

Executive Summary

Background

Government of Meghalaya responded to the Twelfth Finance Commission's (TFC) recommendation by legislating "Meghalaya Fiscal Responsibilities and Budget Management (MFRBM) Act" in November 2006. It sets out a reform agenda through fiscal correction path in the medium term with the long-term goal of securing growth stability for its economy. The State Government implemented the Value Added Tax in May 2005 which will go a long way in increasing tax revenue of the State.

The State Government has done well in establishing an institutional mechanism on fiscal transparency and accountability as evident from the year-on-year presentation of outcome budgets. These outcome indicators tend to serve the limited purpose of measuring the performance against the targets. They do not, however, give the 'big picture' of the status of financial management including debt position, cash management, *etc.* for the benefit of the State Legislature and other stakeholders.

The Comptroller and Auditor General's (C&AG) civil audit reports step in to fill this gap. C&AG's reports have been commenting upon the Government's finances for two years since the MFRBM legislation and have published two reports already. Since these comments formed part of the civil audit report, it was felt that the audit findings on State finances remained camouflaged in the large body of audit findings on compliance and performance audits. The obvious fallout of this well-intentioned but all-inclusive reporting was that the financial management portion of these findings did not receive proper attention. In recognition of the need to bring State finances to center-stage once again, a stand-alone report on State Government finances is considered as an appropriate audit response to this challenge. Accordingly, from the report year 2009 onwards, C&AG has decided to bring out a separate volume titled "Report of the Comptroller and Auditor General of India on State Finances".

The Report

Based on the audited accounts of the Government of Meghalaya for the year ending March 2009, this report provides an analytical review of the Annual Accounts of the State Government. The report is structured in three Chapters.

Chapter I is based on the audit of Finance Accounts and makes an assessment of Meghalaya Government's fiscal position as at 31 March 2009. It provides an insight into trends in committed expenditure, borrowing pattern besides a brief account of central funds transferred directly to the State implementing agencies through off-budget route.

Chapter II is based on audit of Appropriation Accounts and it gives the grant-by-grant description of appropriations and the manner in which the allocated resources were managed by the service delivery departments.

Chapter III is an inventory of Meghalaya Government's compliance with various reporting requirements and financial rules. The report also has an appendage of additional data collated from several sources in support of the findings.

Audit findings and recommendations

Return to fiscal correction

Meghalaya Government's early gains in achieving revenue surplus of a substantial amount, suffered a setback in the current year. Not only did the revenue surplus decline during 2008-09, the fiscal and primary deficits also increased during the year. The fiscal performance of the State *vis-à-vis* MFRBM Act indicate a dismal picture during the year. The total loss of revenue due to underassessment/short levy/non-levy of taxes, *etc.*, which was in excess of 9 *per cent* of the State's own resources consisting of tax and non-tax revenue during 2008-09, indicates the presence of loopholes in resource mobilisation. Pending revenue arrears constituted over 24 *per cent* of tax revenue of the State during 2008-09. Given the robustness of the economy, the State can still achieve the FRBM targets with a concerted effort through better tax compliance, focusing on regaining revenue arrears and by pruning unproductive expenditure.

The State may consider reprioritising its outlays, in view of the fact that its capital expenditure-aggregate expenditure ratio is lower than the average for all the States.

Review of Government investments

The average return on Meghalaya Government's investments in Statutory Corporations, Government Companies and Co-operative Societies was less than one *per cent* during 2004-09, whereas its average interest outgo was in the range of 6.32 to 8.58 *per cent*. This is obviously an unsustainable proposition. The State Government should, therefore, hasten to seek better value for money in investments. Otherwise high-cost borrowed funds invested in projects with low financial return will continue to strain the economy. Projects which are justified on account of low financial but high socio-economic return may be identified and prioritized with full justification for the high-cost borrowings. It is high time to revisit the working of state-owned public sector undertakings incurring huge losses and work out either a revival strategy (for those that are strategic in nature and can be made viable) or close down (if they are not likely to be viable given current market conditions).

Prudent cash management

The cost of holding surplus cash balances is high. In 2008-09, interest received on investment of cash balances was only 3.28 *per cent* (Rs. 15.78 crore) of the amount invested during the previous year, while the Government borrowed during the year on a minimum market rate of interest at 7.59 *per cent* per annum. Proper debt management through advanced planning could minimise the need to hold large cash surpluses.

Debt sustainability

The Government of Meghalaya should endeavour to achieve the total liabilities-GSDP ratio as specified in the MFRBM Act that the total liabilities on the Consolidated Fund of the State should not be more than 28 *per cent* of GSDP. Efforts should be made to return to the state of primary surpluses and increase revenue surplus at the earliest possible opportunity. Maintaining a calendar of borrowings to avoid bunching towards the end of the fiscal year and a clear understanding of the maturity profile of debt payments will go a long way in prudent debt management.

Funds transferred directly from the GOI to the State Implementing Agencies

Funds flowing directly to the implementing agencies through off-budget routing inhibit FRBM requirements of transparency and therefore bypass accountability. A system has to be urgently put in place to ensure proper accounting of these funds and the updated information should be validated by the State Government as well as the Accountant General (A&E).

Financial management and budgetary control

During 2008-09, there was an overall saving of Rs. 786.95 crore, which was the result of saving of Rs. 894.52 crore offset by excess of Rs. 107.57 crore. The excess of Rs. 107.57 crore requires regularisation under Article 205 of the Constitution of India. Three grants, viz. 'North Eastern Areas', 'Welfare of Scheduled Castes, etc.' and 'Roads & Bridges, etc.' posted large savings persistently for the last five years. There were also instances of inadequate provision of funds and unnecessary/ excessive re-appropriations. Rush of expenditure at the end of the year is another chronic feature noticed in the overall financial management. In many cases, the anticipated savings were either not surrendered or surrendered on the last day of the year leaving no scope for utilising these funds for other development purposes. Detailed bills were not submitted for large amount of advances drawn on abstract contingent bills within the stipulated time limit. Budgetary controls should be strictly observed to avoid such deficiencies in financial management. Last minute fund releases and issuance of re-appropriation/ surrender orders should be avoided.

Financial reporting

State Government's compliance with various rules, procedures and directives was unsatisfactory as evident from delay in furnishing utilisation certificates for grants given by Tourism Department and also non-submission of information regarding utilisation certificates by the Finance Department. Delays also figured in submission of annual accounts by some autonomous bodies. There were instances of losses and misappropriations. Departmental enquiries in such cases should be expedited to bring the defaulters to book. Internal controls in all the organisations should be strengthened to prevent such cases in future.

Conclusion and Recommendations

During the current year the revenue account increased by Rs. 1,265 crore over 2004-05 and the growth of revenue receipts was 15.16 *per cent* while growth of revenue expenditure was 19.09 *per cent* over the previous year. The tax revenue and non-tax revenue receipts exceeded normative assessments made by TFC by 4.82 *per cent* and by 1.81 *per cent* respectively.

The non-plan revenue expenditure (NPRE) increased by 9.46 *per cent* over the previous year. The NPRE exceeded the normative assessment made by TFC and assessment made by Government in its FCP by 16.3 *per cent* and 7.09 *per cent* respectively. The growth of plan revenue expenditure during 2008-09 significantly improved to 39.53 *per cent* against 27.39 *per cent* during the previous year.

The capital expenditure during 2008-09 (Rs. 531 crore) increased by 35.46 *per cent* over the previous year, but was 1.85 *per cent* lower than projected in FCP (Rs. 541 crore) and constituted only 16 *per cent* of total expenditure during the year.

The GOI directly transferred Rs. 313.79 crore to the State Implementing Agencies during 2008-09.

The fiscal deficit relative to GSDP at 4.53 *per cent* far surpassed the target set in Medium Term Fiscal Policy Statement for 2008-09 (1.56 *per cent*) and also the ceiling of 3 *per cent* to be achieved by 2008-09 as per the MFRBM Act.

The State was successful in restricting the expenditure on salaries during 2008-09 as assessed in its FCP (Rs. 1,052 crore) for the year and also within the norm of 35 *per cent* prescribed by the TFC for the total salary bill relative to revenue expenditure net of interest payment and pension. Pension payments exceeded the normative assessment made by TFC by 47 *per cent*. The ratio of salaries, interest payments, pensions and subsidies to revenue receipts marginally decreased by one percentage point over the previous year.

The ratio of total liabilities to GSDP at 47.48 *per cent* was higher than the limit of 28 *per cent* prescribed in the MFRBM Act, 2006.

As of 31 March 2009, there were 21 incomplete projects in which Rs. 31.62 crore were blocked.

During 2008-09, though the State Government earmarked 75.56 *per cent* of the estimated aggregate expenditure for development expenditure, this assessment fell short by around 6 *per cent* at the end of the year. The capital expenditure and the expenditure on social sector, though increased during the current year over the previous year, the ratio of these expenditure as a proportion of aggregate expenditure is lower than all States'/National Average and therefore, need higher fiscal priority.

During 2008-09, recovery of loans and advances was Rs. 18 crore against payment of Rs. 50 crore. Return on outstanding loans and advances given by the State Government, which stands only at 0.41 *per cent* in 2008-09, indicates that the possibility of achieving 7 *per cent* return within the next one year as assumed by the TFC is remote.

In view of the heavy losses of some of the undertakings, the Government should review their working so as to wipe out their losses in the short run and to make them self-sustaining in medium to long term.

Return to fiscal correction: Meghalaya adopted FRBM Act in November 2006. Although the fiscal performance of the State *vis-à-vis* targets set in FCP as well as MFRBM Act and Budget indicate a dismal picture during 2008-09, the State has the reasonable prospect of achieving the targets set out in the MFRBM Act of 2006 provided an effort is made to increase tax compliance, collect revenue arrears and prune unproductive expenditure so that deficits are contained to the levels envisaged in the Act.

Greater priority to capital expenditure: The State may consider enhancing the priority it gives to capital expenditure as a proportion of Aggregate Expenditure as this ratio is lower for Meghalaya than the All States' Average.

Enhancing fiscal capacity: The per capita development expenditure, per capita social sector expenditure and per capita capital expenditure in Meghalaya is higher than the national average.

Review of Government investments: The average return on Meghalaya Government's investment in Statutory Corporations, Government Companies and Co-operatives was less than one *per cent* during 2004-09, whereas its average interest outgo was in the range of 6.32 *per cent* to 8.58 *per cent*. It would be advisable for the State Government to ensure better value for money invested. Projects which are justified on account of low financial but high socio-economic return may be identified and

prioritized with full justification. It would also be prudent to review the working of state public sector undertakings which are incurring huge losses and work out either a revival strategy (for those that are strategic in nature and can be made viable) or close down (if they are not likely to be viable given current market conditions).

Prudent cash management: The cost of holding surplus cash balances is high. In 2008-09, interest received on investment of cash balances was only 3.28 *per cent* (Rs. 15.78 crore) of the amount invested during the previous year, while the Government borrowed during the year on a minimum market rate of interest at 7.59 *per cent per annum*. Proper debt management through advanced planning could minimise the need to hold large cash surpluses.

Debt sustainability: The prevalence of fiscal deficit *indicates continued reliance of the State on borrowed funds, resulting in increasing fiscal liabilities of the State over this period, which stood at 37.18 per cent of the GSDP in 2008-09 and would further increase to 47.48 per cent after incorporating the contingent liabilities in the fold of total liabilities on Consolidated Fund of the State during the year and appears to be quite high especially if compared with the limit of 28 per cent prescribed in the MFRBM Act, 2006.* Government of Meghalaya should, therefore, take immediate steps to restrict the debt-GSDP ratio as per commitment made in the MFRBM Act, 2006.

Funds transferred directly from the GOI to the State implementing agencies: Direct transfers from the Union Government to the State Implementing Agencies runs the risk of poor accountability. As such, a system should be put in place to ensure proper accounting of these funds which remain outside the State budget.