary proposals based on their own estimates reflecting sector policies. The budget circular issued by the Ministry of Finance contains the guidelines for budget preparation for the years and also appends the instructions and guidelines issued by other authorities.

The budget circular is issued in September and it provides sufficient time to the ministries/departments to complete their budget preparation before the budget is presented in February (*Table 3.9*). The circular provides guidance for framing the Revised Estimates for the current year and Budget Estimates for the coming fiscal year, which starts from 1st of April. It gives detailed instructions about the preparation of estimates of receipts and expenditure, the required format and the various statements that are to be appended to the estimates. However, the budget circular does not contain the expenditure ceilings for the ministries/departments, which are communicated after the submission of the initial round of budget estimates followed by pre-budget meetings.

The ministries and departments submit the initial Statement of Budget Estimates by the end of October after which pre-budget meetings are held between the Ministry of Finance and the departments. After the pre-budget meetings are over, the approved ceilings for expenditure, as finalized in these meetings, are communicated including ceilings for revenue and capital expenditures. The expenditure ceilings are determined by the Ministry of Finance based upon the resource availability and the initial estimates provided by the ministries and departments. The final SBE is submitted by the departments after finalizing the expenditure proposals taking into account the ceilings fixed by the Finance department relating to non-plan expenditure and the annual plan allocations determined by the Planning Commission. The departments review the on going programmes and schemes and the Planning Commission’s guidelines for new schemes. Enhancement of plan outlays and investment approval of the plan schemes are included in the final estimates. While finalizing the budget proposals, the Ministry of Finance has to keep in view the amount of resources available and the acceptable levels of budgetary deficits. The respective Ministries/Departments prepare the detailed demand for grants containing the details of proposed expenditures following budget classification. The budget proposals are placed before the Parliament by the end of February.

The legislative process for approving the budget is discussed in PI-27. The budget approval process involves passage of 'Appropriation Bill' that confers authority on the Government to spend from the Consolidated Fund of India, and passage of 'Finance Bill' containing the annual tax proposals. These bills after getting assent from the President of India enter into the statute as acts. Parliamentary scrutiny of budget proposals, passage of Appropriation Bill and Finance Bill, and receipt of assent on these bills from the President does not get completed before the second week of May. As the fiscal year starts on 1st of April, the Government seeks an interim approval, called 'Vote-on-Account', to meet the expenditures pending the approval of the Budget. This system is in accordance with the Constitutional provisions guiding the entire budgetary process, and the Vote-on-Account as a rule is approved by the Parliament. Thus, while the budget is finally approved in the month of May, the interim arrangement facilitates the Government to continue with its commitments. The receipt of President's assent on the Finance Bill marks the completion of budgetary exercise. The dates of introduction of budget proposals in the Parliament, receipts of assent on the Appropriation and the Finance Bills for the last three years are contained in *Table 3.10*. During 2007-08 and 2008-09 the Finance Bills received the Presidents' assent on 11 and 10 May respectively. As the country went into general elections, between 16 April 2009 and 13 May 2009, an interim budget was presented on February 16, 2009 and the full budget by the new Government was presented on July 6, 2009. The Finance bill of the full budget for the year 2009-10 was approved on August 19, 2009.

Table 3.9: Budget Calendar

Budget Circular	September
Proposed Statement of Budget Estimates	End of October (Followed by pre-budget discussion)
Final Statement of Budget Estimates	Immediately after ceilings are communicated
Statement of Budget Estimates with Budget Estimates for the ensuing year and statement showing provision for externally aided projects in central plan	Within 3 days of receipt of plan allocation from Planning Commission
Notes on Demand for Grants for expenditure Budget Vol.2	Within 3 days of rendition of SBE (Final) for plan expenditure for the ensuing year
Material for statement to be appended to demands for grants/expenditure budget	Within 3 days of rendition of SBE (Final) for plan expenditure for the ensuing year
Budget presentation	End of February (Usually last day of February)

Table 3.10: Budget Approval Dates

	2007-08	2008-09	2009-10 (Interim Budget)	2009-10 (Final Budget)
Presentation of Budget	February 28, 2007	February 29, 2008	February 16, 2009	July 6, 2009
Approval of the Appropriation Bill	March 22, 2007	March 25, 2008	March 4, 2009	July 29, 2009
Approval of the Finance Bill	May 11, 2007	May 10, 2008	March 20, 2009	August 19, 2009

Indicator	Policy Based budgeting	Score	Justification
PI-11	Orderliness and Participation in the Annual Budget Process	C+	
(i)	Existence of and adherence to a fixed budget calendar	A	A clear annual budget calendar exists, is generally adhered to and allows MDAs enough time (and at least six weeks from receipt of the budget circular) to meaningfully complete their detailed estimates on time
(ii)	Guidance on the preparation of budget submissions	D	The Ministry of Finance issues a budget circular to the ministries/department along with instructions and guidelines of other authorities. However, the budget circular does not contain the expenditure ceilings for the ministries/departments, which are communicated after the submission of the initial round of budget estimates followed by pre-budget meetings.
(iii)	Timely budget approval by the legislature	C	While the fiscal year starts on 1st April, the budget was approved, marked by the receipt of President's assent on the Finance Bill, within two months of the start of the fiscal year in 2 of the last 3 years.

3.3.2 PI-12 Multi-year Perspective in Fiscal Planning, Expenditure Policy and Budgeting

A multi-year perspective in expenditure planning and budgeting has been lacking in India. Integration of planning and budgeting, a key requirement for performance of government sectors, is possible under a multi-year expenditure planning. A multi-year perspective to budgeting is necessary as a single year is not sufficient to expenditure priorities. Also a realistic multi-year expenditure planning is an important requirement for performance oriented budgeting, linking resources to policy objectives. A multi-year approach to expenditure planning depends on getting unbiased revenue forecasts in the medium term that provides the available resource envelope for the government to formulate different developmental schemes/programmes within the envelope to achieve the sector objectives.

Attempts were made in the 1980's to introduce a medium-term framework, which was not followed up in later years. The enactment of the FRBM Act and stipulation of presenting a Medium Term Fiscal Policy (MTFP) along with the budget brought back the issues once again into the budgeting system. However, the MTFP mandates to present three year rolling targets relating to major fiscal indicators such as revenue deficit, fiscal deficit, tax revenue and

outstanding liabilities as percent to GDP. These fiscal indicators are derived from a macroeconomic framework. A detailed medium term expenditure framework for various sectors is not worked out by projecting expenditure implications of programmes undertaken for outward years. The budgeting thus remains strictly annual without a multi-year perspective relating to expenditure commitments of various sectors.

It is maintained that the five year plans in India provide the basis for a multi-year perspective for resource allocation. The Planning Commission of India, in consultation with the Ministry of Finance relating to likely resource availability, allocates annual limits for plan expenditure which is reflected in the final budget estimates of ministries/departments. However, the economic planning and budget differ in their scope and time span. While plans provide a conceptual framework by focusing on various sectors in the economy, the budget is more concerned with systems of control over the use of funds by government and pays more attention to financial aspects. There are divergences between plan and budget in resource mobilization and allocation and organizational structure. New investments may be funded when there are insufficient recurrent costs to operate and maintain the new infrastructure. It is not uncommon to initiate major projects and schemes which are not provided for in the plan. This results in changes in allocation for other projects and schemes thereby diluting plan objectives.

Further, in the context of current budgetary practice, the link between the plan and the budget is weak. In the process of budget preparation the plan allocations are dispersed over various heads and sub-heads of expenditure. It needs to be noted that while the plans in India are prepared scheme-wise and sector wise, the budgets are formulated under different heads and sub-heads, which is followed in the accounting system as well. The budget classification system is shown in PI-5. It takes considerable effort to link the plan objectives of the various schemes/projects to the expenditures under various heads and sub-heads.

Forecasts of revenue and expenditure aggregates in a multi-year framework needs to be consistently worked out to predict the consequent deficit indicators and the potential need for deficit financing including government debt. In this context, review of debt sustainability involving both external and internal debt is important in a multi-year framework. The borrowing requirement of the Government is determined by the level of fiscal deficit, which essentially reflects the uncovered gap between expenditure and total non-debt receipts of the Central Government. This deficit is financed largely through domestic public debt and to a smaller extent through external debt and other internal liabilities or through cash draw down. While the debt information including both from external and internal sources are regularly reported by the government and Reserve Bank of India, debt sustainability analysis in a multi-year framework is not carried out.

Indicator	Policy Based budgeting	Score	Justification
PI-12	Multi-year Perspective in Fiscal Planning, Expenditure policy and Budgeting	D	
(i)	Multi-year fiscal forecasts and functional allocations	D	Forecasts of fiscal aggregates (on the basis of main categories of economic and functional/sector classification) are not prepared on a rolling annual basis. Links between multi-year estimates and subsequent setting of annual budget ceilings are not there in a strictly annual budgeting system. The rolling fiscal indicators presented in the MTFP document stipulated under the provisions of the FRBM is derived from a macroeconomic framework and a detailed estimation of forecast of sectoral spending are not carried out.
(ii)	Scope and frequency of debt sustainability analysis	D	DSA for external and domestic debt is undertaken at least once during the last three years.
(iii)	Existence of costed sector strategies	D	Sector strategies may have been prepared for some sectors, but none of them have substantially complete costing of investments and recurrent expenditure.
(iv)	Linkages between investment budgets and forward expenditure estimates	D	Budgeting for investment and recurrent expenditure are separate processes with no recurrent cost estimates being shared.

3.4 Predictability and Control in Budget Execution

3.4.1 PI-13 Transparency of Taxpayer Obligations and Liabilities

Taxes in India have an explicit legal basis as taxations are possible under the authority of law. The application of tax laws is subject to procedural and legal safeguards. Major central taxes comprise direct taxes such as personal income tax and corporate tax and indirect taxes such as customs and excise duty, constituting about 90 percent of gross tax collection. There are tax legislations and procedures specified under these central taxes. The complete set of tax laws and amendments to tax laws are available on the internet and are widely published. Tax payers have the facility to contest tax liability through a well functioning appeal structure involving quasi-legal tribunals and ultimately the judicial system of the country.

The overall responsibility for the administration of direct and indirect taxes lies with the Department of Revenue under the Ministry of Finance. The Department of Revenue through the Income Tax Department controls the

administration of direct taxes with the Central Board of Direct Taxes (Board), a statutory board, at its apex. Similarly the department administers levy and collection of Customs and Central Excise duties and other indirect taxes through another statutory board, the Central Board of Excise and Customs (CBEC). These two Boards were constituted under the Central Board of Revenue Act, 1963. The CBDT and CBEC provide essential inputs for policy and planning and responsible for administration of direct and indirect tax laws respectively.

The tax legislation at central level in terms of its clarity and scope for administrative discretion leaves much to be desired. In the Indian tax system the scope for administrative discretion is considerable in practice due to the existence of large numbers of exemptions and reliefs, and frequent changes in tax provisions, making the tax laws relatively complex. A tax structure abounding with exemptions and relief is usually characterized as non-transparent and these features add to the discretionary power of lower level tax administrators. For customs and excise duty, the large number of exemptions, in terms of their description under the specified conditions and lists make the exemptions unclear and subject to interpretation and the discretion of administrators, leading to corruption and loss to the exchequer. For instance any standard publication of excise tariff structure runs into more than 700 pages of which more than 200 pages are devoted to exemptions. The direct taxes, both personal and corporate income taxes, are also replete with exemptions and incentives resulting in loss of revenue, inequity across sectors, and unjustified discretion.

An important feature of a transparent tax structure is the absence of case by case negotiation of tax liabilities between officials and tax payers as such practice encourages corruption. In the India there are frequent contacts between tax-payer and tax administrator which leads to non-transparency and discretion. The internal audit system has not been strengthened to ensure accountability of tax collection staff and system and adherence to established tax administration policies and procedures in their dealings with taxpayers. The use of IT in tax administration is not sufficiently widespread to eliminate opportunities for discretionary action or to provide for effective monitoring of arrears, appeals, and payments.

An efficient tax administration facilitates voluntary compliance through the provision of quality taxpayer services in which taxpayer education with regard to registration, declaration and payment procedures and taxpayer access to information on tax liabilities and administrative procedures are important elements. Despite various efforts of the government, the taxpayers face difficulties in accessing the information on tax liabilities and administrative procedures. Filling up the appropriate tax return forms following the complex provision of the tax laws and filing these tax returns to specified tax offices remains a challenge. Submitting tax returns electronically is not widespread. The emphasis given to correctly filling up the required tax return forms often put the taxpayers in difficulty. While taxpayer education activities are taken up by the tax

administration through their websites and print media, a structured taxpayer education programme covering various aspects tax payment is missing, which adds to the compliance cost.

The efforts of the Government in providing information relating to registration, declaration and payment procedures, although with limited impact, are elaborated here;

- Provision of information on tax laws and registration procedures, and various forms to pay taxes and guidelines for filling the tax return forms in the websites of the Department of Revenue and websites of CBDT and CBEC.
- The facility of submitting online return forms
- Establishment of large taxpayers units (LTU) initially in big cities under the Department of Revenue, which are self-contained tax administration offices acting as a single window clearance point for all matters relating to central excise, income tax/corporate tax and service tax. Taxpayers can file all their tax returns at the LTUs for assessment. Such units have the objective to assist the tax payers in all matters relating to direct and indirect tax / duty payments, filing of documents and returns, claim of rebates/refunds, settlement of disputes etc. The scheme aims at reducing tax compliance cost and delays, and bringing out uniformity in the matters of tax/duty determination. It is expected that large taxpayers, especially those having multi-location units/factories, would take the benefit of the scheme by opting for it.
- The Revenue Department also has initiated a Business Process Reengineering Project aimed at providing better taxpayer service, reducing the compliance burden on tax payers and improving enforcement. Some of the recommendations of this project focused around taxpayer services such as setting up a Directorate of Taxpayer Services to address the issues of taxpayer grievances and education, additional provision for filing tax returns, making the payment system easy and simpler, establishing call centers to deal with taxpayer queries, providing IT enabled services to the taxpayers and providing better infrastructure.

There exists a well structured tax appeal mechanism through which the tax disputes arising out of various provisions tax assessments and penalties are taken up. The first level of dispute resolution mechanism is Commissioner (Appeals) to which the tax payers can file an appeal if not satisfied with the assessment carried out or refund order passed by the concerned officials. The second level is the Appellate Tribunal, Income Tax Appellate Tribunal (ITAT) in the case of direct taxes and a similar Appellate Tribunal for customs and excise, which the taxpayers can approach if not satisfied with the orders of the Commissioner of Taxes or Commissioner (Appeals). The tax payers can also approach the High Court and Supreme Court on any question of law arising out of such orders of the tax appellate authorities.

Although there are standing instructions from the respective boards regarding the minimum required disposal of cases by each Commissioner (Appeals), it takes time to settle the cases. The number of appeals coming for disposal at the Commissioner (Appeals) level and the disposals given in *Table 3.11* shows that there is large number of cases remain pending. The disposal of cases at the Appellate Tribunal level and at the level High Courts and Supreme Court is even lower as is shown in *Table 3.12*. So, in the tax appeal system, the disposal rate of appeals is less than the instructions issued by the respective boards.

To improve the efficiency and eliminating distortions in the direct tax system, the Ministry of Finance has brought out a new Direct Tax Code in 2009. The Direct Tax Code was released for public debate and will be placed in the Parliament for its approval. The Direct Tax Code was prepared to address the problems such as the complex structure of the Income Tax Act, lack of comprehensibility due to numerous amendments, tax avoidance, regressive nature of the costs of compliance, and high administrative cost. The proposed Tax Code attempted to recognize the realities relating to the changing economic environment and development of information technology. The strategy of the Code, as enumerated in the discussion paper, was to undertake a periodic exercise of rewriting the Tax Code in the light of new trends in interpretation by the judiciary, aggressive tax planning by taxpayers, new opportunities for reducing compliance cost through massive induction of technology and public private partnership, and checking of erosion of the tax base through tax evasion.

Table 3.11: Appeals for Disposal and Pending with the Commissioner (Appeals)

	2004-05	2005-06	2006-07
Appeals for disposal	156049	134919	175201
Disposal	93254	70794	67360
Pending	62795	64125	107841
Pending Cases % of Total Appeals	40	48	62

Source: Audit Reports of the CAG

Table 3.12: Appeals Pending with Various Authorities (2006-07)

	Cases for Disposal	Cases Disposed	Cases Pending	Pending % to Appeals
Supreme Court	3231	136	3095	96
High Court	33826	1957	31869	94
ITAT	47998	8714	39284	82

Source: Audit Reports of the CAG

Indicator	Predictability and Control in Budget Execution	Score	Justification
PI-13	Transparency of Taxpayer Obligation and Liabilities	C+	
(i)	Clarity and comprehensiveness of tax liabilities	C	All the central taxes in India have explicit legislative basis and the tax obligations, procedures, regulatory mechanism are clearly indicated in the respective tax laws. The authorities controlling the administration of direct and indirect taxes, namely CBDT and CBEC provide wide range of information on tax laws, procedures and guidance to the taxpayers through their websites. However, due to large number of exemptions provided under the tax laws, discretion of administrative authorities in assessment of tax liabilities is also large.
(ii)	Taxpayers' access to information on tax liabilities and administrative procedures	C	Despite various efforts of the government that include providing information through websites and establishing Large Taxpayer Units (LTU), the taxpayers face difficulties in accessing the information on tax liabilities and administrative procedures. Taxpayer education programme is not designed in a structured manner to reduce the compliance cost of the taxpayers.
(iii)	Existence and functioning of a tax appeals mechanism	B	A tax appeals system with independent institutional structures exists following transparent administrative procedures, appropriate checks and balances. However, in the tax appeal system, the disposal rate of appeals is less due to delay in settling the disputes.

3.4.2 PI-14 Effectiveness of Measures for Taxpayer Registration and Tax Assessment

The taxpayer registration is maintained through a process of allotting a Permanent Account Number (PAN), a ten-digit alphanumeric number, to the existing taxpayers or persons who are required to furnish a return of income. The PAN is the key element of maintaining a taxpayer registry and it is linked with other government registration systems. It has been made compulsory to quote PAN in all documents pertaining to financial transactions notified from time-to-time. Financial transactions involving sale and purchase of immovable property, motor vehicles, payments in cash above a stipulated amount to hotels and restaurants or in connection with travel to any foreign country require mentioning the PAN number. PAN has to be mentioned for making deposits exceeding a stipulated amount with a Bank or Post Office. While PAN serves the mainstay of income tax registry, it also captures financial transactions of individuals and the linkage with other government registration system is maintained.

The Income Tax department has authorized UTI Investor Services Ltd (UTIISL) to set up and manage IT PAN Service Centers in all cities or towns where there is an Income Tax office and National Securities Depository Limited (NSDL) to dispense PAN services from TIN Facilitation Centers. For convenience of PAN applicants in big cities, UTIISL has set up more than one IT PAN Service Center and likewise there are more than one TIN Facilitation Centers. The PAN number contained in a card with other personal information is obtained from these two designated organization upon application. The UTISIL and NSDL also provide web based service to provide PAN numbers.

The Central Excise Duty database has already been linked with the PAN based taxpayer database. For exercising proper administrative control on collection of Central Excise duty, every manufacturer or dealer who is liable for payment of Central Excise duty is required to be registered with the Central Excise Department. The Central Excise Registration number is provided upon the application of the persons. A web based system for allotment of central excise registration is available where the Central Excise Registration Number is allotted based on PAN. This number is a 15 digit alphanumeric number, which includes 10 digits for PAN and 5 digits for Central Excise Registration. Customs Duty is levied on goods imported into India as well as on goods exported from India. The customs registration database is linked to other government registration systems. While there are linkages between various registration systems, they are not integrated into a single set of control index files.

Tax evasion, fraudulent declaration and non-registration are offenses for which the penalties are designed in the tax system. If an assessee fails to furnish a return of income/wealth or files a false return or fails to produce accounts and documents, penalty is leviable. The assessee is also liable to be prosecuted for the offence. Penalty is also leviable for failure to deduct or pay tax. The quantum of penalty leviable depends upon the nature of default. The relevant section of tax legislation prescribes the minimum and maximum penalties which can be levied. While the penalty system is designed to act as a deterrent for tax evasion and other fraudulent activities, it has not proved to be a very effective enforcement measure. The penalties have not yielded adequate results as the administrative and judicial process is expensive, slow and detrimental in terms of revenue collection. This has led the Government to come out with voluntary disclosure schemes to bring undisclosed income and wealth into the mainstream.

The Government of India has set up various Investigating Agencies under the Department of Revenue for the purpose of effective information gathering, collation and their dissemination regarding tax evasion. The Agencies responsible for investigating and gathering information on tax evasion and other tax related offences are; the Directorate General of Revenue Intelligence for customs related offences, Directorate General of Anti-Evasion for central excise related offences, and Directorate General of Income Tax (Investigation) for income tax related offences. The Central Economic Intelligence Bureau acts as

an apex intelligence and co-coordinating body for all these investigating agencies.

The extent of compliance by taxpayers is considerably influenced by the tax audits conducted by the tax administration. Effective planning and monitoring of tax audit by the tax administration determines its ability to enforce compliance. The income tax collection in India is based on the self-assessment principle. The taxpayers provide information on their income and tax liabilities which are also assessable by the tax administration. The administration also collects third party information on various investments and expenditures to match the information provided by the taxpayers. The tax audit carried out by the audit unit in the administration provides information on fraud and tax evasion that are followed up by the enforcement unit.

A separate division headed by a Commissioner (Audit) looks after the audit function assisted by Directorate of Inspection (Audit). The Audit unit establishes an annual audit work plan and frequency of audit based on the turnover and risk assessment. The audit plan based on turnover and risk assessment is clearer in the case of income tax as compared to other central taxes. Large taxpayers are audited annually and the frequency of audit for taxpayers with relatively lower turnover could be once in two years or five years. For smaller taxpayers, usually a percentage is selected for audit every year.

Indicator	Predictability and Control in Budget Execution	Score	Justification
PI-14	Effectiveness of Measures for Taxpayer Registration and Tax Assessment	B+	
(i)	Controls in the taxpayer registration system	A	Taxpayers are registered in a complete database system with some linkage to other relevant government registration system and financial sector regulation. The Permanent Account Number (PAN) provided by the Income tax Department provides the basis for such linkage. For other central taxes the registration numbers are being issued based on the PAN.
(ii)	Effectiveness of Penalties for non-compliance with registration and tax declaration	B	The tax legislations provide penalties for offences like tax evasion, fraudulent declaration and non-registration, which are consistently administered. However, the penalties for all areas of non-compliance have not proved to be a deterrence leading to improved compliance due to problems in the administrative and judicial system.
(iii)	Planning and monitoring of tax audit programme	B	Tax audit and fraud investigation are carried out by the by a separate division headed by a commissioner (audit) with an annual audit work plan based on turnover and risk assessment.

3.4.3 PI-15 Effectiveness in Collection of Tax Payments

While tax administration in India has adequate legal provisions to take action against delinquent taxpayers, its ability to collect the taxes assessed is obstructed for the tax under dispute. In India the part of the tax arrears under dispute is quite large as compared to the tax arrear not under dispute (*Table 3.13*). Tax demands under dispute before courts sometimes take a long time to be settled. Tax arrears, taking both disputed and undisputed categories, shows relatively lower growth in the case of direct taxes such as income and corporate taxes as compared to the indirect taxes such as customs, excise and services taxes. Further, as shown by the totals row the overall tax arrears not under dispute has grown substantially (59,299 million rupees or 17.5 per cent) in the year.

Table 3.13: Tax Arrears under Dispute and Not Under Dispute

(Rs. Million)

	2006-07			2007-08		
	Amounts under Dispute	**Amounts not under Dispute**	**Total**	**Amounts under Dispute**	**Amounts not under Dispute**	**Total**
Corporation Tax	266030	123520	389550	232420	162000	394420
Income Tax	247300	153910	401210	239100	168340	407440
Customs	28971	12057	41028	43425	14807	58232
Union Excise	105730	46264	151994	115484	48128	163613
Service Tax	7210	1938	9148	10668	3713	14381
Total	655241	337689	992930	641097	396988	1038085
Composition						
Corporation Tax	68	32		59	41	
Income Tax	62	38		59	41	
Customs	71	29		75	25	
Union Excise	70	30		71	29	
Service Tax	79	21		74	26	
Rate Of Change (%)						
Corporation Tax	-6.25	28.32	2.50	-12.63	31.15	1.25
Income Tax	-21.61	159.94	7.07	-3.32	9.38	1.55
Customs	18.59	48.85	26.12	49.89	22.80	41.93
Union Excise	39.10	35.54	38.00	9.23	4.03	7.64
Service Tax	76.15	84.06	77.77	47.96	91.57	57.20

Source: Receipt Budget, Government of India

The cumulative tax arrears and arrears collection in the case of income and corporate taxes, from 1995-96 to 2005-06, shown in *Table 3.14* reveals considerable growth in tax arrears. The percentage of collection of these arrear demands have remained static in the range of 8 to 9 percent, except in the year 1999-00, when a special drive was taken up to settle tax arrears. The growth in outstanding arrears is comparable to similar trend of growth of annual tax

collections. The flat arrear demand collection indicates that there has not been any perceptible change in the effort of the tax administration towards collecting arrears.

The tax is collected by the banks and transferred to Reserve Bank of India (RBI), which takes place daily. The banks are required to remit the tax collection for the day within 2 days to the RBI. The reconciliation of accounts between tax assessments, collection, arrears records and receipts by the treasury has been implemented smoothly, even though the frequency is rather long (one month). The main reasons are: (1) The reconciliation process cannot be done in real time due to the manual-based process; and (2) The tax agency needs time to obtain the confirmation of fund transfer of check payment from taxpayers' accounts.

Table 3.14: Arrear Demand Collection for Income and Corporation Tax

(Rs.Million)

	Cumulative Arrear Demand	Cash Collection	Percentage Collection Out of Arrear Demand
1995-96	229286	20790	9.07
1996-97	292215	23284	7.97
1997-98	339255	28450	8.39
1998-99	450399	30497	6.77
1999-00	438688	300660	68.54
2000-01	514725	49919	9.70
2001-02	492228	39389	8.00
2002-03	730128	54992	7.53
2003-04	723479	55402	7.66
2004-05	928860	70840	7.63
2005-06	986120	80640	8.18

Source: CBDT

Indicator	Predictability and Control in Budget Execution	Score	Justification
PI-15	Effectiveness in Collection of Tax Payments	D+	
(i)	Collection of tax arrears	D	While the tax administration has adequate legal provisions to collect tax arrears, the ability of tax administration to collect arrears is obstructed due to tax disputes pending at courts. The available evidence of collection of arrears for income and corporate tax shows a static trend in the range of 8 to 9 percent.
(ii)	Effectiveness of transfer of tax collection to the treasury by the Revenue Administration	A	The taxes are paid through the banking system and the banks remit the collection to RBI daily.
(iii)	Frequency of Complete accounts reconciliation between tax assessment, collection, arrears records and receipt by the treasury	A	The reconciliation process is carried out monthly.

3.4.4 PI-16 Predictability in the Availability of Funds for Commitment of Expenditure

The expenditures voted by the Parliament are immediately available to the spending departments and ministries. Department/ministry could spend the entire budgetary allocation immediately after enactment of Appropriation Act. However, release of funds by the administrative ministries to the field formations for commitment of expenditures is based on periodic profiles of expenditure projected by the spending agencies. This review is aimed at controlling and monitoring expenditure. The periodic reviews are conducted routinely at the time of release of funds at specified intervals.

The intra-year cumulative expenditure for all departments seems to be reasonably stable. However, variations at the line ministry level are quite significant. There seems to be merit in spreading expenditure more evenly through the year, subject to certain inherently lumpy expenditures. There is a tendency to incur a significant part of the annual expenditure during the last quarter of the financial year, especially during the month of March. Given the significant expenditures of the government in the nature of releases to other implementing agencies—most notably, state governments and sub-state level entities at the district level—the rush of expenditure in the last quarter and last month of the financial year seems to be inconsistent with prudent cash management.

Keeping in view the requirements of an improved cash management system, the Government has introduced a Modified Cash Management System in 2006-07, following a pilot scheme for limited number of departments. The objective of this scheme was to effectively monitor the spending pattern, obtain greater evenness within the financial year, avoid a rush of expenditure in the last quarter, reduce the tendency to park funds, and assist in planning the market borrowings of the Central Government. The Modified Cash Management System applies to only 23 demands for grants. The departments/ministries are required to furnish the Monthly Expenditure Plan (MEP) separately for plan and non-plan expenditures. The MEP is worked out and included in the detailed demand for Grants submitted to the Parliament. The MEP forms the basis of the Quarterly Expenditure Allocation (QEA), beyond which the departments/ministries may not issue cheques without prior approval of the Ministry of Finance. The MEP is limited to 15 percent of the budget estimates and the QEA for the last quarter is fixed at 33 percent of the budget estimates. The inter se variations between months within a quarter are allowed subject to statutory restrictions and guidelines. The departments/ministries not covered under the MEP scheme, are also advised to adhere the QEA for the last quarter to avoid the last quarter spike in the expenditure. The scheme enables the Ministry of Finance and Reserve Bank of India to plan their market borrowing calendar based on more predictable pattern of cash flows.

The Modified Cash Management system, announced in 2006-07 for 23 departments/ministries, however, has not achieved its objective entirely. The rush of expenditure in the last quarter of the financial year still continues. It is also being pointed out that the scheme should be extended to all Demands for Grants to provide a government wide effective cash management system.

In-year budget adjustments are made initially through the grant of additional budgets approved by FD based on assessments and requests made by the line departments. Approval of the Parliament, for all in-year budget adjustments (other than re-appropriation within the same demand), is obtained through the Supplementary Budget. The norms for granting additional budgets through supplementary demands have constitutional backing. While the supplementary demands are introduced in the light of unanticipated events impacting revenues and/or expenditures, the practice has become quite common. Usually three supplementary demands are introduced, first in July, second November and the third in March – before the budget for the ensuring year is presented.

Indicator	Predictability and Control in Budget Execution	Score	Justification
PI-16	Predictability in the Availability of Funds for Commitment of Expenditure	C+	
(i)	Extent to which cash flows are forecast and monitored	C	Under the Modified cash management systems for 23 departments/ministries monthly and quarterly expenditure limits are fixed on the basis of which cash forecast are drawn by the Ministry of Finance and borrowing calendar is determined. However, the updating of the cash flow scheme drawn for the year is infrequent.
(ii)	Reliability and horizon of periodic in-year information to line ministries on ceilings for expenditure commitments	B	The departments submit the Monthly Expenditure Plan (MEP) in their demands for grants which becomes basis for in-year ceilings (Quarterly Expenditure Allocation – QEA) for expenditure commitments
(iii)	Frequency and transparency of adjustment to budget allocations, which are decided above the management of line ministries.	C	The in-year budget adjustments are done through supplementary demands, which require approval of the Parliament and the frequency of such adjustments is known. However, the process of in-year adjustment is not very transparent and predictable for the departments/ministries.

3.4.5 PI-17 Recording and Management of Cash Balances, Debt and Guarantees

A comprehensive report on Central Government liabilities is provided in the *Economic Survey,* which is traditionally presented to Parliament in February, a few days before the budget, and is treated as a budget related document. The information given in the *Survey* distinguishes between internal debt and external debt of the Central Government. Internal debt in turn is broken down into "market borrowings" (securities issued by the Government of India as part of its market borrowing programme), "other internal debt" (mainly small savings certificates) and other internal liabilities (deposits in the public account). The budget documents also provide a comprehensive statement on liabilities in the *Receipts Budget*. In the Indian context, all internal debt is rupee denominated while the external debt is denominated in various foreign currencies. The currency composition of total external debt is reported in the Ministry of Finance Status Report on External Debt.

A comprehensive, comparable, reliable and regularly disseminated set of statistics on external debt is crucial for policymakers, financial markets and others. Towards this end, the Government of India has been collecting, compiling and publishing regularly a Status Report on India’s external debt since 1993 providing extensive statistics, *inter alia*, on the magnitude, composition, key indicators of India’s external debt. Over the years, the coverage and compilation procedures of external debt statistics have become more comprehensive and the dissemination of external debt statistics too has improved; India has also been able to comply with both the IMF's Special Data Dissemination Standard (SDDS) and the World Bank's Quarterly External Debt Statistics (QEDS). External debt management received explicit attention in the policy framework designed as a part of economic reforms initiated in 1991. Non-debt creating flows have been accorded primacy over debt creating flows to finance the external current account gap. As a consequence, India’s debt accumulation was moderated in the post reform period and debt sustainability indicators improved markedly over the years.

While the domestic and foreign debt records are updated and reconciled on monthly basis, the dissemination of management and statistical reports is done on a quarterly basis. The compilation and dissemination of external debt data at the end of March and June each year is carried out by RBI and for the quarters ending September and December, it is done by External Debt Management Unit (EDMU) in the MoF. For the dissemination of data for QEDS, EDMU is the nodal agency for all the four quarters. In addition, India's external debt data along with a commentary are also published in RBI's 'Annual Report' and 'Monthly Bulletin' and MoF's 'Economic Survey' and 'India's External Debt: A Status Report'. Besides the above, the publication titled 'External Assistance' published annually by the Controller of Aid Accounts and Audit, MoF carries a detailed account of grants and loans obtained by the Government of India,

including currency mix, interest rate structure and maturity profile. The external debt statistics of India are disseminated within three months from the end of the reference quarter in both the country-specific formats and also in IMF's SDDS format. These are accessible at www.finmin.nic.in and www.rbi.org.in.

As regards financial assets, the budget provides information on the government's opening cash balance. The Reserve Bank of India (RBI) is the banker to the Government. It maintains the cash balance of the Government and invests in government securities held in its portfolio for the purpose. Cash balance consolidation happens daily by RBI which maintains a specified Government of India Account. Detailed procedures to be followed for remittance of Government receipts into Government cash balance are laid down in the Memoranda of Instructions issued by the Reserve Bank of India.

The Ministry of Finance has the responsibility of approving all loans and guarantees and the RBI manages the public debt of the Government. The Ministry of Finance formulates the long term debt management strategy and annual debt issuance strategy and periodic calendars of borrowing. The Government is in the process of establishing a Debt Management Office (DMO) in the Ministry of Finance to undertake all debt management functions. The Central Government's contracting of loans is determined on the basis of projected requirements and annual fiscal targets enshrined in the FRBM Act. The FRBM Act limits the Government borrowing through the indicator of debt-GDP ratio. The FRBM Act also limits the government guarantee to be issued in a year. Government often issues guarantees to cover part or all of the risk that a borrower will fail to repay a loan or other guaranteed asset or that an institution will fail to fulfill its obligations. Common examples include state guarantees of debt and other obligations of sub-national governments and various public and private entities, such as, budgetary institutions, credit and guarantee funds, development banks, and enterprises. The contingent liabilities are the contractual obligations of the government to provide for any eventuality of default by the borrower either on principal amount borrowed or interest payment on such amount or both. The Ministry of Finance has issued clear instructions and guidelines including undertaking guarantees for the Public Sector Undertakings for issuance of Government guarantees. Loan guarantees given by the Central Government are reported in the budget.

Indicator	Predictability and Control in Budget Execution	Score	Justification
PI-17	Recording and Management of Cash Balances, Debt and Guarantees	A	
(i)	Quality of Debt Recording and Management	A	Comprehensive records on domestic and external debt are compiled and are updated and reconciled on a monthly basis. Comprehensive statistical reports providing information on debt stock, debt service, and debt management operations are prepared on a monthly basis.
(ii)	Extent of Consolidation of the Government's Cash Balance	A	The government cash balance is deposited with the Reserve Bank of India, the banker to the Government, which invests in government securities, held in its portfolio. The Detailed procedure to be followed for remittance of Government receipts into Government cash balance are laid down in the Memoranda of Instructions issued by the Reserve Bank of India.
(iii)	Systems for Contracting Loans and Issuance of Guarantees	A	Central Government's contracting of loans and issuance of guarantees are based on transparent criteria and fiscal targets set under the FRBM Act. Ministry of Finance has the responsibility of approving Government loans and guarantees.

3.4.6 PI-18 Effectiveness of Payroll Controls

The management of personnel, maintenance of the personnel database, and preparation of payroll are the prime responsibility of departments and ministries. An Integrated Financial Management Information System (IFMIS) incorporating systems for management of personnel database and payroll records at central level does not exist. Thus the departments/ministries are the cadre controlling authority. The recruitment of personnel and fixing of pay scales, however, to a large extent are centralized.

The Department of Personnel & Training (DOPT) under Ministry of Personnel, Public Grievance and Pensions is the nodal agency that formulates policy on personnel management relating to recruitment, regulation of service conditions, posting/transfers, deputation of personnel as well as other related issues to be followed by the departments/ministries. The DOPT has direct responsibility as the cadre controlling authority for the Indian Administrative Service (IAS), the higher civil service, and Secretariat Services in the Central Secretariat. The Department also operates the Central Staffing Scheme under which suitable officers from All India Services and Group 'A' Central Services are selected and then placed in posts at the level of Deputy Secretary/Director and Joint Secretary, on the basis of tenure deputation. The Department also deals with cases of appointment to the posts of Chairman, Managing Director, full-time

functional Director/Member of the Board of Management of various Public Sector Undertakings/ Enterprises, Corporations, Banks and financial institutions. The two organizations through which the Department ensures recruitment of personnel for the Government are the Union Public Service Commission (UPSC) and the Staff Selection Commission (SSC)**.** The former is constituted under a provision of the Constitution and is responsible for conducting examinations for appointment to the higher civil services and civil posts under the Union Government; including recruitment to the All India Services. The SSC is responsible for recruitment of subordinate staff such as Assistants, Stenographers etc. The Public Enterprises Selection Board (PESB), an expert body responsible for selection and placement of personnel for top managerial posts in the Public Sector Undertakings, works under the DOPT.

Pay fixation is centralized as the pay structure for government employees is decided by a Pay Review Commission established by the government. While no specific time period for the constitution of a Pay Commission for Central Government employees was stipulated, successive Central Pay Commissions were set up at intervals of 10 to 13 years. The last Pay Review Commission was the sixth one and submitted its report in 2008. While the Government revises pay scale for all government employees based on the recommendations of the Pay Review Commission, the rates of change differ for different grades and different services. For example, government employees working in services such as defense, police, and college/universities get different pay revisions. Different rates of change in pay scale also take place for autonomous bodies/quasi government employees. After every six months Government declares discretionary allowances according to the inflation rate of that period. The government also pays city allowances which differ according to the cost of living in different cities.

The personnel database of government employees in terms of their number, staffing pattern as against approved posts, salary bill are maintained by each department and ministry. The Drawing and Disbursing Officers (DDO) in the Accounts Section of each Ministry and Department have the responsibility of preparing the payroll each month. While a direct link between personnel database and the payroll for each month is not established, the payroll is prepared by the DDO after reconciling with the previous month's payroll. Ministries and departments maintain a service book for each employee where all the personnel details and payroll data are recorded. Any change in personnel records and the payroll are recorded in the service books of the Government employees, which are updated regularly. The updating of personnel records may not reflect the changes in the following month's payments. However, the changes are usually incorporated in the payroll within one to three months.

The Budget Section of Ministry of Finance collects the information on staff strength and salary amounts from every ministry, which is part of their expenditure proposals shown in demands for grants, and this information enters

into the budget estimates of the government. The information on staff strength and expenditure on pay and allowances are published in the Expenditure Budget of the Central Government. The Budget Account Section of the Ministry of Finance maintains the payroll data and personnel records for all Ministries and Departments. Each year in March, at the time of budget publication the Ministry of Finance sanctions the amount to be spent for salary and personnel expenditure. Then in August each ministry submits the estimated expenditure and updates payroll data and personnel records. These are published as revised estimated figures.

A database on government employees is also maintained by the Pay Research Unit working under the Department of Expenditure, Ministry of Finance. The Unit is mainly responsible for collection, compilation and analysis of data on actual expenditure incurred on pay and various types of allowances as well as data pertaining to the strength of the Central Government Civilian employees and Employees of Union Territory Administrations. This unit brings out an annual publication entitled "Brochure on Pay and Allowances of Central Government Civilian Employees". The Brochure provides statistical information regarding expenditure incurred by the different Ministries /Departments of Central Government on pay and various types of allowances such as Dearness Allowance, House Rent Allowance, Compensatory (City) Allowance, Overtime Allowance etc. in respect of its regular employees. It also provides information Ministry/ Department- wise and Group-wise on the number of sanctioned posts and number of incumbents in position. The Brochure contains information about the disparity ratio i.e. the ratio of the maximum to minimum pay of different State Government Employees. The latest Brochure brought out by the Unit pertains to the year 2006-07 published in November 2008.

According to the Central Government rules every ministry/department should audit payroll records and personnel data every year. For this purpose every ministry/department maintains an Internal Audit section where auditors check these data. However, the internal audit relating to payroll records and personnel data does not follow the rules diligently. The Comptroller and Auditor General can audit the payroll data and personnel records and tally that with the records of the existing workers. Some times the existence of ghost workers was pointed out in the CAG audit reports.

The Directorate General of Employment and Training under the Ministry of Labour and Employment has a survey division, which conducts a Census of Central Government Employee at intervals of 4-5 years. In this survey report the details of the number of employees in different department/ministries in different scale are published. The latest census of the department pertains to the year 2004, which was published in 2007.

Indicator	Predictability and Control in Budget Execution	Score	Justification
PI-18	Effectiveness of Payroll Controls	C+	
(i)	Degree of integration and reconciliation between personnel records and payroll data	B	The payroll data are reconciled with the previous month's payroll and are supported by full documentation for all changes made to personnel records each month at the level of departments and ministries.
(ii)	Timeliness of changes to personnel records and the payroll	B	The changes in personnel details and payrolls are maintained in their service books, which are updated regularly. It takes between one to three months for the changes in personnel records to reflect in the payments.
(iii)	Internal controls of changes to personnel records and the payroll	B	The internal control system ensures that the changes in personnel records and the payroll are recorded.
(iv)	Existence of payroll audit to identify control weaknesses and or ghost workers	C	According to the Central Government rules ministries should audit payroll records and personnel data internally every year and external audit by the CAG. However, the internal audit is not effective and external audit is not comprehensive.

3.4.7 PI-19 Competition, Value for Money and Controls in Procurement

The PI-19 is evaluated on the basis of existing rules and principles for government procurement and not on the basis of specific data on procurement of departments and ministries. The data on actual procurement by various departments and ministries of the Government is not publicly available.

There is no law exclusively governing public procurement of goods by the departments and ministries. However, rules and directives in this regard are available in the General Financial Rules (GFR), 2005. Guidelines for public procurement are also available in the form of a 'Manual on Polices and Procedures for Purchase of Goods' prepared by the Ministry of Finance. An important number of instructions, issued by the Central Vigilance Commission (CVC), supplement these regulations. Specific sectoral procurement regulations exist in some areas, such as defense procurement. While, certain control and oversight functions are carried out by central authorities such as the Comptroller and Auditor General and the CVC, no central authority exists that is exclusively responsible for defining procurement policies and for overseeing compliance with the established procedures. Article 299 of the Constitution, which stipulates that contracts legally binding on the Government have to be executed in writing by officers specifically authorized to do so, provides some legal framework relating to procurement. Further, the Indian Contract Act, 1872 and the Sale of Goods Act, 1930 are major legislations governing contracts of sale/ purchase of goods in general.

The rules and procedures on procurement are provided in the General Financial Rules (GFR). The Ministries or Departments have been delegated full powers to make their own arrangements for procurement of goods. In case however, a Ministry or Department does not have the required expertise, it may procure goods through the Central Purchase Organization, Directorate General of Supplies and Disposals (DGS&D) with the approval of competent authority.

DGS&D is the Central Purchase and Quality Assurance Organization of the Government of India working under the aegis of the Ministry of Commerce & Industry, Department of Commerce (Supply Division). The key function of DGS&D is to conclude rate contracts of various common user items frequently required by various Ministries and Departments. The system of rate contracts enables the user departments to place orders directly on the firms without going through the process of tendering under a specified threshold. Beside advantages of prices due to bulk buying there is considerable saving in time and expenditure by avoiding repeated tendering at multiple user locations. In addition, the rate contract system promotes decentralization of the procurement activity, while maintaining uniformity of prices in the procurement made by different user Departments.

DGS&D concludes rate contracts with the registered suppliers, for goods and items of standards types which are identified as common user items and are needed on recurring basis by various Ministries / Departments. DGS&D is to post the specifications, prices and other salient details of different rate contracted items, appropriately updated, on its web site for use by the procuring ministries and departments. The ministries and departments are to operate those rate contracts to the maximum extent possible. In cases where a Ministry or Department directly procures such goods from suppliers, the prices to be paid for such goods shall not exceed those stipulated in the rate contract and the other salient terms and conditions of the purchase should be in line with those specified in the rate contract. The ministries and departments have to make their own arrangement for inspection and testing of such goods where required.

With a view to establishing reliable sources for procurement of goods commonly required for Government use, the DGS&D prepares and maintains item-wise lists of eligible and capable suppliers. Such approved suppliers are known as "Registered Suppliers". All Ministries or Departments may utilise these lists as and when necessary. Such registered suppliers are prima facie eligible for consideration for procurement of goods through Limited Tender Enquiry. They are also ordinarily exempted from furnishing bid security along with their bids. A Head of Department may also register suppliers of goods which are specifically required by that Department or Office. The DGS&D has the responsibility of verifying credentials, manufacturing capability, quality control systems, past performance, after-sales service, and financial background of the supplier(s) before registration.

The ministries and departments can procure goods of small value without inviting quotations or bids. Goods up to the value of Rs. 15,000/- (Rs.015 million) can be purchased by the department without any bids and goods above this amount and below Rs.1 lakh (Rs0.1 million) can be purchased on the recommendations of a duly constituted Local Purchase Committee. The ministries and departments can directly procure DGS&D rate contracted goods from suppliers. In this case the prices to be paid for such goods should not exceed those stipulated in the rate contract and the other salient terms and conditions of the purchase should be in line with those specified in the rate contract.

The procurement of goods of higher value has to be done through a bidding system. The standard method of bidding prescribed is of three types; (i) Advertised Tender Enquiry; (ii) Limited Tender Enquiry; and (iii*)* Single Tender Enquiry.

For procurement of goods of estimated value Rs. 25 lakh (Rs. 2.5 Million) and above open tender by advertisement is used. Advertisement in such cases is given in the Indian Trade Journal (ITJ), published by the Director General of Commercial Intelligence and Statistics, and in print media having wide circulation. The departments and ministries also publish all advertised tender enquiries on their web sites. The departments and ministries are required to post the complete bidding document in their web sites and permit prospective bidders to make use of the document downloaded from the web site. Ordinarily, a minimum time of three weeks is given for submission of bids.

Limited Tender Enquiry method is adopted when estimated value of the goods to be procured is below Rs.2.5 million. In this case bids are invited from firms which are in the list of registered suppliers for the goods in question. The number of supplier firms in Limited Tender Enquiry should be more than three. Further, web based publicity is given for limited tenders. Purchase through Limited Tender Enquiry is adopted even where the estimated value of the procurement is more than the specified threshold in the case of urgency, which is put on record. Procurement from a single source may be resorted to if only a particular firm is the manufacturer of the required goods. For standardization of machinery or spare parts to be compatible to the existing sets of equipment, the required item can be purchased only from a selected firm.

In the absence of an exclusive law governing public procurement, the conditions governing the contract contain provisions for settlement of disputes and differences binding on both the parties. Mode of settlement of such disputes and differences is through Arbitration. If the parties fail to resolve the dispute by mutual consultation within a specified time limit, either the purchaser or the supplier can give notice to the other party to commence the arbitration as provided under Indian Arbitration and Conciliation Act, 1996.

Indicator	Predictability and Control in Budget Execution	Score	Justification
PI-19	Competition, Value for Money and Control in Procurement	Not Rated	
(i)	Use of open competition for award of contracts that exceed the nationally established monetary threshold for small purchases	Not rated	While rules and procedures for procurement are provided through the GFR and Manual on Policies and Procedures for Purchase of Goods, the data on actual procurement by various departments and ministries of the Government is not publicly available.
(ii)	Justification for use of less competitive procurement methods	Not rated	In the absence of data on actual procurement by the ministries and departments, this dimension was not rated.
(iii)	Existence and operation of a procurement complaints mechanism	D	A complaints mechanism relating to procurement operations does not exist. However, the parties can commence arbitration under the Indian Arbitration and Conciliation Act, 1996 to settle any dispute or difference.

3.4.8 PI-20 Effectiveness of Internal Controls for Non-Salary Expenditure

Internal Control is an integral component of management processes which are established in order to provide reasonable assurance that the operations are carried out effectively and efficiently; financial reports and operational data are reliable and applicable; laws and regulations are complied with so as to achieve organizational objectives. An effective internal control system helps planning, implementing, supervising and monitoring an organization's activities. Internal control safeguards resources against fraud, waste, and mismanagement, and helps in maintaining reliable financial data and information on assets through timely reports. Internal audit is a key element of internal control system.

The internal control rules and procedures at Central Government level, typically understood as administrative controls, and accounting and financial controls, are diffused. The General Financial Rules (GFRs), Delegation of Financial Power Rules (DFPRs), Treasury Rules, Receipt & Payment Rules Procedures provides the core of internal control procedures and systems. At the same time internal control systems in the ministries and departments is also bound by Acts of Parliament such as FRBM, directions of Parliamentary Committees, and guidelines given by Central Vigilance commission (C.V.C). The Ministry of Finance from time to time issues directives and circulars to the ministries and departments for strengthening internal control and expenditure management.

For an effective internal control and better financial management, the Head of the Department - Secretary, has been designated as the Chief Accounting Authority responsible and accountable for financial management of the Department. The head of the department is entrusted with the responsibility of ensuring proper use of public funds for the purpose for which they were voted and has to ensure that the Department maintains full and proper records of financial transactions and adopts systems and procedures that will afford internal control. The GFR details the responsibility of the Secretary in the financial management of the department.

Effective control over expenditures against the budgetary provisions remains the key element in the internal control system in the ministries and departments. The primary control over expenditure is the budget allocation as no expenditure can be incurred by the executive except with the approval of Parliament. The departments have the responsibility for control of expenditure against the sanctioned grants and appropriations placed at their disposal. Heads of Departments and other Controlling Officers, and Disbursing Officers subordinate to them exercise this control. As per the financial rules expenditures approved in the Parliament cover the financial year and can not be authorized after the expiry of the financial year.

Although the expenditure is limited to the grant or appropriation authorized by Parliament for a financial year, excess payment can be incurred by the Pay and Accounts Officer on receipt of an assurance from the head of the department controlling the grant of re-appropriation orders to accommodate the disbursement. The excess expenditure is regularized following the financial rules. During the year budget amendments through supplementary grant is also allowed. The Head of Department or Controlling Officer has the responsibility to estimate the likelihood of savings or excess expenditure every month. Departments of the Central Government have to surrender all the anticipated savings in the Grants or Appropriations controlled by them to the Finance Ministry, by the dates prescribed by that Ministry before the close of the financial year. The funds provided during the financial year and not utilized before the close of the year lapse at the close of the financial year.

Re-appropriation of Funds is possible between primary units subject to Delegation of Financial Powers Rules and any other restrictions imposed by the Finance Ministry. The primary units refer to the object heads on the expenditure side of the accounts which are primarily meant for itemized control over expenditure and indicate the object or nature of expenditure in terms of inputs such as “Salaries”, “Office Expenses”, “Grants-in-aid”, “Loans” and “Investments” etc. The re-appropriation of funds with sanctions by a competent authority has to be done before the close of the financial year to which such grant or appropriation relates. Re-appropriation of funds is usually sanctioned only when savings are anticipated in the unit from which funds are to be transferred.

Despite the existence of the financial rules for effective internal expenditure control, the actual practice falls short of the standard. The unevenness of expenditures during the year that spikes during the last quarter of the financial year still remains a problem in expenditure control. The surrender of unspent amounts, 'savings', from various grants to the Finance Ministry and excess expenditures not regularized are witnessed regularly as brought out by the CAG in their audit reports. These deviations indicate inadequate programme management and internal control through the year. There is also the prevalence of personal ledger accounts, a device intended to facilitate the designated officer to credit receipts into and effect withdrawals directly from the account to avoid losing it at the end of the year. Internal controls may also take the form of inspections, periodic meetings or monitoring through periodic progress reports, but these have not been extensive and regular. Lack of comprehensive data base limits the ability to manage the assets efficiently. The internal audit (discussed in PI – 21), a useful management tool to control misuse and mismanagement of public funds, has not been effective to serve the objectives of an effective internal control system.

Expenditure commitment controls that limit commitments to actual cash availability and approved budget allocation are important dimensions of overall internal control systems. Expenditure commitment is the obligation to make future payment arising out of contractual commitments - contracts for goods and services, or due to continuing commitments such as staff salaries, scholarships, and other entitlements. The key feature of commitment control is management of initial incurrence of expenditure obligations within the expenditure ceilings, imposed through budget appropriations or cash plan, rather than the actual payments in order to avoid arrears. The expenditure ceilings or cash plan facilitates commitment control and reconciles the availability of resources to commitments. This ensures that spending departments are able to enter into contracts, or other obligations, provided resources are available or likely to be available for payment. Indeed a well functioning cash management is necessary to guide the expenditure ceilings enforced on the spending departments.

Successful implementation of commitment controls requires improvements in budget formulation and execution process. Among others two important preconditions, good cash planning and accounting and reporting system, need to be mentioned in this context. Cash management and commitment control are inter-dependent and cash planning on its own will be ineffective unless it is integrated with control over commitments. An effective commitment control system can not be implemented in the absence of effective cash management. The principal task of cash planning is to ensure that the ceilings are consistent with the projected cash availability, which enables them to be used as ceilings for approving commitments. The accounting and reporting system organized on the basis of accrual basis is ideally suited for implementing an effective commitment control system. A well functioning internal and external audit system also facilitates introduction of commitment controls.

Judged from the above angles the expenditure commitment controls are not effective in India. The annual budget estimates are formulated on a cash basis. The Appropriation Act, meant for authorizing withdrawals from the Consolidated Fund for incurring expenditure based on the approved budget estimates, do not distinguish between commitment and expenditures. The budget preparation exercises faults on overlooking expenditure arrears as there is no provision in the budget for the ensuing year to discharge the expenditure arrears of the previous year(s). The year end financial statement, Appropriation Accounts, is also prepared on a cash basis reporting cash execution of the expenditure plans approved by parliament and do not report on commitments. The statutory requirements for budget implementation focus exclusively on controlling expenditures with respect to budget appropriations. Thus the accounting and reporting system, prepared on the cash basis, do not fulfill the basic precondition required to operate an effective commitment control system.

The Ministry of Finance initiated a Modified Cash Management System in 2006-07 with the objective of effectively monitoring the spending pattern, obtaining greater evenness within the financial year, avoiding a rush of expenditure in the last quarter, and reducing the tendency to park funds, and assist in planning the market borrowings of the Central Government. The Modified Cash Management system, introduced for 23 departments/ministries, however, has not achieved its objective entirely. The rush of expenditure in the last quarter of the financial year still continues. The cash management system is not integrated with control over commitments. Lack of an effective cash management mechanism in the line Ministries and Departments is a stumbling block to implement commitment control system.

The expenditure ceiling, which is communicated to the departments during their pre-budget meeting with the Ministry of Finance, mostly relate to the line item control. The monitoring or reporting mechanism of the outstanding commitments and the expenditure arrears is weak. There is no instrument to assist and guide the Head of the Accounts to know that sufficient unencumbered funds are available at the time of entering to obligations. The other issue that is relevant in this context is the unforeseen political demands on the budget for political reasons, which persists even in the post FRBM phase.

Indicator	Predictability and Control in Budget Execution	Score	Justification
PI-20	Effectiveness of Internal controls for Non-Salary Expenditure	D+	
(i)	Effectiveness of Comprehensive expenditure commitment controls	D	Comprehensive expenditure commitment controls are not effective. The existing cash management system and accounting and reporting system do not support an effective commitment control system. The end-year spike in expenditure, unspent amounts and excess spending in departments are indicative of lapses in internal control system in the Ministries and Departments.
(ii)	Comprehensiveness, relevance and understanding of other internal control rules/procedures	B	Other internal control rules and procedures incorporate a comprehensive and generally cost effective set of controls.
(iii)	Degree of compliance with rules for processing and recording transactions	D	The degree of compliance with rules for processing and recording is low.

3.4.9 PI-21 Effectiveness of Internal Audit

A robust internal control system and an effective internal audit system are foundations for sound financial management. These systems provide management control 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 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. Unless the system of internal control is updated continuously, it becomes obsolete over time, because of inability to cope with new challenges.

Internal audit is no longer considered as a mere routine review of financial and other records by specially assigned staff. The Institute of Internal Auditors, Florida, USA defines the scope of internal auditing as “the examination and evaluation of the adequacy and effectiveness of the organization’s system of internal control and the quality of performance in carrying out assigned responsibilities.”[1] The International Organization of Supreme Audit Institutions (INTOSAI) as well as the Institute of Internal Auditors (IIA) has issued auditing standards to guide the auditing and accounting professions. These standards are

[1] The Institute of Internal Auditors (1978), Standards for Professional Practice of Internal Auditing, Florida, USA, p.1

regarded as reflecting “best practices” which countries are expected to keep in view, while setting up their own internal auditing standards.

Internal audit units in India have been set up in the accounts organizations of the ministries/departments. These units work directly under the chief controller of accounts, with overall responsibility remaining with the concerned Financial Advisor and secretary of the ministry/department. The scope of internal audit covers the Principal Accounts Office, the Pay and Accounts Offices, and the DDOs in the Ministries/Departments. In addition, internal audit units are required to audit the implementing agencies for various schemes and programmes of the Ministries/Departments. The revenue departments have their own internal audit departments, where the focus is on post assessment reviews of transactions. There is an inspection wing in the Controller General of Accounts (CGA) and Controller General of Defence Accounts for inspection of audit work. The reports of internal audit are issued to audited units on an annual basis and important audit observations are brought to the attention of the Secretary of the Departments. The general duties of the internal audit unit include study of accounting procedures, implementation of the prescribed procedures and orders, scrutiny and check of payments and accounting work, investigation of important arrears, periodical review of all accounts records, and examination of irregularities brought to its notice.

The internal audit is conducted on the basis of departmental codes and manuals issued by accounting departments. These codes refer to what is generally understood to be standards of financial propriety. While the internal audit follows these principles, financial propriety involves going beyond the observance of rules and orders, but in the internal audit codes precise procedures are not laid down to regulate the course of audits conducted to assess propriety. Without universally acceptable norms or standards relating to financial propriety and not just principles, it is difficult to rely only on the judgment of the auditors in highlighting cases of financial improprieties. Considering the requirement of examining that the expenditure is not more than the occasion demands, a better known financial propriety principle, and such examination involves in-depth assessment of the issues and thus requires full-fledged performance auditing. The existing internal audit with its limited mandate is ill equipped to attempt such a performance audit.

Thus internal audit in India is basically confined to ‘compliance’ audit or ‘regularity’ audit. Internal audit involving compliance or regularity audit with emphasis on compliance of rules, regulations and procedures, makes its ambit extremely narrow. As the internal audit is conducted on the basis of departmental codes and manuals, which are limited in scope, it does not necessarily bind the audited entity to take action on the basis of observations and recommendations of internal audit. Internal audit is perceived as fault finding activity rather than adding value to the management in achieving stated goals of the organization. The internal audit does not focus on systemic issues in helping the management

in improving the efficiency and effectiveness of operations. Thus there is no systems review as against the transaction review. Further, the audit is undertaken at clerical level, which enables them to bring out only routine observations and minor objections pertaining to observance of rules or instructions.

One of the main weaknesses in financial management in the Government of India, emanates from the fact that the systems of internal audit and internal control in financial management of the government, have not been updated over several decades, nor has the government given due importance to it in securing 'value for money' and accountability. The Task Force on Internal Audit, constituted by the CAG to study the status of the internal audit in India in 2006 observed that "restricted mandate has resulted in non-evaluation of risk associated with various activities of the Ministries/Departments. PSUs and autonomous bodies have been kept outside the purview of internal audit thus further diluting its usefulness and effectiveness". The Task Force further observed that no standards have been evolved for internal audit in India. There was no segregation of duties especially at supervisory levels and between those who were responsible for internal audit and those responsible for pre audit, disbursement and accounting functions. The internal audit did not have the required independence for its effective functioning as oversight of internal audit vested with the Chief Controller of Accounts, who were also responsible for accounting and payment functions.

Indicator	Predictability and Control in Budget Execution	Score	Justification
PI-21	Effectiveness of Internal Audit	D+	
(i)	Coverage and Quality of the Internal audit function	D	The scope of the internal audit covers the offices involved in financial management in the ministries/departments and the implementing agencies for various schemes and programmes. The internal audit is conducted on the basis of departmental codes and manuals issued by accounting departments. However, the internal audit in India is not independent, has not evolved standards, does not evaluate risks, and is conducted in a routine manner. The internal audit does not focus on systemic issues in helping the management in improving the efficiency and effectiveness of operations.
(ii)	Frequency and Distribution of Reports	C	The audit reports carried out and prepared yearly and submitted to the concerned Financial Advisor. The reports are not submitted to Ministry of Finance and the SAI.
(iii)	Extent of management response to internal audit findings	D	The internal audit does not necessarily bind the audited entity to take action on the basis of observations and recommendations of internal audit

3.5 Accounting, Recording and Reporting

3.5.1 PI-22 Timeliness and Regularity of Accounts Reconciliation

The general banking business of the Central Government (which includes the receipt, collection, payment and remittance of moneys on behalf of the Government) is carried on and transacted by the Reserve Bank of India (RBI). The RBI handles the receipt and payment transactions of the Ministries or Departments through branches of the Reserve Bank and other public sector banks nominated for the purpose. The collections and payments are made by the banks first and the net amount is settled with the RBI later. Each branch of the Reserve Bank or the bank handling transactions of the Ministries or Departments maintain separate accounts in respect of each Ministry and Department and render an account of the transactions to the Pay and Accounts Officer of the concerned Ministry or Department together with all the supporting documents. These transactions are incorporated in the books of the Reserve Bank of India, Central Accounts Section, at Nagpur which is responsible for keeping a complete account of receipts and payments (including inter-Governmental adjustments and adjustments *inter se* of Defence, Railways and Posts—other than Telecommunications) on account of the Central Government.

A statement of the closing balance with required break up of the Central Government is sent each month, by the Central Accounts Section of the Reserve Bank to the Controller General of Accounts, indicating the Central Government Account Balance. The Central Accounts Section of Reserve Bank maintaining individual accounts of various Central Government Ministries, Departments and of Union Territory Administrations having separated accounts offices sends a monthly statement to their Principal Accounts Offices with supporting details.

The transactions of Railways, Posts, Telecommunications and Defence Department maintained at the branches of the Reserve Bank and State Bank of India are distinguished from other Central transactions in the initial accounts and classified separately for each of the Railways, each circle of Posts, each Accounts Officer of Telecommunication, and each Controller of Defence Accounts respectively. These transactions are carried through separate accounts such as the Railway Fund, Postal Account, Telecommunication Account and Defence Account respectively, in the books of the Reserve Bank.

All receipts in India on behalf of the Central Government are paid into the designated banks on behalf of the Central Government from which payments are made by cheques drawn thereon. These are accounted for by the bank as receipts and payments on behalf of the concerned Ministries/Departments of the Central Government. In support of receipt and payment transactions at the bank, daily receipt and payment scrolls with required supporting documents such as

challans and paid cheques are sent by the bank to the Accounts Officer of the Ministry or Department concerned.

The reconciliation of accounts of the ministries and departments of the Central Government with that of the Central Accounts Section of the Reserve Bank is carried out in a monthly basis, within 4 weeks of end of period. The Controller General of Accounts (CGA) in the Ministry of Finance compiles the aggregate accounts of the ministries/departments from the compiled accounts received from the departmental accounts sections and these accounts are reconciled with the cash balance of the ministries/departments maintained by the RBI in its Central Accounts Section.

The authorized officers of the Central Government (including DDOs with cheque drawing powers) who pay their receipts in the Consolidated Fund or the Public Account or withdraw moneys in lump for expenditure there from or from the Contingency Fund, submit detailed 'accounts' of their transactions to their respective Accounts Officers. From the accounts received from the bank and departmental officers, and from the book adjustments initiated in an Accounts Office, a classified abstract is compiled by the Pay and Accounts Officer showing the monthly receipts and payments pertaining to the Ministry or Department, following the accounting classification (under major, minor, sub and detailed heads of accounts). From the classified abstract, a Consolidated Abstract showing the progressive totals month by month under major, minor, sub and detailed heads of accounts is also compiled. The Pay and Accounts Officer sends the monthly compiled account showing the receipts and payments under major, minor, sub and detailed heads of account to the Principal Accounts Office in the Ministry, which enables preparing a consolidated account of the Ministry/Department. From these compiled accounts received from Principal Accounts Offices, the Controller General of Accounts prepares a Consolidated Account of the Central transactions as a whole. The cash balance of the Central Government in the books of the Controller General of Accounts, at the close of each month is reconciled with the statements of closing cash balance received from the Central Accounts Section of the Reserve Bank.

While procedures, rules and regulations exist for reconciliation of accounts of Central Government with respect to accounting data held in the government’s books and banks undertaking government transactions, in the Finance Accounts (year end financial statements) non-reconciliation with ‘Deposits with RBI’ was pointed out by the CAG that affects accuracy of government finance accounts. The CAG in their audit report for the year 2009, based on the government accounts for the year 2007-08, have observed that there were un-reconciled amounts between figure of balance maintained by the RBI and figures furnished by the CGA. In the earlier paragraphs it was mentioned that the accounts figures held in government’s books also represent the receipts and payments booked by the RBI and the consolidated figures should normally

tally. The difference, if any, between these two figures should be reconciled and explained satisfactorily to ensure the accuracy of the accounts.

The differences between the book figure of balances lying with RBI as furnished by the CGA and accounts figures as appearing in the Finance Accounts under the head 'Deposits with Reserve Bank' as observed by the CAG for the last five years, are given in *Table 3.15* . From the Table it is apparent that un-reconciled difference in 2007-08 was more than that of the last year. The CGA in their response to the audit observations clarified that the difference was due to the figures pertaining to the Market Stabilization Scheme (MSS) incorporated in the Finance Accounts but not included in the figures reported by RBI. The amounts with asterisks pertain to MSS. The other differences were due to delays in receipts and payment clearance documents and misclassification of bank transactions. Removing the figures pertaining to MSS, which was the major reason for non-reconciliation, other amounts were rather small.

Table 3.15: Variation in Book Figures and Account Figures of RBD

	Finance Accounts Figures	Reported by RBI	Difference	Difference as per Record of RBD Section
2003-04	7411.95	7387.12	24.83	-24.83
2004-05	79753.07	15733.48	64019.59	191.57 *64211.16
2005-06	65491.39	36341.39	29150.00	-87.90 *29062.10
2006-07	94886.59	32073.80	62812.79	161.10 *62973.89
2007-08	229639.47	60968.97	168670.50	278.08 *168392.42

Source: Audit Report of CAG, 2009

The Suspense Account is a transitory minor head operated for the accounting of transactions which for want of certain information, documents *viz*. vouchers, challans etc. cannot be taken to the final head of expenditure or receipt. On receipt of requisite information/documents etc., this account head is cleared by minus debit or minus credit when the amount under this is booked to its respective final head of account. The balance under the suspense head goes on accumulating if the amount is not cleared and the accuracy of government receipts and expenditures is affected. The Principal Accounts Offices in departments/ministries have the responsibility for reviewing the suspense balance and reporting to CGA for regular monitoring purposes. The process of reconciliation and clearance of suspense accounts is carried out annually within two months of end of the period. The aggregate net balance during the year under the suspense heads is reported in the Finance Account of the government that includes civil departments, Defence, Railways, and Posts and Telecommunication. For instance the balance under the suspense head

pertaining to all these departments/ministries in 2007-08 was Rs.6524.85 crore (debit).

The Finance Accounts reflect the net balances under the suspense heads pertaining to departments and ministries. According to the CAG (Audit Report, 2009), due to the practice of including net balances, the real magnitude of outstanding balance under these heads does not get reported in the year end financial accounts presented to the Parliament. According the audit report, netting of debit/credit balances leads to significant understatement of the suspense balance in the Finance Accounts. The correct balances under these heads should be determined by aggregating the outstanding debit and credit balances in disaggregated manner under various suspense heads.

Test check of the suspense accounts by the CAG during their audit, reported in his 2009 report, for Principal Accounts Offices relating to settlement of inter-departmental and inter-governmental transactions, civil departments, suspense accounts for purchases abroad operated by Controller of Aid Accounts and audit (CAA&A), public sector bank suspense, and Central accounts office revealed that outstanding balances were pending without being reconciled.

Indicator	Accounting, Recording and Reporting	Score	Justification
PI-22	Timeliness and Regularity of Accounts Reconciliation	B	
(i)	Regularity of bank reconciliation	B	Reconciliation of government accounts, consolidated by the CGA, with that of the RBI takes place regularly on a monthly basis at aggregate and detailed level. Despite the existence of detailed procedures and rules, un-reconciled amounts were detected by the CAG in their audit report.
(ii)	Regularity of reconciliation and clearance of suspense accounts and advances	B	The reconciliation and clearance of suspense account and advances is carried out annually within 2 months of end of the period. However, outstanding balances were reported by the CAG in their audit report.

3.5.2 PI-23 Availability of Information on Resources Received by Service Delivery Units

Most primary service delivery units typically are the responsibility of sub-national governments (State Governments) in India. This is following the constitutional demarcation relating to the functional responsibility between Central and State Governments. However, the Central Government intervenes in social sectors such as education and health through specially designed Centrally Sponsored Schemes (CSS). The CSS are meant to provide additional resources

to the states for implementing programmes that are considered by the Government of India to be of national/regional importance. For some major CSS separate implementing agencies have been created at State level and central funding is directly routed to these agencies outside the State budgets. The major CSS in education and health receiving central funding are the Sarva Siksha Abhiyan (SSA) for primary education with the objective of universalizing elementary education and the National Rural Health Mission (NRHM) for improving rural health service.

The CSS for rural health and primary education, termed as flagship programmes due to the importance attached to these programmes, are run by the respective ministries at central level. The resource provision form part of the internal budget estimate preparation of administering ministries. The resources received by the front line delivery units, spread across the country, in a timely manner and as per the provisions is a concern that was sought to be addressed in the implementation design of the schemes. The concern regarding delay in transfer of resources to the service delivery units prompted the Government to create specific implementing agencies for these programme at the state level, and to transfer funds directly to the bank accounts of the implementing agencies. Thus the funds for SSA and NRHM do not enter the state exchequers obviating the possibility of delays in transfers to the agencies in case the State Governments divert the funds for other uses. The agencies at all levels are empowered to make their own procurements following the procurement procedures of the State Governments.

Starting from the State level the fund flows to the actual service delivery units is carried out using the banking system. The funds released by Government of India are credited to the bank accounts established by the State implementing agencies, who in turn release the funds to districts within 15 days of its receipt from Government of India. Funds to local level agencies are advanced on the basis of annual work plans and objectives as approved through project approval system. Funds are released in installments (usually two per annum), based on the satisfactory utilization of the previous installment. The agencies report the fund flow situation and actual resource position following the prescribed financial management rules for these schemes. The agencies are also audited by chartered accountants and the audit reports provide information on resource position of the agencies and their use.

A financial management framework has been established for these schemes that includes procedures of flow of funds to the service delivery units, maintenance of accounts, reporting, internal control, and auditing. As per the financial management manual complete accounts in respect of the monetary transactions of the implementing agencies at state headquarters as well as in the subordinate offices is maintained in the same manner as required in a State Government. These are made available for inspection by the auditors, State implementing agencies, State Government and the concerned Ministries of

Government of India. In order to support the programme management at district, state and national level with information on fund flows, progress of the programme and utilization of funds during the year against the approved budget allocation, agencies prepare quarterly financial reports as prescribed in the financial management manuals of these schemes. As the Government of India and State Government release funds directly to State implementation agencies, and the latter releases funds to districts and sub-district level Institutions, the quarterly fund flow statement reflect the same information by way of sources and applications of funds. The quarterly reports of the primary units are submitted to State level implementing agency, which in turn prepares a consolidated quarterly financial statement that is submitted it to the concerned department of the State Government and Government of India.

The annual audit reports of the agencies also provide information on funds received by the agencies and use of such funds. The implementing agencies are audited by chartered accountants appointed by the State level agencies following the rules and regulation. The agencies are made responsible for the maintenance of proper accounts and other relevant records, as well as preparing annual accounts comprising the receipts and payments accounts and statement of liabilities in prescribed formats to facilitate proper auditing. The scope of the audit covers all the State implementing agencies, all district offices, and a sample of primary service delivery units such as schools and health service units. However, all the primary units are covered by the audit in a three year cycle.

Given the diversity and size of the country and the number of CSS and implementing units across the country it has been a challenge to have meaningful information on all the schemes. While for major schemes such as SSA and NRHM, detailed financial management framework has been prescribed, for many other schemes information on resources and expenditure is not adequate. There are also gaps in information relating to actual progress and achievement of the schemes. To support informed planning, budgeting and effective monitoring of these schemes the Central Government has initiated a 'Central Plan Scheme Monitoring System' implemented by the CGA in 2008. Under this mapping of central schemes with the code of accounts and compiling information required for financial management is being attempted from across the states. The information on overall releases under all the central schemes, state-wise and agency-wise data on releases, and information on resources received by the implementing agencies is expected to be captured in this information system. In addition to expenditure tracking on the central schemes, this information system is designed to provide complete lists of implementing agencies at each level with details of their associated bank accounts and their resource position.

Indicator	Accounting, Recording and Reporting	Score	Justification
PI-23	Availability of Information on Resources Received by service delivery units	A	The information on resources received by primary service delivery units under central run primary education and rural health schemes are reflected in the consolidated financial reports prepared by the State level agency quarterly. The service delivery units are audited annually by the chartered accountants and the audit reports provide information on resources and their use.

3.5.3 PI-24 Quality and Timeliness of In-Year Budget Reports

There is no provision for a mid-year budget report to be presented to the Parliament. However, the FRBM act stipulates that the Finance Minister should review, every quarter, the trends in receipts and expenditure in relation to the budget and place the outcome of such reviews before the Parliament. The review of trends of receipts and expenditure is expected to provide information on shortfall of revenue or excess of expenditure over the pre-specified levels indicated in the fiscal strategy statements so that the government can take appropriate actions to adhere to the FRBM provisions. The review mandated by the FRBM act pertains to macro-aggregates and is not so much related to budget implementation in different sectors

The aggregate budget outturns of the Central Government covering expenditure, revenues and fiscal deficit are prepared by the Controller General of Accounts (CGA) on a monthly basis. The monthly accounts of the Central Government are important in-year budget reports that are accessible to the general public through the website of the CGA. The monthly accounts are published following the general budget classification, which facilitates analysis of budget implementation on a monthly basis. The CGA prepares monthly accounts of the Central Government from the financial data compiled by the controller of accounts office of the ministries/departments. The monthly accounts become available before the end of the following month.

Controller General of Accounts is the apex accounting body in the Government of India. The accounts of the Civil Ministries are compiled and maintained by the Pay and Accounts Offices, the basic accounting units. The Pay and Accounts Offices maintain line item wise accounts of all the transactions involving Consolidated Fund of India, Contingency Fund of India and Public Account of India. Various subsidiary accounts such as Loan accounts, Fund accounts etc. are also maintained by these units. The accounts compiled by the Pay and Accounts Offices are consolidated on a monthly basis in the Principal Accounts Offices at the Ministry's headquarters. The consolidated accounts of the Ministry are rendered to the Controller General of Accounts. The accounts received from various Ministries are consolidated in the office of the Controller

General of Accounts to generate the accounts of the Government of India as a whole. These monthly accounts are reviewed and a critical analysis of expenditure, revenue collection, borrowings and deficit is prepared for Finance Minister.

The monthly accounts prepared by the CGA follow the broad budget classification and broad division of accounts into consolidated fund, public account and contingency fund. The expenditure classification in terns of plan and non-plan and the division of expenditures into revenue and capital account is maintained in the monthly accounts. While, monthly accounts compiled by the CGA serves as an important aid in planning of expenditure and deficit control, the information captured is only at payment stage. The monthly accounts, although provides data and compares the actual with budget over all items budget estimates with a fair degree of dis-aggregation, the information does not pertain to commitments.

Indicator	Accounting, Recording and Reporting	Score	Justification
PI-24	Quality and Timeliness of In-Year Budget Reports	C+	
(i)	Scope of reports in terms of coverage and compatibility with budget estimates	C	The monthly accounts prepared by the CGA covering the aggregate government finances, which compares actual with budget estimates with a fair degree of dis-aggregation, serves as an useful in-year budget report. However, the monthly accounts capture information only at payment stage and not commitments.
(ii)	Timeliness of the issue of reports	A	The monthly accounts are prepared on a monthly basis and become available before the end of the following month at the website of the CGA.
(iii)	Quality of Information	A	There are no material concerns regarding data accuracy in the monthly accounts prepared by the CGA.

3.5.4 PI-25 Quality and Timeliness of Annual Financial Statements

The Finance Accounts and Appropriation Accounts prepared by the Controller General of Accounts (CGA) are the consolidated year-end financial statements of the Government of India. These documents are based on the detail information for all the ministries/departments and decentralized units. The year-end financial statements are accessible to the general public. The accounts for the government sector in India are prepared on a cash basis and the year-end financial statement reflects this accounting system. The annual accounts of the Government, comprising the Union Government Finance Accounts and the Appropriation Accounts, are presented before the Parliament after their statutory audit by the Comptroller and Auditor General of India. Preparation and submission of Appropriation Accounts to the parliament completes the cycle of

the budgetary process. Through Appropriation Accounts parliament is informed about the expenditure incurred against the appropriations made by the parliament in the previous financial year. All the expenditures are duly audited and excesses or savings in the expenditure are explained. The Finance Accounts show the details of receipts and expenditure for all the three funds in the form of various statements including liabilities of the government such as guarantees etc. and loans given to states, union territories and public sector undertakings.

The Constitution of India has divided the moneys of the Government of India into three parts, namely:

- Consolidated Fund: All revenues collected, loans raised and their repayment go into this fund. All the expenditure of the Government is also met from this fund. Money can be spent through this fund only if it is appropriated by Parliament.
- Public Account: All other moneys received by or on behalf of Government are credited to Public Account
- Contingency Fund: The unforeseen expenditure which cannot wait approval of Parliament is met from this fund. The government can incur expenditure from this fund and seek the approval of Parliament later.

Based on the above scheme of division of government purse, the accounts are kept separately for each part (fund).

There are certain kinds of expenditure which are exempted from vote in the Parliament, these are termed as "Charged" which include salaries of President, Judges, Comptroller and Auditor General etc. All the other expenditures are put to vote and are called "Voted". Sovereign debt and releases to state governments are also "charged" on the Consolidated Fund of India. Apart from the above broad division, in order to serve information needs, the accounts are maintained on the basis of functional classification after dividing them into revenue and capital. There is a six tier classification of transactions which is being followed in government of India at present, as laid down in the list of Major and Minor Heads. The expenditure of the Government is further divided into Plan and Non-Plan. Plan expenditure is directly related to expenditure on schemes and programmes as envisaged in the five year plans and the Non-Plan expenditure is incurred on administrative and maintenance activities. The accounts are compiled every month by the Pay and Accounts Officers broadly as per the classification mentioned above. For the Government of India as a whole, year-end financial statements are prepared by the CGA and are presented in the Parliament. After formal presentation of the Appropriation Accounts and Finance Accounts to the Parliament, the CGA brings out 'Accounts at a Glance', which contain summary of these accounts presented in an easily understandable format.

The year-end financial statements in the form of Finance Accounts and Appropriation Accounts are presented to the Parliament 8 to 10 months after the end of the fiscal year. The CGA indicates a time schedule for preparation of year-end financial statements that includes receipts of financial statements from the Principal Accounts Offices in the ministries and departments, consolidating the financial statements, getting them audited by the CAG, reconciling any audit observations keeping close liaison with the concerned the ministries and departments, and getting clearance from the CAG. After getting certified by the CAG, the financial statements are placed in the Parliament. According to this time schedule, the CGA after receiving the financial statements from the Principal Accounts Offices is to prepare the consolidated statements in June, which are then forwarded to the CAG for their audit. The CAG audit, reconciliation with audit observations, and final clearance from CAG are to be completed within 2 to 3 months. The time schedule drawn by the CGA for finalization of year-end financial statements is indicative in nature and generally the statements are placed in the Parliament 8 to 10 months after end of the fiscal year. While, the Financial statements for the year 2006-07 was placed in the Parliament on 27 November 2007 (fag end of the 8th month after the end of the fiscal year), the same for the year 2007-08 was placed on 5 February 2009 (11 months after the end of the fiscal year). The delay in placing the statements for the year 2007-08 was ascribed to complying with some audit observations raised by the CAG.

The accounting standards, known as Indian Government Accounting Standards (IGAS), are prescribed by the government following the provisions of Article 150 of the Constitution, which stipulates that the Accounts of the Union Government would be kept in a form as prescribed by the President of India, on the advice of the CAG. The Controller General of Accounts (CGA) in the Ministry of Finance is entrusted with responsibility of prescribing the form of accounts of the Union and States, and to frame, or revise, rules and manuals relating thereto on behalf of the President of India in terms of Article 150 of the Constitution of India, on the advice of the Comptroller and Auditor General of India. All the IGAS are mandatory from the effective date(s) of notification by the government. Where the accounting authorities of the Union and State Governments deviate from the applicable IGAS, a disclosure has to be made with reasons for such deviations as well as the effect of the deviations on the Financial Statements.

The main principles, which guide the maintenance of the accounts of the Government of India are contained in Government Accounting Rules, 1990; Accounting Rules for Treasuries; and Account Code Volume-III. Detailed rules and instructions relating to the forms of the initial and subsidiary accounts to be kept and rendered by officers of the Department of Posts and other technical departments are laid down in the respective Accounts Manuals or in the departmental regulations relating to the department concerned.

The Government of India constituted an advisory body called Government Accounting Standards Advisory Board (GASAB) under the Comptroller & Auditor

General of India in 2002. The objective of the GASAB is to formulate standards relating to accounting and financial reporting by the Union, the States and Union Territories with Legislature. The IGAS so formulated by GASAB are recommended to the Government of India for notification in accordance with the provisions of the Constitution. The GASAB was entrusted with the following responsibilities:

- To establish and improve standard of Government accounting and financial reporting in order to enhance accountability mechanisms;
- To formulate and propose standards that improve the usefulness of financial reports based on the needs of the users;
- To keep the standards current and reflect change in the Governmental environment;
- To provide guidance on implementation of standards;
- To consider significant areas of accounting and financial reporting that can be improved through the standard setting process; and
- To improve the common understanding of the nature and purpose of information contained in the financial reports.

The GASAB takes into account the well-established system of Government accounts in India with underlying accounting concepts and principles and international best practices while suggesting the IGAS. It has encouraged disclosures and provision of additional information in the government accounting practice in India. Consequent upon the recommendation of the Twelfth Finance Commission (TFC) for introduction of accrual basis of accounting in Government and acceptance by Government of India in principle, GASAB is suggesting an operational framework and roadmap of transition to the accrual basis of accounting in Governments.

In this context it is important to note that the Twelfth Finance Commission while recommending in favour of introducing accrual accounting, suggested provision of some additional information during the process of transition to accrual accounting in the form of statements appended to the existing system of cash accounting to enable more informed decision making. The statements to be provided as suggested by the TFC include; (i) Statement of subsidies given, both explicit and implicit, (ii) Statement containing expenditure on salaries by various departments/units, (iii) Detailed expenditure on pensioners and expenditure on government pensions, (iv) Data on committed liabilities in the future, (v) Statement containing information on debt and other liabilities as well as repayment schedule, (vi) Accretion to or erosion in financial assets held by the government including those arising out of changes in the manner of spending by the government, (vii) Implications of major policy decisions taken by the government during the year or new schemes proposed in the budget for future

cash flows and (viii) Statement on maintenance expenditure with segregation of salary and non- salary portions.

However, the CAG in their audit report in 2009 have pointed out that even four years after the Commission's Report, these important statements have not been included in the Union Finance Accounts. In replying to the query of the CAG, the CGA indicated that the inclusion of the above additional statements in the Finance Accounts has been accepted in principle by the Government and the process of consultation is on in the Ministry of Finance to deliberate on the manner and form in which the additional information could be provided, within the existing system of cash based accounting. The CGA emphasized that inclusion of these additional statements in accounts would require necessary approvals and would be a time consuming exercise.

The national accounting standards, IGAS, are not fully aligned with International Public sector Accounting Standards (IPSAS) prescribed by the International Federation of Accountants (IFAC). The IFAC has issued IPSAS standards for cash basis of accounting (popularly known as Cash IPSAS). It prescribes the manner in which the general purpose financial statements are to be presented under the cash basis of accounting. There are differences between Government Accounting system in India and cash basis IPSAS relating to the structure, disclosures and basis of accounting at present. The variations are found with regard to the financial statements presented in the IPSAS, accounting policies and explanatory notes, reporting period, adequacy of information about the entity, presentation of comparative information, and the structure of the Consolidated Financial Statement. According to a study by the GASAB (GASAB, 2008, A Study on Gap Analysis of Indian Government Accounting with International Standards) the accounting standard in India can be easily aligned with Cash IPSAS by undertaking some changes in procedural issues like inclusion of statement of accounting policies, inclusion of information about the entity, reducing the reporting lag, better disclosure of information, consolidation of cash flows of Government companies and corporations with Government account etc. There is a need for changes in the existing cash system to comply with Cash IPSAS as its adoption will facilitate eventual migration to accrual basis accounting.

Indicator	Accounting, Recording and Reporting	Score	Justification
PI-25	Quality and Timeliness of Annual Financial Statements	C+	
(i)	Completeness of the financial statements	A	The Finance Accounts and Appropriation Accounts prepared by the Controller General of Accounts (CGA) are the consolidated year-end financial statements of the Government of India. These documents are based on the detail information for all the ministries/departments and decentralized units.
(ii)	Timeliness of the issue of reports	B	The year-end financial statements in the form of Finance Accounts and Appropriation Accounts are presented with a time lag of 8 to 10 months.
(iii)	Accounting standards used	C	The accounting standards prescribed by the Government (President of India) on the advice of the CAG, IGAS, are not fully aligned with the Cash IPSAS prescribed by the IFAC. There are differences between Government Accounting system in India and cash basis IPSAS relating to the structure, disclosures and basis of accounting at present.

3.6 External Scrutiny and Audit

3.6.1 PI-26 Scope, Nature and Follow-up of External Audit

Audit of the accounts of the Union and of the States is a union Subject in India. A unitary audit in the federal setup is designed to play a significant role in effective financial administration of the country. The Comptroller and Auditor General of India (CAG) is the Supreme Audit Institution (SAI) in the country and derive the position and authority in relation to the external audit from the Constitution of India. The duties and powers of the CAG are enshrined in Articles 148 to 151 of the Constitution and set out in the CAG's (Duties, Powers and Conditions of Service) Act, 1971. The Constitution prescribes exhaustive safeguards for the independent functioning of CAG like fixed non-renewable term, full access to information, right to table the reports in the Parliament/ Legislature; power to determine the nature and extent of audit checks and to decide what should be included in the Audit Reports. To exercise the power entrusted, the CAG is empowered to inspect any office of the organization subject to audit, call for relevant documents, and call for any required information. The auditing standards of the International Organization of Supreme Audit Institutions (INTOSAI) have been suitably adapted with due consideration to the Constitution of India. The audit assists Parliament in exercising financial control over the executive to ensure that funds approved have been utilized with

due regard to economy and efficiency for the purpose intended, and the funds authorized to be raised through taxation and other measures have been assessed, calculated and credited to the government properly.

The CAG is entrusted with the responsibility of external audit of central and state government accounts, compilation and keeping of accounts of states, and audit of public entities. The CAG also audits Government Companies and Corporations in accordance with the provisions of the Company's Act. The CAG audit reports placed in the Parliament are prepared in several volumes, which are grouped on the basis of their subjects: Civil, Defence, Railways, Revenue Receipts and Commercial. The Reports contain major audit findings on the Ministries and offices under their control, including Autonomous Bodies and Public Sector Undertakings. However, certain bodies and authorities are not covered by the audit performed by the CAG. These include implementing agencies relating to various schemes of the Central Government and rural and urban local bodies. These bodies receive government funds relating to Central Government schemes and schemes for rural employment and poverty alleviation. For the last three years (2006-07 to 2008-09) these implementing agencies have received direct central funding amounting to 7 to 8 percent of total Central Government expenditure. While independent chartered accounts have been entrusted with auditing the implanting agencies, the local fund auditors of the state government and the chartered accountants audit the accounts of the local bodies. The CAG has been entrusted with the responsibility of providing technical guidance and supervision**/s**upport to the audit of rural and urban local bodies.

The range of audit performed by the CAG includes regularity (financial) audit, regularity (compliance) audit, IT audit and performance audit. The objective of the financial audit is to verify whether the financial statements (accounts of the Government) are properly prepared, complete in all respects and are presented with adequate disclosures. The compliance audit verifies the transactions relating to expenditure, receipts, assets and liabilities of the Government to ascertain whether the provisions of the Constitution, the applicable laws, rules, regulations and various orders and instructions issued by the competent authority are being complied with. The performance audit is an independent assessment of the extent to which any organization, programme or scheme operates economically, efficiently and effectively. While emphasis is being given to appraisal of performance of programmes and projects and soundness of the systems, currently the performance audits are limited to review and assessment of selected programmes of the government.

The dates of placement of audit reports in Parliament are given in *Table 3.16*. From the *Table* it is evident that the report containing audit observations on Accounts of Union Government was placed in the Parliament earlier than other reports, which took more than 12 months. Leaving the report on Accounts, placed 10 months after the end of the year, all other reports took more than 15

months in 2008-09. In 2007-08, while, the report on Accounts was placed 8 months after the end of the year, all other reports took more than 11 months. Three of the reports in 2007-08 were placed a long 18 months after the end of the year. In 2006-07, the full set of reports was placed in the Parliament 13 months after the end of the year. The audit observations on Government Accounts could be placed earlier than other reports (at least in the last two years) as the year-end financial statements prepared by the CGA have been audited and certified by the CAG within 2 to 3 months (see PI- 25). The audit observations on the finances of the Government and financial transaction of the ministries and departments are contained in the report on Union Government Accounts.

The Parliament scrutinizes the audit reports through a parliamentary committee called the Public Accounts Committee (PAC). The PAC examines the audit reports and makes recommendations to Parliament on various issues involved. However, the PAC's examination of the audit report is not comprehensive, as the committee over the years has scrutinized a limited portion of the audit reports. The Ministries/Departments take only those audit paras seriously which come up for discussions in the PAC. The submission of CAG report to the Parliament and its examination by the PAC followed by its recommendations is considered to be the first level in the process of follow up action by the executive, which as limited to the portion considered by the PAC.

Table 3.16: Placement of Audit Reports in the Parliament

	2006-07 (Year ending 2005-06)*	**2007-08 (Year ending 2006-07)***	**2008-09 (Year ending 2007-08)***
Civil			
Accounts of the Union Government	14 May, 2007	7 Dec, 2007	20 Feb, 2009
Compliance Audit Observations	14 May, 2007	24 Oct, 2008	10 July, 2009
Autonomous Bodies	14 May, 2007	14 Mar, 2008	24 July, 2009
Scientific Departments	14 May, 2007	14 Mar, 2008	24 July, 2009
Defence Services	14 May, 2007	14 Mar, 2008	10 July, 2009
Direct taxes	14 May, 2007	11 Mar, 2008	10 July, 2009
Indirect Taxes	14 May, 2007	11 Mar, 2008	10 July, 2009
Railways	14 May, 2007	24 Oct, 2008	10 July, 2009
Commercial			
Financial Reporting by PSUs	15 May, 2007	24 April, 2008	9 July, 2009
IT Applications in Public Sector Undertakings	15 May, 2007	24 Oct, 2008	9 July, 2009
Compliance Audit Observations	15 May, 2007	24 April, 2008	9 July, 2009
Telecommunications sector	14 May, 2007	10 Mar, 2008	13 July, 2009

* The year to which the audit report pertains
Source: CAG of India

The Ministries/Departments are supposed to submit Action Taken Notes on the paras not discussed by the PAC. This is the second level in the process of follow up on the CAG report which involves submission of audit findings to all the units including ministries/departments and other bodies covered under the external audit and asking for action taken report by the CAG. The detailed audit findings are generally sent to the chief of the departments or bodies audited by the CAG. However, this process is the weakest in the follow up action on the external audit carried out by the CAG. There is no law which binds them to provide action taken report to the CAG. As a result the replies in the form of action taken reports by the audited units come with a substantial time lag. There were instances of not responding to such audit findings for a long time. Even when the Action Taken Notes are submitted, these are largely formal rather than substantive. The CAG does not have the power to summon officials and seek explanations for their decisions and it does not have the power to make erring officials pay for the loss caused by misspending or misappropriation of funds.

Indicator	External Scrutiny and Audit	Score	Justification
PI-26	Scope Nature and Follow-up of External Audit	D+	
(i)	Scope/nature of audit performed (including adherence to auditing standards)	B	The CAG audits all government departments and public and constitutional entities every year as per prescribed law. The audit range includes regularity (Financial, compliance) and performance audit of selected programmes. The auditing standards of the International Organization of Supreme Audit Institutions (INTOSAI) have been adapted. However, some autonomous implementing agencies of central schemes and rural and local bodies, receiving government funds, are not audited by the CAG.
(ii)	Timeliness of submission of audit reports to the legislature	D	The audit reports are submitted to the legislature after 12 months of the end of the financial year.
(iii)	Evidence of follow up on audit recommendations	C	While the recommendations regarding corrective actions given by the PAC, that examines the external audit reports, were taken seriously by the executive, its scope was limited as the PAC considers only a small portion of the audit reports. The Action taken Notes submitted by the departments and units audited by the CAG relating to other audit observations not examined by the PAC were largely formal rather than substantive.

3.6.2 PI-27 Legislative Scrutiny of the Annual Budget Law

The preparation of the budget and its approval in the Parliament, provision for which is enshrined in the Constitution of India, goes through legislative scrutiny and the Parliament exercises full control over the annual budgetary system through this mechanism. The procedure of parliamentary control established through the Constitutional provisions is adhered to. The Annual Financial Statement, commonly known as the budget, confers specific authority for raising revenue through taxation and incurring expenditure. Without the approval of the parliament no tax measures can be introduced (barring executive ordinances for temporary measures) and no expenditures can be incurred by the executive. The process of preparing the budget including parliamentary discussion during the budget session after its presentation, and its subsequent approval is considered as an effective instrument of financial control of government activities.

The financial year in India is from 1 April to the 31 March of the following year. The Annual Financial Statement, commonly known as budget, comprising of receipts and expenditure of the government is placed before the Parliament usually on the last working day of February. After the budget is presented in the Parliament for its consideration and adoption, the members of the Parliament get the opportunity for discussing the budgetary proposals. The budget discussion by the legislature at this stage is limited to general examination of the budget, tax policies and expenditure proposals of the government as included in the budget. During the budget discussions motions are not moved to change the contours of the budget and the budget is not submitted to the vote of the house.

The Government of India enacted the Fiscal Responsibility and Budget Management Act (FRBM) in 2004. As per the provisions of the FRBM Act, the government presents three statements, Macro-economic Framework Statement, Medium Term Fiscal Policy Statement, and Fiscal Policy Strategy Statement along with the budget. The macro-economic statement includes an appraisal of the growth prospects of the economy as well as assessment relating to various sectors of the economy. The medium term fiscal policy statement provides the three year rolling targets for fiscal indicators such as revenue deficit, fiscal deficit, tax-GDP ratio and outstanding debt at the end of the year. The fiscal policy strategy statement outlines the government polices relating to revenues generation and expenditures composition and strategic priorities for the ensuring year. The target fiscal indicators as per the FRBM Act and the fiscal strategy to achieve these targets are reviewed during the general debate on the budget. The reasons for not achieving the fiscal targets, if breached in any year, are laid out before the Parliament by the Government. The fiscal policies adopted by the Government and the time frame to come back to agreed fiscal path as enshrined in the FRBM Act are also discussed in the budget session of the Parliament. As the FRBM policy statements are part of the budget documents, these are covered under legislative scrutiny.

The expenditures proposed by the departments are presented in the form of a demand for grants containing a statement of the total amount required and a statement of the detailed estimates under each demand divided into items. To facilitate proper examination of different demands for grants leading to more meaningful discussion in the Parliament departmentally related Standing Committees are constituted drawing members from both the houses of the Parliament. The Standing Committees consider the demands for grants of the concerned ministries/departments and make a report to the House. After the general discussion on the budget in the two houses is over, the house is adjourned for a fixed period and the Standing Committees consider the demand for grants during this period and report to the House. Through this mechanism the Parliament gets considered advice on the demand for grants of the departments. The committees are not empowered to suggest any cut in the demands for grants.

When the demands for grants of the ministries/departments are taken up for discussion the members of the house can initiate cut motions to reduce the demands for expenditures. After the discussions on demands the demands for grants as well as any cut motions are put to vote. After the demands are passed the appropriation bill is introduced which enables withdrawal of money after it is passed in the Parliament. The financial bill containing tax proposals is passed in the Parliament which enters into the statute as the Finance Act.

Parliamentary scrutiny of budget proposals and the passage of the budget are not normally completed until the second week of May, well after the commencement of the new fiscal year. Since expenditures cannot be incurred in a new fiscal year without Parliamentary approval, the government usually seeks an interim approval to meet emergent expenditures that have to be incurred pending the approval of the budget. This is called the vote-on-account and the sanctions given by the passage of the vote-on-account are automatically overridden once the Budget is approved by Parliament.

The Parliament also exercises its control over the provision of supplementary or additional funds required in a particular year and for regularizing any excess expenditure over the approved appropriations. For this purpose, supplementary demands for grants or demands for excess grants have to be presented and relevant Appropriation Acts passed. The Constitutional provisions regulating budgetary process provides for such introduction of supplementary demands and regularizing excess expenditures during the year.

Indicator	External Scrutiny and Audit	Score	Justification
PI-27	Legislative Scrutiny of the Annual Budget Law	A	
(i)	Scope of the legislature's scrutiny	A	The legislative control covers the details of revenue and expenditure estimates, passing of respective acts for new tax proposals and expenditure appropriations, and proposals for supplementary demands and budget adjustments during the year. The medium term fiscal framework provided by the Government as per the FRBM Act is reviewed b y the Parliament.
(ii)	Extent to which the legislature's procedures are well-established and respected	A	The legislature's powers are enshrined in the Constitution, which are adhered in the budgetary process. The House rules govern appointment of committees that examine the budget proposals.
(iii)	Adequacy of time for the legislature to provide a response to budget proposals (time allowed in practice for all stages concerned)	A	The legislative control is involved through out the budget cycle. Starting from the month of February, when the budget is presented in the Parliament, the legislature has enough time to discuss and evaluate the budgetary proposals till the final passage of the budget in May.
(iv)	Rules for in-year amendments to the budget without ex-ante approval by the legislature	A	The in year budget amendments are done through introduction of supplementary demands and regularizing any excess expenditures during the year for which constitutional provision exist. Supplementary demands for grants or demands for excess grants are presented in the parliament and relevant Appropriation Acts passed

3.6.3 PI-28 Legislative Scrutiny of External Audit Reports

When presented to Parliament, the audit report of the CAG relating to the Central Government is automatically transferred to two Committees. The Public Accounts Committee (PAC) scrutinizes those sections of the report dealing with the accounts of the various ministries, departments and offices of the Central Government such as the Railways, Defence, Post and Telegraph, Agriculture, and Social Empowerment. The sections dealing with central public sector undertakings (PSUs) are scrutinized by the Committee on Public Undertakings (COPU). The members of the committees are drawn from both the houses of the Parliament and the Speaker of the Lok Sabha appoints the Chairman from among the members.

While scrutinizing the Reports of the Comptroller and Auditor-General on Revenue Receipts, the PAC examines various aspects of the Government's tax administration. The Committee thus examines cases involving under-assessments, tax-evasion, non-levy of duties, misclassifications etc., identifies the loopholes in the taxation laws and procedures and makes recommendations in order to check leakage of revenue.

The CAG sits in the meetings of these committees as a 'friend philosopher and guide' of its members. Representatives from the ministries and departments appear before the PAC when matters relating to them are taken up. They are required to answer questions raised by committee members on the basis of the report of the CAG. The PAC may constitute sub-committees to conduct an in-depth study of the specific departments or projects if necessary. The PAC hearings are conducted in-camera, which was often criticized as not being transparent. The COPU selects PSUs from time to time for a detailed study of their functioning. The concerned Ministries responsible for the PSUs are asked to furnish all details. The COPU often visits the selected PSUs and examines their working on the spot. Both committees submit reports on their findings to Parliament.

If it appears to the Committee that it is necessary for the purpose of its examination that an on the-spot study should be made, the Committee may, either in its entirety or by dividing itself into Study Groups decide to undertake tours to make an on-the-spot study of any project or establishment. All discussions held during tour by the Committee/Study Groups, with the representatives of the establishment, Ministries/Departments, non-official organizations, Labour Unions etc. are treated as confidential. Government takes action on the recommendations of the Committee and submits action taken notes to the Committee. The Committee then presents an Action Taken Report after considering the views of the Government. The Government further submits an "Action Taken Statement" on the action taken by the Government on the "Action Taken Report" of the Committee. The Action Taken Statement is generally laid before the House without any further examination by the Committee.

Effectiveness of external audit to a large extent depends on the interest it evokes and support it obtains from the PAC. In turn, the effectiveness of PAC depends on the government accepting its recommendations and implementing them. It needs to be mentioned here that some of the Committee's recommendations have led to major changes in government's policy, amendments in tax laws and setting up of enquiry committees to probe into irregularities.

The functioning of PAC over the year has shown that the percentage of audit paras being discussed in PAC is reducing. During the last few years, The PAC was able to examine only a fraction of paras which appear in audit reports. 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. Examination of audit reports by the PAC and subsequent submission of replies and Action Taken Report by the ministries take substantial time period. The examination of audit report by the PAC takes more than six months and can stretch unto one and half years after which the ministries also get time of six months to submit their replies. Thus the process of legislative scrutiny of audit reports takes more than 12 months to complete.

Indicator	External Scrutiny and Audit	Score	Justification
PI-28	Legislative Scrutiny of External Audit Reports	D+	
(i)	Timeliness of examination of audit reports by legislatures	D	Examination of audit reports by the legislature (through PAC) usually takes more than 12 month to complete.
(ii)	Extent of hearing on key findings undertaken by legislature	C	The PAC scrutinizes only limited portion of the audit report. The extent of hearing of the portion of Audit reports selected by the PAC is generally intensive. Representatives from the ministries and departments appear before the PAC when matters relating to them are taken up.
(iii)	Issuance of recommended actions by the legislature and implementation by the executive	A	Traditionally the recommendations of the PAC were acted upon by the government.

IV. Government Reform Process

4.1 Description of Recent and On-going Reforms

The PFM reform process in India has evolved over a number of decades and reveals a series of efforts made in different areas. The efforts made over the decades, however, do not provide a continuum and are specific to the context. Perceived from the key objectives of PFM systems namely, fiscal discipline, strategic resource allocation, and efficient service delivery, reforms measures yielded results in many areas. The fundamental changes to the PFM systems, however, have not been achieved. The reform measures are being attempted to make a transition to a more improved system.

Budgetary innovations are an important part of PFM reforms where attempts were made to introduce performance based budgeting. Attempts were made to improve upon the input-based compliance budgeting system emphasizing results and bringing in management-based financial administration. The government had introduced performance budgeting in the 1970's, when performance budgets were prepared for a few central ministries. Later the scope of the performance budgeting was expanded to cover all ministries. However, the scope was later limited to plan programmes and departments continued to prepare the performance budgets. The performance budgets for all these years remained supplementary to the main budget with very little impact on budget planning and resource allocation decisions. During the late 1980, an attempt was made to introduce zero-based-budgeting (ZBB) However, the contours of ZBB was not clear to the departments introducing it and it was given up in later years.

The latest in the budgetary reforms is the introduction of outcome budgeting in 2005-06, claimed to have been designed to move beyond the traditional line item system to clearly defined outcomes of all government programmes. The performance budget has been merged in the outcome budget in 2007-08 and a single document called the outcome budget is presented. Although the outcome budget recognizes the principles of programme performance budgeting, its usefulness is limited. In practice the basic elements of the outcome budget, such as measurement of outputs and outcomes, specification of benchmarks, costing of programmes, monitoring and evaluation system and the institutional aspects are still emerging. The outcome budget, like its predecessor – performance budget, is viewed as a supplemental device rather than an effective system to influence budget policy and decision making. However, the introduction of the outcome budget underlines the effort to improve the budgetary system and needs to be strengthened further to make it a potent force to influence budget policy and decision making.

The preparation of medium term fiscal policies was introduced in 2004 through the Fiscal Responsibility and Budget Management Act (FRBM). During the mid 1980s, attempts were also made, as part of the formation of long-term fiscal policies, to introduce a multi-year rolling expenditure plan. However, due to institutionalizing of the planning process in India, this aspect was sought to be addressed by the Planning Commission of India. The FRBM mandated achieving stipulated levels of fiscal and revenue deficits and limited the scope of borrowing of the government from the central bank and put a cap on government guarantees. As per the provisions of the FRBM, the government started publishing information on the fiscal strategy of the government through fiscal policy strategy documents to be submitted in the Parliament along with the Budget. Through these measures fiscal transparency in government was sought to be improved. The FRBM Act also mandated to prepare a medium term fiscal framework (MTFP) specifying the agreed upon fiscal indicators projected for three years including the budget year. While through MTFP attempts were made to bring in a multi-year perspective to fiscal management, the efforts were limited to projecting broad fiscal indicators. The multi-year strategy for sectors is still not being worked out as part of the budgetary exercise affecting the ability to improve the strategic allocation of resources.

The relationship between the central and spending agencies was expressed through a code of delegated financial powers. Under the existing scheme of budgetary and financial control and delegation of powers, the Ministries have a Financial Adviser (FA), who plays a pivotal role in the Ministry's financial management. The entire scheme of Integrated Financial Advisor (IFA) scheme was reviewed in 2006. The overarching concept in redefining the charter for FAs was that they are meant to assist in the achievement of objectives/goals of the respective administrative ministry with due financial prudence and to ensure that monies allocated are spent on time to achieve the indented outcomes. The revised charter to the FA has widened the scope of this institution in assisting the administrative department in budget reparation, expenditure control and budget implementation. Fundamental changes in the PFM systems are required to bring in changes that will enable the IFA system to work efficiently.

Progress was also made in the accounting system of the Government. The conventional pattern of classification following organizational lines was changed to a function-cum-programme basis 1974. The new accounting classification came into force from 1987, where a new coding pattern was devised and Account Heads were rationalized and changes were initiated so that expenditure on plan programmes could be extracted directly from the accounts. Further efforts are ongoing to revise the coding pattern to reflect the changing scenarios of government fiscal management and improve the functional and economic classification of accounts. In a major exercise of departmentalization of accounts covering all the ministries and departments of the Union Government was undertaken in 1976, with the main objective of integrating accounts with the

administrative ministries and departments, which was earlier the responsibility of CAG along with audit.

The basis of government accounting has always remained the cash despite its shortcomings. Although it had inherent advantage in facilitating effective coordination with monetary policy, it did not have the capacity to reveal the full outlays on the programme or a project. The Twelfth Finance Commission (2005-10) in its report made recommendations in favour of an accrual based accounting system. The government has initiated steps to introduce an accrual based accounting system in the country. As part of this effort, the government has established the 'Government Accounting Standards Advisory Board' (GASAB) in the office of CAG. The GASAB has been entrusted with the task of recommending a detailed road map and an operational framework for introduction of accrual based accounting system. The GASAB has already prepared a roadmap for transition to accrual accounting envisaging a period of 10-12 years.

In order to strengthen the cash management system, streamlining the borrowing calendar of the government and addressing the problem of the uneven expenditure pattern during the financial year, the government has introduced a modified cash management system in 2006. Through this modified system, a monthly expenditure plan (MEP) and Quarterly Expenditure Allocation (QEA) was introduced for the departments. The departments subject to MEP were asked to provide MEP forecasts along with their demand for grants. The Finance departments through this exchequer control are expected to streamline the cash management and borrowing programme of the government of India.

Internal audit has remained a weak link in the overall financial management system of the government of India. The system of internal audit and internal control in financial management of the government, have not been updated over several decades**.** Showing concern over the state of internal audit system, a Task Force was constituted in 2006 for benchmarking the status of internal audit in the Central Government and determination of a roadmap for its improvement. In view of the required change in mandate for internal audit, the Task Force considered it necessary that in the interest of independence and more effective functioning of internal audit, there was need for segregation of duties relating to internal audit from those relating to financial advice and accounting functions. All the reports of internal audit, the Task Force felt must be submitted directly to the Secretary of the department. After considering various models that are available internationally, the Task Force has felt that the Inspector General model of the U.S.A., with appropriate modifications—as the one most suited for effective internal audit. But it felt that it might not be possible to implement that model immediately. In the interim period, it recommended that to facilitate moving towards legislated internal audit, a Board of Internal Audit (BIA) comprising of Controller General of Accounts, Controller General of Defence Accounts, Financial Commissioner, Railways and Member (Finance)

Telecommunications, might be constituted for the oversight of internal audit in Government of India. Eventually under a proper mandate through a specific statute or cabinet resolution, internal audit in each ministry/department should be established as an entity directly reporting to the Secretary of the department/ministry, and becoming exclusively responsible for internal audit activities. The internal auditor will act strictly in accordance with the prescribed standards and processes.

4.2 Institutional Factors Supporting Reform Planning and Implementation

The Ministry of Finance takes the lead in continuing efforts for improvements in PFM in India. Implementation, oversight and monitoring of policies relating to PFM reforms are managed by different departments in the Finance Ministry and other administrative departments as prescribed in the delegation financial powers. The Finance Minister, usually one of the senior members of the Union Cabinet, and two other ministers (Minister of State rank) provide political leadership to the department. The Ministry comprises several departments that deal with various responsibilities relating to PFM issues. The Department of Economic Affairs (DEA) in the ministry is the nodal agency of the Union Government to formulate and monitor country's economic policies and programmes having a bearing on domestic and international aspects of economic management. The DEA has the responsibility of preparing Union Budget annually and formulation and monitoring of fiscal policy, and public debt management. It looks at ways and means to raise internal resources through taxation, market borrowings and mobilization of small savings. While the Reserve Bank of India, the banker to the Government, manages the borrowings of the Central Government, a Debt Management Office is being set up in the DEA to undertake all debt management functions. The Department of Revenue, in the Ministry exercises control in respect of matters relating to Central taxes through two statutory Boards namely, the Central Board of Direct Taxes (CBDT) and the Central Board of Excise and Customs (CBEC). The Department of Expenditure in the Ministry looks after the matters relating to the Central plan with an overview of the entire canvas of development activity of the Central Government, both at the project level and sectoral policy level. The Department of Expenditure also deals with issues relating to implementation of the recommendations of the Central Finance Commission, polices relating to delegation of financial powers, financial rules, purchase of goods, works contract, and e-governance.

The Controller General of Accounts (CGA), in the Department of Expenditure of the Ministry of Finance, is the apex Accounting Authority of the Central Government. The CGA is the principal Accounts Adviser to the Government of India and is responsible for establishing and maintaining a technically sound management accounting system. The CGA prepares monthly accounts of the Government containing critical analysis of expenditures,

revenues, borrowings and the deficit and annual Appropriation Accounts and Union Finance Accounts for presentation to the parliament. The CGA provides key institutional support in preparing suitable accounting framework and modernizing the account keeping process in Government departments. The CGA takes the lead in training the internal audit officials of the Civil Accounts Organization. The CGA has been undertaking measures to reinforce and improve internal audit techniques, initiate IT and system audit, strengthening follow up process in the internal audit, and improving expenditure tracking systems for the Central Government schemes implemented at the State level.

The CGA prescribes the accounting framework on the advice of the Comptroller and Auditor General of India (CAG). Under the aegis of CAG, Government Accounting Standards Advisory Board (GASAB) was established to recommend accounting standards and prepare a road map for transition to accrual system of accounting. The Government decision to introduce accrual accounting system is considered as an important step in PFM reforms in the country and the role of GASAB assumes significance in providing institutional support in this regard.

The CAG, the Supreme Audit Institution in the country, has the responsibility of auditing government accounts and has been providing institutional support in improving the auditing standards. The CAG, in addition to the compliance and regularity audit has been putting significant effort in preparing performance audit of Government departments and programmes. However, the follow-up process of the CAG audit recommendations has remained an area of concern affecting the PFM systems. The Parliamentary review of the CAG audit recommendation relating to weaknesses and required corrective measures and the actual action taken by the executive in response to these recommendations has remained inadequate.

While institutional support for PFM reforms and implementation is the primary responsibility of the Ministry of Finance, the role of Planning Commission is also significant. The five year development plan prepared by the Planning Commission and linking of annual plans with the budgetary process provided a key role to it in the expenditure management. The budget making and implementation remained divided into plan and non-plan expenditures, the allocation of plan resources being determined by the Planning Commission. The role of Planning Commission in deciding new programmes to be adopted remains paramount. However, the transformation of plan allocations into the budgetary process retaining their objectives has not been smooth as the budgetary decision making and its accounting orientation is not strictly similar with that of the planning.

The budget innovations, mainly through adoption of ‘performance budget’ in 1970’s and more recent ‘outcome budget’ in 2005 were initiated by the Ministry of Finance. While the attempt was made to bring in management concepts and

achieving budgetary outcomes rather than intents through the outcome budget, these initiatives did not have the desired results. The budgetary decision making has not made effective use of performance information and analysis related to program classification. Preparing the budget following performance-programme budgeting principles requires considerable staff capacities to understand policy objectives and implementation strategies of administrative ministries and departments much more than under input budgeting. Thus to have a successful outcome budget, besides the role of the political leadership in accepting a fundamental change in budgeting, the institutional framework needs to be reorganized and strengthened.

The Fiscal Responsibility and Budget Management Act (FRBM) was adopted in 2004 to reduce the already high fiscal deficit and stabilize the Government debt in a medium term through a rule based fiscal management. The stipulations in the Act regarding fiscal targets were more focused on macro management, apparently by the Ministry of Finance. The FRBM requirement of presenting a Medium Term Fiscal Policy Statement (MTFP), however, is directly related with the process of budget management. Although the MTFP provided an element of multi-year perspective through rolling fiscal and revenue deficit targets, these are not derived from a multi-year expenditure planning to influence the actual budget making. Thus multi-year expenditure planning is still lacking in the budgetary process. While the role of Ministry of Finance in this context is significant, the administrative ministries and departments have to actively participate to provide a coherent and effective multi-year expenditure plan.

Delegation of financial powers to the spending agencies for developing an institutional form for financial management in the spending departments and ministries and provision of Financial Advisors (FA) were important improvements in the PFM in the country. The FA represented the Ministry of Finance in the departments and remained responsible to both spending department and the Ministry of Finance. The Ministry of Finance, Department of Expenditure, has revised the charter of responsibilities and duties for the FA in 2006. The revised charter indicates that the FAs would facilitate implementation of approved programmes, ensure expenditure control, and help in achieving intended outcomes and assist ministries and departments in ensuring ‘value for money’. The FA was thus envisaged as the principal advisor to the departmental head in financial matters. While the FAs were expected to carry out manifold tasks, it was pointed out that the required professional expertise in financial aspects and administrative aspects of the ministries associated with these positions were lacking. These limitations stand in the way of getting full benefit out of this key institutional structure.

The PFM reform initiatives were supported by policy recommendations by the statutory bodies like Central Finance Commission and specially designated committees and commissions. The Government appointed committees on issues like improving accounting system, internal audit and computerization of

Government functions have many ways influenced changes in the PFM system and supporting institutional structure. The Government decision to make a transition to accrual based accounting system was based on the recommendations of the Twelfth Finance Commission (TFC). The TFC also recommended disclosure of key fiscal information on assets and liabilities in the Government accounts as part of a transition to accrual accounting. In fact the preparation of Performance Budget by the departments was the result of a recommendation by the First Administrative Reform Commission in 1968. While the performance budgeting remained supplemental to the main budget, the initiatives resulted in improved budget classification and changes in accounting structure. The Second Administrative Reform Commission in their report 'Strengthening Financial Management System (2009)' has also recommended several reform measures for improving PFM system. The report emphasized on taking appropriate measures to produce realistic budget estimates and removing delays in implementation of projects, strict adherence to Modified Cash Management System, institutionalizing medium term expenditure limits for Ministries/Departments, strengthening institutional mechanism for implementing a realistic outcome budget, removing strict plan-non-plan distinction, ways and means to improve flow of funds and implementation of CSS, developing Financial Information System and capacity building, streamlining the process of migration to accrual system of accounting, strengthening internal audit, improving the expertise of integrated financial advisors, and improving timeliness and follow-up process of external audit.

Annexes

Annex 1 PFM Performance Measurement Framework Indicators Summary

Indicator		Score	Justification
Credibility of Budget			
PI-1	Aggregate Expenditure Out-turn Compared to Original Approved Budget	C	Actual expenditure deviated from budgeted expenditure by more than 10% of budgeted expenditure in all the years considered. The deviation in at least one year, i.e. 2008-09 was more than 15 percent.
PI-2	Composition of Expenditure Out-turn Compared to Original Budget	C	Variance in expenditure composition exceeded overall deviation in primary expenditure by 10 percentage points in no more than one of the last three years.
PI-3	Aggregate Revenue Out-turn Compared to Original Approved Budget	A	Aggregate revenue collection exceeded 97% of the budget estimates in two of the three year period reviewed.
PI-4	Stock and Monitoring of Expenditure Payment Arrears	D	
(i)	The stock of arrears as percent to total expenditure	Not rated	As there is no information available on stock of arrears, the level of stock in arrears as percentage of total expenditure is not assessed.
(ii)	Reliable and complete data on stock of arrears	D	There is no reliable data on the stock of arrears
PI-5	Classification of the Budget	A	The budget classification system is uniform for all stages of financial administration and is based on economic, administrative, programme classification that can produce consistent documentation according to GFS/COFOG standards. The budget classification system is consistent with COFOG and GFS manual of 1986.
Comprehensiveness and Transparency			
PI-6	Comprehensiveness of Information Included in Budget Documentation	A	Budget documentation fulfills all 9 benchmarks. The budget documents are comprehensive.
PI-7	Extent of Unreported Government Operations	A	
(i)	The level of unreported extra-budgetary expenditure	A	The financial operations of the extra budgetary funds are reported in the budget documents. The available budgetary information suggests that

Indicator		Score	Justification
			the scope for unreported government operations is minimal.
(ii)	Complete income/expenditure information of donor-funded projects reported in fiscal reports	A	The external assistance to the Government for financing development projects and programmes is routed through the budget and recorded as an inflow in budget documents with corresponding expenditure items reflecting the use of resources
PI-8	Transparency of Inter-Governmental Fiscal Relations	B+	
(i)	Transparency and objectivity in the horizontal allocation among SN governments	B	The transfers based on the recommendations of FC, constituting 63 % (Average over 2005-06 to 2008-09) of total transfers are rule based and transparent. The plan transfers constituting about 30 % (Average over 2005-06 to 2008-09) of total transfers are a mix of rule based and discretionary schematic transfers. The rule based transfer in the Plan transfers is about 30 percent.
(ii)	Timeliness of reliable information to SN governments on their allocations	B	The share of individual states in central taxes depends upon the tax realization of the Central Government. The grant recommended by the FC is fixed for whole of the five years. The state governments finalize their plans after deliberation with central Planning Commission. Thus before the state budget is presented the states get to know about the likely flow of funds under these heads. The CSS flow for the year is known and the actual release depends on the stipulated utilization of funds during the year.
(iii)	Extent of consolidation of fiscal data for general government according to sectoral categories	A	Fiscal information (ex-ante and ex-post) that is consistent with Central Government fiscal reporting is collected for 90% (by value) of SN government expenditure and consolidated into annual reports within 10 months of the end of the fiscal year.
PI-9	Oversight of Aggregate Fiscal Risk from Other Public Sector Entities	C	

Indicator		Score	Justification
(i)	Extent of Central Government monitoring of AGAs/PEs	C	All major AGAs/PEs submit fiscal reports to Central Governments annually and audited accounts are also presented. The Ministry of Heavy Industries and Public Enterprises presents consolidated 'Annual Survey of Industries' including their financial and physical progress. The CAG audits the accounts of the PSEs, which are presented in the Parliament. The Parliament exercises legislative control over the functioning of the PSEs through a parliamentary committee. However, a consolidated fiscal risk report is not prepared and the fiscal risk arising from the functioning of the PSEs does not form part of the central budget.
(ii)	Extent of Central Government monitoring of SN governments' fiscal position	C	The ability of SN governments to generate fiscal liabilities for Central Government is limited. The net fiscal position of SN governments is monitored is reported by the RBI through its publications annually for all levels of SN government. The CAG audits the accounts of the SN governments and its reports are presented to the state legislature. However, macro-economic risks in terms of the likely impact of changes in the underlying macro-economic forecast taking combined accounts of central and state governments are not generally quantified.
PI-10	Public Access to Key Fiscal Information	A	The government makes available to the public 5 of the 6 listed types of information
Policy Based Budgeting			
PI-11	Orderliness and Participation in the Annual Budget Process	C+	
(i)	Existence of and adherence to a fixed budget calendar	A	A clear annual budget calendar exists, is generally adhered to and allows MDAs enough time (and at least six weeks from receipt of the budget circular) to meaningfully complete their detailed estimates on time

Indicator		Score	Justification
(ii)	Guidance on the preparation of budget submissions	D	The Ministry of Finance issues a budget circular to the ministries/department along with instructions and guidelines of other authorities. However, the budget circular does not contain the expenditure ceilings for the ministries/departments, which are communicated after the submission of the initial round of budget estimates followed by pre-budget meetings.
(iii)	Timely budget approval by the legislature	C	While the fiscal year starts on 1st April, the budget was approved, marked by the receipt of President's assent on the Finance Bill, within two months of the start of the fiscal year in 2 of the last 3 years.
PI-12	Multi-year Perspective in Fiscal Planning, Expenditure policy and Budgeting	D	
(i)	Multi-year fiscal forecasts and functional allocations	D	Forecasts of fiscal aggregates (on the basis of main categories of economic and functional/sector classification) are not prepared on a rolling annual basis. Links between multi-year estimates and subsequent setting of annual budget ceilings are not there in a strictly annual budgeting system. The rolling fiscal indicators presented in the MTFP document stipulated under the provisions of the FRBM is derived from a macroeconomic framework and a detailed estimation of forecast of sectoral spending are not carried out.
(ii)	Scope and frequency of debt sustainability analysis	D	DSA for external and domestic debt is undertaken at least once during the last three years.
(iii)	Existence of costed sector strategies	D	Sector strategies may have been prepared for some sectors, but none of them have substantially complete costing of investments and recurrent expenditure.
(iv)	Linkages between investment budgets and forward expenditure estimates	D	Budgeting for investment and recurrent expenditure are separate processes with no recurrent cost estimates being shared.

Indicator		Score	Justification
Predictability and Control in Budget Execution			
PI-13	Transparency of Taxpayer Obligation and Liabilities	C+	
(i)	Clarity and comprehensiveness of tax liabilities	C	All the central taxes in India have explicit legislative basis and the tax obligations, procedures, regulatory mechanism are clearly indicated in the respective tax laws. The authorities controlling the administration of direct and indirect taxes, namely CBDT and CBEC provide wide range of information on tax laws, procedures and guidance to the taxpayers through their websites. However, due to large number of exemptions provided under the tax laws, discretion of administrative authorities in assessment of tax liabilities is also large.
(ii)	Taxpayers' access to information on tax liabilities and administrative procedures	C	Despite various efforts of the government that include providing information through websites, establishing Large tax Payer Units (LTU), the taxpayers face difficulties in accessing the information on tax liabilities and administrative procedures. Taxpayer education programme is not designed in a structured manner to reduce the compliance cost of the taxpayers.
(iii)	Existence and functioning of a tax appeals mechanism	B	A tax appeals system with independent institutional structures exists following transparent administrative procedures, appropriate checks and balances. However, in the tax appeal system, the disposal rate of appeals is less due to delay in settling the disputes.
PI-14	Effectiveness of Measures for Taxpayer Registration and Tax Assessment	B+	
(i)	Controls in the taxpayer registration system	A	Taxpayers are registered in a complete database system with some linkage to other relevant government registration system and financial sector regulation. The Permanent Account Number (PAN) provided by the Income tax Department provides the basis for such linkage. For other central taxes

Indicator		Score	Justification
			the registration numbers are being issued based on the PAN.
(ii)	Effectiveness of Penalties for non-compliance with registration and tax declaration	B	The tax legislations provide penalties for offences like tax evasion, fraudulent declaration and non-registration, which are consistently administered. However, the penalties for all areas of non-compliance have not proved to be a deterrence to improve compliance due problems in administrative and judicial system.
(iii)	Planning and monitoring of tax audit programme	B	Tax audit and fraud investigation are carried out by the by a separate division headed by a commissioner (audit) with an annual audit work plan based on turnover and risk assessment.
PI-15	Effectiveness in Collection of Tax Payments	D+	
(i)	Collection of tax arrears	D	While the tax administration has adequate legal provisions to collect tax arrears, the ability of tax administration to collect arrears is obstructed due to tax disputes pending at courts. The available evidence of collection of arrears for income and corporate tax shows a static trend in the range of 8 to 9 percent.
(ii)	Effectiveness of transfer of tax collection to the treasury by the Revenue Administration	A	The taxes are paid through the banking system and the banks remit the collection to RBI daily.
(iii)	Frequency of Complete accounts reconciliation between tax assessment, collection, arrears records and receipt by the treasury	A	The reconciliation process is carried out monthly.
PI-16	Predictability in the Availability of Funds for Commitment of Expenditure	C+	
(i)	Extent to which cash flows are forecast and monitored	C	Under the Modified cash management systems for 23 departments/ministries monthly and quarterly expenditure limits are fixed on the basis of which cash forecast are drawn by the Ministry of Finance and borrowing calendar is determined. However, the updating

Indicator		Score	Justification
			of the cash flow scheme drawn for the year is infrequent.
(ii)	Reliability and horizon of periodic in-year information to line ministries on ceilings for expenditure commitments	B	The departments submit the Monthly Expenditure Plan (MEP) in their demands for grants which becomes basis for in-year ceilings (Quarterly Expenditure Allocation – QEA) for expenditure commitments
(iii)	Frequency and transparency of adjustment to budget allocations, which are decided above the management of line ministries.	C	The in-year budget adjustments are done through supplementary demands, which require approval of the Parliament and the frequency of such adjustments is known. However, the process of in-year adjustment is not very transparent and predictable for the departments/ministries.
PI-17	Recording and Management of Cash Balances, Debt and Guarantees	A	
(i)	Quality of Debt Recording and Management	A	Comprehensive records on domestic and external debt are compiled and are updated and reconciled regularly. Comprehensive statistical reports providing information on debt stock, debt service, and debt management operations are prepared on a monthly basis.
(ii)	Extent of Consolidation of the Government's Cash Balance	A	The government cash balance is deposited with the Reserve Bank of India, the banker to the Government, which invests in government securities, held in its portfolio. The Detailed procedure to be followed for remittance of Government receipts into Government cash balance are laid down in the Memoranda of Instructions issued by the Reserve Bank of India.
(iii)	Systems for Contracting Loans and Issuance of Guarantees	A	Central Government's contracting of loans and issuance of guarantees are based on transparent criteria and fiscal targets set under the FRBM Act. Ministry of Finance has the responsibility of approving Government loans and guarantees.
PI-18	Effectiveness of Payroll Controls	C+	
(i)	Degree of integration and reconciliation between personnel records and payroll data	B	The payroll data are reconciled with the previous month's payroll and are supported by full documentation for all changes made to personnel

Indicator		Score	Justification
			records each month at the level of departments and ministries.
(ii)	Timeliness of changes to personnel records and the payroll	B	The changes in personnel details and payrolls are maintained in their service books, which are updated regularly. It takes between one to three months for the changes in personnel records to reflect in the payments.
(iii)	Internal controls of changes to personnel records and the payroll	B	The internal control system ensures that the changes in personnel records and the payroll are recorded.
(iv)	Existence of payroll audit to identify control weaknesses and or ghost workers	C	According to the Central Government rules ministries should audit payroll records and personnel data internally every year and external audit by the CAG. However, the internal audit is not effective and external audit is not comprehensive.
PI-19	Competition, Value for Money and Control in Procurement	Not rated	
(i)	Use of open competition for award of contracts that exceed the nationally established monetary threshold for small purchases	Not rated	While rules and procedures for procurement are provided through the GFR and Manual on Polices and Procedures for Purchase of Goods, the data on actual procurement by various departments and ministries of the Government is not publicly available.
(ii)	Justification for use of less competitive procurement methods	Not rated	In the absence of data on actual procurement by the ministries and departments, this dimension was not rated.
(iii)	Existence and operation of a procurement complaints mechanism	D	A complaints mechanism relating to procurement operations does not exist. However, the parties can commence arbitration under the Indian Arbitration and Conciliation Act, 1996 to settle any dispute or difference.
PI-20	Effectiveness of Internal controls for Non-Salary Expenditure	D+	
(i)	Effectiveness of Comprehensive expenditure commitment controls	D	Comprehensive expenditure commitment controls are not effective. The existing cash management system and accounting and reporting system do not support an effective commitment control system. The end-year spike in expenditure, unspent amounts and

Indicator		Score	Justification
			excess spending in departments are indicative of lapses in internal control system in the Ministries and Departments.
(ii)	Comprehensiveness, relevance and understanding of other internal control rules/procedures	B	Other internal control rules and procedures incorporate a comprehensive and generally cost effective set of controls.
(iii)	Degree of compliance with rules for processing and recording transactions	D	The degree of compliance with rules for processing and recording is low.
PI-21	Effectiveness of Internal Audit	D+	
(i)	Coverage and Quality of the Internal audit function	D	The scope of the internal audit covers the offices involved in financial management in the ministries/departments and the implementing agencies for various schemes and programmes. The internal audit is conducted on the basis of departmental codes and manuals issued by accounting departments. However, the internal audit in India is not independent, has not evolved standards, does not evaluate risks, and is conducted in a routine manner. The internal audit does not focus on systemic issues in helping the management in improving the efficiency and effectiveness of operations.
(ii)	Frequency and Distribution of Reports	C	The audit reports carried out and prepared yearly and submitted to the concerned Financial Advisor. The reports are not submitted to Ministry of Finance and the SAI.
(iii)	Extent of management response to internal audit findings	D	The internal audit does not necessarily bind the audited entity to take action on the basis of observations and recommendations of internal audit
Accounting, Recording and Reporting			
PI-22	Timeliness and Regularity of Accounts Reconciliation	B	
(i)	Regularity of bank reconciliation	B	Reconciliation of government accounts, consolidated by the CGA, with that of the RBI takes place regularly at a monthly basis at aggregate and detailed level. Despite the existence of detailed

Indicator		Score	Justification
			procedures and rules, un-reconciled amounts were detected by the CAG in their audit report.
(ii)	Regularity of reconciliation and clearance of suspense accounts and advances	B	The reconciliation and clearance of suspense account and advances is carried out annually within 2 months of end of the period. However, outstanding balances were reported by the CAG in their audit report.
PI-23	Availability of Information on Resources Received by service delivery units	A	The information on resources received by primary service delivery units under central run primary education and rural health schemes are reflected in the consolidated financial reports prepared by the State level agency quarterly. The service delivery units are audited annually by the chartered accountants and the audit reports provide information on resources and their use.
PI-24	Quality and Timeliness of In-Year Budget Reports	C+	
(i)	Scope of reports in terms of coverage and compatibility with budget estimates	C	The monthly accounts prepared by the CGA covering the aggregate government finances, which compares actual with budget over all items budget estimates with a fair degree of dis-aggregation, serves as an useful in-year budget report. However, the monthly accounts capture information only at payment stage and not commitments.
(ii)	Timeliness of the issue of reports	A	The monthly accounts are prepared on a monthly basis and become available before the end of the following month at the website of the CGA.
(iii)	Quality of Information	A	There are no material concerns regarding data accuracy in the monthly accounts prepared by the CGA.
PI-25	Quality and Timeliness of Annual Financial Statements	C+	
(i)	Completeness of the financial statements	A	The Finance Accounts and Appropriation Accounts prepared by the Controller General of Accounts (CGA) are the consolidated year-end financial statements of the Government of India. These documents are based on the detail information for all the

Indicator		Score	Justification
			ministries/departments and decentralized units.
(ii)	Timeliness of the issue of reports	B	The year-end financial statements in the form of Finance Accounts and Appropriation Accounts are presented with a time lag of 8 to 10 months.
(iii)	Accounting standards used	C	The accounting standards prescribed by the Government
			(President of India) on the advice of the CAG, IGAS, are not fully aligned with the Cash IPSAS prescribed by the IFAC. There are differences between Government Accounting system in India and cash basis IPSAS relating to the structure, disclosures and basis of accounting at present.
External Scrutiny and Audit			
PI-26	Scope Nature and Follow-up of External Audit	D+	
(i)	Scope/nature of audit performed (including adherence to auditing standards)	B	The CAG audits all government departments and public and constitutional entities every year as per prescribed law. The audit range includes regularity (Financial, compliance) and performance audit of selected programmes. The auditing standards of the International Organization of Supreme Audit Institutions (INTOSAI) have been adapted. However, some autonomous implementing agencies of central schemes and rural and local bodies, receiving government funds, are not audited by the CAG.
(ii)	Timeliness of submission of audit reports to the legislature	D	The audit reports are submitted to the legislature after 12 months of the end of the financial year.
(iii)	Evidence of follow up on audit recommendations	C	While the recommendations regarding corrective actions given by the PAC, that examines the external audit reports, were taken seriously by the executive, its scope was limited as the PAC considers only a small portion of the audit reports. The Action taken Notes submitted by the departments and units audited by the CAG relating to other audit observations not examined by the

Indicator		Score	Justification
			PAC were largely formal rather than substantive.
PI-27	Legislative Scrutiny of the Annual Budget Law	A	
(i)	Scope of the legislature's scrutiny	A	The legislative control covers the details of revenue and expenditure estimates, passing of respective acts for new tax proposals and expenditure appropriations, and proposals for supplementary demands and budget adjustments during the year. The medium term fiscal framework provided by the Government as per the FRBM Act is reviewed by the Parliament.
(ii)	Extent to which the legislature's procedures are well-established and respected	A	The legislature's powers are enshrined in the Constitution, which are adhered in the budgetary process. The House rules govern appointment of committees that examine the budget proposals.
(iii)	Adequacy of time for the legislature to provide a response to budget proposals (time allowed in practice for all stages concerned)	A	The legislative control is involved through out the budget cycle. Starting from the month of February, when the budget is presented in the Parliament, the legislature has enough time to discuss and evaluate the budgetary proposals till the final passage of the budget in May.
(iv)	Rules for in-year amendments to the budget without ex-ante approval by the legislature	A	The in year budget amendments are done through introduction of supplementary demands and regularizing any excess expenditures during the year for which constitutional provision exist. Supplementary demands for grants or demands for excess grants are presented in the parliament and relevant Appropriation Acts passed
PI-28	Legislative Scrutiny of External Audit Reports	D+	
(i)	Timeliness of examination of audit reports by legislatures	D	Examination of audit reports by the legislature (through PAC) usually takes more than 12 month to complete.
(ii)	Extent of hearing on key findings undertaken by legislature	C	The PAC scrutinizes only limited portion of the audit report. The extent of hearing of the portion of Audit reports selected by the PAC is generally intensive. Representatives from the ministries and departments appear before the PAC when

Indicator		Score	Justification
			matters relating to them are taken up.
(iii)	Issuance of recommended actions by the legislature and implementation by the executive	A	Traditionally the recommendations of the PAC were acted upon by the government.

Annex 2 List of Academics and Government Officials Interviewed

Name	Organization	Position
Dr. M. Govinda Rao	National Institute of Public Finance and Policy	Director
Dr. R. Kavita Rao	National Institute of Public Finance and Policy	Professor
Amiya K. Ghosh	Centre for Air Power Studies	Distinguished Fellow
A. K. Thakur	Comptroller and Auditor General of India	Director General of Audit, Central Revenue
V. Sivasubramanian	Department of Economic Affairs, Ministry of Finance	Director, Budget
Anuradha Prasad	Ministry of Defence	Financial Manager (Maritime System) and JS
S. M. Kumar	Controller General of Accounts, Department of Expenditure, Ministry of Finance	Additional Controller General Accounts
J. K. Mishra	Controller General of Accounts, Department of Expenditure, Ministry of Finance	Deputy Controller General Accounts
Sanjay Kumar	Central Board of Direct Taxes, Department of Revenue, Ministry of Finance	Commissioner, Income Tax
Vijay Singh Chauhan	Directorate of Revenue Intelligence, Department of Revenue, Ministry of Finance	Additional Director

Annex 3 List of Documents Consulted

Legislations and Acts

1. The Constitution of India, December, 2007, Ministry of Law and Justice, Government of India.
2. Fiscal Responsibility and Budget Management Act, 2004
3. Comptroller and Auditor General's (Duties, Powers and Conditions of Service) Act 1971
4. Central Board of Revenue Act, 1963
5. The Direct Tax Code, 2009, Department of Revenue, Ministry of Finance, Government of India.
6. Indian Contract Act, 1872
7. Sale of Goods Act, 1930
8. Government Accounting Rules, 1990
9. CAG's (Duties, Powers and Conditions of Service) Act, 1971
10. Societies Registration Act 1860
11. Appropriation Act
12. Finance Act

Budget Documents (2001-02 to 2009-10)

1. Budget Circular, 2008-09 and 2009-10
2. Budget Speech
3. Budget at a Glance
4. Annual Financial Statement
5. Finance Bill
6. Receipt Budget
7. Expenditure Budget
8. The Macro Economic Framework Statement, 2007-08 to 2009-10
9. The Medium Term Fiscal Policy Statement, 2007-08 to 2009-10
10. The Fiscal Policy Strategy Statement, 2007-08 to 2009-10
11. Guidelines for Preparing Outcome Budget, 2007-08

Government Reports

1. Tenth Five Year Plan: 2002-07, Planning Commission, Government of India.
2. General Financial Rules, 2005, Ministry of Finance
3. Report of the High Level Committee on Estimation of Saving and Investment, 2009 Central Statistical Organisation, GOI.
4. Review of the Economy 2008-09 Economic Advisory Council to the Prime Minister.
5. Eleventh Five Year Plan 2007-12, Planning Commission, Government of India.
6. Report of the Fifth Central Pay Commission, 1999, Government of India.
7. Economic Survey 2005-06 to 2008-09.
8. Public Enterprise Survey 2007-08, Volume I, II & III, Annual Report on the Performance of Central Public Sector Enterprises.
9. Organisational Structure of Government of India, Thirteenth Report, Second Administrative Reforms Commission, Government of India, April 2009

10. Strengthening Financial Management Systems, Fourteenth Report, Second Administrative Reforms Commission, Government of India,
11. April 2009
12. 'An Economic and Functional Classification of the Central Government Budget', Ministry of Finance, 2004-05 to 2008-09.
13. Finance Accounts, 2004-05 to 2008-09, Comptroller & Auditor General, Govt. of India.
14. State Finances: A Study of Budgets, 2002-03 to 2007-08, Reserve Bank of India.
15. Public Finance Statistics, 2005-06 to 2008-09.
16. Modified Cash Management System in 2006-07
17. Website of Ministry of Finance (www.finmin.nic.in)
18. Website of Reserve Bank of India (www.rbi.org.in)
19. Census of Central Government Employee, March 2006, Survey Division, Directorate General of Employment and Training, Ministry of Labour and Employment
20. Manual on Polices and Procedures for Purchase of Goods' prepared by the Ministry of Finance
21. Compliance/Regularity Audit Report, Comptroller and auditor General of India, 2006-2009.
22. Report of the Eleventh Finance Commission, 2000, Government of India.
23. Report of the Twelfth Finance Commission, 2004, Government of India.
24. Classification of Government Transactions: Report of the Expert Group Constituted to Review the Classification System for Government Transactions, Ministry of Finance

Other Documents

1. Government Finance Statistical Manual, 2001, International Monetary Fund
2. Rao, M. Govinda and Tapas K. Sen (1996), Fiscal Federalism in India, Theory and Practice, Macmillan
3. Ghosh, Amiya Kumar and Pratap Ranjan Jena (2008), Strengthening Financial Management Systems, National Institute of Public Finance and Policy, New Delhi