THEME PAPER ON

STRENGTHENING PUBLIC FINANCIAL REPORTING

Paper prepared by:
Shri S. C. Pandey

STRENGTHENING PUBLIC FINANCIAL REPORTING

Governments need quality information at right time

1. Many problems, whether at individual level or at organization/Government level, arise mainly due to non-availability of reliable, high quality information at right time, at right place, to the right people to enable right decisions being taken. This implies that there should be robust systems for capturing, validating, compiling, consolidating, and suitably pigeonholing/tagging data thus converting the raw data into meaningful reports rendered to different stakeholders for different purposes. Governments' most important decisions involving significant financial implications are often based on not very comprehensive, reliable and up-to-date information. The need for quality information at right time to right people in any sphere of activity can hardly be over-emphasized.

Official sources of public financial reporting

2. The documents authored by IAAD concerned with 'public financial reporting' are (a) Appropriation and Finance Accounts of States (b) Combined Finance and revenue Accounts of the Union and the States (c) Union and State Accounts at a Glance (d) Audit Reports on Union Finances (e) Audit Reports on State Finances for each State

3. The official documents authored by non-IAAD sources concerned with 'public financial reporting' are (a) Finance Accounts of the Union Government compiled by the CGA and the Appropriation Accounts of the Union Government compiled in five volumes – Civil, Post, Telecommunication, Railways and Defence by respective Principal Accounts Officers (b) Annual Budget documents of Union and State Governments (c) Annual, 5 year and Vision documents brought out by the Planning Commission (d) Periodic Statements by Finance Ministers on fiscal and economic situation, as required under Fiscal Responsibility and Budget Management (FRBM) Acts (e) Economic Survey, Economic Classification of budget and Annual Public Financial Statistics brought out by Economic Division, Ministry of Finance (f) Periodic public disclosures by Ministry of Finance under commitments made to international community through IMF especially concerning Public Debt and other liabilities (g) Annual Review on State Finances and several other Reports and Statements brought out by the Reserve Bank of India. (h) Occasional Press releases (i) Occasional White Papers on various aspects of public finance brought out by the government such as Public Debt, Subsidies, Disinvestment Railway Finances.

Scope of 'public financial reporting' in an era of fragmented governance systems

4. In a bygone era, 'public financial reporting' would have been synonymous with reporting on government accounts and finances but not anymore. To be meaningful, it must cover the monetary receipts and disbursements and monetary commitments of not only Government but also of Public Sector Undertaking, Autonomous Bodies and other parastatals discharging Governmental/quasi-Governmental functions. The public finances used to be earlier confined largely to the Government and in a single resource pool controlled by the Government, typically called the Consolidated Fund in the Commonwealth countries. In a global trend, the Consolidated Fund is getting fragmented. There are not only earmarking arrangements but also off-loading of government activities to parastatals.

5. There are several motivations guiding the creation of government owned, funded and controlled by the government. Theoretically, it is expected that these parastatal function in a truly autonomous fashion with an arms-length relationship with the government. There should be clear demarcation between government's role as owner/promoter and as a client/customer. However, there are many autonomous bodies and companies that simply function as extended arms of the government and discharge basically functions that the government departments would have discharged or were actually discharging prior to creation of these parastatal. The driving motivation for the corporatization/ "society-fication" of governmental activities is to operate in a more relaxed environment, free from the usual constraints of funding and staffing. The functional Ministries/Departments both at Centre and the States detest the complex webregulations and procedures imposed by Finance/Personnel/Government Audit.It is argued that Government systems are highly bureaucratic involving too complex a web of checks and balances to the extent of frustrating the basic objectives of administration. Instead of remedying the root cause of this 'malaise' and liberating the bureaucracy from stifling regulations based on mistrust, the Government has found it more convenient it to create companies and societies with more "de-bureaucratized" operational structures subjected to laxer and different types of controls. Depending on which side of the boundary we are standing we can look at proliferation of such companies and societies as

aberrations and a dilution of accountability. Alternatively, we can also look at such structures as entities having a different accountability mechanism, where the accountability is – at least theoretically - in terms of outcomes and results rather than mere compliance to regulatory processes. The evolution of alternative governance structures per se is not the subject matter of this paper but it is being mentioned because of the increasingly felt need to get a total picture of public finances including the national government, sub national governments and public sector companies/autonomous bodies discharging governmental/ quasi-governmental functions. Purely commercial ventures of government - there are hardly any - which are to be clubbed with the country's corporate sector rather than with the Government sector are excluded from this reckoning.

6. The boundary line between quasi-governmental and purely commercial ventures taken at the behest of the government is thin and definitely creates problem for those engaged in compiling public finance statistics. The companies and State-run banks become convenient tools to hide true extent of government's indebtedness. The budget link with PSUs/ABs/PSBs is often somewhat fuzzy, offering plenty of scope for 'quasi-fiscal' activities.

'General Government' Accounting: Combined Finance and Revenue Accounts

7. The International Public Sector Accounting Standards Board (IPSASB) develops high-quality International Public Sector Accounting Standards (IPSASs), guidance, and resources for use by public sector entities around the world for preparation of general purpose financial statements. The aim is to two-fold: (a) to ascertain true extent of public exchequer's indebtedness, buried in the layers of complex web of relationships of governments with parastatal and (b) to arrive at cross country comparisons of 'consolidated public sector'.

8. The importance of such reporting on aggregates on what the government does directly through budget and through its sub-national governments and other parastatalhas been highlighted by the financial crises and fiscal crises faced by the different countries in recent years. After the 1998 South East Asian currency crisis, questions were raised on the efficacy of IMF in keeping proper surveillance on the emerging risks in various economies. It was therefore considered desirable to evolve new mechanisms of fiscal/financial reporting and their verification by international monitors. This resulted in the adoption of several codes by member countries of IMF including the

codes on fiscal transparency and financial sector disclosures.

9. That the IMF surveillance on fiscal/financial situation of countries has not been up to the mark has been amply demonstrated by the financial crises that gripped the United States and the European Unions in the last few years.

10. All countries want to present a very rosy picture of their fiscal situation to the international community and to their own public by resorting to all sorts of financial engineering. The Supreme Audit Institutions are caught in the dilemma whether and to what extent they should expose the window dressing of debt and deficit by their respective governments.

11. Every country would like to assert its sovereignty and try telling the world that it knows best what is suitable for it and why it can't get tagged to an international template. While to some extent these may be genuine concerns but often these are to conceal internal weaknesses. International community and the institutions like IMF/World Bank who are supposed to maintain a vigil and assist crisis-ridden countries in 'rescue operations' would like a credible surveillance of fiscal and external sector's 'true and fair' view. . The unique nature of the credit crisis and the unprecedented response by governments around the world has reinforced the importance of high-quality standards for financial reporting by governments and their parastatal . .

12. In terms of the Cash Basis IPSAS, not a single country in the world has actually adopted the standard. The main problem is the key requirement to produce consolidated financial statements for all controlled entities. Consolidating government business entities with ministries and departments would be very time consuming and almost all governments consider that it is not worth the very real costs."A Study on Gap Analysis of Indian Government Accounting with International Standards" a Research Study by GASAB Secretariat is relevant to consider. We need to work towards adherence to IPSAS.

13. For fair international comparison of India with other [non-federal] countries it is important to work out aggregated fiscal statements for "Central Government + All State Governments + substantially financed autonomous bodies" even if we don't include government's business enterprises, treating them all as commercial!.

14. The Combined Finance and Revenue Accounts (CFRA) brought out by IAAD provides fiscal researchers a ready reckoner of the profile

of public expenditure in particular functional areas at one place, duly consolidated, though not as summarised as it should be. The aggregated picture of 'general government' in India can theoretically be deduced from CFRA. However, it does not give the kind of fiscal aggregates IMF etc are looking for. This gap has since been filled up to some extent by another publication since 2007-08 called "Union and State Finances at a Glance". Recently, 2010-11 issue has been released, fourth in the series..

15. Besides preparation of Appropriation Accounts and Finance Accounts of individual States, IAAD is also preparing Combined Finance and Revenue Accounts. The CFRA for 2010-11 was put out in the public domain only in July 2012. Such delay reduces its utility. Despite its limitations, it has some values to the fiscal planners. If we have to move towards IPSAS, we have to expand the coverage of CFRA to consolidate the autonomous bodies and public sector discharging governmental/quasi-governmental functions i.e. excluding fully commercial government ventures.

16. In a federal set-up like ours, the sub-national entities like States/UTs have a sizeable share of public revenues and public expenditures. For valid international comparisons with other non-federal countries, such aggregation is required. CFRA has better alternatives like the "Public Financial Statistics" brought out by the Economic Division of the M/o Finance and the Annual Report of the RBI on States' Finances. However, "Union and State Finances at a Glance" which is essentially a summary of CFRA is definitely an improvement but it can be improvised further. Definitely CFRA should be more than mere compilation of fiscal statistics. It should contain meaningful analyses and commentary from the perspective of the "watchdog of country's finances". Perhaps it provides more academic freedom than in formal individual Audit Reports on Union and each State's finances. It can be CAG's report to the nation on the 'country's finances' [of course presently limited to Central and State governments but can later be enlarged to cover Public Sector and Autonomous Bodies, something what IMF etc are keenly looking forward to. That will also help us move towards compliance of IPSAS.

17. CFRA had greater relevance when central transfers to the States were largely through the State Accounts. Now State and District level societies and Local Bodies have joined the fray as significant recipient of Central transfers. Hence, CFRA needs to be expanded and redesigned. The CFRA data has in-built double counting of inter-

governmental transfers and presents both types of figures here and there. A consistent and standardized depiction of 'general government' aggregates on debt, deficit, taxation and sectoral spending is the basic requirement of a sound public financial reporting system.

18. As members of Indian SAI, we have to deliberate on the issue and formalize our position. Substantive Audit comments should flow based on CFRA. For example, in a certain sector increase in expenditure by the Centre may be accompanied by decrease in spending by the State(s) with general government expenditure remaining static or having declined in real terms. [This perhaps is the story of health, education and social welfare, as per an untested hypothesis.]

Accrual Accounting and non-cash based disclosures

19. The emerging risks hidden in the form of unpaid bills and other unfulfilled financial commitments do not get adequate attention in such financial reporting.Accordingly, from the days of the Committee on Fiscal Responsibility Legislation(2001), there has been a growing clamour for supplementing the government's cash based accounts with accrual-based accounts so as to capture the details of revenues due but not realized and expenditure commitments due but not discharged. The next logical extension of accrual accounting would be to look at the whole portfolio of expenditure commitments and revenue potential.

20.There are obvious difficulties in this venture. Prudent fiscal planners would like credible report of what is the 'due/collectible' revenue that can or should be collected but not collected so far and what is the magnitude of expenditure commitments in the coming years. In both the cases, there is a problem of defining a proper accounting standards to determine when do we consider a revenue as due/realizable and when do we consider expenditure commitment as 'due' - sacrosanct enough to start recording in official books. These questions are not easy to answer within the confines of the public accountant community. What tax is realizable and what is going to be the expected tax yield at different tax rates can be a contentious deliberation with no single credible figure emerging out of such deliberations. Likewise, on expenditure commitment side it is realized that there is a hierarchy of commitments. The most firm commitment is where the goods and services have been availed but not paid for. Next is the pool of goods and services, where supplies have been contracted for but not received. Next in hierarchy of commitments are the procurements and works or other services on which certain estimated expenditure has been "sanctioned" by a competent financial authority, whether or not the sanctions have been fully converted into contracts/supply orders. Up to this level of commitments (sanctions/contracts/unpaid bills), there is a fair degree of documentation and relative certainty about the financial implications of the commitment. However, there are higher level commitments contained in the annual and five year plans, long term perspective plans and manifestos of ruling parties, which may at one level be dismissed as simply aspirational in nature. Audit should be able to comment on the ability of the government, based on fiscal trends, to fund various commitments including that on planned development.

21. Finally, there is a set of indeterminate financial commitment, which is fast emerging as a new fiscal reality. This is expenditure commitment arising out of duly enacted laws, rules and regulations e.g. NREGA Act, Right to Education Act and the contemplated legislation on food security. The financial implications of the full-fledged implementation of RTI Act are now realised to be far higher than what was mentioned at the time of piloting the legislation in Parliament. Unlike typical sanctions issued by the HODs, which quantify time and cost, which some of us are used to auditing and commenting in Central Audit, these statutory commitments are expenditure sanctions at the highest level without specifying a time frame and a definite cost limit. In conventional sanction audit, if a government functionary issues a vague sanction, it would be challenged in Audit but these indeterminate expenditure sanctions being issued by Legislatures cannot be so challenged. Nevertheless, the financial commitments arising out of such legislations have to be factored in any assessment of the fiscal sustainability of countries' finances and hence it is incumbent upon us as members of the SAI to grapple with these issues. After all, the C&AG has been called by the Sarkaria Commission on Central State Relations "the watchdog of country's finances".

22.In this background, strengthening of public financial reporting requires supplementing the reports generated based on the accounting data by other non-accounts data. The accounts do not capture full fiscal reality.

23.We cannot dismiss non-accounts data as mere MIS generated by the departmental authorities. We have to evolve strategies to audit and validate such non-accounts information and comment on its quality and reliability.

Disclosure requirements under FRBM Act

24.Under Rule 6 of the FRBM Rules, 2004, the Central Government is obliged to include the following disclosure statements as part of the annual Budget presented to the Parliament.

a) Tax revenues raised but not realised (principal taxes)
b) Arrears of non-tax revenue
c) Guarantees given by the government
d) Asset register

25.Of these four statements, the first three are based on departmental MIS and can in no way be derived from government accounts. The fourth is also essentially departmental MIS but has some linkage with accounts. It can be reconciled with government accounts. However, no such attempt has been made so far. In fact, so far these statements have not received audit scrutiny and comment. This should be done. Same applies to similar disclosures under State FRBM Acts. Since the data in these Statements are mere aggregates of figures reported by lower formations of the government, their validity should be test checked from whatever subsidiary accounting records /files are maintained by them.

Recommendations of the 12th Finance Commission on reforming Accounting and Financial Reporting System

26.The 12th Finance Commission (2004) had given wide-ranging recommendations (vide Para 14.13 to 14.18). The Commission inter alia recommended a move by the Centre towards introduction of accrual accounting and standardization of accounting classification down to the object head for all States to improve fiscal management. The Government had accepted this recommendation in principle. The Government Accounting Standards Board was tasked to draw a detailed road map and operational frame work for its implementation.

27.The Commission had specifically recommended inclusion of following eight additional statements / information in Government accounts for greater transparency and to enable informed decision making as an illustrative list, pending transition from cash to accrual basis of accounting. (Although the Commission's recommendation was accepted in principle by the Government but this is yet to be fully implemented. This is a major part of unfinished agenda in strengthening public financial reporting though the 14th Report of the Administrative Reforms Commission did not carry an enthusiastic endorsement of accrual accounting.)

(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.

28.Of the above, some statements are based on non-accounts data compiled by the departments as internal MIS and also are matters of judgment. (For example, on quantification/assessment of 'implications of major policy decisions', there can be genuine differences of opinion between the authorities compiling the Finance Accounts and the respective government. Also, there could be definitional issues in deciding as to what constitutes 'committed liability', as discussed above.

29.At present, the definition of 'Asset' in the Finance Accounts is simply cumulative total of nominal sums accounted in various years as 'Capital Expenditure'. There is no provision for applying any appreciation/depreciation in the 'book value'. Provision exists for dropping the balances pro forma for assets lost/written off but one cannot vouch for the completeness of this process. Thus, the 'assets' may probably include the price paid for all those fighter aircrafts that have fallen off from air. Erosion of capital value invested in physical assets owing to poor maintenance and security is not factored. Encroached upon public lands do not find reflection in the change in the book value. Since lands are valued in the accounts at acquisition cost, these assets remain grossly under-valued providing scope for exercise of discretion unfavourable to public exchequer.

30.Presently, the Audit comments relating to significant deficiencies in the presentation (accuracy, completeness and transparency) of the Accounts and the Audit comments on Appropriation Accounts are discussed in the Audit Reports on Union /State finances. The observations on regularity, economy, efficiency and effectiveness of Government spending are incorporated in Compliance and Performance Audit Reports presented separately.

Need of standardizing parastatal accounting formats and framework

31. An important area of public finance reporting that needs our attention is the fund flow to parastatal. There is sporadic reporting of parking of funds with PSUs, autonomous bodies (including State and Distt level societies, Boards and Authorities etc). Generally we do regular reporting of outstanding Utilization Certificates for grants-in-aid. However, unspent balances available with implementation agencies at different nodes of long and complicated fund flow chain seldom get reported regularly. Tracking of unspent balances with implementing agencies should be an important area of improvement in public financial reporting.

32.The absence of financial reporting formats in the implementing agencies has to be addressed. The GOI has prescribed formats for central autonomous organizations only (GFR 209(6)(xiii). The same should be extended to all grantees- central/state Government or private- recurring or non-recurring grants. The ICAI should be made to give a directive to the CAs that they should insist on a minimum of Receipt and Payment, Income and Expenditure/ Profit and Loss Account, Balance-sheet, Cash Flow Statement, Accounting Policies and Notes to accounts to enable attest audit. The CAs certify financial statements presented in any format by just saying that they are in accordance with the books of accounts. This is not a true and fair view of their accounts that the stakeholders should have. This is because the Acts under which the bodies are registered (like the Societies Registration Act, 1860, Indian Trust Act, 1882, Charitable Endowments Act, 1890 or the Cooperative Societies Act of various State governments.) do not have any sections or clear provisions on accounts and audit The implementable solution is to insist on accounting formats and frameworks as prescribed by the Union Government (as it is not necessary to reinvent the wheel) and to discipline the CAs. The message should reach the DLFAs also where they are primary auditors.

33.At the moment the details of direct transfers to implementing agencies are available in the central budget and in the Appendix to Finance Accounts of State governments, though we in Audit are not in a position to vouch for the COMPLETENESS of this information. To get the correct balances, audited statements of implementing agencies are necessary. To have reliable figures, stable accounting framework is necessary. Also the accounts and audit should be done on time. In this connection, it is apt to study an order of Karnataka Government (No. FD 03 TFP 2012 dt. 27th April 2012 on "Accounting of Direct Releases of Funds by Government of India to the State Implementing Agencies" is relevant. It seeks to account for direct transfers in the budget on the receipt and expenditure sides. Though not a full solution to the problem, it can be a beginning on which some more thinking can be done. May be, the State Governments can give a statement to the budget on the amount transferred and the unaudited balance / audited balance as on 31 March of the previous financial year.

34.In the Report on Union/State Finances, we should attempt to give information on liabilities of the ABs and non-profit PSUs. This is a very possible and valuable addition. We can identify clear and contingent liabilities of Central and State PSUs and Abs, which are totally dependent on the Government and also the capture the amounts shown as receivable from the Government in their final accounts and debts, which are serviced through innovative structures like lease rent paid by Railways to IRFC.

Overlap in 'Public Financial Reporting' by IAAD through State Appropriation/Finance Accounts and Audit Reports on State Finances

35.In general, the accounts and the audit reports are to be treated as a single aggregate report to the stakeholders even though some Audit comments may be embedded in the document containing the accounts and some may appear as separate volumes containing only Audit findings. That is a matter of convenience. The more exhaustive the 'Notes on Accounts' prepared by the Management are, less is the scope for the auditors to comment on accounts. Needless to say, the content of the "Audit Report on State Finances" will be greatly influenced by the content of Appropriation and Finance Accounts. What PAG/AG(Audit) has to say in the Audit Report would critically depend upon what the PAG/AG(A&E) has left unsaid in the Accounts documents. Concurrent audit can help AG(A&E) plug the gaps and add proper disclosures and explanatory notes in the accounts. The scope of improvement – by way of sharper / deeper analysis / commentary – exists not only in the Audit report on State Finances but also in the

Appropriation and Finance Accounts. Some such areas of improvements are discussed below.

Role of State Government in preparation of Appropriation and Finance Accounts

36.Carryingforward the analogy of Management's Notes on Accounts in commercial parlance, there is a case of revisiting the extent to which the State Governments have a say in deciding the structure and presentation of Appropriation and Finance Accounts. If the accounts prepared by PAG/AG(A&E) are not acceptable to the State Governments, there should be fair reporting of such differences. In fact, one extreme view can be that the PAG/AG(A&E) should prepare Appropriation and Finance Accounts in consultation with respective State Government giving due primacy to Government's viewpoint and the CAG's views/comments should then be in the Audit Report on State Finances. If both – the annual accounts and the audit reports – are to be prepared only from the viewpoint of IAAD's two different wings, the State Governments can legitimately disown the accounts so prepared. In fact, there is evidence to this effect. Some States are not using the fiscal data contained in the 'Accounts prepared by the IAAD and audited by the IAAD'. They are using their own 'departmental actuals' in their Budget and Plan documents and all other fiscal planning and management. This is so where there are serious problems of reconciliation and quality of accounts as prepared by IAAD is suspect. We have to insist that only the figures appearing in the duly audited and certified Appropriation and Finance Accounts are used in the Budget documents.

Areas of improving the content and presentation of the Audit report on State Finances

37.Since April 2012, restructuring of all Audit Offices in all the States/UTs has come into effect. The prime objective of restructuring is to imbue an integrated perspective to our audits, by integrating audits of government offices, special purpose agencies, local bodies, parallel bodies, autonomous bodies, PSUs, etc. into suitable sectoral audits, such as 'social', 'economic', 'general' and 'revenue'. The restructuring affords us an opportunity to position CAG's annual report on State Finances as the CAG's report-primus for a State. It should cover all aspects of State Finances comprehensively; such as resources and application of funds, management of cash flow, debt, deficit, subsidies, guarantees, financial performance indicators of state PSUs, funds flow to parastatal and availability of unused resources etc.

38.In a State that has more than one audit office, the office of PAG or AG (Audit)-I is expected to prepare this report, under the specific charge of a senior Group Officer, in a collegial manner with inputs from the other AsG, including AG (A&E). In a State, where there is a winter session of the State Legislature, this report is expected to be presented to the State Legislative assembly in its winter session. With a comprehensive CAG's report on State Finances, there should be no need to repeat financial information in other audit reports as is presently done in chapter 1 of the Commercial and Revenue audit Reports. Indeed, observations on significant fiscal aggregates and fiscal indicators made in CAG's report on State Finances could (and should) be linked to relevant findings of compliance and performance audits in other (sectoral) audit reports.

39.The content and structure of the Appropriation and Finance Accounts themselves have been going through incremental changes over the years. There have been several and continuous efforts in the past to improve the quality of Audit Reports dealing with review of government accounts and finances. The Central Audit Report no. 1 of 2001 marks a significant departure from past practice in presenting Audit comments on the Appropriation and Finance Accounts. It was decided to bring out a separate report entitled ' Report on State Finances' from the year 2009 onwards to bring the State finances to the centre stage. It was further decided in the Workshop of the Report States Wing held in New Delhi in February 2010 to study and suggest an action plan to improve the content/quality of Report 1 on the State Finances. Some of the areas identified for focused Audit comment were as follows:-

- Audit of budgetary assumptions including those for supplementary grants.
- Adequacy of disclosures relating to sources of financing of fiscal deficit, outstanding liabilities including off-budget borrowings and implicit and explicit subsidies in the budget.
- Disclosure of unspent balances lying with the local bodies etc in the budget out of the funds transferred by the Government and the mechanism for their monitoring.
- The quality aspects of the asset accounting like confirmation of the outstanding liabilities by the lending agencies, physical verification of assets (shares etc.) by the concerned departments etc.
- The position of reconciliation of balances lying at the credit in the

deposit accounts and quality of investments made by the Government.

- Adjustments/transfers/Nil payment vouchers to various final accounts, deposit accounts, amounts kept outside the Government Account, etc. and justification of such transfers and continuation of such PDAs/PLAs.
- Status of reserve funds and transfer of its balances to Consolidated Fund of the States.
- Utilisation certificates.

40.Audit Reports on State Finances are patterned on the prototype of the Report circulated by Headquarters in letter no.1216/ Rep(States)/ Coord/ SAR-State Finance/2009 dated 4 September 2009. Furtherrefinements in the Audit Report on State Finances have been circulated by DG(ER) vide 112-ER/28/Co-ord/State Fin./2012 dt. 12 June 2012.

41. The existing template of the Report is supposed to provide a common framework but it should not mean that the entire effort of report writers should be to merely fill the details in the template. It is expected that the template would be supplemented with State-specific narratives and conclusions. A review of select State Audit Reports on State Finances shows that the main emphasis is on template-filling only. The overview chapter which is supposed to bring the perspective and holistic assessment on the health of State finances lacks punch. It is extremely guarded recapitulation of facts contained in the Report rather than a commentary on the resulting scenario. There is wide-spread use of 'textification of data tables', which perhaps only irritates the discerning reader. The comments should go deeper to note merely state the fact of variations/growth but the material factors contributing to such variations/growth.

42.A very important gap is the endogenous nature of Audit comments based exclusively on the accounting data, with all its imperfections whereas in the fiscal and budgetary policy discourse the accounts are secondary inputs. The structure of Accounts that has not been revised for long to reflect contemporary trends in budgeting is not very helpful to fiscal planners. They only source the accounts for raw data. The gap between Budget and Accounts in terms of data aggregation methodology is an important matter which itself should invite serious Audit comment. For example, Central Government's Budget documents contain budgeted figures (Expenditure Budget Vol I, II and Receipts Budget) for which no corresponding actuals are reported in the Appropriation/Finance Accounts, mainly due to Gross/Net differences and aggregation of scheme data at one place in the budget while scattered in the Accounts(direct expenditure/grants/loans).

43.One of the identified problems in the public finance reporting is the divergence between Accounts on the one side and the Budget/Economic Survey on the other. The presentation of receipts, expenditures and fiscal aggregates is different in these public documents. The divergence of Annual / 5 Year Plans and Budgets is another important gap in the public financial reporting system. The Audit review should attempt to take a holistic view of the Plan-Budget-Accounts-Economic aggregates trilateral divergence. The divergence becomes a selective source of suppressing inconvenient information in a mass of data. Over-disclosure of data without meaningful and truthful analysis actually harms the cause of fiscal transparency.

44.We need to demonstrate the ability to interpret macro-economic data in auditing perspective for general readers. The economists usually take the raw accounting data and put it through their econometric models. They do not fully factor the nuances of government accounts and the gaps/ inconsistencies/ misclassifications in these government accounts that can materially affect their conclusions. Thus, their impressive technical insights & conclusions are vitiated by this warped view of accounting data. (For example, they miss out the effect of 'expenditures' in accounts which are mere transfers to reserve funds, civil deposits and public deposit accounts. Likewise, the unspent funds available with implementing agencies which in accounts get included as final expenditures, vitiate the conclusions. The accounts show expenditure but it may be a mere expenditure on paper, not final expenditure for the intended purpose.) The task of macro-analysis of public finances and then presenting these findings to a general audience of politicians and bureaucrats can be undertaken by HQrs office in the final stages of processing of Audit Reports. There is a strong case for engaging with academic community and public finance analysts/practitioners through workshops/seminars - say through NIPFP - to sensitize them to these issues each year analysing financials of Union and State Governments and audit findings thereon.

45.For such a holistic report, we have to augment our comments based solely on accounting data to external reference data like the Central

Budget & Economic Survey, Planning Commission and the Finance Commission. Some special enhancements in the States' Audit Report Primus not attempted earlier are proposed as follows:-

- Movement of receipt /expenditure profile and key fiscal aggregates in relation to GSDP and GDP to highlight the State's contribution to national economy and general government public finance profile
- Movement of receipt /expenditure profile and key fiscal aggregates in relation in real and nominal terms to highlight REAL growth
- Assessment as to what extent the underlying assumptions behind the 5 year Plans and the Finance Commission's package of devolution of Central resources to the State are matched by actual fiscal outcomes or identified reform measures to be taken
- Movement of receipt /expenditure profile and key fiscal aggregates in relation to parameters of 5 year Plan formulation like the BCR- Balance from Current Revenues, ARM- Additional resource Mobilization, Resource contribution vs State PSUs, States' Own Resources and States' Own Expenditure (other than Centrally financed) with comment on significant deviations and their impact
- Movement in State Indebtedness parameters in economic terms
- Financial health of State parastatal – the State PSUs and substantially financial grantee bodies
- Status of implementation of the recommendations of the State Finance Commissions

46.In commenting on 'expenditure' by the State, we can meaningfully talk of 'actual final expenditure' in addition to the expenditure shown in the accounts books, i.e., expenditure in accounts minus the unspent amount in reserve funds, civil deposits, personal deposits and unspent cash balances of implementation agencies.For accounting for the amounts parked in Funds/Deposits, we have to arrive at the figures carefully with due segregation of firmer liabilities like civil deposits from those under reserve funds. We may have to insist on rules for operating such accounts so that non-admissible expenditures are not accounted for. For example, in Karnataka the expenditure incurred on a guarantee invoked, instead of being classified as loan to the beneficiary (as per Indian Accounting Standard on guarantees published by the MOF) has been debited to the Fiscal Management Fund. (Page 47, Chapter 1, State Finances Report 2010-11).(Since a sizeable expenditure remains on paper, this is likely to be a major highlight of the report. Rising balances in the deposit accounts have found comments in many State Audit reports. Besides the system of large amounts being drawn in advance on AC Bills, some States also allow DDOs to draw lumpsum amounts from treasury to be kept in separate bank accounts. We need to put all these in the broader perspective of States' overall fiscal performance.. Time difference between financial and compliance audit is something, which needs to be addressed through effective risk assessment and audit planning.

- There is anecdotal evidence pointing to the following trends (An important objectives of this review would be to test if and to what extent such pointers are truthful.)
- Overspending by Centre without matching intended results
- Marked variation in performance of State governments
- General under-spending by States
- Poor state of delivery mechanism – leakages, inefficiencies
- High cost of public delivery

47.The deep inter-linking of Central and State finances is too well known to be highlighted. Over the years, the States' financial dependence on the Centre has increased sharply. The Finance Minister elaborated at length in his reply to the general budget, how the transfers to States have sharply increased over the years especially in last 10 years. The general picture appears to be that the States' own expenditures have contracted in tandem with Central fiscal expansion with overall public expenditure levels remaining more or less constant as % of GDP. The aggregate public expenditure of the Central and State governments may have actually declined in real terms in many sectors. The internal resource generation of many States has been robust but this has not translated in matching increase in their expenditures financed from own resources. Also, the nature of internal resource generation (like mining, disinvestment, selling natural resources) and its long term sustainability and its social, economic and environmental costs needs to be suitability highlighted in the Audit Reports.

48.In the Constitutional scheme of a unified Audit machinery for the Centre and the States with CAG's role in the framing of the form of government accounts, the CAG comes out as more than a mere auditor of individual governments. He is to borrow a phrase from the Sarkaria Commission is the 'watchdog of country's finances'. Hence, in days of a fractious polity affecting both the governance and finances, the CAG as an independent, apolitical institution can provide the voice of reason above politics. The edge of political contestability can be blunted if the Audit Reports meaningfully comment on contribution to, allocation from and usage of national resources to States.

49.In this context, it becomes imperative that the general public gets to know as to what is the CAG's holistic take on the state of public finances. The propaganda machinery of the governments (both the Central and States) would like to present only a brushed up picture through their economic surveys, budgets and publicity material.

50.The official documents hide more than they reveal. For example, it is a verifiable fact that the general government expenditure (Centre + States) is even now at 26-27% of GDP as was say in 1990-91 despite a number of major schemes / programmes announced by Centre. While the Centre has expanded, States have contracted. Centre is running high debt and deficit, States have reduced their and sitting on piles of unutilised cash. Almost all States have had large cash balances for extended periods. The general picture appears to be that the States' own expenditures have contracted in tandem with Central fiscal expansion with overall public expenditure levels remaining more or less as % of GDP. The aggregate public expenditure of the Central and State governments may have actually declined in real terms in many sectors. The irony is that we, having access to both the Central and State accounts, have not been able to effectively tell this to the nation!

51. The Government of India is now seeking a review by the C&AG on the implementation of the Fiscal Responsibility and Budget Management (FRBM) Act. It has amended the FRBM Act through the Finance Bill presented with Budget 2012-13 to not only postpone the revenue deficit reduction target but also to have an enabling provision for a CAG review of the Act's implementation.Shouldn't we have a CAG's version of the Economic Survey for the Centre, for each State and for general government (an integrated report covering both the Centre and the States) that can serve as an Audit verdict on the health of nation's public finances?It would be ideal to dovetail our exercise to improve the content and impact of the Audit report on State Finances with the exercise of FRBM review.Though we cannot do so at the Central level but at State level, bringing proper balance between the content of State Appropriation and Finance Accounts on the one hand and the 'Audit Report on State Finances' on the other requires careful deliberation.

52.Needless to say, long-winded narrations, which are mere 'textification of data tables' should be avoided. We have to go behind numbers, disaggregate and look for material variations and their causes.

53.The above are generic suggestions for improving the content of the Audit Reports on Union/State Finances. Many of the above can also find overlapping coverage in the Appropriation and Finance Accounts through appropriate 'Notes on Accounts' and say an appreciation note on the state of accounts. It may be from the perspective of the Accounts office/concerned government and may not fully provide a critical view that can come in the Audit reports on Union/State finances.

Curtailment of time lag in finalization of accounts

54.The information contained in the Accounts and other reports generated by Accounts offices can be useful feedback to the management only if it is received in time. Despite advances in ICT, considerable time lag continues to exist in providing monthly and annual accounts after the month/year is over. While Accounts offices can account for the time lag and how much of it is beyond their control, but the fact remains that the utility of the Accounts to the management is considerably diminished by the time lag.

Improvement in quality of accounts

55.Apart from time lag, the quality of accounts is also an issue in many States. The position of reconciliation in 2010-11 is less than 10% in two major States of Bihar and West Bengal while 100% in Chattisgarh, Gujrat, Haryana, Himachal Pradesh, Nagaland, Punjab, Rajasthan, Tamil Nadu and Tripura. We have to deliberate whether it is worthwhile to present State accounts that do not carry a certain minimum level of reconciliation, say 95%? Un-reconciled outstanding balances carry risk of concealment of frauds and need closer attention.

56.The process of reconciliation needs to be streamlined to improve quality of accounts. In some States, the Accounts offices do not provide detailed output of VLC system to the Controlling Officers/DDOs suomoto. In some cases, the Controlling Officers do not get any regularly update even on a summary basis. The departments get to know what is there in VLC only when their teams visit the Accounts office for 'reconciliation'. The reconciliation may not be that a serious an issue in a few A&E offices dealing with computerised/networked treasuries and securing matching with or without many Transfer entries, but for most Accounts offices, handling a large number of departmental reconciliation teams is a major logistical problem. It is recommended that VLC data may be proactive pushed to the departments to facilitate the reconciliation process. Instead of supplying VLC output 'on demand', the Accounts offices must resort to supplying the information suomoto. ICT channels should be used for fast and paper-free transmission of the information.

Need of standardization of public financial reporting and comprehensive coverage of all entities

57.The following issues are framed for discussion by the Conference: Whether all the above mentioned documents proclaim and actually follow any pre-set Standards? Are those Standards kept up-to-date with best professional practices at home and abroad? Whether we need to follow international standards or devise our own? Who should be recognized as a Reporting Entity bound by certain standards of financial reporting? Whether the same standards should apply to all authorities entrusted with power to collect and spend public funds? Whether we should move from entity accounts towards consolidated accounts of inter-related entities? What value addition can be done to the documents generated by IAAD pending adoption of formal Reporting Standards covering all public entities?

58.It is axiomatic for the sake of consistency and inter-entity comparability that Public Financial Reporting is done in accordance with certain formally prescribed Standards. Accounting standards are standards for financial reporting (in the form of General Purpose Financial Statements) by entities in the public and private sectors. There are currently two sets of international accounting standards for entity financial reporting (a) International Financial Reporting Standards (IFRS) issued by the International Financial Standards Reporting Board (IFRSB) provide for financial reporting standards for commercial entities including Governments' Business Enterprises. (b) International Public Sector Accounting Standards (IPSAS) issued by the International Public Sector Accounting Standards Board (IPSASB), which is part of the International Federation of Accountants (IFAC), provide for financial reporting standards for public sector entities (including sovereign governments but excluding Governments' Business Enterprises). Initially, financial reporting standards were developed by national accounting bodies. The International Financial Standards Reporting Board (IFRSB) is an international body created by national accounting bodies to establish the IFRS as international financial reporting standards. IPSAS have been developed from IFRS specifically to be applicable to public sector entities.

59.Statistical reporting systems have been introduced by international bodies to gather information on countries in order to provide cross-country comparisons on a standardised basis. There are three systems for statistical reporting by countries (financial and non-financial). The UN System of National Accounts (SNA-1993) promulgated by the United Nations provides a framework for countries to report in a standardised format information of a financial and economic nature about each sovereign entity. SNA has been revised in 2008. The second is the Government Finance Statistics Manual (GFS-2001) issued by the International Monetary Fund (IMF) laying down a system for each country to report on Government financial information. GFS-2001 is harmonized with SNA-93. The European System of National and Regional Accounts (ESA 95) issued by the European Statistical office, which is followed by all European countries, provides for information covering both UNSNA and GFS. All countries except those reporting under ESA 95 or other regional systems follow GFS-2001. Actually, GFS-2001 is SNA-93 compliant standard for financial reporting. Basically, SNA 93/ ESA 95 are the umbrella standards for macro-economic statistics by governments to international community. The IMF GFS is concerned exclusively with financial information on the General Government Sector. The coverage of the UNSNA and ESA 95 extend beyond financial information on the government to national economic data.

60.The Government Finance Statistics Manual 2001 (GFSM 2001) brought out by the IMF Statistics Department's, an update on the 1986 edition of 'A Manual on Government Finance Statistics (GFSM 1986)'. GFSM 2001 describes an integrated statistical system that is harmonized, to the extent possible, with the 1993 edition of the 'System of National Accounts (1993 SNA)'. GFS-2001 compliance yields a set of interrelated statements - derived from the 1993 SNA - that integrates flows and stocks. It covers concepts, definitions, classifications, and accounting rules, and it provides a comprehensive analytic framework within which the statistics can be summarized and presented in a form appropriate for analysis, planning, and policy determination. Currently the 2001 GFSM is in the process of being updated to reflect the changes made in the SNA revision in 2008.

61. In response to rising concerns by users who are experiencing

difficulties in understanding and reconciling the macro (statistical) and micro (public accounting), an international project was launched in 2003 for the greater harmonization between statistical and public accounting systems.

62.The Budget formats and reporting of fiscal statistics by the Central government is supposed to be based on IMF's GFS-2001. IMF from time to time conducts appraisals. The Central Budget is loosely anchored to GFS2001. Since the Budget and fiscal reporting is based on the Government Accounts and under Art 150 of the Constitution, the form of accounts of the Union and the States is prescribed by the President on the advice of the CAG (except in J&K where it is prescribed by the CAG with the approval of the President) and now GASAB is in place, it is imperative that all accounting norms followed Central and State Governments are comprehensively studied for their compliance to GFS/IPSAS. GFS itself is under revision and there is a move to harmonize it and converge it to the IFRS inspired IPSAS. The trend is to extend ideas applicable to business entities to General Government, with appropriate adaptation, including accrual accounting to get comparable fair valuation of the assets and liabilities of the governments and the soundness of their finances.

63.We have so far not carried out any formal assessment whether and to what extent the public financial reporting by governments in India is compliant with IPSAS and GFS-2001. Art 150 of the Constitution has not been effectively used to institute a strong, stable and consistent Financial Reporting Framework for Accounts, which should by proxy extend to Budgets as well. Further, The Financial Regulatory Framework is not uniform across the Union and the States. Non-standard deviations have emerged in Financial Codes and Manuals.

64.The Budget templates have historically evolved from the accounting framework, as value addition around 'Annual Financial Statement', the statement of 'major head-wise' budgeted receipts and expenditures. The Appropriation and Finance Accounts do not conform to any declared Standards though of late some peripheral areas of reporting have been covered by statutory notifications based on GASAB recommendations. As stated above, the Central Budget is loosely anchored to GFS-2001. Both the need to source international funding and the declared policy of seeking integration rather than isolation from international community call for adherence to international standards rather than continuing with our own. It is recommended that a process be formally initiated by the HQrs office under Article 150 of the Constitution for getting the financial reporting standards compliant with international standards (GFS-2001 and IPSAS) prescribed through statutory notifications with full scope coverage. The grace periods for compliance to various stages may be built into the notifications so that there is a sound legal basis for accounting reforms in the years to come. Simultaneous capacity-building program should be undertaken to restructure financial attest audit practices to verify compliance to standards so as to enrich the Audit Reports on annual accounts of the Government and CAG reviews on compliance to FRBM legislations by the Centre and the States.

65.Ideally authority to spend/collect public funds must accompany the responsibility to generate standard financial reports. Since the numbers of DDOs is very large, we should aim at such compliance at least at CCO/HoD level. Further, we should also work towards evolving and refining systems of aggregating public financial statistics of national and subnational governments and parastatal. While the stand alone accounts of all Reporting Entities should be covered with formal reporting standards in medium term (say 3 years), eventual move towards preparation of consolidated accounts should be an aspirational goal (say 5-7 years).

66.The present reporting by parastatal (the autonomous bodies, societies and trusts especially at State /District level) is highly minimalistic and in the nature of donor reporting (Utilization Certificates without audited statements of compiled accounts conforming to a standard chart of accounts.) The framework mandating them to prepare General Purpose Financial Statements for stakeholders is rather weak. For Central Autonomous Bodies, a standard template for financial statements is in place but there is no standing mechanism for its regular updating. Likewise, Municipal Accounting is anchored to the National Municipal Accounts Manual for which there is no standing mechanism for updating. Incidentally, the International Public Sector Accounting Standards (IPSAS) also apply to local authorities.

67.Besides the sub-national governments, urban/rural local bodies and host of societies/trusts, the PPP operators / concessionaire and revenue/production sharing contractors have also emerged as extended arms of government. Fiscal transparency requires proper disclosure and standardized reporting by these non-government entities for a proper assessment of the financial rights and obligations of the government and Audit assurance. We have to catalyse the process of evolving suitable reporting standards within the framework of FRBM legislation.

68. It is recommended that GASAB should take the initiative to start consultative process for integrating/harmonizing the existing reporting practices by parastatal with IPSAS, a live and regularly updated accounting standard.

69.The above is an ambitious agenda sounding too aspirational but this is the direction for both A&E and Audit offices to move to next levels of excellence. The accounting reforms process is already underway, triggered by the 12th Finance Commission recommendations and FRBM legislation providing for increased fiscal transparency. The Sundermurthy Committee Report on revision of List of Major/Minor Heads of Accounts and the pilot projects on Accrual Accounting should be used as an opportunity to usher in accounting/reporting standards, notwithstanding the not-so-encouraging tenor of the 2nd ARC and 13th Finance Commission reports. We should take this opportunity to overhaul our VLC systems, embed in it accrual elements and seek standardization at object head levels across the Centre and the States.

70.The above is not just an agenda for GASAB and Accounts Offices but for Audit offices as well. IPSAS is a response to calls for greater government financial accountability and transparency. IPSAS compliance will also enable us to achieve greater compliance towards International Standards on Auditing. It has been said that wars are too important to be left to generals. Likewise, government accounting is too important to be left to accountants alone. Being a catalyst in standard setting will enrich both streams of our work in IAAD.

RECOMMENDED READINGS

The websites of International Public Sector Accounting Standards Board(http://www.ifac.org), International Monetary Fund (http://www.imf.org) , Ministry of Finance, Controller General of Accounts, Planning Commission, Reserve Bank of India and the Institute of Public Auditors of India are recommended for browsing. In particular, the following documents may be looked into.

i. International Public Sector Accounting Standards (32 notified so far)
ii. The Government Finance Statistics Manual, International Monetary Fund (2001)
iii. IMF Code and Manual of Fiscal Transparency, International Monetary Fund (1999)
iv. Report of the High Level Expert Committee (HLEC) on Efficient Management of Public Expenditure, Planning Commission, (2011)
v. Reports of the 12th and 13th Finance Commissions, Ministry of Finance.
vi. Report of the Committee on Fiscal Responsibility Legislation, Ministry of Finance (2000)
vii. Fiscal Responsibility and Budget Management Act, Ministry of Finance (2003)
viii. Fiscal Responsibility and Budget Management Rules, Ministry of Finance (2004)
ix. Report of Task Force on Implementation of the FRBM Act, Ministry of Finance (2004)
x. Report of the Advisory Group on Fiscal Transparency, , Reserve Bank of India (2001)
xi. Report of the Core Group on Voluntary Disclosure Norms for State Governments, Reserve Bank of India (2001)
xii. Report of the Standing Committee on International Financial Standards and Codes (2002)
xiii. Annual Reports of the RBI on 'Finances of State Governments'
xiv. Annual Public Finance Statistics, Ministry of Finance
xv. Combined Finance and Revenue Accounts, CAG of India
xvi. Accounts of the Union and States at a Glance, CAG of India
xvii. Report of the Expert Group on Review of Classification System for Government Transactions, Ministry of Finance (2004)