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INVITATION FOR ARTICLES

The Indian Journal of Public Audit and Accountability welcomes original articles of professional interest. The articles should broadly cover aspects relating to Public Accountability, Financial Management, Accounts, Audit, Public Administration with focus on Good Governance.

Ideally the article should be between 3000 and 3500 words and should not normally exceed 5000 words. Short articles on topical interest are also welcome which can be included in Commentary Section of the Journal. They should preferably be between 1000 and 2000 words.

Two printed copies of the articles should be submitted along with a soft copy in a word processing format. Articles can also be sent by e-mail followed by hard copy by post.

Articles in Hindi are also welcome, which will be published in original. They should preferably be in simple spoken Hindustani language format. An abstract of the article in about 100 words should also be sent.

EDITORIAL

While the Central Government employees wait eagerly for Government decision on Sixth Pay Commission recommendations, in this issue we feature a very illuminating article by Dharam Vir that critically examines, in particular, its recommendation on reforms in administration.

Dharam Vir has questioned the introduction of pay band system by the Commission concluding that it may not have the desired impact on the quality of administration. On the other hand, the pay band system may result in diminished incentive for performance. He also fears that the proposed pay band system may have the merit of alleviating frustration amongst employees. He concludes "Prescribing pay bands and expecting that these would be leveraged to rationalize structures, organizations, systems and processes would appear to be turning conventional wisdom on its head."

Dharam Vir also questions the wisdom of inclusion of administrative reforms in the terms of reference of the Pay Commission; the recommendations on such reforms of the Fifth Pay Commission largely remained unimplemented.

India is now rapidly becoming a globalised economy and in that context, issues of tax reforms, tax administration and audit of tax revenue have thrown up challenges as never before. K.P. Sasidharan's article on 'Tax Reforms Issues' gives an overview of important research findings on such reforms and their implications for tax administration from organizations like IMF, World Bank, OECD studies as well as reports of the Tax Reforms Committee of the Government of India. The paper highlights tax reforms, procedures and practices in various developed and developing countries. The article also discusses how the tax administration in India is gearing up to keep pace with the momentous changes in international trade, e-commerce, new business structures, innovative financial products and technological advancements in this area.

Everybody agrees that audit has an important role in promoting good governance. Dr. Banerjee's article on "Role of Public Audit in Good Governance" has described this role in a global perspective. The author has also illustrated from the Indian experience in this regard the impact that the CAG has made in this direction. The high point of all this is that audit contributes so much towards good governance

at a very nominal cost – expenditure of audit was only 0.041% of the total expenditure and receipts of the Union and State Governments audited in 2005-06 – it pays back to exchequer much more than what it spends.

Sangeeta Choure deals with an emerging audit area of considerable interest to the IA&AD viz. Audit of Toll Collection contracts. Given the new policy initiatives in public private partnership in infrastructure projects a large number of such cases will attract audit of CAG. Her article includes several interesting audit case studies on toll audit, mainly drawn from CAG's Audit Reports on Government of Maharashtra. These studies bring out the deficient areas of contract management on the part of Government/ PSUs engaged in this activity.

S.K.F. Kujur has focused on one of the key Government policies in power sector viz. rural electrification and has analyzed what ails this programme. He has specifically dealt with rural electrification issues in Jharkhand State and has offered useful suggestions for improving the matters.

In the Document Section, we have included the document "Rules for Approving Research and Development Projects by IPAI" which were framed and recommended by a Special Committee constituted for the purpose. The Institute is now well established to go in for such research to advance the discipline of public auditing and accounting.

Disclaimer:

The views and opinions expressed in the articles are entirely those of the contributors and do not reflect the official policy of the Institute.

SIXTH PAY COMMISSION AND REFORMS IN ADMINISTRATION

Dharam Vir [*]

Introduction

The primary and commonly understood function of the pay commissions is to define the basic and guiding principles of compensation packages for Government employees and to recommend scales of pay of different categories of staff to bring them in alignment with the prevailing conditions. Accordingly, the first four Central Pay Commissions dwelt extensively on application of concepts like '*minimum wage*', '*basic wage*', '*living wage*', '*Government as a model employer*', '*Government as a good employer*' etc. besides suggesting scales of pay for different categories of staff**.**

Administrative reforms were neither specifically included in the terms of reference of the first four pay commissions nor were these significantly factored in their recommendations, though the Second Pay Commission (1957) made an important recommendation for pooling Secretariat and attached offices into a single headquarters organisation and the Fourth Pay Commission (1986) recommended undertaking a careful exercise to reduce the surplus staff for releasing some funds to meet a part of the additional expenditure arising out of its recommendations.

Fifth Pay Commission

The inclusion of administrative reforms in the terms of reference was a major innovation when the Fifth Pay Commission was constituted in April 1994. The Commission was specifically mandated to examine the work methods and work environment as also the variety of allowances and benefits available in addition to pay to Government employees and to suggest rationalization and simplification thereof with a view to promoting efficiency in administration, reducing redundant paper work and optimizing the size of the Government machinery.

The Commission commissioned 19 studies through research institutes of excellence; nearly two third of the studies related to matters connected with promotion of efficiency in administration. The members of the Commission held detailed discussions with these institutes, studied the matter during their visits to Malaysia, New Zealand, Canada and the United Kingdom and exhaustively dealt with the subject of public services management upfront in Part II of the Commission's report (January 1997) immediately after the introductory Part I i.e. before getting down to the core issue of determination of compensation packages. This was the first occasion that a pay commission had taken recourse to consultancy services.

In what may be described as a major overdrive, the Commission's Report ranged over the entire gamut of issues relating to public services management, from what Government should or should not do, to how what needed to be done should be done. More specifically, the Commission recommended exit of Government from non-

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essential activities, abolition/ realignment/ merger of certain Ministries/ Departments, optimizing the size of Government machinery and right-sizing of Ministries/ Departments dealing with subjects that should be with the State Governments, discontinuance of a large number of the Centrally sponsored and Central sector schemes, enhanced delegation of powers to the Ministries/ Departments, delayering and limiting the number of hierarchical levels for decision making to three, gradual replacement of the vast army of ministerial staff by Executive Assistants with Group 'D' being treated as multi-skilled functionaries, automation, management information system, recruitment, training and development, performance appraisal etc. The Commission also made specific recommendations for promotion of openness and transparency in administration, insulation of the civil services against extraneous considerations and pressures, improvement in work culture and environment, reduction in the number of days of casual leave admissible to staff, staff morale and motivation, and accountability, productivity, and responsiveness of administration.

The Commission emphasized that its recommendations relating to all aspects should be viewed holistically, and the inter-connectedness of the various elements of its report should be kept in mind while taking individual decisions. The Commission entered the caveat that the size of bureaucracy had to come down drastically and the public servant had to be much more productive and accountable.

A consolidated report card on the implementation of the recommendations of the Commission is not readily available but the general impression is that while the revised pay scales were implemented (even more generously in some cases), the corresponding reforms in administration did not fully materialize.

Sixth Pay Commission

Although a separate Administrative Reforms Commission had already been announced, hope triumphed over experience when the Sixth Pay Commission was constituted and the following was included in its terms of reference:

"To transform the Central Government Organizations into modern, professional and citizen friendly entities that are dedicated to the service of the people".

More specifically, the Commission was mandated to work out a comprehensive pay package for the Government employees 'that is suitably linked to promoting efficiency, productivity and economy through rationalization of structures, organizations, systems and processes within the Government, with a view to leveraging economy, accountability, responsibility, transparency, assimilation of technology and discipline.'

Sixth Pay Commission's Methodology and Approach

The Commission's questionnaire invited specific proposals/ suggestions for reduction and redeployment of staff, reduction of paper work, better work environment, economy in expenditure, professionalization of services, reduction in litigation on service matters and better delivery of services by Government agencies to the users.

The Commission also outsourced a study on the feasibility of performance related incentive scheme that would replace the current system of annual bonuses, which is essentially a euphemism for ex gratia payments. The study is stated to have provided the basis of the outlines of an alternative scheme recommended by the Commission.

Nevertheless, adopting a subdued approach and by its own admission the Commission did not directly address the issue of reforms in administration in any comprehensive manner, mainly because a separate (Second) Administrative Reforms Commission is currently functional. Instead the Commission seems to have intended the changes recommended by it in the pay structures (and its other recommendations) as a facilitator, even a trigger, of necessary transformation in administration for ensuring its enhanced effectiveness and responsiveness to the needs of end users.

According to the Commission the Government employees are generally a demotivated lot with poor self- perception that is reflected in low morale and performance. This is despite the fact that at the recruitment stage the competitive selection procedures are designed to ensure the selection of quality material and talent. The crux of the problem lies in retaining the excellence through designing motivating jobs with greater responsibility, accountability and recognition of merit. A system of rewarding performance has to be ushered; and pride in public service values with effective and responsive delivery systems has to be rebuilt .in terms of results achieved

The Commission has also observed that there should be decentralization of power and delegation of powers with clear accountability at each level of delivery combined with flatter management structures so that responsibility is pushed down to the operating level and to the employees who are close to the cutting edge. The definition of accountability itself has to be revisited so as to connote the ability of the system to deliver timely results and quality services in a timely manner.

Thus, the fundamentals of reforms in administration must address the following issues

- Institution of appropriate incentives for performance;
- Decentralization and delegation of powers;
- Flatter management structures;
- Simplification of procedures and process re-engineering; and
- Clear definition of accountability at each level of delivery.

The basic and guiding philosophy underlying the Commission’s approach is the promotion of an environment that encourages and rewards excellence and performance. To quote the Commission “the (current) machine model approach to jobs with the employee as a cog in the wheel and extreme division of work has to be replaced by a learning organization approach where employees are continually enhancing their capabilities in high performance work cultures.”

The Commission has sought to address the issue of management structures through its recommendations relating to revised pay packages that are predicated on long pay bands and are expected to delayer decision making and disposal of work. Additionally, the Commission has made a slew of recommendations aimed at incentivising and rewarding innovation, performance and responsiveness. These include

(i) multiskilling of Government employees that would enhance their operational efficiency;
(ii) grant of performance-linked higher rate of annual increment to the achievers;
(iii) fast track promotions through limited departmental competitive examinations; and
(iv) upgradation of critical cutting edge level jobs like those of teachers, staff nurses and constables.

The Commission has recommended introduction of a system of lateral entry at higher echelons in the Government of the best talent from within and outside Government with performance contracts. This is a welcome recommendation though rather modest and even half-hearted since such lateral entry is to be limited to non-sensitive posts requiring technical or specialized knowledge that should be identified in the first instance[1].

The Commission has also recommended the introduction of performance related incentive scheme that rewards performance in lieu of the current system of annual bonuses. Although it has devoted one complete Chapter to this with additional background material in six Annexures and rightly listed a number of benefits expected to flow from its introduction, the Report only provides the methodology and guidelines for wheeling such a scheme into operation. The Report catalogues a number of changes in organizational functioning that are considered essential for its effective implementation and suggests pilots being tried in the first instance. These call for not merely major reforms in administration but also paradigm shift in the mindset. A tentative template of the application of the scheme to one or two departments would have enabled a better comprehension of the issues involved and provided the basis for assessment of its feasibility. The scheme is at best futuristic[2].

Proposed pay structure and pay bands

The Commission's recommendations relating to pay structures and compensation packages are both critical and of immediate relevance, which have a bearing on the management structures as well as incentivisation for excellence in performance. In lieu of the current pay scale system the Commission has recommended determination of compensation packages with reference to the pay bands (PB) for all posts below the apex level secretary equivalent posts. Under the pay band system all posts are to be placed in one of the four pay bands that would replace the existing twenty-eight scales of pay and an employee would be remunerated at the rate of the particular stage in the pay band and in addition a grade pay appropriate to the post held by him.

[1] [1] The Constitution Review Commission had recommended that 'above a certain level-say the Joint Secretary level- all posts should be open for recruitment from a wide variety of sources including the open market.'

[2] Annexure 2.5.4 contains reference to IIM-A synthesis report on the subject in five Ministries but does not mention the Ministries' response, if any, .to these studies

The grade pay has been generally determined as the amount equivalent to forty per cent of the maximum of the existing pay scale. The pay bands will have long spans that range from 20 to 50 years.

Broadly speaking for the Indian Audit and Accounts Department[3], PB-1 includes entry-level posts of Clerk and Auditor/ Accountant and PB-2 includes posts of Senior Auditor/ Accountant, Section Officer, Assistant Audit/ Accounts Officer, Audit/ Accounts Officer and Senior Audit/ Accounts Officer. In PB-3 are included all posts in the Indian Audit and Accounts Service up to the post of Selection Grade of the Junior Administrative Grade while posts in the Senior Administrative Grade and above (other than the apex Secretary-equivalent post) are included in PB–4.

According to the Commission, the proposed pay band system with its long spans has the merit of alleviating frustration arising out of the inevitable stagnation of the employees at the maximum of the existing short span pay scales and consequential demands for cadre reviews, which is a short hand for creation of higher level posts sans functional justification. The pay band system will also make the Government system less hierarchical and provide flexibility to remove layers by removing specific grade pay and may be, in the long run, even eliminating grade pays altogether.

These recommendations are indeed debatable. On the other hand, the pay band system may result in diminished incentive for performance.

The pay band system can offer only limited relief against frustration on account of stagnation. So long as different grades exist and the number of posts in a particular grade is limited, upward mobility will get blocked due to non-availability of posts in the higher grade because of the pyramid nature of Government organizations. It will be a matter of time before the demands for cadre reviews for creation of additional posts in higher grades are heard again.

The remedy against stagnation lies in a more dynamic and scientific cadre management that contains a carefully calibrated and judicious mix of appointment by direct recruitment, by promotion and through limited departmental examination, each stream providing a distinctive age profile of employees that guards against stagnation.

The grades carry different levels of responsibility and powers, some time prescribed by law, and are not likely to wither away in a hurry. This is also recognized by the Commission, since, according to the Commission, facilities like Government housing etc;(sic) will still be governed by grade pay.

Introduction of long pay bands and then expecting that the grades can be reduced or even done away altogether in the future is putting the cart before the horse. In Government ‘future’ is indeed very far off in respect of such radical reforms, as these are likely to meet resistance from entrenched mindsets and interests.

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[3] [3] The Indian Audit and Accounts Department is used as the background for the sake of convenience, familiarity and simplicity but the observations are equally relevant to other departments. Also, other questions like inter-service relativities, amounts of increase etc; have not been discussed

Further, the fixation of grade pay at an amount equivalent to forty per cent of the maximum of the existing pay scales would inevitably narrow down the difference between the compensation packages admissible to different grades of employees included in a pay band. Coupled with the proposed long spans of the pay bands this has the potential of leading to diminished incentive for performance. In PB-2, for example, the grade pay of Rs.4200 has been recommended for the lowest post of Senior Auditor/ Accountant and Rs.5400 for the highest post of Senior Audit/ Accounts Officer. The difference of Rs.1200 is a mere pittance, less than 4 per cent, considering that the maximum pay of the band of Rs.34800, which an employee can reach by sheer efflux of time. Currently, the difference is 50 per cent; the maximum of the post of the Senior Audit Officer/ Accounts being Rs.13500 against the maximum of Rs.9000 prescribed for the post of the Senior Auditor/ Accountant; in absolute terms the difference works out to Rs.7830 inclusive of 74 per cent dearness allowance adopted by the Commission.

The small difference in the aggregate pay package as per the revised dispensation is hardly sufficient to provide incentive for efficiency and excellence in performance. Those who merely mark time are likely to end up not very much behind those who do the quick march by negotiating the stiff departmental examinations and work hard to achieve the benchmarks for promotion. The long pay bands may as well promote a culture of minimalism; the minimum an employee can do is the maximum he will be inclined to attempt. They also serve who sit and wait; there are apparently no inbuilt roadblocks by way of efficiency bars etc; which can act as negative incentive against poor performance and output. The minimalist *chalta hai* approach may well be the preferred choice if combined with opportunities for moonlighting in a liberalized economy.

The pay band system neither provides redress against the problems associated with stagnation nor is it likely to promote the avowed objective of rewarding performance!

The other advantage claimed for pay band system may also be illusory. According to the Commission, the merger of many of the existing pay scales will bring about a structural reduction of layers in the Government, accelerating decision making process, and improve flexibility in functioning. The Commission's recommendations undoubtedly reduce the number of grades to 24 (including those recommended for the existing Group 'D' posts, which are expected to 'waste out' in due course) from the current number of 34 pay scales (below the apex level Secretary or equivalent post) but this by itself is unlikely to result in any substantial delayering and acceleration of decision making process. This is because the proposed reduction in grades is mainly on account of

(i) merger of some of the current pay scales that do not constitute decision making hierarchical structure, and merely reflect the perceived levels of importance of duties and responsibilities attaching to the parallel posts included therein; and
(ii) grant of parity to some of the existing scales of pay in the field offices with the scales attaching to similar posts in headquarters offices.

The mergers of the type referred to in (i) above may not be an unmixed blessing for obvious reasons and may in fact prove counterproductive since it would eliminate the

incentive associated with promotion as well as the opportunity for a more critical assessment of the employee for promotion.

Grant of accelerated rate of increment

With a view to incentivising performance, the Commission has recommended a higher rate of annual increment at the rate of 3.5 per cent of the basic pay[4] and the grade pay for the achievers limited to 20 per cent of the total number of employees against the normal rate of 2.5 per cent for Group 'A' employees with a suggestion for extending similar incentive to Group 'B' and Group 'C' employees after consultation with the staff associations.

A reality check would be in order. The maximum recommended by the Commission is likely to become the minimum and it would not be unrealistic to expect that in due course 20 per cent of the employees would start looking forward to the accelerated rate of increment. The smooth implementation of this recommendation is also likely to be problematic because of the heterogeneity of jobs in Government and the work environment particularly at the Group 'A' level. The performance norms will require to be defined in quantitative as well as qualitative terms, the latter always a tricky job. There will be demands for disclosure of norms for grant of accelerated rate of increment, criteria for judging achievement and also affirmative action to promote the interests of the persons coming from the underprivileged sections of society.

A study of the circumstances and reasons relating to the prohibition of the erstwhile practice of grant of advance increments to achievers under the Fundamental Rules may provide some useful lessons. Incidentally, as mentioned in the Commission's Report, the Fourth and the Fifth Pay Commissions had also recommended performance linked variable rates of increment; the latter had gone a step further and recommended that non-performers should be denied even the normal annual increment. But these recommendations were not implemented.

Fast track promotions through Limited Departmental Competitive Examinations

Recognizing that promotion channels are not very attractive for many posts in Group 'B' and Group 'C' and stagnation and consequential frustration may persist despite the recommended long span pay bands, the Commission has recommended that 10 per cent of the vacancies to be filled by direct recruitment for all posts in these Groups should be filled by Limited Departmental Competitive Examinations. This will meet the career aspirations of the brighter amongst the employees who possess the requisite qualifications but are stuck in the lower grades because of the long queue ahead of them and the limited number of promotion vacancies.

[4] There is some confusion in the Commission's report regarding the basic pay to be adopted for calculating the amount of increment. Paragraph 2.2.11 gives the impression that the amount of increment shall be calculated with reference to the pay in the pay band on the date of increment (and the grade pay) but in the illustration given in paragraph 2.2.22 the amount of increment has been calculated with reference to the minimum of the pay in the pay band (and the grade pay).

This is a welcome recommendation. However, the percentage of vacancies to be filled through the Limited Departmental Competitive Examinations appears to be much too meagre to make the proposed scheme viable or sufficiently attractive.

The scheme of Limited Departmental Competitive Examinations should have a wider purpose. It should be visualized not merely as a means of meeting the career aspirations of qualified persons, who may have joined in lower positions, but also as an instrument of sound cadre management given the pyramid nature of Government organizations with the number of posts progressively thinning out in the higher echelons. Recruitment should be so regulated that while the open market direct recruits can aspire for the top level posts, others reach the age of superannuation before they are anywhere near the top. The latter should come from within the department who are so to say caught sufficiently young, but not too young, through the limited departmental competitive examination. The intake from the open market should be reduced in favour of recruitment through the limited departmental examination. Thus the three methods of appointment, by promotion, through limited departmental examination, and direct recruitment from the open market would provide different age profiles so that the persons belonging to each stream earn reasonable number of promotions and reach the age of superannuation before they start stagnating on account of the limited number of higher-level posts.

In fact it may be desirable to extend the scheme of appointment through limited departmental examinations to Group ‘A’ services. It will at once take care of the career aspirations of qualified persons, who may have joined in subordinate positions, as well as the problem of stagnation that leads to demands for the so-called cadre reviews. The Union Public Service Commission will have to be taken on board.

Conclusion

The introduction of the pay band system in lieu of the pay scale system is the most crucial recommendation of the Sixth Pay Commission, which is of direct and immediate relevance, but it may not have the desired impact on the quality of administration. The Commission’s recommendation regarding lateral entry at the higher echelons is at best tentative, while the implementation of the recommendation relating to grant of accelerated rate of increment to achievers is likely to bristle with practical difficulties. On the other hand the Commission’s recommendation relating to limited departmental examinations is much too restrictive in approach, objective and coverage. The performance related incentive scheme is much too sketchy and at best futuristic.

While the revised structure of compensation packages may be implemented, the anticipated reforms in administration may not materialize.

This raises the wider issue of inclusion of administrative reforms in the terms of reference of pay commissions. By and large reforms in administration have proceeded independently of the structure of emoluments. While, during the last six decades there have been six central pay commissions, about six hundred commissions and committees have been set up by the Central and the State Governments from time to time to look into various aspects of administrative reforms.

The comprehensive package of administrative reforms recommended by the Fifth Pay Commission had remained largely unimplemented. Subsequent to the Fifth Pay Commission Government set up an Expenditure Reforms Commission, which made a series of recommendations that too have not been fully implemented. Further, a number of committees/ commissions headed by eminent persons like Y.K. Alag, Lt. General Surendra Nath and P. C. Hota have again examined some of the very issues dealt with by the Fifth Pay Commission. The Department of Administrative Reforms, functioning under the Prime Minister, aims to facilitate the promotion of excellence in Government through improvements in Government structures and procedures on an on-going basis. The Planning Commission has also been making observations and suggestions of a strategic and directional nature relating to bureaucracy.

Reforming administration is a complex issue and institutions and structures apart it must address upfront the core issues of systems, processes and procedures, decision making hierarchy etc; these would define the job content, attaching duties and accountability, and expected set of qualifications etc; for different positions and these should provide the input for settling the corresponding compensation package. Prescribing pay bands and expecting that these would be leveraged to rationalize structures, organizations, systems and processes would appear to be turning conventional wisdom on its head. Also, pay revision is a big bang affair, once in a decade or so, something that cannot be said of administrative reforms.

TAX REFORM ISSUES

K.P. Sasidharan[*]

INTRODUCTION

Tax administration reforms have become increasingly complex in a rapidly globalizing economy. Emerging domains of international trade, e-commerce and business operations; aided by sophisticated computers and communication technology, changes in employment patterns, new business structures, innovative financial products, transfer pricing, commoditization of tax schemes etc. pose multifarious challenges to tax administration and compliance.

As far as tax administration issues are concerned, institutional and organizational arrangements, management approaches and practices, procedures for filing of tax returns, payment and assessment regimes for major taxes, administrative powers and procedures of revenue authorities vary significantly across developed and developing countries. Any desirable tax system is broadly built upon certain essential principles i.e. raising revenues needed to source State spending in a simple, equitable and stable manner that is conducive to economic growth. The real test of any well-designed tax reform is that the intended change works in the real world.

This paper begins by highlighting some of the problematic tax administration issues with organizational structures, management approaches, procedures and practices adopted by different developed and developing countries. It then goes on to enumerate major tax reform initiatives in India and also covers International Taxation and Transfer Pricing issues.

TAX ADMINISTRATION REFORM STRATEGY

In order to select an appropriate tax administration strategy, it is inevitable to assess the effectiveness of extant tax administration in a country and diagnose existing problems. The overall effectiveness of tax administration in a country is generally indicated by its tax gap – difference between taxes actually paid and should be paid based on prevalent tax laws and regulations, including tax evasion, tax arrears, shortfall in tax remittance due to misinterpretation of laws and other non compliance issues.

Countries can be categorized into 4 groups based on the magnitude of tax gap: First category countries as Denmark, New Zealand and Singapore have a very effective tax administration with tax gap 10% or lower as Second category of countries also have relatively effective tax administration with tax gap ranging between 10 to 20 percent. Amongst these are Canada, USA and some western European countries; Third category countries including both developing and developed countries have relatively

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ineffective tax administration with tax gap ranging between 20 to 40 percent of the potential tax; and Fourth group of countries are those with even more ineffective tax administration with tax gap ranging between 40 % or more of the potential tax (IMF Working Paper; 1997).

Some of the problematic issues for initiating a comprehensive tax reform include lack of financial and material resources; poorly qualified and poorly trained staff; ineffective procedures; inadequate measures to address noncompliance issues; absence of effective tax payer services; high turn over of technical and management staff; and corrupt practices. The IMF paper identifies 10 major issues encountered by tax administration: i) taxpayer registration with controls to check that no Tax Identification Number (TIN) is assigned to more than one taxpayer, and that only one TIN is assigned to each tax payer; ii) submission of tax returns and payment processing including transfer of payments received directly or through banking system to the treasury account; iii) computerization of tax administration's key procedures including registration, collection, audit, and enforcement along with computerization of major economic sectors like banking, trade and communications; iv) detection of return stop filers due to several factors including outdated data base, errors in TIN, and not properly dealing with stop filing taxpayers and monitoring taxpayers with the highest income or the largest scales of volume; v) delinquent taxpayers and taking swift and effective action to check delinquency; vi) effectiveness of audit in discouraging tax evasion; vii) sanctions and penalty system to encourage taxpayers to settle their tax liabilities promptly and to discourage them from resorting to judicial process; viii) consistent, objective, courteous, and prompt taxpayer services and well designed and targeted publicity campaigns; ix) management and organization issues; and x) effective personnel policies, human resource management, training and deployment of staff.

The 10 guiding principles that can be applied in designing an appropriate overall tax reform strategy, according to the working paper, are: i) political commitment to reform; ii) simplification of tax system with a few taxes, limited number of rates, limited exemptions, and deductions. A broad tax base may enhance effectiveness and efficiency of tax administration and reduce cost of collection; iii) encouraging voluntary compliance by initiating various measures including detection of non-compliance and penalizing tax evaders; iv) formulation of a clear strategy after diagnosing the problems; v) identification of tax and accounting laws that require amendments; vi) taking an integrated approach to the tax collection process comprising registration, collection, enforcement, audit, legal affairs, and tax services; vii) differentiating treatment of taxpayers by size with special units for monitoring, auditing, and enforcing collection for the largest taxpayers, special programmes for controlling medium size and small tax payers; viii) ensuring strong management team accountable to both the government and the taxpayers; ix) determining priorities and establishing a timeframe; and x) commencing fundamental reforms with pilot projects.

Organization for Economic Cooperation and Development (OECD) also studied tax administration issues in OECD and selected non OECD countries and compared the system and procedures across the nations. Some of the key findings in a few selected countries are discussed below in order to have a better appreciation of the international scenario and globally prevalent varied strategies (OECD; 2007).

a) Organizational Arrangements

Depending on inherent variations in the political structure, historical legacy and system of public sector administration, organizational structure, institutional arrangements and the degree of autonomy of national revenue bodies differ significantly across the nations. Some of the discernible trends in existing practices and recent tax reforms are:

- Allocation of responsibility for the administration of both direct and indirect taxes to single unified body;
- Provision of a broad range of autonomous powers to the revenue body;
- Integration of the collection of social contribution with other taxes; and
- Recognition that customs administration is separate and different from other revenue administration requiring its own dedicated leadership, management, and support infrastructure.

While OECD countries, USA, UK, Canada, Australia and Japan have unified semi-autonomous bodies for direct and indirect taxes collection; China has separate body with minister; and India, has separate departments for direct and indirect taxes under a single ministry.

The extent of powers that can be exercised by the national revenue body differs from country to country. In OECD countries like USA, UK, Canada and Australia, revenue bodies have enormous powers such as to give tax law rulings, impose administrative sanctions (penalties and/ or interest) for acts of non compliance, establish internal design/ structure, allocate budget, fix levels and mix of staff, maintain own information technology operation, set service performance levels, influence staff requirement criteria, hire and fire staff and negotiate staff pay levels. In Japan, revenue body has all these powers except establish internal design/ structure, allocate budget, and fix levels and mix of staff. The Chinese revenue body has all the powers listed except remit penalties/ or interest and negotiate staff pay levels.

A formal management/ advisory board comprising externally appointed officials has been established in many countries to provide independent advice on the general operations of the revenue body and tax administration matter in general. For instance, USA has a nine member IRS Oversight Board set up by the Congress under the IRS Restructuring and Reform Act of 1998 to oversee the IRS' administration, management, execution and application of the internal revenue laws. Similarly in Canada; Canada Revenue Agency's Board of Management was created in 1998 as an independent government agency to administer the tax and custom laws.

Indian revenue departments have limited powers of making tax laws and remitting penalties and/ or interest.

b) Planning and Management Approaches of National Revenue Bodies

In the government management process, performance-oriented budgeting and performance management based on formalization of targets and measures have increasingly been adopted to improve efficiency and effectiveness of agencies and

ministries. For example, the performance management cycle adopted by the Australian Department of Finance and Administration cites the following 6 cyclical steps:

- Identify the crucial areas of performance in terms of desired results and means of achieving them;
- Establish benchmarks for effectiveness, quality and efficiency;
- Develop information systems to generate appropriate data;
- Report on results and interpret the information to identify areas for improvement;
- Make appropriate changes to improvement structures, delivery mechanisms etc; and
- Revise the relevant benchmarks and/or data collection strategies accordingly

OECD countries such as USA, UK, Canada, Japan, Australia and non OECD countries like China develop and publish multiyear business plan, service delivery standards, and annual performance reports, guided by formal taxpayers' rights in law or official documents.

US Internal Revenue Service (IRS) formulates its strategic plan, annual performance plan and annual performance report. Key elements of IRS Strategic Plan 2005-09 states its vision as "the IRS in 2009 is a 21st century agency with the human capital and technology capabilities to effectively and efficiently collect the taxes owed with the least disruption and burden to taxpayers". The Strategic Plan has also defined its values, goals, objectives, key measures of success and accountability through annual performance report. The Canadian Revenue Agency (CRA) has also clearly laid down its vision, values, mission, strategic outcomes, expected results, and performance measures. It has detailed service delivery standards for sending income tax refunds, VAT refunds, response to tax payers correspondence, telephone calls, visits, complaints and registering a new business. These plans and standards clearly demonstrate commitment to formalized internal planning process, formulation of measurable goals and targets, preparedness to external scrutiny and accountability. Number of countries have not only recognized the tax payers rights and obligations, but also codified these right in tax laws like Netherlands and Russia and some countries have elaborated them in administrative documents or charters like Australia, Singapore and South Africa.

c) **Return Filing, Payment, and Assessment Regimes**

In case of Personal Income Tax (PIT), different types of income of resident tax payers that are generally withheld by the payer are wages and salaries, dividends, interest, independent personal services, royalties and patents and other income payments.

However there is no uniformity in procedures across countries. USA, Australia and Canada follow withholding tax from source only in respect of wages and salaries whereas Japan and China adopt this procedure in respect of other types of PIT. In case of salary and wages which constitute bulk of Personal Income Tax (PIT), majority of countries deduct tax at source. While OECD countries like UK and Japan, adopt cumulative withholding in respect of employee tax payers and free them from filing returns; USA, Canada and Australia and non OECD countries like China follow non

cumulative withholding from wages and salaries and insist on filing of returns. In regard to Corporate Income Tax (CIT), most of the countries insist on filing annual returns and advance payment of tax. Self assessed returns are electronically filed in many of the OECD countries.

d) Administrative Powers of Revenue Bodies

Majority of revenue bodies have powers to issue public rulings and/ or private rulings, which are binding. Private rulings are generally provided at the request of tax payers and some of them are empowered to charge a fee for such requests. In UK, Australia and China, revenue authorities have powers to issue binding public and private rulings and time limits have been prescribed for private rulings, though fees for private rulings are not charged.

In most of the countries, revenue bodies have powers to gather information, access tax payers' business premises and dwellings, and seize documents to assess the tax payers' liabilities.

Revenue bodies are empowered to enforce tax debt collection by a) granting extension of time for payment; b) making payment arrangements; c) collecting from third parties who are liable to the tax payer; d) seizing tax payer's assets; e) offsetting tax payer's liabilities to his/her tax credits; and f) initiating bankruptcy. Additional powers have also been provided such as imposition of restrictions on overseas travel by debtor tax payers; withdrawal of business licenses; obtaining lien over tax payer's assets etc.

Most revenue authorities impose penalties for non filing of returns on time, failure to report their correct tax liabilities, and non payment of tax on time. Interest on delayed payment of tax is levied by most of the revenue bodies. Penalties vary, based on the seriousness of the offence: failure to exercise reasonable care, deliberate underreporting or fraud/ criminal offence.

e) Tax Revenue Collections

'Taxes' are recognized as compulsory, unrequited payments to government; for the benefits provided to taxpayers by the government are not generally in proportion to their payments. Aggregate tax revenues for major categories of taxes extending all levels of government as percentage to gross domestic products (GDP) vary substantially across countries. For example, in fiscal year 2003, some European region countries – Austria, Finland, France, Italy, Luxembourg, Norway and Sweden – had tax more than 40% of GDP. In countries like China, India, Mexico and Chile, tax revenue constitutes more than 20% of GDP. In some of the countries like USA, Japan and South Africa, the ratio ranges between 20% and 30%.

f) Operational and Performance Information

In 2003 and 2004, salary constituted the single largest cost item for tax administration in most of the countries ranging from 50 to 90 percent of tax administration cost. Cost of collection ratios – ratio of administrative costs to tax revenue collections as an indicator to compare relative efficiency and effectiveness of revenue bodies vary

significantly due to certain unrelated factors. Similarly, comparison of relative staffing levels, staff resources deployed for tax audit and other verification functions appear to vary substantially across countries due to certain factors. Nevertheless, tax audit and verification activities play important role in compliance functions and 30% of staff resources are deployed in tax audit, investigation, and verification activities.

Ratio of aggregate tax arrears – all unpaid taxes, including those where a dispute is involved – to the annual net revenue collections of all taxes for the years indicated – is a measure to gauge the broad trend over time of tax payment compliance. The relative incidence of unpaid taxes varied from 5% to 50% of annual net revenue collections, while some countries were not able to provide this information in their management information systems.

g) Administrative Practices

Comprehensive system of tax payer registration and tax payer identification numbering system, unique for each major tax type are critical features of the tax administration arrangements. Unique tax payer identification numbers (TINs) for registration facilitate matching of data, cross verification of information supplied and other tax administration applications.

Less than 50% of PIT payers are registered with the revenue body. Most of the revenue bodies use a unique taxpayer identifier like a citizen identification number for PIT purposes and a unique number for business tax purposes. Unique tax payer identifiers are utilized with information relating to wages, pensions, government benefits, interest, dividends, contract income, sale and purchase of assets for verification purposes.

Over the last 15 years or so, revenue bodies are automating tax administration functions through rapid computerization and optimal applications of technological advancements to derive expeditious benefits: a) speedier collection of government revenue; b) improved data accuracy; c) reduced paperwork for tax payers; d) facilitating faster crediting of tax refunds; and e) speedier processing of tax payer data for a range of administration purposes.

TAX ADMINISTRATION REFORMS IN INDIA

India has a well developed tax structure with a three-tier governing structure, comprising central government, state governments and urban/ rural and local bodies' administration. The power to levy taxes and duties is distributed among the three tiers of governments, in accordance with the provisions of the Indian constitution. The main taxes/ duties that the federal government is empowered to levy are PIT except tax on agricultural income, CIT, Customs, Central Excise, Sales Tax and Service Tax. The principal taxes levied by the state governments are Sales Tax (tax on intra-state sale of goods), Stamp Duty (duty on transfer of property), State Excise (duty on manufacture of alcohol), Land Revenue (levy on land used for agricultural/ non-agricultural purposes), Agricultural Tax, and duties on Entertainment, Professions and Callings. The Local Bodies levy tax on properties (buildings, etc.), Octroi (tax on entry of goods for use/ consumption within areas of the Local Bodies), Tax on Markets and Tax/ User Charges for utilities like water supply, drainage, etc. Rural

local bodies viz. Panchayati Raj Institutions also have some limited powers to levy duties.

Though tax reforms were initiated by independent India with the implementation of the report of the Taxation Enquiry Committee in 1953, followed by Kalador Committee in 1956, the Direct Taxes Enquiry Committee in 1971, systematic and comprehensive tax reforms at the central level were accelerated only after market based economic reforms were initiated with implementation of the recommendations of the Tax Reforms Committee (TRC) (Chaired by Dr. R.J. Chelliah the noted economist) in 1991. TRC followed the best practices approach and recommended broadening the tax base, reduction of marginal tax rates along with rates differentiation, simplifying the tax structure, laws and procedures and taking appropriate measures to make administration and enforcement more effective. In order to improve the revenue productivity in the long run, major emphasis was on enhancing the comparative contribution of direct taxes; improving the share of domestic consumption taxes; reducing the contribution of trade taxes in total tax revenue and full conversion of taxes on domestic production into a Value Added Tax (VAT). The committee emphasized minimization of exemptions and concessions and the need for developing an information system, computerization of tax returns. Major impetus for tax reforms was given in the new millennium with the recommendations of the Advisory Group on Tax Policy and Tax Administration for the Tenth Plan in 2001, Expert Group on Taxation Services in 2001, the Kelkar Taskforce (KTF) on Direct Taxes and Indirect Taxes, ministry of finance in 2002 and report of the Task Force on Implementation of the Fiscal Responsibility and Budget Management Act of the Ministry of Finance in 2004.

Consequent to tax reforms, PIT reduced from 11 slabs in 1973-74 to 3 slabs in 1997-98 onwards. The highest tax rate decreased from 85% to 30% during the period. In case of Corporate Income Tax, the highest rate was reduced to 35% in 1997-98; Minimum Alternate Tax (MAT) was also introduced in the same year to curb tax avoidance by ‘zero tax companies’, insisting on paying tax on 30% of their book profits; and in 2005-06, CIT rate was reduced to 30% and a new tax Fringe Benefits Tax was introduced at 30% rate to tax perquisites provided by companies and other specified persons in the form of entertainment, conference, welfare, sales promotion, conveyance, tour, phone etc. Another new tax - Securities Transaction Tax **-** is collected on purchase and sale of shares and securities traded through Stock Exchanges and units repurchased by mutual funds. Banking Cash Transaction Tax was charged @ 0.1% on every transaction on any single day being withdrawal of cash from an account (other than savings account) or being receipt of cash on any single day on encashment of one or more term deposits, whether on maturity or otherwise exceeding INR 25000 in case of individual accounts and INR 100000 for others. Another significant area of reform focuses on expansion of Tax Deduction at Source to cover the ‘hard to tax’ groups. Filing returns was made compulsory in case of individuals living in large cities who own house, cars, have membership of a club, credit card and travelled abroad.

Tax Revenue Collections

(INR in 10 million)

Components of Tax Revenue							
Period	**Total Gross Tax Revenue #**	**Corporation Tax**	**Income Tax**	**Custom duties**	**Excise duties**	**Service Tax**	**others**
1992-2007	195222	43559	29883	44730	66021	3009	4312
VIII Plan (1992-1997)	96533	13567	12575	30273	37014	465	2638
IX Plan (1997-2002)	166087	29508	25353	43418	60838	2317	4652
X Plan (2002-07)	323047	87602	51720	60497	100210	17373	5645
2002-03	216266	46172	36866	44852	82310	4122	1944
2003-04	254348	63562	41387	48629	90774	7891	2105
2004-05	304958	82680	49268	57611	99125	14200	2074
2005-06	366151	101277	55985	65067	111226	23055	9541
2006-07	473512	144318	75093	86327	117613	37598	12563
Average Annual Rate of Growth (per cent)							
1992-2007	12.95	20.41	15.94	7.73	10.49	*	4.46
VIII Plan (1992-1997)	15.89	21.71	24.72	18	10.45	*	-2.5
IX Plan (1997-2002)	9	17.15	18.58	1.61	11.41	19.19	-30.18
X Plan (2002-07)	21.31	31.59	18.83	17.36	9.60	73.21	68.93
2002-03	15.61	26.12	15.19	11.38	13.44	24.83	-16.28
2003-04	17.61	37.66	12.26	8.42	10.28	91.44	8.28
2004-05	19.9	30.08	19.04	18.47	9.2	79.95	-1.47
2005-06	20.07	22.49	13.63	12.94	12.21	62.36	360.03
2006-07	29.32	42.50	34.13	32.67	5.74	63.08	31.67

**** Service Tax was introduced in 1994-95*** ***# Includes figures of taxes/duties assigned to States/UTs.***

(Source Table 2.7 of CAG's Report No. 13 of 2007)

In respect of import duties, nominal tariff rate of 125% and peak rate of 355% were brought down to 20% in 2004. Quantitative restriction on imports was reduced to 90% of imports in 1991. There has been substantial simplification and rationalization in central excise duties as well. Apart from cutting down number of slabs, the tax has been progressively converted from specific duties into ad valorem levy and the facility to credit on input taxes under the CENVAT has been extended to about 80% of taxed commodities. CENVAT credit has also extended to tax on services.

Replacement of state sales tax with state level VAT in 2005 is a major initiative in case of states. Evolving a manufacturing stage VAT on goods and services at the centre, Converting the state sales tax into VAT at the states level by permitting input tax credit not only for intra-states sales and purchases but also for interstate

transactions may take some more time. Levying the tax on services and integrating it with VAT on goods with a view to develop comprehensive goods and service tax system is an important area of further reforms.

Tax/ GDP Ratio of Major Taxes

Period	Gross Tax Revenue	Corporation Tax	Income Tax	Customs Duties	Excise Duties	Service Tax
1992-2007	9.50	2.12	1.45	2.18	3.21	0.33
VIII Plan (1992-1997)	9.32	1.31	1.21	2.92	3.58	0.04
IX Plan (1997-2002)	8.65	1.54	1.32	2.26	3.17	0.12
X Plan (2002-2007)	10.07	2.73	1.61	1.89	3.12	0.54
2002-03	8.80	1.88	1.50	1.82	3.35	0.17
2003-04	9.20	2.30	1.50	1.76	3.28	0.29
2004-05	9.75	2.64	1.58	1.84	3.17	0.45
2005-06	10.26	2.84	1.57	1.82	3.12	0.65
2006-07	11.48	3.50	1.82	2.09	2.85	0.91
Average Annual Rate of Shift in the shares						
1992-2007	0.65	7.31	3.33	-4.00	-1.53	*

* Annual Rate of Shift not worked out as Service Tax was introduced in 1994-95
(Source Table 2.10 of CAG's Report No. 13 of 2007)

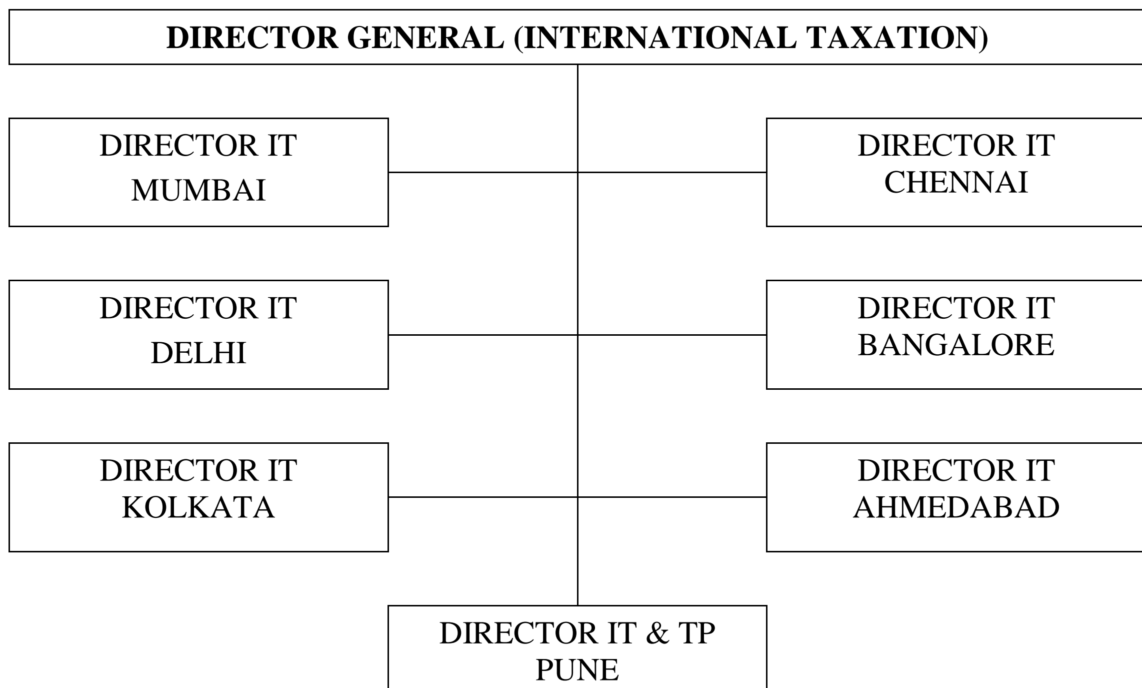
Economic reforms accompanied by tax reforms resulted in revenue growth. During the tenth plan (2002-07), there had been consistent growth in tax revenue, reaching 20.07% in 2005-06. There were changes in tax structure as well. During the early 1990s, direct taxes constituted 27%, indirect taxes 70% and other taxes 0.48% whereas in 2005-06, contribution of direct taxes increased to 43%, indirect taxes 48% and service tax 6% of the total tax revenue. Tax revenue of the central and states governments combined had a buoyancy of 0.93 during 1985-2006 which shows that tax revenue grew only 93% compared to every percentage point increase in GDP. Buoyancy of direct taxes comprising CIT and PIT was greater than 1 and that of indirect tax consisting central excise and customs accounted for only 48%. Tax-GDP ratio increased from 6.3% in 1950-51 to 16.1% in 1987-88 and continuously declined thereafter reaching 13.8% in 2001-02 and improved to 15.2% in 2003-04. Contribution of Tax Deduction at Source (TDS) increased from 41.75% in 1990-91 to 64.03% in 2003-04((Public Finance Statistics, Ministry of Finance, 2003-04). Low levels of compliance and high compliance cost are major issues in tax collection in India. Absence of adequate reliable database is a major hindrance and consequently compliance cost is high. In case of PIT, it is 49% and in respect of CIT, it ranges from 6% to 15% of the tax paid, with substantial legal cost of compliance. Non filing of returns by TDS assessees reduced from 80% in earlier years to 40% in 2003-04 (CAG Reports).

INTERNATIONAL TAXATION AND TRANSFER PRICING

The 1990s was marked by liberalization of the Indian economy since and has made India one of the attractive destinations for foreign investments. The inflow of foreign investments has increased from USD 103 million in 1990-91 to USD 59288 million in 2007-08 (Source RBI document). The ever increasing transnational investment and trade imply a potential conflict of tax jurisdictions. Central to this conflict is the issue of sovereign right of two or more jurisdictions to levy tax on one and the same transaction or one and the same taxpayer. Improper conduct of taxpayers could aggravate the jurisdictional conflict when there are mismatches between national tax laws. Jurisdictional conflicts can be resolved unilaterally under national tax laws, or bilaterally and even multilaterally under "tax treaties" or "Double taxation avoidance agreements" (DTAA). The paramount issue underlying all international tax considerations is how to appropriately allocate income and equitably divide or share the revenues between host and home countries. The resolution of this issue is the main purpose of DTAAs, which seek, inter-alia, to set out detailed allocation rules between the "source" and "resident" countries for different categories of income.

India has entered into DTAA with over 70 countries including countries like U.S.A., U.K., Japan, France, Germany, etc. These agreements provide for relief from the double taxation in respect of incomes by providing exemption and also by providing credits for taxes paid in one of the countries. These treaties are based on the general principles laid down in the model draft of the Organization for Economic Cooperation and Development (OECD) with suitable modifications as agreed to by the other contracting countries.

In view of the larger number of non-resident assesses in and huge volume of transactions in the cities of Mumbai, New Delhi, Kolkata, Chennai, Bangalore, Ahmedabad and Pune, the department has restructured its set up in these places by creating Directorates of International Taxation and Transfer Pricing.



Transfer Pricing

Transfer Pricing law has been enacted for Income Tax purposes in 2001 by amending the Income Tax Act, supplemented by Transfer Pricing Rules, which are broadly based on OECD Guidelines. Transfer Pricing under the Income Tax Act is administered by the Directorate General of Transfer Pricing in the Income Tax Dept.

The Income Tax Act was amended in the Finance Act, 2001, incorporating suitable provisions in sections 92 to 92 F, and section 27 to regulate Transfer Pricing. Supplementary provisions in Income Tax Rules were incorporated to prescribe the procedures on Transfer Pricing controls.

As per CBDT instruction No.3 of 2003 dated 25/03 wherever the aggregate value of international transaction exceeds Rs.5 crores the case is transferred by the regular jurisdictional assessing officer to the Transfer Pricing Officer (TPO).

SAI, India's efforts in the area of International Taxation

In the face of growing significance of international taxation and the emphasis given by the Revenue Departments to issues relating to this area, the Supreme Audit Institution, India is also intensifying its efforts to keep audit abreast with the latest developments in this area and highlight significant audit findings in respect of foreign companies and other non-resident assessees. In the year 2004-05, SAI, India had conducted a systems appraisal of Double Taxation Avoidance Agreements entered into by India with various countries with special emphasis on the Indo-Mauritius treaty. The report highlighted how the special consideration bestowed in the Indo-Mauritius treaty on business entities of Mauritius led to establishment of conduit companies in Mauritius through which investors of third countries routed their investment, which in turn led to concern among tax authorities in India about the loss of rightful revenue. Efforts are being made to form dedicated Local Audit Parties for audit of International Taxation Circles equip these teams with training on the nuances of international taxation and transfer pricing. In the Audit Report for the year 2006-07, the SAI, India had compared the quantum of outflows or payments to residents abroad on account of payments such as salaries, commission, royalties, dividends etc. which are liable for tax deduction at source subject to the conditions specified in the Act and the tax at source actually deducted and pointed out a huge gap in the tax deductible at source and the tax actually deducted at source.

CONCLUSION

Tax administration reforms and compliance risk management are inextricably interlinked, assuming critical significance in the new millennium, characterized by e-commerce, innovative business practices across the borders, emergence of new products and services. While India has taken significant steps towards simplification and rationalization of its tax laws and administration system, substantial work is yet to be done for enforcing effective tax compliance and reducing tax gap.

Having a three tier federal polity with centre, states, urban and local bodies with identified domains of tax revenue jurisdiction, it is a herculean endeavour to

streamline and modernize tax administration. Complexity of reform strategy intensifies taking into account the multiparty political system functioning in different combinations at centre, states and local bodies, with divergent political interests and goals. Nevertheless, tax reforms have been accelerated despite having change in governments over the years. Reforms have also been accompanied by comprehensive computerization drives at all levels, encompassing administration of direct and indirect taxes at the centre and states and even at urban and local bodies.

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ROLE OF PUBLIC AUDIT IN GOOD GOVERNANCE

A.K. Banerjee [*]

What constitutes good governance? While good governance is being widely discussed, there does not appear to be any statutory definition prevalent in any country about what constitutes good governance. United Nations Development Programme (UNDP) had, in a report in 1977, defined governance as "exercise of economic, political and administrative authority to manage a country's affairs at all levels. It comprises the mechanisms, the processes and institutions through which citizens and groups articulate their interests, exercise their legal rights, meet their obligations and mediate their differences… Governance encompasses the state, but transcends the state by including the private sector and civil society organisations." Thus, governance can be used in several contexts such as international governance, national and sub-national governance, local governance and corporate governance. For the purpose of this article, we would confine ourselves to national governance.

The essence of 'Rajdharma' or good governance especially in a democracy where the government is 'of the people, by the people and for the people', is maximum good of the maximum people. Thus, it can perhaps be safely said (as also reinforced by the conclusions of the conference of Chief Ministers held in 1997) that good governance has eight major attributes i.e., it would be participatory, consensus oriented, accountable, transparent, responsive, effective and efficient, equitable and inclusive and follow the rule of law. It should assure that corruption is minimised, the views of minorities are taken into account and that the voices of the most vulnerable in society are heard in decision-making. Good governance should also be responsive to the present and future needs of the society. Governance involves people who are entrusted with the responsibility to govern and the systems which they put in place. Since the persons and institutions involved in governance enjoy enormous powers which is fraught with the risk of being used arbitrarily and erroneously, it becomes necessary to ensure their accountability in the interest of good governance. On whom should this responsibility devolve? Globally this has generally been assigned to audit, which in most countries has been constituted under the law of the land as an entity independent of the executive.

Corruption is now receiving worldwide attention primarily as its existence is one of the principal causes of "bad governance". It is a complex issue with its roots being grounded in a country's social and cultural history and ethics, political and economic ambience, bureaucratic traditions and policies. Corruption tends to flourish when institutions are weak and economic policies distort the market place. It has been described as a cancer that violates public confidence in the State and endangers social cohesion. Corruption can be defined as the abuse of public power for personal gain or for the benefit of a group to which one holds allegiance. Klitgaard (1996)[5] has developed a simple model to explain the dynamics of corruption:-

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[5] Klitgaard, Robert, 1996. "Boliva: Healing sick institutions in La Paz" in "Governance and the Economy in Africa: Tools for Analysis and Reform of Corruption": Center for Institutional Reform and the Informal Sector.

C (corruption) = M (monopoly power) + D (discretion) – A (accountability)

Kenneth Dye, former Auditor General of Canada, and Rick Stapenhurst, a public sector management specialist, had outlined[6] the concept of national integrity systems in an article published by the Economic Development Institute of the World Bank in 1998 in the contest of curbing corruption. Such a system rests on the following eight institutions or 'pillars':-

- political will
- administrative reforms
- 'watchdog' agencies (anti corruption commissions, Supreme Audit Institutions, Ombuds offices)
- Parliaments
- public awareness/involvements
- the judiciary
- the media
- the private sector

Public audit, which is one of the pillars of integrity, can help curb corruption and act as an effective deterrent to waste/abuse of public funds. Since accountability itself is a function of transparency (T), Dye and Stapenhurst argue that Klitgaard's equation can be re-written as C = M + D – A (T). The responsibilities of audit now, therefore, would appear to include, the promotion of ethical behaviour, efficiency and cost effectiveness and the encouragement of sound internal financial controls to reduce the opportunities for corruption and increase the likelihood of its detection. How does audit analyse different attributes of good governance bringing out the deficiencies in governance and recommending the actions that can be taken? In 1999, the National Audit Office of Denmark (NAOD) introduced certain principles for good governance which were applied by it as benchmarks while examining governance in State agencies. For this purpose, governance was described by it through four steering tasks and seven steering processes. The processes concern target setting, planning, budgeting, implementation and management control, presentation of accounts, follow-up and reporting and evaluation whereas steering tasks included performance management, activity management, resource management and day-to-day budgetary management. During the same year, NAOD applied these principles as part of examining governance in the following six agencies:-

- the Customs and Tax administration
- the Prison Services
- the Ministry of Social Affairs
- the EU Directorate
- National Survey and Cadastre
- Copenhagen Hospital Administration

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[6] Dye, Kenneth M and Stapenhurst, Rick 1998. "Pillars of Integrity: The importance of Supreme Audit Institutions in Curbing Corruption": The Economic Development Institute of the World Bank.

Let us now examine how public audit in India examines the different attributes of governance. The need for keeping a watch over expenditure has been recognised from the earliest times. Aristotle had once stated "To prevent the treasury from being defrauded, let pubic money be issued openly in front of the whole city, and let copies of the accounts be deposited in the various wards………" Kautilya in his 'Arthashastra' has detailed how the king should keep a watch over public finances through an independent functionary. The necessity of the audit of public funds being conducted by an independent authority was also recognised by the framers of our Constitution. The Constitution of India provides for the appointment of a Comptroller and Auditor General of India and grants him a unique position of independence. However, the genesis of this independent functionary in independent India can be traced back to the Government of India, Financial Constitution order no. 5126 dated 4th December 1857 constituting a General Department of Accounts including the offices of audit, pay and accounts and appointing the Accountant General to the Government of India. The Government of India, Finance Department Resolution of 1860 introduced far reaching financial reforms by providing that 'A definite standard will be laid down by the Budget – a precise authority will be prescribed for everything; a definite limit on every point will have to be fixed. Then an imperial audit will try every branch of the public expenditure by that standard; will observe whether that limit has been transgressed.' As part of the reforms, the Accountant General of India was redesignated as Auditor General of India. The designation underwent a few changes before becoming Comptroller and Auditor General of India in 1950. The Comptroller and Auditor General of India is not an officer of the Parliament unlike his counterpart in U.K. Instead, he is an independent authority appointed under Article 148 of the Indian Constitution and is guaranteed a fixity of tenure to enable him to function without fear or favour. He can be removed from office only in the manner prescribed for a sitting Judge of the Supreme Court. During one of the debates in the Constituent Assembly, Dr. B.R. Ambedkar had even mentioned that the Comptroller and Auditor General of India was probably the most important functionary under the Constitution of India. The role of being the watchdog of public finances is assigned to this independent authority who discharges his functions through the Indian Audit and Accounts Department.

The concept of governance in India has been continuously evolving. Before independence the stress of governance was basically on the maintenance of law and order as well as providing the essential infrastructure. After independence the emphasis shifted to balanced economic development coupled with empowerment of the less privileged sections of the society. With the increase in literacy and general awareness and also with sustained growth of the democratic institutions of the country especially the media, the expectations of the citizens from those who govern, have been rising. In line with the changing pattern and purpose of public expenditure in India after independence, the emphasis of audit has shifted from checking compliance with the rules (audit of regularity) to scrutinising the propriety of an expenditure (audit of propriety) and thence to examining fulfilment of the objective of the expenditure in a cost effective manner (value for money audit/ economy, efficiency and effectiveness audit or performance audit). With the exponential growth in both the nature and quantum of expenditure on public sector activities, the need for public accountability has assumed considerable significance. This has been further accentuated by the latest trends of delegation of increased financial and functional autonomy to local bodies and the various measures like privatisation, relaxing of

controls, dismantling of administered price regime etc. The total receipts and expenditure of the Union and State Governments audited by the Comptroller and Auditor General of India in 2005-06 is a mind-boggling sum of Rs.1802724 crore. This figure does not include transactions of the Union and State Public Sector Undertakings, Autonomous Bodies, Bodies substantially financed by government grants and loans, public debt transactions of the Union and State Governments which also come under the audit ambit of the Comptroller and Auditor General of India.

In India, audit ensures accountability for good governance through the reports of the Comptroller and Auditor General of India, which are presented to the Union or State Legislatures by the President/ Governor of the State. These reports highlight the nature of accountability for various deficiencies in spending/ receiving public funds and include reasons for fiscal imbalances, subsidies, irregular/ unauthorised/ excess appropriations as well as persistent savings etc., which are crucial for good financial governance. Audit also reports instances of unauthorised/ excess expenditure, diversion of funds, illegal appropriation, spending for personal gains, misappropriation of funds/ frauds etc. in the civil ministries, defence, railways, tax departments etc. Through performance audit, deficiencies in the implementation of developmental programmes including those targeted at the disadvantaged sections of the society are pointed out. A few recent examples of performance audit reports on matters of topical interest, which have been received quite well by the international agencies also, are those on 'National AIDS Control Programme', 'Empowerment of the Disabled' etc. Various aspects of tax administration are also reviewed by audit in performance audit. A major contribution of audit to good governance has been the changes in tax laws as well as plugging of loopholes that have come about on the recommendations of audit. Effective use by public audit of the tools of financial and performance audit as well as scrutiny of the state of internal controls in various organisations (every year the Comptroller and Auditor General of India examines the state of internal controls in selected ministries of the Union Government and gives his recommendations) are likely to act as deterrent to corruption and promote good governance.

The role of the Comptroller and Auditor General of India in securing a clean and efficient financial management system in the process of democratic decentralisation has also been recognised by the eleventh and twelfth Finance Commissions set up under the Constitution of India. On the recommendations of these commissions, the Comptroller and Auditor General of India has been entrusted with the task of providing technical guidance and supervision for the development of the urban and local self government's accounting and financial management system. The oversight of the audit system of the local bodies as well as the capacity building process of the personnel of these bodies has also been assigned to the Comptroller and Auditor General of India. Efforts to achieve an inclusive growth through the Panchayati Raj system may receive an impetus through the involvement of the Comptroller and Auditor General of India in the process of implementing the 73rd and 74th amendments of the Constitution in letter and in spirit.

The discussion about the role of audit in good governance cannot be complete without a mention of the cost of audit. The total expenditure on audit functions during 2005-06 was Rs. 747 crore including administrative and training overheads. Expressed as a percentage, this expenditure was only 0.041% of the expenditure and receipts of the

Union and State Governments audited in that year. As against this, audit has pointed out overpayments/ underassessments of Union/ State receipts of Rs.46053 crore, of which they have accepted underassessments amounting to Rs.17007 crore and have recovered Rs.1523 crore. Also, as already mentioned, laws have been amended by the Union/ State governments to rectify the deficiencies pointed out by audit. Thus, even without considering the non-quantifiable benefits accruing from audit observations which can be used by the executive to avoid future irregularities/ extravagance/ misutilisation of resources, it is clear that while contributing to good governance, audit also pays for its functioning many times over.

AUDIT OF TOLL COLLECTION CONTRACTS

Sangita Choure[*]

Introduction

With the Indian Economy growing at a rate of 8%, it is estimated that over Rs.20,00,0000 crore (2006-07 prices) would be required for investment in the Infrastructure Sector during the next five years. Public Private Partnerships (PPPs) present the most suitable option of meeting these targets, not only in attracting private capital in creation of infrastructure but also in enhancing the standards of deliveries through greater efficiency.

The Government of India has acknowledged PPP as a suitable model for accelerated growth in creation of Infrastructure and have introduced several innovative Schemes in promoting PPPs. Whereas to attract the private sector, commercially viable projects would be on offer and to inculcate discipline of user pay principle, the provision of these services would be based on payment of tariff. However, at the same time Government has to ensure that the tariffs fixed are based on the capacity of the common man to pay for these services. In order to address the constraints of policy and regulatory gaps; availability of long term finance for funding of the projects; inadequate capacities in the private sector, the GOI has taken several initiatives to create an enabling framework for PPPs.

Progressively more sectors have been opened for private and foreign investments, levy of user charges is being promoted, regulatory institutions have been and are being set up and strengthened, fiscal incentives are being given to Infrastructure projects, standardized contractual documents including Model Concession Agreements have been notified, approval mechanisms for Central Sector PPPs have been streamlined with the setting up of the PPP Advisory Committee and a website devoted exclusively for PPPs has been launched to serve as a virtual market place for PPP projects.

In 2007-08 the Govt. of India, set up a corpus usage titled 'India Infrastructure Project Development Fund "-IIPDF in the Ministry of Finance with an initial corpus of Rs 100 crore for supporting the development of credible PPPs that can be offered to the private sector. It is a mechanism through which the sponsoring authority will be able to source funding to cover a portion of the PPP costs viz. the project development costs in respect of feasibility studies, environment impact studies, financial restructuring and documentation etc.

Thus, the private sector, as mentioned above is now involved as a matter of Government policy in financing the construction, operation and maintenance of the projects which are mostly implemented on Build Operate and Transfer (BOT) basis. The expected toll revenues from the project form the life line of the project since this is the major source of revenue for recovering the capital cost of the project.

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This paper discusses the parameters essential for fixing toll contracts, methods of toll collection and case studies from Maharashtra featuring in Audit Reports of the C&AG of India on road projects (highways).

Essential features of Toll Contracts

(a) Cash flow planning

Cash flow is the lifeblood of any business entity. If cash flows are not correctly planned, resultant the problems could threaten the very existence of the entity. The detailed annual cash inflows by way of toll for the collection period is required to be worked out which will help in recovery of investment repayment[1] of loans raised to finance the project. The time schedule for repayment of loans should match with the cash flow pattern of the project. The synchronisation of the cash inflows and outflows by proper tie up with the lending institutions would obviate the need for going in for fresh financing to repay the existing debt.

(b) Fixation of concession period

The main aim of the toll collection is to recover the cost of the project constructed. The concession period is the period during which the project manager is to recover the cost of investment on the project. The basic criteria which determine the fixation of the concession period are the construction cost of the project, maintenance cost of the project, cost of toll collection and rate of the toll. The concession period should not be longer than required or else it would result in unnecessary and an avoidable burden on the toll paying public.

(c) Legal requirement

According to the Bombay Motor Vehicle Act, Section 20 'Toll can be levied and collected in respect of a bridge, tunnel including approach roads, or section of roads on bypasses, declared by the State Government in the *Official Gazette'*. The bridge, road, etc. may have been constructed at the expense of the State Govt, or at the expense of any private person or agent appointed by the State Govt. or a State Public Enterprise authorized by the Govt. in this behalf, by entering into an Agreement with such entrepreneur or agent under the Build, Operate and Transfer basis (BOT)... For the purposes of Section 20 of the Act **"CAPITAL OUTLAY**" of a project is defined to "include the anticipated cost of certain essential on goings or imminent works like improvements, strengthening, widening, structural repairs, maintenance, management, operation, reasonable returns and interest on such outlay, at such rates as the State Govt. may fix, until the **full amount of such outlay is recovered".** Therefore the important point to be noted is that **toll collection cannot exceed the capital outlay of the project** which, inter-alia includes interest capitalized and or rate of return if any determined for the project at the initial stages. It is possible that implementing agencies in their zest to collect more toll for meeting the costs, may overlook this important legal restriction and pass on unnecessary toll burden to the public. As auditors, we would fail in our duty if we would not examine this and point out excess toll collection, if any.

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[1] alternate phrase from ……………

Toll collection methods

(a) Appointment of toll collection contractor

As the project implementing authorities may not have required staff strength for collection of toll on the project, the work is usually outsourced to the toll collecting contractor/ agent by inviting competitive bids. Under such an arrangement, the contractor has to remit the toll collected at periodical intervals to the authority and toll collection expenses are repaid to the contractor. In this method the project authorities have full control on actual toll collected by the contractor and are only required to ensure the correctness of the toll collected. The authenticity of data on number of vehicles traveled can be checked by fixing vehicle counting machines etc. The normal procedure followed is that the party for toll collection is decided on the basis of maximum toll revenue agreed to be remitted compared to the expected toll revenue and minimum collection charges. Penalty and rescission of the contract in case of failure in remission of the collected toll are included in the contract conditions

(b) Award of contract on upfront payment basis

Under this method the rights of collecting the toll for a definite period of time (not exceeding the concession period of the project) are sold to the contractor and he may be asked to maintain the asset also during the period. The contractor has to quote the expected revenue during the period and the amount they are ready to offer **on "upfront basis"**. The project Managers then calculate the lump sum amount for future period on upfront basis, at discounted rate of return. This method is resorted to when huge debt has been incurred by the project agency for creation of the Asset and they decide to reduce the debt by repayment through the toll revenue collected in advance over the entire pay back peruse. This is also called as "**Securitisation of Debt"**. The advantage of this method is that the project agency collects the toll revenue upfront and does not have to suffer any financial losses arising out of future defaults of the toll Contractor. Under this method, the fixation of **Reserve Price** of the toll collection is critical because the contractor's financial quote is in comparison with the Reserve Price fixed. The manner of fixation of reserve price is a point for a detailed audit check. The authenticity of the data regarding vehicular traffic, projected increase in the traffic, discounted rate of return etc. and the source of all this data needs to be verified carefully by the audit. It is possible that the agencies totally rely on workings of an appointed consultant for fixing the Reserve price and accept the same without any independent check. Incorrect fixation of the Reserve Price may prove extremely detrimental to the financial interest of the project and consequently that of the Company/ State Govt.

Cases of toll collection contracts audit-Maharashtra

1. Fixation of lower reserve price

i) In fixation of reserve price of the Toll contract in case of the "Mumbai/ Pune Express Highway" the Net Present Value (NPV) of revenues from toll collection and expenditure on maintenance of the project was Rs.4,104 crore as per the projections made in the Agreement between the State Government and the Maharashtra State

Road Development Corporation(implementing project agency). The Company fixed reserve price for Rs.900 crore only based on a fresh vehicular study done by a traffic Consultant and the contract was awarded (August 2004) for an upfront payment of Rs.918 crore. The upfront payment by the eventual awardee assumed a discounting factor of 8.5 percent. Even if only 60 *per cent* of the projected toll revenue were to be considered and the bidder was to obtain a clear profit of 11% the reserve price would have worked out to Rs.2, 236 crore at a discounting factor of 8.5 percent. Thus, due to fixation of lower reserve price the contract resulted in loss of revenue of Rs.1318 crore. The Company defended the Reserve Price fixed by them; stating that the projections in the earlier study were estimates whereas the later study and projections made by the Consultant were more realistic taking into account actual toll collections made till then. The Company's reply was rebutted by audit stating that even at 60% of the expected toll revenue as per the study done by the Company for the Agreement with the State Govt, the expected toll was much more than the Reserve Price fixed subsequently and the reserve price fixed at Rs 900 crore was based on the remittances made by the toll contractor, which was unreliable. Further the Mumbai-Pune route was a very widely used route with assured vehicular traffic which was bound to increase and hence fixation of a lower reserve price than the earlier agreed one was not warranted. The Company conceded that wiping off the debt incurred for the project at least partially, was the main consideration in fixation of the lower "upfront toll price".
(AR 2005-Commercial.GOM, Para 2.34 and COPU evidence)

ii) In another project (Thane-Ghodbunder Road Project), based on a consultant's study, the Company fixed the reserve price of the toll contract at Rs.115 crore (net of toll revenues and expenditure on maintenance of road). The reserve price fixed failed to take in to account the revenue realisation based on the last toll contract awarded. Based on the previous contract price, the reserve price worked out to Rs.146.33 crore instead of Rs.115 crore fixed. In fact, as traffic was bound to increase, the reserve price should have been fixed on the higher side.. Due to fixation of lower reserve price there was loss of revenue to the Company to the extent of Rs.31.33 crore.
(AR 2007- Commercial-GOM-Para 4.11)

2. Non consideration of Revenue projections given by bidders

The Company had asked the bidders to furnish their revenue and expenditure details along with the composite bid for toll collection and maintenance of the road and upfront payment of toll. The Net Present Value (NPV) of net revenue (revenue less expenditure) was more as per the toll projections furnished by the bidder. However, the contract was awarded on the basis of higher upfront payment quote. The Company did not invite other bidders for negotiations though their NPV projections were higher. This method of awarding the contract based on the highest upfront payment, ignoring the toll projections given by the bidders and the NPV of the future earnings, reduces the process of calling for financial bids to a farce. Auditors will have to compare the final award with the details of the bids received with reference to the toll projections to conclude whether the awarded price was the best price.
(AR 2007- Commercial-GOM-Para 4.11)

3. Restrictive clause relating to upfront payment

The normal procedure in toll collection contracts is that the party is asked to quote the amount that it would remit on a weekly/ monthly basis. In a major departure from this practice, the bidders were asked to make upfront payment of toll for 15 years period ostensibly to reduce the debt incurred for the project. Weekly payments would have attracted more participants as requirement of financial capability of parties would have been lower. Clause relating to upfront payment in lump sum was highly restrictive in nature. Such a provision acted as a serious deterrent in ensuring wider participation and benefit of competitive bids was not available. Consistent practice of awarding toll contracts based on "upfront payments" also creates monopoly of contractors and unhealthy practices as it enables only "cash rich" agencies to bid for such contracts, The C&AG's Audit Report of Maharashtra Government Commercial Undertakings, has brought to notice, the manner in which only one private Company managed to bag the toll contracts of all the major road projects, due to award of toll contracts on "upfront basis" by the Maharashtra State Road Development Corporation
(AR 2007- Commercial-GOM-Para 4.11and Para 2.38 of 2005 Report)

4. Clubbing of major expenditure work and toll collection

Toll collection contract being a revenue contract is required to be awarded to the highest bidder and expenditure contract for maintenance of the asset is awarded to the lower bidder. When the two contracts are clubbed the highest bidder in toll collection contract may not be executing the work at the lowest cost. Besides the expertise of the contractor to carry out the maintenance works as per quality standards may not be ensured by such clubbing of contracts. Toll collection does not require any expertise whereas maintenance works of public assets calls for requisite technical expertise. Hence to get full benefits, the expenditure and revenue contracts should be separated for obtaining the bids. Due to netting of both the contractors the Company may not receive the best bid for the maintenance of the asset and this practice also results in **payment of the entire maintenance expenditure upfront** to the Contractors. As per prevailing manuals and financial procedures, works expenditure is required to be incurred based on progress of the work. Netting of the two contracts results in advance payment to the contracting agency of the entire contract value and is irregular as payment has been given for work to be done in future.

The Company's practice of awarding the toll collection and maintenance contracts to the same contractor is not backed by any Financial Rules, and hence it is open for the audit to examine such contracts to see whether they were financially detrimental to the organisation.
(Para 2.39 of AR 2005)

5. Fixation of excess concession period

In the project of Thane Ghodbunder Road, while deciding the toll collection contract though the balance expenditure on the project to be recovered through toll from the public was Rs.44.84 crore, the Company (MSRDC) awarded the toll contract for 15 years for Rs.140.40 crore. Thus an avoidable burden of Rs.95.56 crore was passed on to the toll paying public which was against the public interest.
(AR 2007- Commercial-GOM-Para 4.11)

6. Irregular extension of contract period

The Company awarded (December 2002) toll collection contract at five entry points to Mumbai City, to the contractor on upfront payment of Rs.225 crore for three years. Immediately after one month, the contract was extended for further period of three years by accepting additional upfront payment of Rs.201.50 crore without calling for tenders. The upfront payment, which should have been increased considering the traffic increase, was actually reduced by Rs. 23.50 crore compared to the original contract value.

The extension in contract period of three years immediately after one month of award of contract on the same terms and condition without calling for the competitive bids or checking performance or any recorded justification of volume of traffic was irregular and lacked transparency also resulting in total loss of Rs 23.50 crore
(AR 2007 Commercial-GOM, Para 4.14)

7. Contingency Plans for Toll Collection

It is seen that very often the toll contractors do not remit the toll collections or delay the remission of the receipts The Company may not have put any alternative contingency plans in place to continue with the toll collection in event of such defaults. They therefore continue with the same agency and delay the finalisation of the new contract, which is not only an undue benefit to the contractor but also results in financial loss to the Company.

8. Delays in collection of Toll Revenues

As mentioned in the beginning the toll rates are approved by Government for which a gazette notification has to be issued to make the toll collection legal. Very often Governments delay the issue of the notification resulting in delays in collection of the toll revenues. The project implementing agencies also delay the handing over of sites, non finalisation of the site for the toll plaza resulting in loss of toll revenue. Such instances have been pointed out in the CAG's Audit Report (Commercial 2005-Para 2.4) in the Performance Appraisal of the National Highways Development Project. There are occasions where the public oppose the toll collection and unless the dispute is settled amicably the agencies cannot go ahead with the toll collection and at times the project may have to be abandoned as a pay and use one, throwing the entire financial economics of the project out of gear.

9. Internal Checks and Controls

In cases of periodical remission of toll by the toll collecting agency it would be necessary to see what systems have been put in place to ensure the correctness of the toll and its regular remission to the Company's Account. In order to have a check on the vehicular data, some Companies have installed vehicle counting machines at some toll centres. It is seen that the machines are deliberately kept out of use stating some repairs and maintenance problems and hence there is no independent check by the Company on the number of vehicles passing through the toll centres. The numbers given by the toll contractor are accepted. Therefore auditors will have to see whether

vehicle counting machines are installed, whether they are being put to use and otherwise what other systems are in place to check the authenticity of the vehicle data and toll collected.

To Summarise following are the checks in audit of Toll Contracts:

- Government resolution authorising toll collection and the rate as required under the Motor Vehicles Act and delays if any in issue of the Notification
- Fixation of the Concession period with reference to the project cost and toll notified
- Method adopted for toll collection and its suitability for the project
- Evaluation of the bids process
- Fixation of the Reserve Price
- Fixation of the upfront payment in case of such toll contracts
- Creation of monopolies due to restrictive conditions
- Financial Impact due to Clubbing of revenue contracts with Maintenance works
- Excess toll collected/ awarded with reference to concession period
- Non renewal/ delays in renewal or finalising toll collection sites and irregular extension of Toll Contracts
- Contingency Plans for Toll Collection
- Internal Checks and Controls for toll revenue

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DEVELOPING RURAL ELECTRIFICATION – JHARKHAND A CASE STUDY

S.K.F. Kujur[*]

The Electricity Act 2003 was passed by the Parliament and was implemented throughout the country with effect from 10th of June 2003. The preamble to the Act defines the objectives of the Act as "to consolidate the laws relating to generation, transmission, distribution, trading and use of electricity and generally for taking measures conducive to development of Electricity Industry, promoting competition therein, protecting interest of consumers and supply of electricity to all areas, rationalization of electricity tariff, ensuring transparent policies regarding subsidy, promotion of efficient environmental paying policy, constitution of Central Electricity Authority, Regulatory Commissions and establishment of Appellate Tribunal for matters connected there with or incidental there to". It was realized that electricity should be at the core of development for without electricity no development could be visualized. But the satisfactory position of electricity supply and its availability to all the consumers still remains a distant dream. The position of the availability of the electricity specially has been very unsatisfactory. The Electricity Act 2003 and policies like National Electricity Policy and National Tariff Policy lay down the road map for making electricity available to all our citizens at affordable price, irrespective of whether they live in urban or rural India. Electricity to all by 2012 was the goal Electricity Act 2003 set.

The National Electricity Policy which has been notified in February 2004 laid down the objective under which the access to electricity should be made available for all household in next 5 years, power should be available on demand by 2012, the per capita availability of electricity is to be increased to 1000 units by 2012. The minimum life line consumption of 1 unit/ household/ day has to be made possible by 2012. We all know that the majority of our population lives in the rural area. Government of India has laid down that all the villages should be electrified by 2009 and each household in the villages to be electrified by 2012; this could be taken as the national goal. So far as the power sector is concerned, as on date, the implementation of the electrification of villages varies from State to State, similarly the position of rural household electrification also varies from State to State.

For the implementation of the rural electrification within the given time frame, the Government of India have launched rural electrification through Rajiv Gandhi Gramin Vidutikaran Yojna. Under this scheme, Government of India decided to give grant of 90% (10% to come from the State Government) for rural electrification in the states. Each State has to prepare its detail project report, which is approved by Government of India after which the funds for this purpose are released. For implementing this scheme the Government of India also decided that the Central Undertakings (dealing with Power Sector) will be given the task for implementing the scheme and funds to be released by Government of India directly to these Undertakings. The State Government has to sign agreements with the concerned Central Undertakings for the implementation of this scheme in pre-determined districts of the State.

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The Rajiv Gandhi Gramin Vidutikaran Yojna is a good scheme to implement the rural electrification programme but there are factors that have to be kept in view before the scheme is implemented. The position of the village electrification as on December 2005 worked out as 85% on a national average, but there is wide disparity among the States. The percentage of un-electrified villages varied from 10% in Sikkim to 74% in Jharkhand. Similarly the national average of the access to electricity by rural household was stated to be 43% as per 2001 census. In only three States more than 75% of the rural households have electricity. The percentage of the un-electrified household varies from 25% in Sikkim to 92% in Bihar and 90% in Jharkhand. Several scheme were introduced to bring about the electrification in the rural area such as Kutir Jyoti in 1988-89, Prime Minister Gramin Yojna (PMGY) in 2000-01, Accelerated Rural Electrification Programme (AREP) in 2003-04 and accelerated electrification on one lakh villages and one crore household in 2004-05 Result of all this at the end of the year 2005 stood as under:-

Status of village electrification and Rural Household electrification

Name of states	Per centage of un-electrified villages	Per centage of un-electrified households	AT&C loss	Loss of SEBs in crores of Rs.	Per centage of utilization of Kutir Jyoti allotment
Sikkim	10%	25%	NA	No SEB	
Manipur	12%	33%	NA	No SEB	
W Bengal	16%	78%	27%	500	28%
Uttranchal	17%	50%	31%	No SEB	
Orissa	21%	79%	50%	No SEB	33%
Assam	24%	81%	39%	700	
Arunachal	40%	52%	40%	No SEB	
UP	42%	78%	49%	2500	22%
Meghalaya	48%	62%	31%		
Bihar	51%	92%	70%	1000	59%
Jharkhand	74%	90%	65%	500	57%
Himanchal			20%		

The rural electrification to be achieved by 2012 is thus a very big task that has lot of problems which need to be looked into.

Difficulties facing rural electrification:

1. Declining trend in investment in this sector: While talking of implementation of Rural Electrification Programme, the Planning Commission data indicates that the plan wise outlay for rural electrification as a percentage of total power sector outlay shows a declining trend over the plan period.

Plan period	Percentage of power sector outlay allocated for rural electrification
First Plan	5.0%
Second Plan	17.0%
Third Plan	10.2%
Three Annual Plans	14.2%
Fourth Plan	18.2%
Fifth Plan	10.8%
Sixth Plan	8.2%
Seventh Plan	6.2%
Eighth Plan	5.0%
Ninth Plan	6.0%

2. **Financial health of SEBs**: One of the main reasons for rural electrification not achieving its target has been the Electricity Board's heavy losses over the years and these losses have a direct relationship with the poor implementation of the rural electrification. If one has to consider per capita income then it could be correlated with the level of household electrification, higher the village household electrification, higher is per capita income. The data regarding the rural electrification and the per capita income and expenditure on rural electrification by the utility suggests the lack of utility interest in electrifying the areas with low per capita income.

3. **Non-utilization of funds**: There has been a wide variance among the States for the utilization of the funds, for example, if we take Kutir Jyoti scheme as an example it is seen that most of the States have not been able to implement this scheme but some have done extremely well. The achievement against the allocation varies from 22% in Uttar Pradesh compared to more than 100% in Andhra Pradesh and Karnataka. As per the information of the Rural Electrification Corporation the poor finance of the utilities is a kind of viscous circle, there is low users' charges with high cost of delivery and high T&D losses, low collection efficiency and low revenue. It directly affects the performance of the utility. The low collection efficiency results in high AT&C losses which results in low revenue which in turn makes the financial health of the Board/ utility poorer and this in turn results in the technical and operational inefficiency which further results in the low collection, and so on.

4. **Poor supply in rural and semi rural areas**: If we look at the power deficiency, the problem appears during the peak deficit, and when the supply condition becomes very poor in rural and semi urban areas. There is absolutely no supply reliability in the rural areas. If the performance report of Electricity Board/ Utilities and PFC is analyzed, the results which come out indicate that the States which have high AT&C losses, have low level of household electrification, for example Bihar with more than 70% AT&C losses, has only 5% households electrified. In the State of Jharkhand the AT&C losses are 65% with only 10% of rural household electrification. On the other hand Himachal Pradesh with around 17-18%

AT & C losses has more than 90% of the household electrification. Similar is the case in Goa, Punjab and Haryana.

With so much of variance in the rural electrification, a single system or rule cannot be made applicable in all the States.

JHARKHAND: A case study:

With this background let us discuss the position that prevails in the State of Jharkhand. As on date Jharkhand has 22 districts with more than 29,000 villages, of which more than 74% are not electrified. The reasons for all villages not being electrified, have been discussed above which are true for Jharkhand as well. The Jharkhand State Electricity Board (JSEB) came into existence with effect from April 2001 succeding Bihar State Electricity Board (BSEB) in Jharkhand. The supply position even during the period of BSEB was very poor. The JSEB inherited a very weak and inadequate transmission and distribution system. The Board is in a very poor financial health and, above all, the Government Department's dues on account of electricity supply was very huge and is increasing every day further affecting the financial health of the licensee. After Government cleared its huge outstanding bills in one go, it did not seem to improve the financial health of the Board. Over and above this, the State of Jharkhand has its own difficulties. One side of the State, the western side, does not have enough transmission and distribution network, this area is a hilly terrain. Apart from this the Planning Commission has declared 3,824 villages in Jharkhand spread over 12 districts in 115 blocks with 18,72,612 populations as "isolated villages" in which the grid connection is economically not viable.

LIST OF REMOTE UNELECTRIFIED VILLAGES IN JHARKHAND				
SL. NO.	**DISTRICT**	**NO. OF BLOCKS**	**NO. OF VILLAGES**	**POPULATION IN DISTRICT**
1	Palamu	16	688	390367
2	Hazaribagh	20	514	293771
3	Singhbum	3	39	13851
4	Ranchi	13	253	162501
5	Dumka	11	328	120073
6	West Singhbum	13	328	143932
7	Gumla	14	462	314360
8	Lohardaga	2	9	411
9	Giridih	10	604	223577
10	Sahibganj	8	527	190351
11	Deoghar	2	16	6851
12	Godda	3	56	12572
	Total	**115**	**3824**	**1,872,617**

The CPU's namely NTPC, DVC as also the Electricity Board have been given the responsibility of creating the distribution network for rural electrification by dividing the districts among them. The functions of these three entities are to construct the rural distribution network. In other words these three entities will create the assets for the distribution of the electricity in the rural area. The question remains as to how and from where the electricity will be obtained and supplied to these villages. As on date the electricity generated in the State of Jharkhand by Electricity Board and the State Undertakings is not enough to meet even the present demand, which is mostly urban.

Some suggestions:

(1) Availability of electricity: The additional availability of the electricity must keep pace with the creation of rural electricity distribution network under Rajiv Gandhi Gramin Vidutikaran Yojna. If this is not done, the result will be disastrous, the effort and money put in creating the distribution network will go waste or idle and if the network is not used after its creation, chances of the assets being lost in theft or otherwise are quite high.

(2) Use of rural distribution network: The rural distribution network created under the Rajiv Gandhi Gramin Vidutikaran Yojna can be used by any one who likes to use it on payment basis. It can serve two purposes, it can provide the much-needed electricity to the rural consumers and it will also put into use the asset created for the purpose. Proviso 8 under Section 14 of Electricity Act 2003 provides that if a person indents to generate and distribute electricity in rural area to be notified by State Government such person shall not require license for these activities, though he has to comply with the measures, which may be specified by the authority under Section 53 of the Act. Thus the Act provides for exemption from license for distribution with generation in the rural area. In the State of Jharkhand the State Government has notified the rural area. The villages which have been declared isolated can be served by stand-alone system of generation which can also supply power to the nearby villages.

(3) Power from Non Conventional/ New Energy Sources: In Jharkhand, generation of electricity through stand alone system can be affected by use of non-conventional energy sources. Jharkhand has plenty of sun shine, large number of rivulets, streams, forest products etc. which give good scope of generation of electricity through Solar Power, Wind Power, Small and Mini Hydel and Biomass. Some of the rivulets have water through out the year and some do not have water in the summer. About 50 spots have been identified for the generation of electricity through Small and Mini Hydel projects; for the generation of wind energy a few places have been identified but as far as the sunshine is concerned its availability is plenty through out the State of Jharkhand.

Generation of electricity by using the non-conventional energy sources and distributing it to the rural household through the distributing network created under Rajiv Gandhi Gramin Vidutikaran Yojna will help in solving the problem of isolated villages. Electricity can be generated from the running water of canal. The paper presented by hon'ble retired Member of NEPRA during the APEC second meeting held in Beijing indicated how the electricity can be generated at the minimum cost from the running water and in this direction another research is going on at IIT

Kharagpur. If such generation from the water of rivulets is combined with the generation of electricity from the solar energy, the local demands can be met to a great extent and if required additional power will be available for sale and in absence of grid connection this gives a scope for development of rural industry.

In Jharkhand there are 7 small projects which were ongoing projects of undivided Bihar, these projects remain un-attended after the creation of this State. The status of the projects at present remains unutlised/ un-attended the completion status varies from 20% to 90% and now equipments lying there can be used or not is doubtful.

There are 15 small hydel projects, all in rural area, for which Feasibility Reports were got prepared; these projects can generate 44.944 MW electricity. Similarly 44 spots (all in rural areas) have been identified with initial report and bids have been invited for preparation of its Feasibility Reports, these projects can provide 59.676 MW electricity.

(4) Rural Distribution network- ownership: The rural distribution network is being created under Rajiv Gandhi Gramin Vidyutikaran Yojna. The question of its ownership is important and must be decided before it is put to use. Rural electrification has already suffered at the hands of SEBs hence it should be kept separate. The Rural Distribution Network created under RGGVY should be put under a separate entity to be created by the State Government for this purpose. The usage charges from its users should be recovered by this entity and it will be the responsibility of the entity to maintain the network.

(5) Distribution in rural area: The distribution in the rural areas can be done by the electricity distribution company (DISCOM) directly through its grid network or electricity can be supplied by the distribution licensee by appointing franchisee. The village panchayats or village samitees can be given the task of local distribution as a franchisee and in case of Stand alone system they can be distributor. The electricity supply to the village household can be done by the village panchayat/ samitees they can take over the distribution and the collection of the revenue they can also take over the distribution management. The village panchyat/ samitee can also outsource the generation. For the success of this scheme it is necessary all the connections are metered. If the panchayats or the village samitee manage the power supply in the village it will ensure people getting good power and their revenue collection will ensure that the distribution licensee does not end up in making losses.

In Jharkhand Open Access is available, the panchayats or the village samiti if they want they can buy power through Open Access using the grid connection. In other words the independent power producers can enter into contract with the village panchayats and supply power as per the power purchase agreement.

(6) Transmission Network

It is of utmost importance that complete State Transmission network is studied afresh and modernization planning is done, which can take care of present load, the increased load expected due to RGGVY and increased load expected due to fresh Industrialization in the state, expected intrastate and inter-state power transfers and a large number of new power generating units likely to come up in the length and

breadth of in and around the state. In fact putting transmission network is not a matter which can be done with "Doing when it is required approach". Transmission lines are built with lot of futuristic analysis/ approach. Building state transmission networks are functions of State Transmission Utility as is clearly laid down by the EA 2003. State Transmission Utilities (STU) will organize study on continuous basis, co-ordinate with Central Transmission Utility (CTU)/ Central Electricity Authority, different transmission licensee's in the state and implements the schemes.

(7) SLDC's operation:

As per EA 2003 section 31, State Government is required to establish a State Load Despatch Centre (SLDC). SLDC is the apex body to ensure the integrated operation of the entire power flow in the state. When Rural Electrification are completed, it would be extremely necessary to permit power flow through "Open Access" mechanism as large amount of power is likely to flow through this mechanism only. Rural area electricity distribution licensee is unlikely to have their own Power Generation Plant hence power flow through open access will be the rule of the day. If SLDC does not operate in the manner as envisaged in the Act, power flow for the rural electrification will be greatly hampered.

(8) Public awareness:

Electricity Act 2003, has given several rights to the consumers and they are not at the mercy of the distribution licensee any more. Consumers have the right to participate in the tariff setting procedure; have the right to un-interrupted power supply at an affordable price. The licensees have to maintain a minimum standard of performance failing which the consumers affected are to be compensated. For keeping a check over the performance of the distribution licensee, public must know their rights and duties. It is therefore essential to make the public especially in the rural areas aware of these developments. All the consumers must be educated about abating the redressal of their complaints through Consumers Grievance Redressal Forum and the Ombudsman.

In short we can summarize the entire rural electrification programme as under:

Objective of the program:

Reach all the villages and provide electricity to all by 2012 and at the same time we aim to improve the quality of supply.

Reduce cost of service by controlling the delivery cost and cost due to loss.

Options available:

-Grid supply.
-Distributed generation and supply—Standalone generation and supply.
- A combination of the above two.

Create a local market, which will continue even after the development assistance phase.

These options are supported by Electricity Act 2003 as under:

Rural areas to be designated so, under Section 14, 8th proviso of the Act:

(a) Areas with grid connectivity
(b) Areas with no grid access
(a) **Areas with grid connectivity**:
(i) Licensee or Franchisee for the network
(ii) Parallel licensee under Section 14, proviso 6 of the Act.
(iii) Exemption under Section 13 of the Act.
(iv) Obtaining power through open access.
(b) **Areas with no grid access**
(i) Combined generation and distribution in the rural area under Section 14, proviso 8th of the Act.
(ii) Getting a generating plant set up for the supply to the distributor of the area.

Identifying the rural demand:

Identified load	Activity for which the load Assessed	Assessed load
High load demand area	For livelihood, agriculture, Industries, commercial. Domestic basic need (light)	More than 25 KW/village
Medium load demand area	Livelihood- agriculture Domestic-Basic need	20 KW+ agriculture/ Village
Low demand area	Domestic-Basic need	10-15 KW/ Village

Conclusion:

In order to complete and achieve the national goal of providing electricity connection to all households by 2012 the following steps need to be taken without loss of time:

There should be a Planning and Monitoring Authority/ Board to see the construction of rural distribution net work, and also look after generation of electricity from other that fossil fuel. This authority/ Board should be made owner of the rural distribution network constructed under RGGVY. Arrangement must be made for electricity being available on completion on net-work. Emphasis must be given to provide electricity generated from sources other than fossil fuel. Small hydel along with solar energy and run of the river projects can easily meet the initial requirement of the rural areas. This can create jobs in the areas and prevention of emission of carbon-di-oxide can give carbon credit that can help reduce the cost of the electrification/ it can also attract private parties in the field. Involvement of rural people in this project is a MUST so that they take the system as their own.

Documents:
RULES FOR APPROVING RESEARCH AND DEVELOPMENT PROJECTS BY IPAI

(Approved by the Central Council of IPAI in its meeting held on 27th March 2008)

INTRODUCTION

The main objective of the Institute of Public Auditors of India (IPAI – referred to as the "Institute") is to advance the disciplines of pubic auditing and public accounting and to promote public education in the aforesaid disciplines. The object clause of the Institute mentions, among other things, that it shall promote, compile and publish research studies and statistics. Since the Institute has been in existence for about ten years now, and has established itself adequately in the field of evaluation studies and professional advancement, the need to foster more attention to the various aspects of research activities is keenly felt. Accordingly, the Central council of the Institute has recently established a Committee for Research (referred to hereunder as the "Committee"), with the following tasks.

(i) Promote various research activities related to public auditing and accounting by providing guidance, granting incentives, initiating research projects and encouraging research activities of all types falling within the Memorandum of Association and rules of the Institute.

(ii) Collaborate with sister organizations and similarly placed professional institutes to promote research activities aimed to give a fillip to research and development in public auditing and accounting and associated areas.

The Committee has evolved the following rules and guidelines to assist in its efforts to promote research activities of the Institute.

THE RULES

1. Application

These rules will apply to all those who desire to participate in any research and development activities to be undertaken on behalf of the Institute, and will be used as guidelines for the selection, approval, funding, monitoring and publishing of all research projects and activities to be taken up on behalf of the Institute, including funding from its sources.

2. Eligibility to Apply

All members of the Institute will be entitled to sponsor research projects for approval by the Institute and to apply for its financial and other support and for the publication of the findings/ finished products through the medium of the Institute.

The Research Committee may, at its discretion, also consider research projects on public auditing and accounting by non-members of the Institute, provided the anticipated impact of such projects on the objectives of the Institute would be

significant, and the sponsors will subject themselves to the rules, ethics and other conditions prescribed by the Committee.

3. Conditions for submission of proposals on Research and Development

All those who submit proposals for research projects shall be bound by the code of ethics formulated by the Institute. The subjects/ themes proposed for research must have relatable nexus with the profession of public auditing and accounting or an associated area of interest. Originality must be the catchword and the aim of the proposed projects and subjects of research must be to arrive at valid and practical findings, conclusions and recommendations, which will assist in the professional advancement championed by the Institute.

In the case of sponsored research projects, the Research Committee will submit quarterly progress report to the Central Council for information.

4. Approval by the Central Council

All projects recommended by the Research Committee shall be placed at the subsequent meeting of the Central Council, which shall be the authority to grant final approval and financial sanction for undertaking the projects and activities. The decisions of the Central Council shall be final.

5. Details to be Provided With Applications For Research Projects

The details to be furnished by the sponsoring members to undertake research activities will, among others, include:

- (a) Name of the Project;
- (b) A brief introduction/ background of the proposal;
- (c) A self-explanatory write-up on the proposed theme of research, with clear demarcation of the areas which are proposed to be covered by the research;
- (d) Justification/ utility/ relevance of the proposed theme of research for the Institute/ the profession of Public Auditing and/or Accounting, or any other area of interest to the Institute;
- (e) Details of similar/ related studies by others and references to past research efforts by the proposer/ others/ International Bodies etc., if any;
- (f) Process/ methodology proposed to be followed for the research activity;
- (g) Estimated time required to complete the project;
- (h) Estimated resource requirements in terms of:
    - (i) Manpower (months) for the research analyst (s) and support staff;
    - (ii) Secretarial Assistance;
    - (iii) Utilities such as space, stationery, others.
    - (iv) Travel costs if applicable;
    - (v) Any other requirements.

(vi) Estimated cost of (i) professional services, (ii) utilities and (iii) travel and of these how much would be certificate based and how much voucher based to be given separately for each category.

(i) Access to official records. Whether the official records could be accessed or would need intervention of the CAG or action under RTI Act.

(j) Total estimated cost for the project, with month-wise projections.

6. Review and Approval of Research Projects

Proposals received for undertaking research projects in a quarter will be considered for review and recommendation by the Research Committee at its subsequent meeting, provided the sponsoring members have submitted all required details in time. The Committee may also, at its option, remit such proposals for comments by select experts to be nominated by the Committee. The Committee may either meet at the Central Office of the Institute to review the research proposals or circulate them for the consideration of the members.

7. Functions of the Secretary to the Research Committee

The Committee will have a Secretary appointed by the President of the Institute, who shall be responsible to prepare the agenda for the Committee's meetings, draft the minutes and process the Committee's recommendations for the consideration and approval of the Central Council. He will also maintain all records and documents related to the research projects in the Central Office as also prepare periodical reports for the use of the Research Committee.

8. Conveying the Sanctions for Research Projects

Approvals for the research projects sanctioned by the Central Council, on the recommendation of the Research Committee, shall be conveyed by the President/ Secretary of the Institute or an Official authorized by the President on this behalf. The sanction will specify, among other things, the resources allocated for the project and the mode and periodicity of release of funds etc., as well as the period for completion of the project and the submission of the report/ final paper to the Institute. 30 per cent of the professional cost shall be payable only on submission of the final report.

9. Monitoring the Research Work/ Projects

The research analyst/ members sponsoring the research/ team leader will be required to submit periodical reports on the progress of the research work and the problems encountered, if any, the extent of utilization of the research grant released and any other details as specified in the Sanction Order. Such reports may be addressed to the Secretary to the Research Committee within the stipulated time, in electronic form, copies of which shall be sent by the Secretary to the members of the Research Committee. The Committee will be entitled to seek clarifications on the progress of the work or any other aspect from the members carrying out the research at any time or to request them to make presentations to clarify any relevant issues. In the case of abandoned projects, the work done till such time will be the property of the Institute.

The Research Committee shall be within its rights to debar the person(s) working on the project for doing any further research assignment.

The Research Committee will submit quarterly progress reports on the various approved projects to the Central Committee for information.

10. Review of the Finished Product / Research Paper

The Research Committee will review the final product of research submitted by the research scholars/ members concerned either by its own or by referring them to a group of selected experts it may choose. The Committee will, after its review, submit the final papers for the information of the Central Council, along with its views and recommendations, as applicable.

The Committee will be entitled to request the members carrying out the research to make presentations of their findings and recommendations on a date and time convenient to it, in the central office of the Institute. The cost if such presentations will be reimbursable.

11. Ownership of the Research Paper/ Final Product

The Institute will be the owner of the final product of the research as well as any other documents and data generated during the research process and will be entitled to use them in whatever manner it chooses, including for all purposes related to and in furtherance of the Memorandum and Rules of the Institute. The Institute will also have the right to publish the findings and recommendations through any appropriate forum and also to publish the articles and papers generated by the research project in its Journal or any other publications, without payment of additional remuneration to the authors concerned. In case the author wants to have these articles and papers published in other publications, he shall have to seek the permission of the Institute.

The names and the contributions of the authors will, however, be appropriately acknowledged in the publications brought out by the Institute.

12. Occasional Papers

Research Committee may encourage serving officers from IA&AD to undertake research and analysis of relevant topics by providing incentives, subject to their getting necessary approval of the Department.

13. Bi-Annual Award for Meritorious Papers

Research Committee may establish a Bi-Annual Award of an appropriate amount, to be decided by the Executive Committee, for the best paper written on a topic to be announced by the Institute, which would be published in the IPAI Journal. The papers would be evaluated by a Committee appointed for the purpose by the Committee. A detailed procedure for the award scheme will be issued separately.

14. Closure of accounts by the author

Upon submission of the final project report the author will submit an account of utilization of funds supported by certificates and vouchers.

15. Miscellaneous Provisions

The Committee shall have powers to regulate the above rules, as required, to carry out its assigned tasks, and to issue supplementary rules and guidelines to facilitate its work. All such rules and directions shall be brought to the notice of the Central Council.

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Comptroller & Auditor General of India

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