Executive Summary

Background

The State of Kerala, located at the southern end of the country, accounts for one *per cent* of the total area of the country and about three *per cent* of the population. The State ranks high in the human development index with a literacy rate of 93.91 *per cent* and life expectancy at birth of 74 years when compared to the General Category States' average. The infant mortality rate (12 per thousand) of the State is very low compared to the All India' average. The State has also less population below poverty line as compared to General Category States. The State has shown marginally lower economic growth in the past decade as the compound annual growth rate of its Gross State Domestic Product (GSDP) for the period 2001-02 to 2010-11 has been 14.57 *per cent* as compared to 14.68 *per cent* in General Category States (GCS). During this period, its population also grew by 4.86 *per cent* only (lowest among General Category States) against 17.56 *per cent* in General Category States. The per capita income compound annual growth rate in Kerala (12.50 *per cent*) has been higher than that of the GCS (11.32 *per cent*) in the current decade. However, the State has slightly higher urban and rural inequality compared to the all India average.

This Report of the Finances of the Government of Kerala is being brought out with a view to assess objectively, the financial performance of the State during 2010-11 and to provide the State Government and the State Legislature with timely inputs based on audit analysis of financial data. In order to give a perspective to the analysis, an effort has been made to compare the achievements with the targets envisaged by the State Government in the budget estimates of 2010-11.

The Report

Based on the audited accounts of the Government of Kerala for the year ended March 2011, this Report provides an analytical review of the Annual Accounts of the State Government. This Report is structured in three Chapters.

Chapter 1 is based on the audit of Finance Accounts and makes an assessment of the Kerala Government's fiscal position as on 31 March 2011. It provides an insight into trends in committed expenditure and borrowing pattern, besides giving a brief account of Central funds transferred directly to the State implementing agencies through the off-budget route.

Chapter 2 is based on the audit of Appropriation Accounts and gives a grant-by-grant description of appropriations and the manner in which the allocated resources were managed by the service delivery departments.

Chapter 3 is an inventory of the Kerala Government's compliance with various reporting requirements and financial rules. The report also compiles the data collated from various Government departments/organizations in support of the findings.

Audit findings and recommendations

Chapter I

Finances of the State Government

Oversight of funds transferred from the Government of India directly to the State implementing agencies: The Government of India directly transferred ₹ 2163.91 crore to State implementing agencies during the year. The direct transfer of funds from the Government of India to the State implementing agencies ran the risk of inadequate monitoring of utilisation of funds by these agencies in the absence of uniform accounting policies and an effective monitoring system.

The Government should ensure proper accounting of the funds transferred to State implementing agencies and the updated information should be validated by the State Government as well as the Principal Accountant General (A&E), Kerala, for monitoring of the expenditure incurred by the implementing agencies.

Revenue receipts: The Revenue receipts during the year increased by 18.7 *per cent* over the previous year as against 6.5 *per cent* during the previous year. The high growth rate was mainly due to growth rate of 23.2 *per cent* in States' own tax revenue compared to 10.2 *per cent* during the previous year.

Revenue expenditure: The revenue expenditure constituted 89 *per cent* of the total expenditure and increased by 11.3 *per cent* during the year over the previous year. Non-Plan Revenue Expenditure (NPRE) increased by 13 *per cent* over the previous year. The NPRE exceeded the normative assessment made by the Thirteenth Finance Commission by 7.5 *per cent*. The committed expenditure on salary and wages, pensions, interest payments and subsidies constituted 75 *per* cent of revenue receipts during 2010-11, a decrease of three percentage points compared to the previous year. Such an improvement may be difficult in the coming years after implementation of the recommendations of the Ninth State Pay Commission.

Capital expenditure: Capital expenditure during the year constituted nine *per cent* of the total expenditure and increased by 63.3 *per cent* over the previous year. The proportion of expenditure spent on capital has been much lower as compared to General Category States. The Government may consider enhancing the proportion of expenditure on economic and capital sectors in order to create the much needed assets to stimulate growth.

Review of Government investments: The average return on the Kerala Government's investments in Statutory Corporations, Government Companies, Joint Stock Companies and Co-operatives was 1.3 *per cent* in the last five years while the Government paid an average interest rate ranging from 7.3 to 8.4 *per cent* on its borrowings during this period.

The Government should take steps to ensure better value for money in investments. Otherwise, high-cost borrowed funds will continue to be invested in projects with low financial returns. Projects which are justified on account of low financial but high socio-economic returns may be identified and prioritized with full justification for channeling high-cost borrowings there. The working of State Public Sector Undertakings which are incurring huge losses should be reviewed and a revival strategy should be worked out for those undertakings which can be made viable. Undertakings which are not likely to be viable may be closed down.

Debt sustainability: The Fiscal liabilities at the end of the current year worked out to ₹ 82,420 crore and stood at 31.1 *per cent* of GSDP. During 2010-11 the quantum spread together with Primary Deficit and the Resource Gap were positive indicating a declining trend in Debt-GSDP ratio and capacity of the State to sustain the debt.

Borrowed funds should be used as far as possible only for creation of assets and revenue expenditure should be met fully from revenue receipts. The State Government may consider adopting a well-planned strategy to review the stock of fiscal liabilities in order to adhere to the target of reducing it to less than 30 *per cent* of GSDP by 2014-15 set by the Thirteenth Finance Commission.

Fiscal correction: The fiscal parameters ie. revenue, fiscal and primary deficits – indicate the extent of overall fiscal imbalances in the finances of the State Government during a specified period. All these fiscal parameters, indicated a declining trend in 2010-11 as compared to the previous year. The revenue, fiscal and primary deficits decreased from ₹ 5023 crore, ₹ 7872 crore and ₹ 2580 crore in 2009-10 to ₹ 3674 crore, ₹ 7731 crore and ₹ 2041 crore respectively in 2010-11. The ratio of revenue deficit to fiscal deficit decreased from 63.8 *per cent* in 2009-10 to 47.5 *per cent* in 2010-11. As a proportion of GSDP, the revenue deficit decreased to 1.4 *per cent* and the fiscal deficit to 2.9 *per cent* in 2010-11 from 2.2 *per cent* and 3.4 *per cent* in 2009-10 respectively. The achievement with regard to revenue and fiscal deficit was better than the targets fixed in the Medium Term Fiscal Plan.

The Thirteenth Finance Commission has prescribed a fiscal consolidation map which require the State to eliminate revenue deficit by 2014-15 and to achieve fiscal deficit of three *per cent* of GSDP by 2013-14. Accordingly, the State Government amended the Kerala Fiscal Responsibility Act, 2003 to conform to the above fiscal reform path. In order to achieve these targets, efforts have to be made to increase tax compliance, collect revenue arrears and prune unproductive expenditure.

Chapter II

Financial Management and Budgetary Control

During 2010-11, expenditure of ₹ 41374.32 crore was incurred against total grants and appropriations of ₹ 56862.22 crore, resulting in savings of ₹ 15487.90 crore. The overall savings were the net result of savings of ₹ 15488.05 crore, offset by excess of ₹ 15 lakh. Excess expenditure of ₹ 15 lakh, in one grant and two appropriations during 2010-11 required regularisation under Article 205 of the Constitution of India. Apart from this, regularisation of excess expenditure under Article 205 of the Constitution of India was pending for ₹ 333.59 crore from 1990-91 to 2009-10 as of December 2011. In 102 cases, augmentation/reduction of provisions by re-appropriation proved either in excess of requirement or insufficient as the final expenditure of the re-appropriated sub-heads resulted in savings/excess by more than ₹ two crore. In 25 cases, ₹ 81.30 crore was surrendered in excess of actual savings. In 50 cases, surrenders of funds amounting to ₹ 13793.53 crore were made on the last two working days of the financial year, while in 27 grants/appropriations, savings amounting to ₹ 1419.09 crore were not surrendered.

Budgetary controls need to be strengthened in all the Government departments. Re-appropriation/surrender of funds may also be done at the earliest in order to make the funds available to the needy departments of the Government.

Chapter III

Financial Reporting

The Government's compliance with various rules, procedures and directives was lacking in various departments, which was evident from delays in furnishing of utilisation certificates against loans and grants by various grantee institutions. Delays were also noticed in submission of annual accounts by autonomous bodies and departmentally managed commercial undertakings. There were instances of large outstanding cases of losses and misappropriations for which departmental action was pending for long periods. Significant amounts of expenditure and receipts under Central and State schemes, booked under the Minor head '800-Other Expenditure' and '800-Other Receipts' were not distinctly depicted in the State Finance Accounts of 2010-11, affecting the correctness in financial reporting.

The departments should ensure timely submission of utilisation certificates in respect of the grants released for specific purposes to the grantee institutions and the annual accounts in respect of the autonomous bodies to the Principal Accountant General (Accounts and Entitlement), Kerala and the Principal Accountant General (Civil and Commercial Audit), Kerala respectively. Departmental enquiries in respect of all fraud and misappropriation cases should be expedited to bring the defaulters to book. Internal controls in all the organisations should be strengthened to prevent such cases. Large amounts received or expended under various schemes should be depicted in the accounts distinctly, instead of clubbing the same under the Minor head '800-Other Expenditure' and '800-Other Receipts' to ensure correctness in financial reporting.