

Improving Public Financial Management in India: Opportunities to Move Forward

Pratap Ranjan Jena

National Institute of Public Finance and Policy, India

jena@nipfp.org.in, prjena@yahoo.com

Abstract

In recent years the role of a sound PFM system in achieving the objectives of fiscal discipline, strategic planning and improved service delivery has been receiving increased public attention in India. Public financial management reforms undertaken intermittently over the years, have not delivered the anticipated results in these areas. Studies and recommendations of Government appointed committees and expert bodies have identified gaps that need attention to strengthen the PFM institutional framework and to improve the efficiency of government spending. This paper examines key PFM reform measures undertaken in India in the recent past and provides suggestions to enhance the effectiveness of these PFM systems.

1. Introduction

Finding ways to improve delivery of public services, establishing an accountability framework, and proper implementation of pro-poor policies remain key concerns in India. India's growth rate of more than 9 percent has declined due to the global financial crisis of 2008-09 and fiscal stress has been building up since then. Although there has been a steady decline in the poverty level, more than 300 million people remain below the poverty line¹. The progress in achieving improvements in human development has been slow and India lags behind several other Asian countries (UNDP, Human Development Report, 2007-08). The Government has expanded the scope of the key central programmes, particularly for social sector spending, it is increasingly apparent that in addition to a pertinent set of policies to address these issues, a sound public financial management (PFM) system that emphasizes institutional efficiency is important to design and implement appropriate policies to achieve the desired results.

While the PFM systems appear to be consistent with well-established budgeting, accounting, audit, and legislative control systems (Swarup, 1990), recent studies point out that there is still considerable scope to improve the efficiency of government spending and public service delivery by strengthening the institutional framework for PFM². Reform initiatives to make the budget performance oriented, transition to accrual accounting, adopting rule based fiscal management and strengthening budget management and expenditure control are

¹ Eleventh Five Year Plan (2007-12) documents mentions that 'the percentage of the population below the official poverty line has come down from 36% in 1993-94 to 28% in 2004-05.

² Report of the Second Administrative reforms Commission, "Strengthening Financial management Systems - 2009", and PEFA India report - 2010,

noteworthy in this context. Still, not all of these efforts have resulted in enduring changes (Premchand 2008) and increasing demand for better accountability, good governance, and improved service delivery has made it imperative to explore alternative ways to strengthen India's PFM system. Reform recommendations by statutory bodies like the Central Finance Commission and Government appointed Committees like the Second Administrative Reform Commission (ARC) and Expert Committee on Expenditure Management need to be evaluated and implemented to bring in desired changes. The areas in need of reform, as identified by the PEFA report on the performance of PFM at the Union (federal) level, provide another useful reference for reform initiatives.

This paper examines PFM reform measures that have been adopted and proposes ways to further enhance the effectiveness of India's PFM system. Given the complex nature of PFM, this paper addresses fundamental PFM issues discretely and does not purport to provide a comprehensive reform programme. Section 2 deals with various issues related to the budgeting system; Section 3 examines the effectiveness of the delegation of financial powers and the system of financial advisers; Section 4 addresses issues related to transitioning from cash based accounting to accrual accounting; Sections 5 and 6 analyze issues related to internal audit and external audit to enhance accountability; Section 7 outlines concerns with specific intergovernmental transfers; Section 8 notes some institutional changes for PFM that are currently underway and Section 9 contains some concluding remarks.

2. Budgeting System

Attempts to Make the Budget Performance Oriented

Given the complexity of budgeting in the public sector where political choice plays a crucial role in decision making, fulfilling the basic objectives of budgeting functions remains arduous and depends heavily on the effectiveness of institutions to achieve better fiscal outcomes. The Indian approach has been to supplement a line-item budget with a ministry-by-ministry performance budget for the same budget session. The general budget presented in the Parliament can best be described as a traditional budget (Wildavsky 1978) and displays the characteristic problems. This system allows substantial adjustments in the budget during the year indicating the absence of a hard budget constraint (Jena, 2010). In addition, departments surrender substantial amounts of unspent money under various programmes at the end of the financial year³. Unspent provisions are indicative of lack of effectiveness in programme management at departmental level in a strict annual budget cycle. Revenue projection has always remained a challenge as the movement of economy and changes in tax administration determine the actual revenue collection.

Since the traditional budget does not provide information on results to be achieved from the use of public resources, one needs to look at the performance budgets of the ministries and departments. The performance budget in India was introduced in 1968 following the recommendations of the first Administrative Reform Commission. The objective of introducing

³ Audit reports of appropriation accounts by the CAG bring out these amounts every year.

the performance budget as a supplement to the traditional budget was to provide a link between the financial budget of departments and tangible targets in order to enhance the effectiveness and efficiency of public spending. In addition to the lack of adequate preparation and capacity development, the major impediment experienced while preparing the performance budget was the absence of realistic performance indicators for schemes and projects run by the departments (Toye, 1981). Over the years the general physical expectations from the plan (capital) schemes were included in the departmental budgets. The preparation of performance budgets became a routine affair without any discernible influence on resource allocation linked to results. The weakness of the former performance budget became more apparent when the Government decided to adopt another version of performance budgeting, called the Outcome Budget, in 2005⁴.

The outcome budget has been designed to rise above the traditional line item system to clearly define outcomes for all government programmes⁵ and to bring about improvements in the quality of governance⁶. The outcome budget at the Central (federal) level is being considered as a model for State Governments to improve the framework for their sub-national budgeting⁷. Preparation of an outcome budget involves the following steps – defining measurable outcomes, standardizing the unit costs of delivery, benchmarking standards, capacity building for attaining the requisite administrative capacity, ensuring the necessary funding, effective monitoring and evaluation and increasing the participation of the community and other stakeholders⁸. Still, there remain multiple difficulties associated with this approach to outcome budgeting.

There are difficulties in measuring the outcomes of programmes in terms of results achieved rather than just the outputs produced. As a result, ensuring managerial accountability by linking funds to outcomes is difficult since outcomes can be influenced by many external factors (Shah and Shen, 2007). In addition, establishing a direct link between the level of funding and performance may not be possible due to the role of political concerns and value judgments involved in trade-offs in budgetary decisions (Kelly 2003). Since the regular budget presented in Parliament is a separate process from the ministry wise outcome budgets tabled later in the budget session, this relationship between the departmental outcome budget and the general budget decisions needs to be strengthened to improve the performance orientation of the budgeting system. An advanced statistical system is also required to collect appropriate data and utilize it to measure the cost of service provision in the various sectors. The evaluation of the achievement of last year's results, a feature provided in the outcome budget, can be utilized to provide feedback to improve the policy design and measurement of performance indicators.

⁴ Guideline for outcome budget 2006-07, Ministry of Finance (MOF), “a need has for some time been felt to address certain weaknesses that have crept in the performance budget documents such as lack of clear one-to-one relationship between the Financial Budget and the Performance Budget and inadequate target-setting in physical terms for the ensuing year. Besides, there is growing concern to track not just the intermediate physical “outputs” that are more readily measurable but the “outcomes”, which are the end objectives of State intervention.”

⁵ Outcome budget, Ministry of Finance, 2007-08, “the Outcome Budget is an endeavor of the Government to convert the “Outlays” into “Outcome” by planning the expenditure, fixing appropriate targets, quantifying the deliverables in each scheme and bring to the knowledge of all, the “Outcomes” of the Budget outlays provided for each scheme/programme.”

⁶ Eleventh Five Year Plan (2007-12), Chapter -10 – Governance, pg 229.

⁷ Some of the State Governments have started adopting the outcome budget, which are almost like replica of the Central one.

⁸ Ministry of Finance, Department of Expenditure (2007), Guideline for Preparation of Outcome Budget 2007-08

The Government of India has also attempted to address the issue of performance management by introducing 'Performance Monitoring and Evaluation System (PMES)' for Departments in 2009. PMES provides a framework to measure performance of all schemes and projects run by the departments. The key element of PMES is the Results Framework Document (RFD), a record of understanding between the departmental Minister and the Secretary of the department, providing physical performance indicators to be achieved during the coming year⁹. While the RFD does not specifically link with the outcome budget, it implicitly settles a debatable issue relating to output versus outcomes by emphasizing that the success indicators are physical achievement of government programmes through which managerial accountability can be ensured¹⁰. PMES, properly integrated with the outcome budget, has the ability to boost the much sought after accountability framework. Strengthening key features of PMES, such as providing a robust mission and vision statement, designing an incentive system, and increasing transparency in result evaluation would improve its effectiveness. Even though the PMES provides for a performance related incentive system, it is still in its evolving stage and its impact remains to be seen.

Medium Term Perspective in Expenditure Planning

Medium-term expenditure planning provides a perspective for capital projects spreading over a number of years and may lead to an adjustment in expenditure priorities. In India it was maintained that five year plans provided the basis for a multi-year perspective for resource allocation. The feature of breaking up the medium term five year plans into annual plans and integrating these with the annual budgets and further monitoring of their progress was an important innovation (Thimmaiah, 1984). The development planning-budgeting link in India, however, has not been unproblematic. While plans provide a conceptual framework by focusing on various sectors of the economy, the budget is more concerned with financial control and so more attention is paid to financial rather than operational aspects of the plans (Premchand, 1983).

With current budgetary practices, the link between the plan and the budget is rather tenuous. Planned goals, objectives, outputs and financial resources needed to achieve them are not adequately integrated into the annual budgetary process. The basic feature of plan allocation through schemes and sectors does not translate well as the budget is prepared under different heads and sub-heads following the existing budgeting classification. It takes considerable effort to link the objectives of the various schemes/projects in the plan to the expenditure allocated under the various heads and sub-heads in the annual budget¹¹.

A fully programme based MTEF involves developing and prioritizing expenditure plans and budgeting for results within the available financial resources. However, the experience of introducing MTEFs in developing countries is that they are a costly affair without many of the

⁹ This is to concur the recommendation of the Second Administrative Reform Commission to have an annual performance agreement to be signed between the departmental minister and the secretary of the department on details of works done during the year.

¹⁰ Guidelines for Results Framework Documents (RFD) 2011-2012, Cabinet Secretariat, GoI

¹¹ Government of India, Planning Commission, (2011), Report of the High Level expert Committee on efficient Management of Public Expenditure

perceived benefits being achieved (Salvatore 2009). Therefore in 2011 the high level Expert Committee on Expenditure Management opted for a realistic approach more suited to India. It recommended removing the plan and non-plan distinction from the expenditure classification and suggested taking a holistic view of expenditure for budgeting with a multi-year perspective. The Committee also suggested developing a three year expenditure framework to be updated in the light of financial resource availability, with sectoral priorities and performance indicators. The key feature of this plan is that the Ministry of Finance would estimate the budgetary resources and indicate the ceilings to ministries on a three year rolling basis.

Fiscal Rules and Budget Management

The Fiscal Responsibility and Budget Management Act (FRBM) was adopted in 2003¹² in response to severe deterioration in public finance both at Central and State levels in late nineties and failure to salvage the situation through discretionary policy actions (Rao and Jena 2009, 12th FC, pp. 62). The combined (both Centre and States taken together) fiscal deficit exceeded 9 per cent of GDP and the debt-GDP ratio grew considerably with the slowing down of the economy during early 2000s. The FRBM Act had the objective of reducing the combined fiscal deficit of Central and State Governments to 3 per cent of GDP by 2008-09, to balance the current account, to maintain long-run fiscal sustainability and prevent future increases in debt levels.

Post FRBM fiscal developments revealed that adherence to the fiscal rules was closely related to economic growth necessitating a revision when the economy slowed down. Close scrutiny of fiscal data shows that significant improvements in the fiscal situation in the country since 2003-04 was mainly revenue driven, particularly due to income tax, riding high on the buoyant economy and modernization of tax administration (Rao et al 2008). The consolidated gross fiscal deficit relative to GDP declined from 9.9 per cent in 2001-02 to 6.4 per cent in 2006-07 and further to 5.4 per cent by 2007-08. On the expenditure front, however, excluding a decline in interest payment (due to the debt swap programme) and a decline in interest rates, not much restructuring was evident. The real test of the fiscal rules came during 2008-09, when the national growth rate slowed down sharply to 6.7 per cent from an average of 9.4 per cent in the preceding three years, because of the international financial crisis. This has triggered an expansionary fiscal stance by the Central Government through fiscal stimulus packages comprising both tax cuts and expenditure hikes (Economic Survey, 2008-09, pp 35). The targets of the fiscal rules were considerably breached in the terminal year of the fiscal consolidation path as the combined fiscal deficit rose to 8.5 per cent of GDP in 2008-09 and rose further to 9.4 per cent in 2009-10.

Although fiscal stress has not been eased since the global economic slowdown of 2008-09, the Government has reemphasized the need to continue with fiscal rules by extending the time line and redefining the parameters. The revised road map for fiscal consolidation was suggested by the Thirteenth Finance Commission with an extended time horizon up to 2014-15 emphasizing the curtailment of debt stock and a fiscal deficit consistent with this objective¹³.

¹² The central Act was followed by the sub-national Governments enacting FRBM Acts separately.

¹³ The revised road map for fiscal consolidation charted by the TFC, which targets fiscal deficit consistent with debt-GDP ratio, was laid down as the fiscal roadmap by amending the FRBM Act for the next five years. In the fiscal

Fiscal prudence requires political commitment without which it becomes difficult to adhere to fiscal rules for a long period (Von Hagen, 2007).

The fact that the fiscal rules have been operating both at Central and State level in India and the Government has opted to reinvent them in difficult times, rather than just having fixed constraints seems to have gained political acceptance. The reasons for the shift from a disciplined fiscal posture to large deficits in 2008 were more economic in nature. An automatic reduction in revenue collection and rise in expenditure through the stimulus package in the difficult year of 2008 produced a large and unplanned deficit in excess of the level stipulated by the FRBM Act. While the modification of fiscal rules was necessary, it does not assure future adherence in the face of adverse economic conditions. The tendency to expand the scope of populist Government programmes and subsidies which have large expenditure commitments in the future years needs to be restricted if fiscal discipline is to continue to be achieved.

3. The Role of Integrated Financial Advisors in Financial Management

Through delegation of financial powers from the Ministry of Finance to agencies, the departments enjoy considerable freedom to spend their own budget allocations and maintain their accounts. To support the departments in exercising the enhanced powers delegated to them, a system of Integrated Financial Advisors was developed. This institutional form has assumed a crucial role in developing the financial management capability of departments. This has spanned from policy formulation and implementation to functional oversight of accounting and budgeting. While assisting the departments to achieve their goals and ensuring value for money, the Financial Advisors also act as representatives of the Ministry of Finance in all financial matters. Indeed balancing the dual role, of both advising the Secretaries of the departments and acting as 'eyes and ears' of the Ministry of Finance is a difficult job.

The role, authority, and accountability of the Financial Advisors were revised through a charter in 2006 to enhance their capacity to meet the challenges associated with this role¹⁴. Redefining the charter, as the official memorandum indicates, was intended to assist the departments in achieving their objectives, facilitating implementation of the approved programmes with due financial prudence, ensuring the monies allocated were spent on time and in the prescribed manner, and ultimately ensuring value for money. The responsibilities assigned to the Financial Advisors through this revised charter have been ambitious since they include most of the financial activities starting from performance (outcome) budgeting, expenditure control and cash management, to project formulation and appraisal, and monitoring and evaluation functions. The revised charter has raised many questions regarding the expectations of Financial Advisors since the expansion of responsibilities does not match their existing powers and support systems.

restructuring plan the consolidated debt to GDP ratio is targeted to decline from 78.8% in 2009-10 to 67.8% in 2014-15. In line with this, the fiscal deficit is supposed to be reduced from 9.5% to 5.4% during the same period. The central government is required to reduce its outstanding debt to GDP ratio from 54.2% in 2009-10 to 44.8% in 2014-15, its fiscal deficit from 6.8% to 3% and its revenue deficit from 4.8% to a surplus of 0.5%.

¹⁴ Ministry of Finance, Office Memorandum of F(5)/L&C/2006 dated 1.6.2006

Since the effectiveness of the role of Financial Advisors is circumscribed by the management framework within which they function, addressing these concerns exclusively with Financial Advisors would not be successful. Rather, capacity building and support from the administrative ministry would be more helpful. In India, there is no separate cadre of Financial Advisers, and it should be recognized that financial management in the public sector can no longer be treated as a function of generalist officers. The lack of attention to the technical and professional skills of Financial Advisors compares unfavourably with the heavy and technical nature of their responsibilities.

4. Efforts to Adopt Accrual Accounting

In India most government accounts are maintained on the modified cash basis, which it is claimed is deficient in not providing a complete picture of the financial position of the Government. It lacks complete information on assets and liabilities, and therefore makes it difficult to ascertain the total cost of services provided by Government departments¹⁵. In 2005 the Government of India accepted the Twelfth Finance Commission's recommendation to switch to an accrual based accounting system. The Government entrusted the GASAB (Government Accounting Standards Advisory Board) with preparing a detailed roadmap and an operational framework for the adoption of an accrual based accounting system.¹⁶

While the benefits from using accrual accounting in the Government sector have been widely mentioned (Blondal 2003, Boothe 2007, Athukorala and Reid 2003), inadequate administrative capacity and the skills required for bringing about such a major reform in accounting system and the high costs involved in its implementation and maintenance are cited as major impediments (Diamond, 2006: a). The benefits of accrual based accounts and reports have also not been clearly established in practice. Concerns range from the technical issues like valuation of assets to broader questions regarding differences in the requirements of the public sector versus the private sector and administrative accountability (Wynne, 2004). The susceptibility of cash accounting to manipulations of financial statements by managing the timing of transactions is considered as key criticism. However, the scope for manipulation in accrual accounting is also present in the formation of estimates of revenues and expenses due to the considerable scope for judgment (Hepworth 2003). There is still limited unanimity at the political and administrative level, even after taking a principled stand to introduce accrual accounting, due to apprehension regarding the risks, likely costs, and the requirement to enhance administrative capacity.

A stage-by- stage approach to introducing accrual accounting is often advocated. The GASAB roadmap to introduce accrual accounting system envisages a transition period of 10 to 12 years divided into several stages. The operational framework details the plan of transition encompassing accounting and treatment of assets, liabilities, revenue and expenses and the final accounts of the Government consistent with the provisions of the Constitution. Progress seems to have been made in the case of Urban Local Bodies where the introduction of accrual accounting has gained momentum. The Comptroller and Auditor general of India (CAG) prepared a

¹⁵ See "Primer on Accrual Accounting", Government Accounting Standards Advisory Board (GASAB

¹⁶ Operational Guidelines for Accrual based Financial Reporting in Government, 21 June 2011

National Municipal Accounting Manual incorporating the principles of accrual accounting in a stage-wise approach. Many State Governments have also shown an interest. Some of the State Governments have adopted a double entry accounting system for their rural local bodies, which is amenable to conversion to the accrual basis.

Systematic efforts are still required over a number of years to implement accrual accounting. Helpful steps to achieve this would include imparting necessary training, recruiting suitable professionals, preparation of accrual accounting manuals, getting together comprehensive data regarding assets and liabilities, establishing suitable accounting standards and norms, and using appropriate information and communication technology.

5. Updating the Internal Audit System

One of the main weaknesses of the internal audit system in India is that it has not kept pace with emerging international standards and practices (Ghosh and Jena, 2008). The modern concept of internal auditing goes far beyond its traditional limits. Internal audit is no longer considered as a mere routine review of financial and other records by specially assigned staff. Internal audit is now seen as a management tool and an integral part of both management controls and communication processes (Diamond 2006). Internal audit is still conducted on the basis of departmental codes and manuals, which are a legacy of the past. These codes mainly emphasize regularity audit and do not encompass management audit and operational audit. The codes also do not require the evaluation of the internal control systems of the units nor require the audited entity to take action on internal audit observations and recommendations.

The concern regarding role and function of internal audit led the Government to constitute a Task Force in 2006 to benchmark the status of internal audit in Central Government and to outline a roadmap for its improvement. The Task Force came to the conclusion that due to the severely restricted mandate and the lack of interest of management, internal audit has not been able to systematically evaluate the risks associated with various activities of the ministry/department when determining their audit strategies. There was no segregation of duties especially at the supervisory levels between those who are responsible for internal audit and those who are responsible for pre-audit, disbursement and accounting functions suggesting a lack of the required independence needed effective internal audit.

The recommendations of the Task Force subscribed to the modern view that internal auditing should not be restricted to financial issues alone, but should also extend to issues like cost benefit analysis, utilization and deployment of resources, matters of propriety, effectiveness of management etc. and the focus should be on risk, control and governance issues. It also provided multiple other recommendations including:

- segregating duties relating to internal audit from those relating to financial advice and accounting functions
- setting up an Apex Board to prescribe internal audit standards and processes across jurisdictions
- legislating internal audit standards and policies
- establishing a Board of Internal Audit (BIA), and ultimately,

- appointing a Chief Internal Auditor (CIA) trained in auditing.

The CIA would function in accordance with standards and procedures prescribed by the BIA.

6. External Audit

External audit undertaken by the Comptroller and Auditor General of India (CAG) has played crucial role and assisted Parliament in exercising financial control over the executive. The recent performance audit reports by the CAG have raised nationwide debate on corruption in Government and the necessity of adopting strong measures to improve the accountability of the executive and the elected representatives. Two recent incidents included the license and allocation of the 2G spectrum by the Department of Telecommunications and the performance audit of the Commonwealth Games 2010¹⁷.

The CAG derives its position and authority in relation to external audit from the Constitution of India¹⁸, which ensures independence and autonomy of public audit. Parliament scrutinizes audit reports through a Public Accounts Committee (PAC). External audit by the CAG has contributed to transparent financial management by raising audit observations time and again relating to budgetary controls, deficiencies in revenue collection, wastage of public resources, inappropriate accounting, poor returns on investments, diversion of funds, and system deficiencies.

The Second Administrative Reform Commission (ARC) in its report on financial management, however, raised several issues relating to external audit. The ARC pointed out that:

- the powers conferred on CAG though wide are not explicit
- timeliness of reporting needs improvement
- audit procedures need to improve to bring in executive accountability
- corrective actions for detected irregularities should be prescribed
- improved risk analysis should highlight systemic issues and analyze causes
- operational synergy should be developed with the internal audit systems of departments, and
- the CAG should play a key role in the audit process of decentralized governance.

These issues are important for the effective functioning of the Supreme Audit Authority. Effectiveness of external audit to a large extent depends on the interest it evokes and support it obtains from the Public Accounts Committee, a parliamentary committee scrutinizing audit

¹⁷ Report No. -19 of 2010-11 for the period ended 2009-10 Performance Audit of Issue of Licenses and Allocation of 2G Spectrum by the Department of Telecommunications (Ministry of Communications and Information Technology

Report No. - 6 of 2011-12 for the period ended 2010-11 - Performance Audit of XIXth Commonwealth Games 2010

¹⁸ 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.

observations. The functioning of the PAC over the years has shown that the percentage of audit observations being discussed in the PAC has reduced. The Ministries and Departments only take seriously those audit observations which are scrutinized by the PAC. Most important there is no law which binds the audited ministries/departments to implement the actions recommended by the CAG. As a result the replies in the form of Action Taken Notes by the audited units come with a substantial time lag. Even when the Action Taken Notes are submitted, these are largely formal rather than substantive. While external audit has been a strong element of the Indian PFM system, the follow-up process needs improvement to enable the external audit system to play its desired role.

7. Intergovernmental Transfers and PFM Concerns

The intergovernmental resource transfer system in India continues to be complex. It involves several conduits like the Finance Commission, Planning Commission and several Central Ministries. In addition to the devolution of central taxes determined by the Central Finance Commission and plan assistance determined by the Planning Commission of India, Centrally Sponsored Schemes have emerged as a key source of funds in social and economic sectors for the states.

These are specifically designed programmes for employment generation, primary education, basic health services and rural infrastructure and are run by the relevant central ministries. The Centrally Sponsored Schemes 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 or regional importance. Over the years the Centrally Sponsored Schemes have become an important tool of the central Government to influence policies and expenditures on subjects constitutionally allocated to the States. The funds under these programmes are provided in the respective budgets of Central Government ministries, implemented at state level by specifically created implementing agencies and rural local bodies. The budgetary provision for direct transfers to implementing agencies has increased from Rs.1,890 billion in 2010-11 to Rs.1,246 billion in 2011-12¹⁹.

There are significant PFM concerns with this type of funding through central programmes. The big ticket Comptroller and Auditor General of India bypass the state budgets and are routed through implementing agencies such as missions or autonomous societies created under the provision of the specific schemes, and local bodies. A direct transfer of resources to state budgets would seem to have merit in terms of accountability. However, apprehensions regarding the timely release of central funds by the states to the designated central programmes led to the creation of implementing agencies in states and directly routing funds to their bank accounts outside state budgets. This funding arrangement is considered to be efficient as funds are promptly utilised. Although state functionaries predominantly run these agencies, the financial management of the implementing agencies remains outside the formal accountability structure of both the Central and the state governments. The release of funds to the agencies from the Central Government is treated as expenditure and this is not reflected in the state budgets.

¹⁹ Expenditure Budget, Vol – I, 2011-12, Ministry of Finance, GoI

Chartered accounts audit Centrally Sponsored Schemes rather than the Comptroller and Auditor General of India. The information on availability of funds and actual expenditure by the service delivery units, schools or health service units, often in remote areas, is limited. Given the diversity in the implementation hierarchy, the number of implementing units and the geographical reach of central schemes, it is a challenge to have meaningful and timely information to support informed planning. These programmes are also often caught in political tangles over their ownership and accountability.

The newly launched Central Plan Monitoring System has attempted to address deficiencies in the existing planning, budgeting and accounting systems for the Centrally Sponsored Schemes. This web-enabled IT application has features to map the flow of funds, releases and expenditure details, payment to the ultimate beneficiary through banking channels, and enhanced report generation capabilities integrated into its transaction databases. In spite of this effort to reinforce the information base of the central plan schemes, the overall financial management of Centrally Sponsored Schemes and its integration with state level systems continues to be weak. The performance management framework for Centrally Sponsored Schemes is split between various agencies from the Central to state governments. Therefore there is an increasing demand for direct routing of funds under these flagship programmes through state budgets. The Expert Committee on expenditure management has also favoured this arrangement hoping to bring these schemes under the financial control of the Central Government.

8. Institutional Changes for Better PFM

There have also been attempts to improve institutional frameworks in other areas. A Debt Management Office has been established in the Ministry of Finance. This is an attempt to separate debt and cash management from monetary management undertaken by the Reserve Bank of India and to change the existing debt management system. The independent Debt Management Office is expected to

- formulate a long term debt management strategy consistent with sustainability requirements
- create an annual borrowing calendar
- forecast cash and borrowing requirements
- formulate a risk management strategy, and
- develop and disseminate debt related information and data.

As recommended by the Thirteenth Finance Commission, a Fiscal Council was established to pursue a sustained dialogue on fiscal policy and to promote independent review and monitoring. The Thirteenth Finance Commission recommended that a committee should be established to review and monitor the implementation of the FRBM process²⁰, and to, over time, evolve into a full-fledged autonomous Fiscal Council to assist the Government in addressing its fiscal tasks in a professional, transparent and effective manner. The Commission referred to

²⁰ Report of Thirteenth Finance Commission, Chapter – 9, pp: 137

examples of such institutional arrangements in countries like Brazil, Japan, Korea, Mexico, and Sweden.

Changes are also expected with procurement by ministries and departments. With the exception of the rules and directives in the General Financial Rules (GFR), 2005, there is no law that exclusively governs public procurement. These rules indicate that the ministries or departments have full power to make their own arrangements to procurement goods. With the exception of limited control and oversight functions carried out by the Central Vigilance Commission (CVC), there is no central authority that is exclusively responsible for defining procurement policies and for overseeing compliance with the established procedures. Acknowledging the weakness in the procurement process, the Central Government is planning to pass legislation to regulate public procurement across Central Government. While the draft bill prescribes open competitive bidding as the preferred method of procurement, for low-value procurement the existing methods of procurement, as specified in the GFR, will continue. This legislation, once passed, is expected to improve transparency and accountability. It includes provisions that emphasize the publishing procurement details in a web-based format starting from the bidding stage to the ultimate award of contracts. The bill also endorses establishing appropriate grievance procedures and anti-corruption mechanisms.

9. Concluding Remarks

While the reform initiatives undertaken to strengthen PFM institutions in India have yet to meet their full potential, they underline the intent of the Government to boost the efficiency and effectiveness of the system. There are a number of areas that remain crucial in strengthening the PFM system. These include:

- producing suitable performance measures to influence budgetary decisions
- continuing with existing efforts to expand accrual accounting
- modernizing internal audit and control
- improving the effectiveness of external audit, and
- introducing an exclusive procurement law.

In contrast to the intermittent nature of past efforts, the future agenda should focus on continuously evaluating the outcome of these reforms in order to take corrective action as soon as possible. At the same time, expectations of immediate results from these reforms may be misplaced. There is always a time lag for institutions to deliver expected results, particularly in a large country like India where the federal nature of the country puts large functional responsibility on sub-national governments. The capacity and willingness to internalize and adopt changes at state level governments and the political involvement and willingness to steer the changes are also essential.

- i Eleventh Five Year Plan (2007-12) documents mentions that ‘the percentage of the population below the official poverty line has come down from 36% in 1993–94 to 28% in 2004–05.
- ii Report of the Second Administrative reforms Commission , “Strengthening Financial management Systems - 2009”, and PEFA India report - 2010,

- iii Audit reports of appropriation accounts by the CAG bring out these amounts every year.
- iv Guideline for outcome budget 2006-07, Ministry of Finance (MOF), “a need has for some time been felt to address certain weaknesses that have crept in the performance budget documents such as lack of clear one-to-one relationship between the Financial Budget and the Performance Budget and inadequate target-setting in physical terms for the ensuing year. Besides, there is growing concern to track not just the intermediate physical “outputs” that are more readily measurable but the “outcomes”, which are the end objectives of State intervention.”
- v Outcome budget, Ministry of Finance, 2007-08, “the Outcome Budget is an endeavor of the Government to convert the “Outlays” into “Outcome” by planning the expenditure, fixing appropriate targets, quantifying the deliverables in each scheme and bring to the knowledge of all, the “Outcomes” of the Budget outlays provided for each scheme/programme.”
- vi Eleventh Five Year Plan (2007-12), Chapter -10 – Governance, pg 229.
- vii Some of the State Governments have started adopting the outcome budget, which are almost like replica of the Central one.
- viii Ministry of Finance, Department of Expenditure (2007), Guideline for Preparation of Outcome Budget 2007-08
- ix This is to concur the recommendation of the Second Administrative Reform Commission to have an annual performance agreement to be signed between the departmental minister and the secretary of the department on details of works done during the year.
- x Guidelines for Results Framework Documents (RFD) 2011-2012, Cabinet Secretariat, GoI
- xi Government of India, Planning Commission, (2011), Report of the High Level expert Committee on efficient Management of Public Expenditure
- xii The central Act was followed by the sub-national Governments enacting FRBM Acts separately.
- xiii The revised road map for fiscal consolidation charted by the TFC, which targets fiscal deficit consistent with debt-GDP ratio, was laid down as the fiscal roadmap by amending the FRBM Act for the next five years. In the fiscal restructuring plan the consolidated debt to GDP ratio is targeted to decline from 78.8% in 2009-10 to 67.8% in 2014-15. In line with this, the fiscal deficit is supposed to be reduced from 9.5% to 5.4% during the same period. The central government is required to reduce its outstanding debt to GDP ratio from 54.2% in 2009-10 to 44.8% in 2014-15, its fiscal deficit from 6.8% to 3% and its revenue deficit from 4.8% to a surplus of 0.5%.
- xiv Ministry of Finance, Office Memorandum of F(5)/L&C/2006 dated 1.6.2006
- xv See “Primer on Accrual Accounting”, Government Accounting Standards Advisory Board (GASAB)
- xvi Operational Guidelines for Accrual based Financial Reporting in Government, 21 June 2011
- xvii Report No. -19 of 2010-11 for the period ended 2009-10 Performance Audit of Issue of Licenses and Allocation of 2G Spectrum by the Department of Telecommunications (Ministry of Communications and Information Technology)
- xviii Report No. - 6 of 2011-12 for the period ended 2010-11 - Performance Audit of XIXth Commonwealth Games 2010
- xix 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.
- xx Expenditure Budget, Vol – I, 2011-12, Ministry of Finance, GoI
- xxi Report of Thirteenth Finance Commission, Chapter – 9, pp: 137

Bibliography

- Athukorala, S. Lakshman, and Barry Reid. 2003. *Accrual Budgeting and Accounting in Government and Its Relevance for Member Countries*. Manila: Asian Development Bank.
- Blöndal, Jón R. 2003. “Accrual Accounting and Budgeting: Key Issues and Recent Developments.” *OECD Journal on Budgeting* 3 (1): 43–60.
- Boothe, Paul (2007), “Accrual Accounting in the Public Sector: Lessons for Developing Countries”, in Anwar Shah (eds) *Budgeting and Budgetary Institutions*, The World Bank

Diamond, Jack (2006), "Budget System Reform in Emerging Economies: The Challenges and the Reform Agenda" Working Paper No. 245, International Monetary Fund, Washington, DC.

Ghosh, Amiya Kumar and Pratap Ranjan Jena (2008), *Strengthening Financial Management Systems*, National Institute of Public Finance and Policy, New Delhi

Government of India, Ministry of Finance (2007), *Guideline for Preparation of Outcome Budget 2007-08*

Government of India, (2008), *Eleventh Five Year Plan: 2007-12, Volume I, Inclusive Growth, Planning Commission, (Chapter 10 – Governance),, pp229*

Government of India, Ministry of Finance (2008), *Economic Survey 2007-08,*

Government of India, (2009), *Report of the Thirteenth Finance Commission*

Government of India, (2009), *Strengthening Financial Management Systems, Second Administrative Reform Commission, 14th Report, pp.82-87*

Government of India, Planning Commission, (2011), *Report of the High Level expert Committee on efficient Management of Public Expenditure*

Hagen, Jürgen von (2007), "Budgeting Institutions for Better Fiscal Performance", in Anwar Shah (eds) *Budgeting and Budgetary Institutions*, The World Bank

Hepworth, Noel (2003), "Preconditions for Successful Implementation of Accrual Accounting in Central Government." *Public Money and Management* 23 (1): 37–44.

Jena, Pratap Ranjan (2010), *India: Public Expenditure and Financial Accountability, Public Financial Management Performance Assessment*, National Institute of Public Finance and Policy, New Delhi

Kelly, Janet M. (2003), "The Long View: Lasting (and Fleeting) Reforms in Public Budgeting in the Twentieth Century." *Journal of Public Budgeting, Accounting, and Financial Management* 15 (2): 309–26

Premchand, A (1983), "Development Planning and Budgeting", Ch – 6, in *Government Budgeting and Expenditure Controls; Theory and Practice*, International Monetary Fund, Washington DC

Premchand, A. (2008), *Trapped in the Comfort Zone of Denial; 50 Years of Expenditure Management in India*, National Institute of Public Finance and Policy, New Delhi

Rao, M. Govinda and Pratap Ranjan Jena (2009), "Recent Trends in State Finances" in M. Govinda Rao and Anwar Shah (eds) *States' Fiscal Management and Regional Equity: An Overview*, Oxford University Press

Rao, M. Govinda, Tapas K. Sen and Pratap Ranjan Jena (2008), "Issues Before the Thirteenth Finance Commission" *Economic and Political Weekly*, September 6,

Salvatore Schiavo-Campo (2009), "Potemkin Villages: The Medium-Term Expenditure Framework in Developing Countries", *Public Budgeting & Finance*, Summer 2009, pp. 1-26

Shah, Anwar and Chunli Shen (2007), "A Primer on Performance Budgeting", in Anwar Shah (eds) *Budgeting and Budgetary Institutions*, The World Bank

Swarup, D (1990), "India: development in Government Accounting and Financial Management", in A.

Premchand (ed) *Government Financial Management: Issues and Country Studies*, International Monetary Fund

Thimmaiah, G (1984), "Budget Innovation in India: An Evaluation", in A. Premchand and Jesse Burkhead (ed) *Comparative International Budgeting and Finance*, Transaction Books, New Brunswick (USA), and London

Toye, John, (1981), "Public Expenditure Reforms in India and Malaysia", Development and Change, SAGE, London and Beverly Hills, Vol. 12, pp. 121-144
UNDP (2011), Human Development Report 2011- Sustainability and Equity: A Better Future for All,
Government of India, (2004), Report of the Twelfth Finance Commission
Wildavasky, Aaron (1978), A Budget for All Seasons? Why the Traditional Budget Lasts, Public Administration Review, , No.38 (November- December), pp.501-9;
Wynne, Andrew (2004), "Is the Move to Accrual Based Accounting a Real Priority for Public Sector Accounting?" Association of Chartered Certified Accountants, London.