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EDITORIAL

This issue contains several articles that raise pertinent questions on contemporary issues.

In their article "Rural Poverty in India: Government Efforts and Other Determinants", S.P. Kashyap and Neeti Mehta have dealt with the vital subject of Rural Poverty. While discussing issues of measurement of poverty, they have highlighted the deficiencies in the current methodology, which has resulted in inaccurate portrayal of poverty. The authors have also analysed the causes of poverty in the pre and post reforms scenario and have specifically focused on the plight of small and marginal farmers. The authors have cited number of finding of the evaluation studies on various anti-poverty programmes by the economists and social scientists. In the opinion of the authors, "Government Efforts for Poverty amelioration" such as PDS, employment programmes and credit schemes, though laudable, have outlived the purpose for which these were put in practice the blame for this is mostly on implementation deficiencies. They conclude that a long term solution lies in more imaginative policies that focus on improving production and incomes of the poorest in the poor regions. The article is of special significance to the public auditors because the SAI of India is vitally concerned with the Government's anti poverty and employment generation programmes and has extensively covered these programmes in his Audit Reports to Parliament/ State Legislatures.

Dharam Vir, in his article, while discussing the problem of delays in the presentation of Audit Reports to the Parliament and State Legislatures, has raised a very pertinent question as to whom the CAG's Audit Reports, after his counter signature, be sent for placing in the Parliament namely the President or the Ministry of Finance. He has raised questions about the present practice of sending the CAG's Audit Reports to the Government (Ministry of Finance) from where they are processed and sent to the President for further action to place them in Parliament. He would like this position to be reviewed and perhaps the practice should be discontinued and instead the Audit Reports should go to the President who can directly authorize their placement in the Parliament. A similar procedure can be followed in the States also. He has also posed the related issue of the availability of Audit Reports in public domain, even if the same cannot be placed in the Legislature due to its not being in session.

With the empowerment of the municipal bodies as a sequel to the 74th Constitutional Amendment Act, the question of municipal accounting reforms has assumed urgency. Recommendations in this regard made by the 11th Finance Commission and 12th Finance Commission were followed up by the Government of India and the CAG was assigned a special role in this task. In her article on "Municipal Accounting Reforms", Meenakshi Gupta undertakes this journey of municipal accounting reforms and analyses the various issues involved in transition to new accounting system in the municipal bodies.

The current financial crisis and economic meltdown in the USA, in particular, and across the globe has been mainly attributed to the failure of financial sector regulation system. In the background to the massive failure of reputed banking corporations and sub-prime mortgage crisis of the USA, there is an extensive debate on the causes for these failures and, this, in general, has focussed on issues and challenges for the financial sector oversight in the current scenario. Praveen Tiwari in his analysis of “Financial Sector Oversight: Issues and Challenges” has argued for, in the Indian context, a role for the CAG in assisting the Parliament in all accountability issues pertaining to the financial sector regulation and supervision. The Raghurajan Committee, amongst others, has recommended evaluation and reporting to a Parliamentary Committee of the performance of the regulators on pre- determined parameters. Praveen Tiwari strongly feels that CAG of India is naturally positioned to be associated with such evaluation in view of his independence, professionalism and apolitical position. He concludes that the time is right for the CAG to assume a proactive, constructive and comprehensive role in the matter.

National Rural Employment Guarantee Scheme under the National Rural Employment Guarantee Act (NREGA) is one of the most ambitious programme of the Government. The CAG has from time to time, brought out his findings on the various employment generation programmes in his Audit Reports to the Parliament and State Legislatures. He undertook Performance Audit of NREGA on a request from the Ministry of Rural Development “to provide assurance that the processes under the Act were put in place and were being adopted effectively by the State Governments”. The report was recently presented in the Parliament. The article by K.R. Sriram who was the Principal Auditor of this Performance Review gives a summary of audit methodology including use of information technology deployed in this Review. The article highlights the major audit findings of the CAG’s Report on the subject. It is note worthy that the Government of India has made a further request (in July 2008) to CAG for an audit of implementation of NREGA in the remaining 200 districts that were notified subsequently. The findings of second round of Performance Audit of the Scheme will be eagerly awaited by all those interested in the success of this very important Scheme of the Government.

P.N. Koul in his article on “Reform in Government Accounting” has highlighted the present shortcomings in the financial reporting by the Government and the common abuses that exist in the system. In the context of migration to accrual accounting, Koul has highlighted the need for higher level of skills required looking to the complexities and the big challenges that migration to accrual accounting poses.

In the book section we are including a very pertinent and interesting document, for our readers namely, summery of recommendations of the Tenth Report of Second Administrative Reforms Commission: “Refurbishing of Personnel Administration – Scaling New Heights”.

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.

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.

Rural Poverty in India: Government Efforts and Other Determinants

S.P. Kashyap and Niti Mehta[*]

Introduction

Rural poverty in India is influenced by several forces, such as, productivity and agricultural performance; changing sectoral composition; extent, nature and quality of employment; availability and pricing of wage goods; globalization and liberalization processes; and official policy and efforts for poverty alleviation. Understanding the nature and extent of poverty presupposes that measurement of poverty and its determinants do not suffer from serious errors. Such preconditions unfortunately are inadequately (if at all) satisfied. Nonetheless we believe that given the importance of the subject and substantial intellectual contribution of more than (at least) four decades, an effort at understanding the role of Government initiatives and other factors influencing rural poverty should be taken as useful.

It must be stated at the outset that the poverty estimates in India, despite scientific sampling techniques and fairly large number of respondents over space and time, have aroused controversies. We had an occasion to review studies on the subject till the end of 1960s (Kashyap and Parikh, 1973).The subject benefited with contributions from several leading economists of the time, Dandekar and Rath, Bardhan, Minhas, Rudra to name a few. It was noticed that poverty estimates differed widely for the same time period, nor did agree in respect to direction of change. It was expected that given the crucial importance of the subject, the refinement in methodology and considerable enlargement of sample size (particularly for quinqueinnial thick samples) would lead to considerable precision in the measurement of poverty. This did not occur, at least to the extent expected. A paper by Palmer-Jones and Sen (2001) examined various issues related to poverty measurement, such as, expenditure growth captured by NSS rounds, appropriateness of price deflators used by the Planning Commission, problems associated with 30 day recall and correspondence of official poverty line and nutritional needs of calories. The authors find "…that there are several possible sources of error in the NSS data on consumption and poverty definition and choice of poverty lines, and price deflator, changes in the distribution of expenditures and inequality and changes over the completeness of recording of expenditures at high income and possibly at low income, leading by the 1990s to significant under-reporting of both food and (probably) non-food expenditures at low and higher incomes. The statistics of poverty in India are in disarray and it would be good to try to improve them." (*Ibid.* p. 217). Himanshu in a recent paper (2007, p.507) also echoes similar concerns.

The measurement concerns are continuing to plague the recent (official) poverty estimates based on 61st round of NSSO (2004-05). Deaton (2008, p. 43) for instance notes that over the five years 1999-2000 to 2003-04 the food component of Consumer Price Index for Agricultural Labourers (CPIAL) understated the rate of food price inflation. It is also alleged that the official poverty line may not be capturing the cost

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of basic necessities, particularly non-food components such as health and education. The calculations by Dev and Ravi (2008) show that poverty ratio for inclusion of these expenditures would raise the rural poverty from 28.3 per cent to 36.4 per cent. Recently, as part of International Comparison Program (ICP), the World Bank estimates (using $ 1.25 a day per person as poverty line) that in 2004-05 about 40 per cent of Indians lived in poverty. The Asian Development Bank for the same period, using a poverty line of $1.35 a day per person, estimates poverty ratio to be around 55 per cent. These measurements are also not free from errors, but it is quite clear that: "The inter-temporal trends from the World Bank reconfirms the existing concerns that there has been a setback in poverty reduction since the 1990s and the acceleration of growth in the latter half of 1990s has not had any significant impact." (Himanshu, 2008, p.43).

Last straw is contributed by Sengupta et.al. (2008, p. 55). "….there are two unmistakable characteristics that emerge from the presentation of the status of poor people. First, the groups of extremely poor, poor, marginal and vulnerable constitute the category of common people in accounting for about three-fourths of population. They also account for the socially underprivileged groups of SC/STs, Muslims and OBCs. Secondly, most of these people belong to the category of unorganized workers….Unorganized workers are either self-employed or regular wage employees or casual workers. Among the unorganized workers over 90 per cent of casual workers and about 75 per cent of the self-employed were in the category of the poor and vulnerable." It seems that the ongoing reform process of more than a decade and a half has not dented poverty and trickle down effects of substantial growth dynamics have been quite feeble.

Determinants of Poverty

Formidable poverty measurement problems, that have persisted over time, have not discouraged investigations into causes of poverty variations over time and space. Indeed these issues have aroused interest of several distinguished social scientists. Causes of rural poverty have no doubt been holding centre stage. Discussion on poverty determinants is broadly partitioned into two phases- (i) pre-reform and (ii) onset and unfolding of reform process. The first phase largely bases on available literature, with the caveat that it has not been possible to take full advantage of wealth of scholarly writings. Further, the recourse is made to studies relating to sixties onwards, rather than a historical excursion. The coverage of post-reforms period, apart from drawing upon available studies, taking major states as cross section, estimates correlates rural poverty at two points, i.e., 1993-94 and 2004-05. The cross section exercise is cast in a comparative static framework, wherein we seek to understand the influence of overall macro tendencies, agriculture related developments and such other variables. Apart from correlation analysis we also try to fathom, to the extent possible, the role that government efforts have played in mitigating rural poverty.

Determinants of Poverty: Pre-reform Period

Based on time series, Ahluwalia's (1978) study showed that the incidence of rural poverty during 1956-57 to 1973-74 fluctuated in response to variations in real net domestic product in agricultural output per head of rural population (NDPARP) but there was no significant time trend for both the variables (rural poverty and

NDPARP). There was, however, statistically significant inverse relationship between rural poverty and agricultural performance for India as a whole. Evidence also suggested there were processes which tended to increase incidence of rural poverty, independently of agricultural output per head.

The period following Ahluwalia's study witnesses some interesting developments. It may be noted that:

(a) Rural poverty during 1977-78 to 1993-94 declined quite rapidly. Based on Planning Commission approach, rural poverty declined from 54 per cent in 1977-78 to less than 40 per cent in 1993-94. The decline was particularly sharp in post 1983 period. (Tendulkar and Jain, 1996).

(b) Agricultural performance during the period 1980-83 to 1992-95 also depicted major departure from earlier trends (Bhalla and Singh, 1998). Firstly the growth rate of the value of output not only accelerated during this period, it spread to areas which had hitherto been left out. There was extension of green revolution to the eastern region and rapid growth due to crop diversification in the central region. This period generally witnessed a distinct change in cropping pattern, away from coarse cereals towards oilseeds and other commercial crops. Another important development, highlighted by state level analysis was that the period witnessed significant increase in the agricultural productivity of (male) agricultural workers across all regions in India. In most cases growth of output far exceeded the growth of labour force.

(c) Another important development during the decade of 1970s and 1980s was the rise in the share of rural non-agricultural sector in the total labour force leading to much needed rural occupational diversification. The phenomenon aroused (and it is continuing) considerable academic interest (for a recent scanning of literature, see, Kashyap and Mehta, 2007). The possibility of distress diversification was not entirely ruled out, but most of the evidence was in favour of agricultural prosperity being the prime mover of rural occupational diversification. It was felt that during late 1970s and 1980s urban influence, surpluses generated in the farm sector, access to physical and social infrastructure interacted leading to growth induced occupational diversification resulting in rising rural wages, falling rural poverty and rural consumption inequalities.

<u>Insights from Village Studies</u>: several village studies have been undertaken that supplement understanding about macro processes that play an important role in reducing rural poverty. (For a survey of some of these studies, see Kashyap and Mehta, 2007). Krishna and his associates (2003, 2004), in a series of village studies across Rajasthan, Gujarat and Andhra Pradesh distill variables that over a period of 25 years played an important role in households escaping poverty as also those that pushed households into the fold of poverty. It was seen that income accruing from outside farm sector has been quite crucial. This may take the form of informal employment within village or in distant lands due to contacts (Rajasthan) or setting up of petty rural enterprises. Jobs in formal economy (private and government) also helped in some states. Besides, dairying (as in Gujarat) and crop diversification (as in Andhra) and minor irrigation (digging, energization of wells) also helped in overcoming poverty. Government programmes, apart from possible help in minor irrigation, did not matter much (only in Andhra such help was crucial for 15 per cent households). What are forces that push rural households into poverty? Story, in spite

of inter-state and inter-village variation, is simple, though painful. It is the heavy health related expenses, expenditure incurred on ceremonies and at times drought situation that push households into clutches of high interest (rather exorbitant) private money lenders. Then there is no escape.

Post-reform Period

Insights from village studies no doubt are important in enriching policy initiatives. It is, however, the macro tendencies that play a crucial role in shaping the policy framework. We may highlight some broad contours (Kashyap and Mehta, 2007):

(a) The growth rate of agriculture has shown continuous deceleration during the last decade and a half. The growth which was also 4 per cent during 1980-81 to 1993-94, declined to around 3 per cent during 1993-94 to 1999-00. There is further deceleration during the 9th and 10th Plan periods, as the growth declines to 2 per cent during 1997-98 to 2001-02 and further to 1.8 per cent during 2002-03 to 2006-07 (Planning Commission, 2006).

(b) Evidence, particularly since late 1980s onwards, suggests that rural growth has become less poverty alleviating. The phenomenon , at least up to 1999-00, was accompanied by:

   i) Continuous fall in employment growth in the farm sector.

   ii) Deceleration in the employment growth in the rural non farm sector (RNFS).

   iii) Continuous decline in the share of self-employed in rural and urban areas.

   iv) Continuous rise in the share of hired casual workers.

   v) The growth rate of real wage rates for casual labourers for rural male in agriculture and non-agriculture sectors showed acceleration up to 1999-00 (Sundaram, 2007).

The picture is altered in recent times on almost all counts- rise in the share of self-employed and a fall for that of casual labourers, acceleration in employment growth in farm and particularly non-farm sector, and deceleration in growth of real wage rates (Himanshu, 2007; Sundaram, 2007). Clearly the recent happenings are quite different vis-à-vis the experience of 1970s and 1980s and even that of during 1990s. We seek to understand this change, as it relates to rural poverty in India. We seek inter-relationships between variables that appear to matter and the extent of rural poverty for the two periods, 1993-94 and 2004-05, which mark the onset and unfolding of so called reform process. Inputs for this section are drawn from information published by official agencies, viz., Census of India, NSS and CSO as well as published articles.

Poverty Incidence: Table 1 looks at head-count ratio of rural poverty and changes between 1993-94 and 2004-05. The estimates are derived by using the uniform recall of frequently consumed items and also for durable goods. The ratios are based on 50th and 61st NSS rounds. During the decade of reforms rural poverty declined by 9 percentage points. The decline was quite sharp for Haryana, Bihar, Kerala, West Bengal and Tamil Nadu. Decline was less remarkable for Karnataka, Maharashtra, UP and Rajasthan. All of the major states witnessed a decline in rural poverty levels, though in MP, Gujarat, Orissa and Punjab, the poverty decline was modest.

Table 1: Rural Poverty Levels for Major States, 1993-94 and 2004-05

State	Head Count Ratio				Poverty change
	1993-94		2004-05		1993-94 & 2004-05
AP	15.9	(2)	11.2	(2)	-4.7
Bihar	56.6	(14)	42.1	(13)	-14.5
Gujarat	22.2	(3)	19.1	(6)	-3.1
Haryana	28.3	(6)	13.6	(4)	-14.7
Karnataka	30.4	(7)	20.8	(7)	-9.6
Kerala	25.4	(4)	13.2	(3)	-12.2
MP	39.2	(10)	36.9	(12)	-2.3
Maharashtra	37.9	(9)	29.6	(10)	-8.3
Orissa	49.8	(13)	46.8	(14)	-3
Punjab	11.7	(1)	9.1	(1)	-2.6
Rajasthan	26.4	(5)	18.7	(5)	-7.7
Tamil Nadu	32.9	(8)	22.8	(8)	-10.1
Uttar Pradesh	43.1	(12)	33.4	(11)	-9.7
West Bengal	41.2	(11)	28.6	(9)	-12.6
All India	37.2		28.3		-8.9
Source: Based on URP consumption (30 day recall period)					
For 1993-94, Himanshu (2007); for 2004-05, Planning Commission, Press Note, March 21, 2007. Note: Figures in brackets are the ranks of the states.					

States such as Kerala, Haryana and West Bengal improved their relative ranks in terms of rural poverty (the highest rank here depicts the lowest incidence of poverty and vice versa) between the two periods. On the other hand, Gujarat, Maharashtra and Madhya Pradesh depicted worsening of relative position among the 14 major states. States whose relative position remained unchanged were AP, Karnataka, Punjab, Rajasthan and Tamil Nadu.

Variables affecting Rural Poverty

What could be the reason for such variations across states in the post reform period? Poverty incidence across cross-section is governed by several endogenous factors, in addition to external influences.[1] Among the various factors, the demographic variables, chiefly *urbanization level*, *urban growth* and also *literacy* levels of the population could be important. Urbanization offers possibilities of alternate avenues for livelihoods for rural poor, besides invigorating the non-farm sector in the rural areas. Also crucial to poverty amelioration is the *structure of employment*, as embodied by casual workers, regular/salaried workers or self employed, that determine quality of jobs (including aspects of social security etc) and potential earnings. *Size of rural non-farm sector* (RNFS) in the workforce is a related aspect. RNFS offers alternate sources of livelihoods/subsistence. RNFS may be growth–led or distress induced, nonetheless it provides secondary employment avenues away from heavily burdened agriculture. A dynamic RNFS tightens the labour market and is often associated with upward movement of wages, which could be poverty alleviating.

[1] For a detailed discussion, see papers by Kashyap and Mehta (2007, 2008).

Labour productivity in agriculture and productivity of land per unit of area are composite indices that indicate overall agricultural performance. The *agrarian structure* and access to agricultural land are also important for livelihoods of rural population. Size structure of holdings in a region may determine the nature of agricultural activities undertaken and technology adopted thereby affecting profitability. Small and marginal holdings are becoming increasingly unsustainable due to rising capital-output ratio and vulnerability to market shocks. Other handicaps faced by small and marginal holdings are lack of adequate or timely access to credit, input markets and scientific knowledge/know-how.

Growth of overall output (net state domestic product) is likely to ameliorate poverty through trickle down of growth impulses. Total output growth as well as performance of agriculture sector are related to well-being and may lead to regional variations in poverty incidence. Also, investment in development activities is crucial in addition to the direct interventions in the realm of employment and poverty alleviation programmes of the government.

Inter-correlations of Variables: We attempt now an analysis to examine the strength and direction of interrelations of head count ratio of poverty with some of the variables mentioned above (Table 2). The absolute figures and cross section data pertaining to chosen variables at the state level are not reported here, however, the sources are cited for ready reference. It may be mentioned that some of the variables such as rate of urbanisation, structure of land holdings, and employment related variables were not found to be of any significance either in 1993-94 or 2004-05.

During 1993-94 rural and urban poverty were significantly and positively correlated (0.53). The relationship gained strength by 2004-05 (0.72). The relation between rural poverty for the two points of time is quite strong (0.94). This indicates perpetuation of structure of poverty and also guards against viewing rural and urban areas as isolated entities. Interventions need to treat rural and urban areas as unbounded spaces.

Rural poverty and urbanization appeared associated. Rural poverty had an inverse relation with urbanization in 1993-94. However, by 2004-05 the negative relation between rural poverty and urbanization weakened. Clearly the forces of growth unleashed in urban areas are failing to make a dent in rural poverty. The earlier situation, that urban growth invigorated rural sector, has changed as of now.

The correlation between rural poverty and overall literacy rate of the population shows the expected direction. The importance of education and skill development for poverty amelioration cannot be over emphasized. For urban poverty the relation was noticed to be much stronger and has over time become statistically significant, indicating the necessity of education for enhanced employability in urban jobs (see, Kashyap and Mehta, 2008).

Table 2: Correlates of Head Count Ratio of Rural Poverty, 1993-94, 2004-05

S.No.	Variables	1993-94		2004-05	
1.	Rural Non Farm Sector Employment (%) [1]	-0.28		-0.39	
2.	Urbanization (%) 1991 & 2001 [2]	-0.57	**	-0.42	
3.	Literacy Rate (%) (Total) [1]	-0.28		-0.42	
4.	Urban Poverty Level (HCR) [3]	0.53	**	0.72	*

5.	Labour Productivity in Agriculture [4] (NSDP at factor cost/worker)	-0.56	**	-0.63	**
6.	Land Productivity 1994-96 & 2003-05 [4] (NSDP Agri/Ha NSA)	-0.29		-0.40	
7.	Per cent Regular Employed (Rural) [5]	-0.47	***	-0.67	*
8.	Growth rate of NSDP (Agriculture) 1985-96 & 1996-05 [4]	-0.59	**	-0.13	
9.	Growth rate of Overall SGDP 1984-94 & 1994-05 [6]	-0.51	***	-0.45	
10.	Per capita Development Expenditure 1993 &2004 [7]	-0.60	**	-0.47	***

* Correlation is significant at the 0.01 level (2-tailed)
** Correlation is significant at the 0.05 level (2-tailed)
*** Correlation is significant at the 0.10 level (2-tailed)

Sources:
1. NSS Reports No. 409 (1993-94) & 518, Part 1 (2004-05).
2. Census of India.
3. Himanshu , 2007 (1993-94) & Press Release, GoI , 2007 (2004-05)
4. Chand et.al. , 2007.
5. Bhalla, 2006 (1993-94) & NSS Report No. 518, Part 1 (2004-05)
6. Virmani, 2008.
7. Fan et.al., 1998 (1993-94) & Authors' calculations (2004-05)

Poverty was correlated vis-à-vis employment aspects. The correlation between rural non-farm sector (RNFS) and head count ratio was negative during 1993-94, and has become somewhat stronger in 2004-05. Deceleration of agricultural growth in the decade of reforms is perhaps pushing more and more people to non-agricultural jobs to sustain livelihoods. The variable thus captures both the distress and development related forces present across the states. It is quite interesting to note that the relation of RNFS was strongly positive and significant with overall literacy and land productivity on the one hand, and with unemployment variables on the other, capturing again both the development and distress aspects simultaneously. In fact, the strength of these relations has increased, emphasizing the need to address the poverty problem in a differentiated manner across space (Kashyap and Mehta, 2007).

In terms of structure of employment, percentage of regular workers (in rural areas) shows a significant negative relation with rural poverty in 1993-94 and with time this relation has further strengthened. Predictably literacy and regular workers were positively correlated; spread of education and skills for better quality of jobs are necessary conditions for poverty amelioration (*ibid*.).

As expected both labour and land productivity in agriculture were inversely related with rural poverty levels. Also, these relations have strengthened over time. Apparently higher productivity from agriculture helps in tightening of rural wage markets and minimizes city ward migration and involvement in urban informal sector. This relation has considerable policy relevance.

We may now examine the relation of poverty with growth indices. In 1993-94, rural poverty incidence was inversely related with growth rate of NSDP from agriculture over the past decade i.e. 1985-96. Thus higher growth performance in agriculture did lead to overall betterment of economic conditions. The relation was strong (-0.60) and statistically significant. Overall growth rate of SGDP was also negatively correlated with the extent of rural poverty. Thus growth trickled down and raised the living standards of rural poor. With the unfolding of economic reforms the situation has changed. Growth performance of agricultural NSDP between 1996 and 2005 showed very little relation with rural poverty. Perhaps stagnancy in agriculture in the 90s decade and early part of 2000s is to be blamed for this disconnect. Agricultural growth is no longer poverty alleviating. Performance of overall SGDP (all sectors combined) between 1984-94, showed inverse and significant correlation with rural poverty in 1993-94, the relation weakened between 1994-05. Such a change indicates widening of rural and urban divide and reiterates the need for corrective measures to effectively link the wellbeing of rural people with processes of economic growth.

Growth rate in total output or value added hinges upon public investments in the development related sectors. We look at the development expenditure of the states (economic and social sectors), normalized by population, and seek interrelations with poverty. Higher per capita development expenditure, as expected, is associated with lower rural poverty levels. The relation with rural poverty was quite significant (-0.60) in 1993-94. However, the relation has weakened somewhat (-0.47) as of 2004-05, though it continues to remain significant. Evidently recent development efforts of government including investments in the rural areas are falling short of invigorating the rural economy.

Government Efforts and Rural Poverty

The above discussion is largely mute about the role of government efforts (Centre and State) in rural poverty reduction. Sen's paper (1997) suggests that government expenditure did play a crucial role in supporting the rural non-farm sector which resulted in poverty decline. The effectiveness of government spending could no doubt be considerably enhanced. Analysis (Fan et.al. 1998) of the interrelationships among government spending, agricultural growth and rural poverty showed that the expenditures that were good for agricultural growth, technology and its dissemination, rural infrastructure (roads), education and irrigation-amounted to a "win-win" strategy for reducing rural poverty. Marginal gains in agricultural productivity and poverty reduction, however, varied significantly across interventions. Compared to investments in rural infrastructure and agricultural technology that had the largest impact on the agricultural growth and rural poverty, additional public expenditure on (canal) irrigation did much less to reduce rural poverty than to promote agricultural growth. It may be noted that (as seen earlier), the effectiveness of development expenditure has tended to weaken in the recent times.

What about maze of government programmes/schemes and other initiatives that have proliferated? Most of these, at least on paper, aim to overcome vulnerability and poverty in rural areas. Given the fact these efforts are spread over time and space in a discontinuous manner their impact cannot be captured through usual statistical analysis. Evaluation studies, official or academic, are the only sources for gauging the impact of government initiatives. Fortunately (?) one is confronted with plethora of schemes and abundance of evaluations. According to a recent count, there were 155 centrally sponsored schemes operated by 30 central ministries and departments with a total outlay of Rs. 71,997 crores (Dikshit et.al., 2007). In this brief paper, we are not in a position to undertake a comprehensive coverage. Instead we limit to those programmes that, according to us, appear to be crucial for rural poverty reduction.

<u>Public Distribution System</u>: The Public Distribution System (PDS) is a significant programme for improving food security at the household level as it ensures

availability of essential commodities (rice, wheat, edible oils, and kerosene) at below market prices. The system operates through a network of fair price shops. Over the years the PDS has expanded enormously. "With a network of more than 462,000 fair price shops distributing commodities worth more than Rs. 300 billion annually to about 160 million families, the PDS in India is perhaps the largest distribution network of its kind in the world." (Parikh et.al., p.444). The access to PDS, which was universal until 1997, was restructured into Targeted PDS (TPDS). The families below poverty line (BPL) were issued special cards. The strategy of exclusion of above poverty line (APL) households is accompanied with pitfalls. The field based studies show that "The programme is reasonably targeted to the poor as their share is higher than the top two quintiles. However, there is substantial leakage of benefits to the non-poor." (Dev et.al., p.3561). Survey data from a Maharashtra village at two points of time (1995, 2000) showed that with a shift from PDS to TPDS errors of wrong inclusion (extending benefits to non-poor) decreased but errors of wrong exclusion (denying benefits to BPL households) increased (Swaminathan and Misra, 2001). A village survey in Rajasthan also showed serious errors of exclusion as well as inclusion (Khera, 2008).

Kundus's (2006) evaluation of PDS shows hat the programme suffers from several limitations such as regional mistargeting, leakages due to corruption and high transport and storage costs. Further, multi-commodity universal PDS has, over time, been transformed into a virtually cereal based system for the poor. "This unfortunately increased the cost of operation and rendered many fair price shops non-viable....many dealers openly admit black market sales without which, they claim, it is impossible to carry on the business after making illegal payment to all concerned officials." (P.126).

Health and Nutrition: India suffers from large scale under nourishment. According to latest report of Food and Agriculture Organisation (*The State of Food Insecurity in the World, 2008*) India has the highest concentration of undernourished people (200 million).[2]

It is seen that compared to reduction in income poverty over time the reduction in malnutrition is less impressive. The incidence of malnutrition in India is higher than that of poverty by a factor of two. Based on the evaluation of Integrated Child Development Services (ICDS), R Radhakrishnan, S. Indrakant and C.Ravi (2006, p.151) show that "...the ICDS programme played an important role in reducing infant and maternal mortality rates. However, these achievements fall short of expectations. In view of the existing degree of malnutrition prevalent among children there is a need to enhance the allocation of resources to the programme. There is also ample scope for enhancing the effectiveness of the programme by ensuring better utilization of funds and modifying the different components of the programme. Community participation in the programme would not only reduce the Government cost of the programme but also make the functioning of the programme more effective." (P.151).

There is little doubt undernourishment amongst poor results in ill health. We have already noted (studies by Krishna et.al.) that heavy health related expenses push households into the fold of poverty. Dev et.al. (2007, p.3565), based on their field studies in rural areas of Orissa, Madhya Pradesh and Karnataka find that: "The prevailing safety net programmes do not seem to address the most dominant and

[2] See, Times of India, Ahmedabad Edition, December 17, 2008, p.14.

pervasive risk of poor households, viz., exposure to serious health risk...episodes of serious illness in the households are the most likely cause of perpetual indebtedness and possibly also to poverty trap situations."

The available literature and official data support nexus between high health expenditure and poverty trap. Consider the following: "More than 40 per cent of individuals, who are hospitalized in India in one year, borrow money or sell assets to cover the cost. Many people do not seek health care because of high costs involved. For example, the poorest quintile of Indians is 2.6 times more likely than the richest to forgo medical treatment when ill. Between NSS 42nd and 52nd rounds, those sick but not availing treatment for financial reasons increased from 15 per cent to 24 per cent in rural areas and doubled from 10 per cent to 21 per cent in urban areas....Almost one-quarter of hospitalized Indians fall into poverty every year as a direct consequence of the medical expenses they pay, out of pocket, for hospitalization." (Acharya & Ranson, 2005, p. 4142).

Reasons for such a state are not shrouded in any mystery. The state expenditure on health services is abysmally low, less than one per cent of GDP. The lion share of this meagre budget (more than 60 per cent) is spent on wages and salaries. "This is consistent with large shortfalls in personnel, equipment, medicines in public facilities reported in primary health centres and sub-centres." (*Ibid*.). Innovative efforts, such as, community-based health insurance (CBHI) schemes show some promise but these are still in their infancy.

<u>Access to Formal Credit</u>: The rural households could escape falling into poverty, provided they had access to formal (low interest) credit at the time of dire need. Several official steps are undertaken so that poor have access to affordable credit services. These include creation of cooperatives and Regional Rural Banks (RRB), bank nationalization and recent efforts at boosting micro finance. An evaluation by Pradeep Srivastava (2006, p. 209-210) in the states of AP and UP presents a "...disappointing picture of access to rural finance in rural areas even after six decades of aggressive policy intervention. Less than a quarter to one –fifth of households in the two large states had formal loans, and the proportions are much lower for poorer households, especially marginal farmers with little or no land. Although the interest costs on formal loans are reasonable, they are accompanied by various other transaction and unofficial costs that increase the costs of these loans substantially thereby again reducing their attraction for poorer borrowers...Given pervasive poverty – in terms of not just households below the poverty line but those at or just above it- it should not be a surprise to learn that a large percentage of rural households had to borrow at different times, and they do so from informal sources." This is understandable as the major reasons that force poor or not so poor to borrow are unusual expenditures incurred for medical or social purposes, neither of these are catered to by the formal institutions. "Micro finance is still small in scope as compared to demand for loans, geographically concentrated in southern states, and is yet to evolve an adequate base of institutional and human capital as well as a conducive regulatory framework." (*Ibid*. p.217).

<u>Employment for the Poor</u>: It is seen that high economic growth of last two decades rarely radiates beyond metropolitan areas with little or no effect on poverty and employment situation in rural areas. Removal of rural poverty, particularly through the generation of non-farm employment, still hinges on official actions and interventions. In this respect Sampoorna Gramin Rojgar Yojana (SGRY) that was

launched on 25th September, 2001, by merging earlier two schemes- Employment Assurance Scheme; and Jawahar Gram Samriddhi Yojana- is an important initiative. SGRY is implemented through Gram Panchayats, with the states meeting only 12.5 per cent of the cost. The focus of the programme is food security, providing 100 days employment to the BPL workers during lean season in identified backward districts, and creation of community assets. Every worker under SGRY is supposed to get a minimum of 5 kg food grains per manday as part of wages. The balance is to be paid in cash so that notified minimum wages are paid. The implementation of SGRY envisages empowerment of Panchayats and involvement of women and weaker sections in decision making and execution of works.

There is no doubt that wage employment programmes are important for protecting poor and vulnerable. Hirway (p.222) notes that "…if wage employment on public works has to result in poverty reduction, it is necessary to ensure that: (i) the employment is made available on a scale that meets the demand, (2) it is provided at the minimum wage rate for an adequate number of days to ensure minimum incomes, (3) the employment is made available locally so as to reduce distressed out migration, (4) the employment is accompanied by a minimum social security package (i.e. security against injury, sickness and death, old age, maternity), (5) there is good public distribution system (PDS) to ensure that workers have access to food grains, (6) the distribution of the benefits /incomes from the assets is equitable, and (7) the assets created are owned and maintained by the workers." These conditions seem to be necessary and perhaps sufficient for the effectiveness of employment programmes.

Unfortunately, such conditions are rarely satisfied. Based on field study in rural UP, whereby 620 beneficiaries under SGRY were contacted, Mazumdar (2007) cites several problems and shortcomings. Against the mandate to provide 100 man-days of employment to each beneficiary, merely 9 to 12 man-days were provided. Eighty seven per cent of the sample beneficiaries received timely payment of the wages but the scenario of food grains distribution was grim. The local available workers were crowded out by the entry of migrant workers. The contractor led infiltration of immigrant workers in local works violated the norms of SGRY. There was pronounced gender bias, women workers vis-à-vis men were paid lower wages and their participation was also negligible (3 to 8 per cent).

Despite these and several other shortcomings, it is noticed that the scheme provides significant income addition to beneficiary households. "The scheme provided income support by 1 to 20 per cent of annual income for 65 per cent beneficiaries, 21 to 30 per cent for 13.1 per cent beneficiaries". (Pp. 176-177).

Field studies in Gujarat also paint a similar picture. A primary survey of below poverty level (BPL) households in tribal talukas in Gujarat revealed that such households had larger proportion (nearly a third) that had female heads. Nearly 40 per cent of the heads of the surveyed households were illiterate, 79 per cent of such households were engaged in landless agriculture labour, and 36 per cent of the households did not own livestock- restricting sources of supplemental income. Moreover, amongst the self-cultivating households, food crops dominated the agriculture, indicating institutional impediments that tribal farmers face in cultivating their land, linked to weak technology adoption (Mehta, 2006).

We also noticed that despite numerous interventions of the state and centre for poverty mitigation, employment creation and overall development of backward areas, in the tribal dominated regions, deprivation is of disproportionately high severity. A typical poor household is the one at the lower end of caste hierarchy or a tribal family residing in a backward and remote region- a reflection of poor endowment of productive assets, low educational standard and little access to regular employment outside the village. It is indicative of inequality in distribution of growth. In the tribal dominated remote areas, impact of policy programmes and support have been very little. Limited avenues for workforce diversification, coupled with negligible public investments in agriculture results in chronic and persistent poverty.

Wither Government Programmes: Laudable though various government efforts have been, most should ultimately outlive the purpose for which these are put in practice. Hirway rightly mentions (2006, p.223). "It is clear that a wage employment programme is successful only if it is needed less and less over time i.e. if it is treated as programme for facilitating the transition of the economy from a labor surplus economy to an economy with a minimum surplus labor." Also these schemes are no panacea even in the short run. Saxena (2006, p.59) suggests that hunger cannot be wiped off by redistributive food based programmes alone, especially in view of the poor implementation capacity of the poorer states. "The long run sustainable solution has to lie in more imaginative policies that focus on improving production and incomes of the poorest in the poor regions."

Concluding Remarks and Policy Suggestions

Measurement of poverty and identifying its determinants have engaged researchers of the country for well over four decades. Poverty estimates nonetheless continue to arouse controversies. Even after considerable refinements and enlargement of sample sizes, methodological and definitional issues continue to afflict poverty estimates. Inadequate (or no) recognition of changing food baskets, fall in food prices, use of base year basket and associated nutritional needs, neglect of non food expenditure components, such as, health and education make poverty lines adopted ill suited and result in inaccurate portrayal of poverty.

Despite these lacunas overall macro tendencies suggest that recent growth dynamics continues to bypass large sections of population. This is also supported by village level longitudinal studies. Escape from poverty, not fall into poverty, has continued to engage the attention. This is despite the fact that vulnerability to poverty afflicts majority of the population, categorised as common people- constituted by underprivileged socio-economic groups as well as unorganized self employed, casual or regular wage earners in rural and urban informal sector.

Measurement issues aside, the causes of poverty are not far to seek. In the pre and post reform scenarios the nature of variables affecting poverty indices has changed. In the 70s and after the green revolution, the relation between rural poverty and agricultural performance was inverse and statistically significant. Even though inter-state variations did exist, agriculture growth tended to reduce incidence of poverty. Later, upto the early 90s, the green revolution extended to hitherto left out areas, especially in the eastern and central regions. Coupled with crop diversification in a number of regions, the agricultural productivity per (male) worker witnessed sharp increase. Locational factors (urban corridor formation) also contributed to significant occupational diversification that took place in the 70s and 80s and agricultural prosperity was seen to be a prime mover of this development. Surplus generated in the farm sector, infrastructure development and urban influences interacted to cause growth, occupational diversification, rise in rural wages and falling rural poverty.

Since the last two decades, (80s onwards) the situation underwent drastic change. Agriculture is showing continuous growth deceleration and evidence suggests that growth has now become less poverty alleviating. After 1999-00, employment scenario has withstood several reversals; rise in share of self employment, fall in the share of casual labourers, acceleration in farm and non-farm employment growth, but decelerating real rural wages. Analysis for post reform period indicates that economic growth has brought inadequate gains to the poor. High urban growth has offered feeble linkages to rural growth and escape from rural poverty.

The unfolding of reforms process has enhanced the role of education and skill development for poverty reduction, particularly in the urban areas. Access of rural areas to education has to be improved for enhancing employability of rural poor. As of now, serious mismatch exists between the skill sets in demand and the skills available. Skill upgradation is essential for employment in RNFS, some of the activities therein offer opportunities to be taken as sole activities for the poor households (see Awasthi, 2005). Provision of affordable health care and credit too are the other priority developmental intervention required in rural areas.

Rural non-farm sector continued to be important for rural and urban poverty decline up to 1993-94 and even after that with reduced intensity. While across the developed regions, it would appear that crop diversification and prosperity may be the underlying cause for occupational diversification. In the other states deceleration of agriculture growth is leading people to non farm jobs to supplement livelihoods. RNFS nonetheless needs encouragement through development of infrastructure, credit availability and marketing channels. Assured regular or even casual wage employment in non farm sectors combined with access to social infrastructure are the most obvious long term steps as solution to poverty. Diversification of income sources continues to be noted as an important factor associated with rural households escaping from poverty.

Measures for raising productivity of the land and labour in agriculture sector are required, given the poverty ameliorating effect of such productivity growth. Initial years of reforms were somewhat favourable for agriculture growth, but since then there has been decline in the overall growth and in nearly all the agriculture sub-sectors. Agricultural incomes are facing increased instability and modest agricultural growth is no longer poverty alleviating. Revival of agriculture growth, in order that it may once again regain its pre-eminent role of poverty reduction requires efforts on several fronts, including stepping up investments for exploiting irrigation potential, credit facilities that would step up input usage, establishment of input markets, improving terms of trade for agriculture and measures to mitigate risks in agriculture (Chand et.al. 2007). Crop diversification is essential to make agriculture profitable. Small and marginal farmers are becoming poverty prone and economically unviable. Policy has to focus on the plight of small and marginal farmers. Rural poverty responds favourably to investments on development related sectors- an indicator becoming increasingly important in recent times.

Clearly the nature of variables affecting poverty has changed over time. Forces of globalization, though not adequately captured here, do matter. Studies conducted for villages, notwithstanding the differences in methodology adopted or lack of comparability with official measurements of poverty, offering insights about escape and fall into poverty need to be taken seriously. It is obvious that formal rural credit system, or officially supported (such as self-help groups) initiatives, deserve quantum leap not only for productive purposes but also to meet health and social needs (marriage and death ceremonies).

Lastly, as self employment is rising in the employment structure, need of the hour, we reiterate "...is to convert the vast pool of human resources into productive assets in such a manner that they ultimately become wealth creators and job providers, instead of mere survivors or job seekers. It is imperative to foster competent entrepreneurs by promoting entrepreneurship. Need is to develop people's enterprise in rural areas and link the same with economically viable opportunities." (Kashyap and Mehta, 2007, p.628).

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Audit Reports and Legislatures

Dharam Vir[*]

Introduction

Broadly speaking, there are two categories of Audit Reports of the Comptroller and Auditor General of India (CAG) that are required to be tabled in the legislatures: Audit Reports relating to *the accounts* of the Union (and the States), that is, Government departments *per* se; and Audit Reports relating to accounts of Government companies and corporations including autonomous bodies classed as (non-commercial) corporations. Under Article 151 of the Constitution, the Audit Reports of the CAG relating to the *accounts* of the Union (and the States) shall be submitted to the President (Governor in the case of a State Government) who shall cause them to be laid before the legislature. These Reports are sent to the Ministry of Finance and the Ministry of Finance takes further action to forward the Reports to the President/Governor and subsequently table them in the Parliament/Assembly[$].

CAG's Audit Reports relating to accounts of Government companies and corporations, including autonomous bodies and authorities classed as (no-commercial) corporations are sent to the nodal Government Departments and under the Comptroller and Auditor General's (Duties, Powers and Conditions of Service Act, 1971 (DPC Act), it is the duty of the latter to table them in the legislature. In the State Governments both categories of Audit Reports are generally handled by the Finance Departments[*]

The forgoing system stands codified in the CAG's Regulations on Audit and Accounts 2007.

The requirement of tabling the Audit Reports in the legislature as laid down in the Constitution and the laws is in salutary recognition of the financial supremacy of the legislature, that no expenditure can be incurred nor any tax levied without the authority of the legislature and that the executive must account to the legislature for the expenditure incurred and for the taxes raised on its authority. The other purpose that is served thereby is ensuring transparency; to recall an old expression there is no better detergent than sunlight (of public exposure).

The Audit Reports are in the public domain only after these have been placed before the legislature. In recent years a national daily had featured a story based on the Audit Report on Kargil purchases on the morning (i.e. before) the Audit Report was tabled. Although there was some talk of breach of privilege at that time, the matter was not pursued to finality.

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[*] The author is a former Deputy Comptroller & Auditor General of India

[$] CAG also sends unsigned copies of the Audit Reports to the Secretary to the President/ Governor in advance.

[*]There is a third category of Audit Reports, but there number is small; these relate to the Union Territories with legislatures. These Reports are prepared under the Union Territories Act, and sent to Government for being forwarded to the Governor and subsequently tabling them in the legislature.

Delays in the presentation of Audit Reports

At the recent Conference of the Accountants' General one of the issues flagged for consideration was the time lag in the presentation of Audit Reports to the legislatures.

According to the technical paper of the Conference on the subject (available on CAG's website) even when the Audit Reports are sent to the President/ Governor/ Government well in time before the commencement of the Parliament/ Assembly session, significant time lags occur in tabling them. Recently, in one of the State Governments, an Audit Report sent in January 2008 was not tabled during the budget session. It was not tabled even during the monsoon session. The State Government had taken the plea that it needed more time to study the Audit Report.

Also, there is a tendency to table the Reports towards the fag end of the session or even on its last working day with the result that there is hardly any time for their immediate meaningful use by the legislators.

Twelve out of the fourteen Audit Reports tabled in the Parliament on 23rd and 24th October 2008 carry the signature of the CAG of March/April 2008. The long time lag of six months and more occurred because while the budget session of the Parliament was cut short in view of elections to the State Assembly of Karnataka, the Lok Sabha met briefly only for two days in July 2008 for the specific purpose of consideration of vote of confidence moved by Government and adjourned thereafter to meet in October.

But there have been other occasions when the Audit Reports have not been tabled in time and remained unavailable to the legislators and the civil society for long periods. According to a February 2007 Audit Report of the CAG, as of October 2006, 26 Audit Reports on Union Government autonomous bodies had not been presented to the Parliament; seven of these Reports had been sent to Government prior to 2005. Ironically, the February 2007 Audit Report itself was presented to the Parliament in May 2007 only.

No reasons for delays

Such delays are inexplicable. The Audit Reports are prepared in a highly transparent manner. Beginning with the raising of preliminary objection and issue of inspection report and right through the development of a comment for the Audit Report (factual statement, draft paragraph) full opportunity is provided to Government at all levels, including offer of discussion with the departmental Secretary, to study and respond to the audit comment proposed to be included in the Audit Report. In the case of Audit Reports on performance audit of major programmes and projects there is, additionally, the system of entry and exit conferences with the Secretary. The audit conclusions and findings are backed by audit evidence that satisfies the rigorous tests of competence, reliability and relevance; such evidence is fully shared with Government Thus adequate opportunity is made available to Government to study, state and clarify its position *before* an Audit Report is finalized for submission to the President/Governor/Government. But a*fter* an Audit Report has been finalized, signed and submitted, Government has hardly any role. In fact even the President/Governor has only a minimal role in causing the Audit Report to be laid before the legislature as mandated by the Constitution[&].

In this background the plea taken by the State Government, in the case mentioned in the technical paper referred to above, that it needed more time to study the Audit Report that had already been shown to it at the draft stage with adequate opportunity to study and to have its say does not make sense.

Absence of timeline

Neither the Constitution nor the DPC Act prescribes any specific timeline within which the Audit Reports should be tabled. While the Constitution is completely silent on the issue, the DPC Act merely states that the concerned Government shall cause every such Audit Report relating to the accounts of a Government company or corporation to be laid before the legislature "as soon as possible".

The Study Team on Financial Administration (1967) appointed by the (First) Administrative Reforms Commission had suggested that specific dates should be statutorily prescribed for the submission of the *audited* appropriation accounts to the President (Ministry of Finance) and by the Ministry of Finance to the Parliament.

The matter had also featured in the deliberations of the Parliament's Joint Select Committee in 1970 when the DPC Act was on the anvil. It was noticed that in some cases the Audit Reports had been held back from the legislatures for unconscionably long periods. A suggestion was made that the CAG could be empowered to present the Audit Report direct to the Parliament, or in the alternative, while sending the Audit Report to the President, the CAG could also send a copy to the Speaker or the Parliament. It was however felt that such a course of action would not be permissible under the Constitution. In this connection, the following observation made by Late Shri A K Roy (CAG 1960-66) in his evidence before the JPC seems to epitomize the prevailing wisdom and thinking on the subject:

"The only remedy is not to infringe the Constitution. The members of the legislatures are more aware of their rights who can force the Government to present it because the Government have nothing to do with the report. It requires only authentication by the Minister that it is a genuine report. That is all this requires. Government have not powers to change a comma, semi-colon etc; in the report. So far as the report is concerned Government has not the power to modify it. That being so why should there be delay?… I think a watchful legislature can see to it that Government functions properly."[@]

Apparently this does not seem to be happening.

[&] This contrasts with the provision in the Constitution relating to the Annual Report of the Union Public Service Commission. The President shall cause the Annual Report of the Commission to be laid before the Parliament with a memorandum explaining, as respect the cases, if any, in which the advice of the Commission was not accepted the reasons for such non-acceptance. (Article 323 of the Constitution)

[@] Lok Sabha Joint Committee on The Comptroller and Auditor General's (Duties, Powers and Conditions of Service) Bill 1969 Evidence

Consequences of delays

Delays in the presentation of Audit Reports to the legislature have a cascading effect on the follow up action. Under the Rules of Procedure and Conduct of Business in Lok Sabha/State Assemblies, after presentation the Audit Reports stand automatically remitted to the legislatures' oversight committees namely the Committee on Public Accounts (PAC) and the Committee on Public Undertakings (COPU) and the Committees get seized of the audit comments after an Audit Report has been tabled. Further, although Government Departments are required *suo moto* to send Action Notes on the matters included in an Audit Report to the PAC/COPU within four months, the clock starts ticking from the date of presentation of the Audit Report. Delays not merely postpone the follow up action and thereby diminish the effectiveness of audit but may also lead to unhealthy speculation about the contents of the Report. Besides a culture of brazen non-accountability is insidiously encouraged if an Audit Report is held back from the legislature for long, as in the case referred to above, despite the legislature being in session.

The speed of change, the accelerated pace of Government spending, the developments in information technology, the need for ensuring most effective use of taxpayers' money, and the civil society's growing hunger for public accountability make it imperative that the Audit Reports are available in the public domain at the earliest.

Also, unlike an Annual Audit Report which used to be timed for the budget session in the past, the CAG currently submits a large number of Audit Reports throughout the year which the civil society would like to see in the public domain at the earliest, perhaps even without waiting till the legislature meets, as a valuable input in any informed discussion.

Crucial issues

The limits of the law need to be tested to see whether the presentation of Audit Reports could be fast-tracked within the law as it stands. There are three crucial issues.

First, whether the Audit Reports can be remitted to the legislature without the intermediacy of the Ministry of Finance thereby removing one layer and cutting down the consequential time lag.

It will be desirable to recall the relevant provisions of the Constitution.

Article 151. Audit Reports.__(1) The reports of the Comptroller and Auditor-General of India relating to the accounts of the Union shall be submitted to the President, who shall cause them to be laid before each House of Parliament.

(2) The reports of the Comptroller and Auditor-General of India relating to the accounts of a State shall be submitted to the Governor of the State, who shall cause them to be laid before the Legislature of the State.

Article 151 of the Constitution deals with two aspects of presentation of the Audit Reports to the legislatures: *submission* of the Audit Reports to the President and the *laying* of the Reports before the legislature. The Constitution does not specify as to who shall submit the Audit Reports to the President.[**] The allotment of Government

[**] The use of passive voice in Article 151 seems to have been the cause of confusion. But in the DPC Act also, the expression used is "shall be submitted" i.e. passive voice. However, the Audit Reports

work to various Ministries and Departments is governed by the Allocation of Business Rules framed under Article 77(3) of the Constitution and issued under the hand and seal of the President. The relevant entry against the Budget Division of the Ministry of Finance in the Second Schedule to the Allocation of Business Rules, 1961 merely reads as *laying of the Audit Reports before the Parliament under Article 151.* There is no mention therein regarding the s*ubmission* of the Audit Reports under Article 151 of the Constitution to the President, that this stands allocated to the Ministry of Finance.

The practice of forwarding of the Audit Report to the Ministry of Finance for being submitted to the President seems to be an atavistic survival from the pre-independence/pre-Constitution days when the Audit Reports used to be sent to the Finance Department[#]. Article 74 of the Constitution specifically prescribes that there shall be a Council of Ministers to aid and advise the President, and the latter shall, in the exercise of his functions, act in accordance with such advice. Notwithstanding this explicit provision, there are occasions when the aid and advice of the Council of Ministers is not relevant; for example, in taking a decision on the issue of disqualification of a Member of the Parliament for holding an office of profit when the President shall act in accordance with the opinion rendered by the Election Commission (Article 103). This is an exception to Article 74 that has been engrafted by the Constitution itself. Another such example could be the return of a bill that has been duly passed by both Houses of Parliament for reconsideration (Article 111) when the President is so to say on his own.

Likewise, Article 151 of the Constitution carries an embedded exception to the rigours of Article 74. Article 151 specifically prescribes that the President *shall* cause the Audit Report relating to the accounts of the Union to be laid before both Houses of Parliament and leaves no discretion in the matter. Advice is relevant when options and alternative courses of action are available. Since the course of action to be taken by the President is mandated in the Constitution itself, the matter is placed beyond the advice of the Council of Ministers. This being the position, routing of the Audit Reports through Government is neither prescribed nor necessary nor does it serve any purpose. It is perhaps for this reason that the Allocation of Business Rules refer only to *laying* of the Audit Reports before Parliament and there is no mention therein of the *submission* of the Audit Reports to the President.

Coming now to the issue of *laying* the Audit Reports before the Parliament, the relevant provision in the Allocation of Business Rules under the Ministry of Finance is intended to prescribe an agency that will *aid* (to the exclusion of *advise)* the President in the fulfillment of the Constitutional obligation under Article 151. But when aid becomes an impediment that delays the fulfillment of the Constitutional obligation, other alternatives have to be looked at. An alternative course of action is available in the Constitution itself. The Constitution empowers the President to send messages to the Parliament whether with respect to a pending bill or *otherwise* (Article 86). By virtue of of these powers the President is authorized to send the Audit Report direct to both Houses of Parliament with an appropriate message. An Audit Report bears the signature of the Principal Audit Officer and is personally

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under the Act are directly sent by the CAG to the concerned Government Ministries and not to the Ministry of Finance for being submitted to the concerned Government Ministries.

[#] For a detailed description of the evolution of the Audit Report and its disposition please see M S Ramayya Indian Audit and Accounts Department countersigned by the CAG and no further authentication may be considered necessary before it is tabled in the Parliament.

The Allocation of Business Rules describe the roles and responsibilities of different Ministries and departments to facilitate the orderly conduct of Government work. The work of laying the Audit Reports before the Parliament can be taken away from the Ministry of Finance or it may continue as an alternative enabling mechanism.

These considerations apply *mutatis mutandis* to the Audit Reports relating to the accounts of a State Government, which the Governor shall cause to be laid before the legislature.

There is no requirement in the Constitution or the Allocation of Business Rules that the Audit Report shall be submitted to the President by the Ministry of Finance. Nor is there any stipulation that the CAG cannot submit an Audit Report direct to the President. Any such arrangement is deemed to be totally inconsistent with and antithetical to the very concept of independence of audit from the executive as enshrined in the Constitution. Article 151 of the Constitution needs to be read seamlessly with the other Articles and the DPC Act. The independence of the CAG guaranteed through several provisions in the Constitution and the DPC Act, like fixed non-renewable tenure, estoppel on appointment to any further office under the Government, protection of the terms and conditions of service of the CAG during the incumbent's tenure, right of report and performance of his duties without fear or favour, affection or illwill and to uphold the Constitution and the laws as enjoined by the oath of office will be reduced to a nullity if the Audit Report is to be made subservient to the convenience of the executive.

Thus the intermediacy of the Ministry of Finance does not appear to be necessary.

Second, whether the executive can delay the presentation of the Audit Reports to the legislature.

This is directly relevant to the Audit Reports relating to accounts of Government companies and corporations, in respect of which the Audit Act, 1971, specifically mandates that every such Audit Report shall be caused to be laid before the legislature "as soon as possible". In the given context, the expression "as soon as possible" can imply only two things; that

(i) the legislature must be in session; and that

(ii) where specific days are allotted to a particular Ministry's business, the presentation of the Report must wait till such a day.

Except in a situation of grave and overwhelming national concern, any other factor is irrelevant, since as already stated, after the Audit Report has been signed and submitted by the CAG, the Government has only a minimal role.

In the case of the Audit Reports relating to the accounts of the Union and the States (Article 151 of the Constitution), their presentation to the appropriate legislature "as soon as possible" can be ensured by the message of the President/Governor.

By virtue of the oath of his office, the President /Governor is enjoined to preserve, protect and uphold the Constitution and the law. In line with the Constitutional and statutory provisions relating to the independence of audit, this includes an obligation to ensure that no delay occurs in the presentation of the Audit Reports to the legislatures.

Additionally, a press release issued by the CAG that an Audit Report has been has been submitted to the President/Governor /Government will alert the media and the civil society and in these days of right to information generate pressures if there is any unjustified or undue delay in its presentation to the legislature.

Third, whether the Audit Reports can be made public even when the legislature is not in session.

This is a sensitive issue, since it involves the question of the privileges of the legislature. But fortunately, some precedents are available that can provide guidance as to what may be feasible.

(a) Under the Companies Act the Annual Reports of Government companies are required to be tabled in the legislature. But in May 1959, the Speaker had agreed that a Government company could despatch copies of its annual report to the members direct soon after its annual general meeting. Ten copies of the reports would be sent to the Parliament's library and the report would be formally laid on the Table of the House as soon as possible. Incidentally, the annual reports of the companies also include the CAG's Audit comments on their accounts.

The adoption of a similar practice in respect of CAG's Audit Reports, with appropriate procedures, could perhaps reconcile the considerations of the sanctity of the privileges of the legislature with the requirements of transparency and civil society's growing demand for public accountability at the earliest.

(b) Under the Rules of Procedure and Conduct of Business in Lok Sabha the report of a Parliamentary Committee shall be presented to the House but the Speaker may, on a request being made to him and when the House is not in session, order the printing, publication or circulation of a report of a Committee although it has not been presented to the House. In that case the report shall be presented to the House during its next session at the first convenient opportunity. Can a similar arrangement be considered for the Audit Reports as a standing practice?

Conclusion

To conclude it is neither prescribed nor necessary that the Audit Reports should be forwarded to Government ('advice') for being submitted to the President/Governor; 'aid' of Government in causing the Audit Reports before the legislature can be dispensed with when such 'aid' acts as an impediment in giving effect to the provisions of Article 151 of the Constitution; and a *modus vivendi* needs to be devised that can make Audit Reports available in the public domain at the earliest when the legislature is not in session without doing violence to the privileges of the legislature. The desirability of co-opting the civil society and media needs to be considered. In these days of right to information a press release issued by the CAG that an Audit Report has been has been submitted to the President/Governor /Government will alert the media and the civil society and generate pressures if there is any unjustified or undue delay in its presentation to the legislature.

The issues need to be debated and discussed. The long-term prescription may be a definite timeline written down in the Constitution and/or the DPC Act for the purpose with or without provision for direct transmission of the Audit Reports to the legislatures by the CAG.

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Municipal Accounting Reforms

Meenakshi Gupta*

The existing municipal accounting system needs to be reviewed in the context of urbanization and potentials for urban growth in view of emerging trends of economic development. The rapid pace of urbanization in the country poses a formidable challenge to the municipal bodies to meet the continuously increasing demand for urban infrastructure and services.

In India, the 74th Constitutional Amendment Act (1992) recognized Urban Local Bodies (ULBs) as an Institution of Self Government, emphasizing necessity for devolution of more powers including financial powers to the local bodies.

In pursuance of the recommendations of the Eleventh Finance Commission, the Comptroller and Auditor General (C&AG) of India was to prescribe the Accounting and Budget Formats for Urban Local Bodies. The Task Force constituted by C&AG noted that there was an urgent need for improved municipal accounting because it would serve as an effective management tool for financial status and activities of ULB, promote more effective and timely decision making, and facilitate greater accountability and transparency.

Subsequently National Municipal Accounts Manual was prepared. To reiterate the importance of municipal accounting reforms, Government of India under Jawahar Lal Nehru National Urban Renewal Mission (JNNURM) has made municipal accounting reforms a necessary precondition for grants-in-aid under the scheme.

This paper attempts to (a) summarize the history of municipal accounting reforms (b) discuss the accounting reforms (c) highlight the issues in transition to new accounting system.

Section-I

<u>Brief History of Municipal Accounting Reforms</u>

The 74th Constitutional Amendment Act of 1992 actually set the stage for municipal accounting reforms by designating ULBs as an Institution of Self Government. It emphasized the necessity for devolution of more powers both financial and administrative at the cutting edge level. The Act envisaged regular elections to these bodies under the supervision of the State Election Commission, devolution of financial resources to these bodies through periodic constitution of the State Finance Commissions. The State Legislature are required to entrust these bodies with such powers, functions and responsibility so as to enable them to function as institutions of self government.

In this backdrop the issue of local bodies was referred to the Eleventh Finance Commission for the first time. The Commission identified maintenance of accounts and their audit as an area of concern. The report of the Commission highlighted the fact that though the states have been transferring funds to the local bodies under

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various heads of accounts, in absence of appropriate accounting systems, procedures and practices meaningful information about financial status of ULB's is not readily available. The Eleventh Finance Commission accordingly, recommended as under:

a. State should review in consultation with C&AG the existing accounting heads under which funds are being transferred to the local bodies so that a clear picture of transfers to each category of local bodies is readily available.

b. The C&AG should be entrusted with the responsibility for exercising control and supervision over the proper maintenance of accounts and their audit for all the tiers/levels of panchayats and urban local bodies.

c. The C&AG should prescribe the format for the preparation of budgets and for keeping of accounts for the local bodies. Such formats should be amenable to computerization in a networked environment.

d. Audit of accounts of the local bodies be entrusted to the C&AG who may get it done through his own staff or by engaging outside agencies on payment of remuneration fixed by him.

e. The report of the C&AG relating to audit of accounts of the panchayats and municipalities should be placed before a Committee of the State Legislature constituted on the same lines as the Public Accounts Committee.

In view of the recommendations of the Eleventh Finance Commission, the Comptroller and Auditor General of India set up a Task Force under chairmanship of Deputy Comptroller and Auditor General (Accounts & LB) in February 2002.

The recommendations of the Task Force were as follows:

1. The ULBs should uniformly follow the suggested formats for presentation of annual financial statements.
2. The budget formats with the codification and classification of budget heads applicable to ULBs need to be uniformly adopted by all ULBs.
3. The suggested formats for determining the cost of important utilities and services like Water Supply, Primary Schools and Hospital be adopted by the ULBs for overall effective financial administration and given as supplementary information to the accounts for the benefit of the Central and State Governments and other stakeholders/users of the information.
4. Significant accounting policies to be followed by the ULBs as per model accounting policies need to be disclosed in a separate schedule forming part of the accounts.
5. The ULBs need to identify some of the major transition issues in the switchover from the cash basis to proposed accrual system of accounting and initiate steps for smooth switch over to the new system of accounting.

The report of the Task Force was considered in the Ministry of Urban Development and Poverty Alleviation (MOUD) and circulated to all States/UTs in April 2003 for implementation. MOUD has accorded high priority to the municipal accounting reforms to facilitate effective and efficient financial management. The States/UTs were, therefore, impressed upon to implement the Task Force Report by using the suggested accounting and budget formats. In this context, MOUD organized a 'National Workshop on Municipal Accounting Reforms', wherein it was agreed that the C&AG of India, with USAID Fire-D support, would prepare a model national accounts manual, and this will be provided by the MOUD to the State Governments. The State Governments in turn can prepare state-level accounting manual. Pursuant to these decisions, the C&AG of India constituted a committee under the Chairmanship of the Deputy Comptroller and Auditor General (Local Bodies), to monitor and provide guidance for the development of the model-accounting manual.

A National Municipal Accounts Manual has been prepared with the assistance of C&AG of India and was released by Ministry of Urban Development in December 2004 for dissemination among the states to enable them to develop state specific municipal accounts manual. Moreover, implementation of certain urban reforms including municipal accounting reforms would be made conditional for availing central assistance under JNNURM.

It is interesting to note that as municipality is a state subject, parallelly, some State Governments initiated municipal accounting reforms on their own. In fact the first attempts were made as early as 1980 in Chennai and Mumbai. Under Technical Assistance from ADB, some initiatives were attempted in state of Gujarat also during 1991-95. However, more concrete efforts were made in later part of the 20th century. Some of them are illustrated below:

Tamilnadu decided to switch over to system of transparent accounting in 1997 for proper asset maintenance and service delivery with appreciation of liquidity and profitability and to facilitate computation of the cost of various services. The implementation process was first put in place for 10 Municipalities and 2 Corporations for the financial year 1999-2000. After the switching over to accrual system in 12 ULBs, it was decided that the balance of 92 ULBs would follow the modified accrual system for financial year 2000-01. The preparatory work, of course started in October, 1997 with formation of a Committee, submission of interim report including Accounting Manual in January 1998 and approval of Government of Tamilnadu in January 1999.

Government of Karnataka decided to switch over to Fund Based Accounting System (FBAS) in 2001 based on Global Best Practices. Bangalore Agenda Task Force constituted by Chief Minister came in as Mentors for managing implementation process. Government of Karnataka signed an MOU with Bangalore Mahanagar Palike for various time based deliverables relating to FBAS implementation and other aspects.

Under Technical Assistance from USAID Government of Maharastra also embarked on a major initiative of municipal accounting reforms in 2001. In fact the Maharastra Municipal Accounts Manual was used as a starting point for National Municipal Accounts Manual of 2004.

The Municipal Corporation of Delhi assigned the work of conversion of accounts from single entry basis to double entry basis for the period beginning March 1, 2002 to the ICAI- Accounting Research Foundation Adoption of GASB standards and preparation of performance reports was at the core of the issue.

The brief history of municipal accounting reforms clearly highlights the following facts:

a) Government at all the three levels namely Union, State and Local were alert to the need for change.

b) All the stakeholders accepted the inadequacy of existing system of accounting i.e. cash based single entry system particularly in context of increased and diversified responsibility of Urban Local Bodies.

c) ULBs cannot be equated with commercial organizations for the purpose of their reporting. Only few functions can be of commercial nature. Therefore, alternative system of accounting has to keep this basic characteristic of ULB in mind.

d) As the basic function of ULB is to provide civic amenities efficiently, the new accounting system must facilitate computation of the cost of various services.

e) There was also an underlying assumption that process of change may not be very smooth both conceptually and at various stages of implementation.

Section –II

The Accounting Reforms

The accounting reforms need to be understood in context of the stakeholders and their expectations of financial information. The major stakeholders for any ULB include:

a) the Citizens

b) the Legislature

c) the Executive

d) the Creditors

They require financial information for following purposes:

a) determining compliance with laws rules and regulations

b) evaluating efficiency and effectiveness

c) facilitating decision making and monitoring

d) assessing financial position

The report of the Task Force on Accounting and Budget Formats for Urban Local Bodies has summarized the objectives of financial reporting as under:

a) Should provide a true and fair picture of the financial position of ULBs

b) Should indicate the efficiency and effectiveness for the operations of ULBs.

c) Should provide complete information but still be simple enough for existing staff to handle.

d) Can be adopted to provide costing information of various services provided by ULBs.

e) Should be able to provide for an effective Management Information System.

Current Accounting System in India

Many municipalities in India follow the ‘cash-based’ , ‘single-entry’ method of accounting. In cash-based accounting systems, a transaction is recorded only when there is movement of cash. Revenue is recognized when cash is received and expenses are recognized when payment is made. The information regarding future payments or receivables is not shown. Revenue earned but not collected during the financial period, as well as expenses incurred but not yet paid, do not get recorded. Cash basis of accounting does not make distinction between receipts or payments on capital account and those on revenue account. Certain capital expenditure e.g. roads, bridges, drainage etc. are treated as capital expenditure.

In a single entry system, every transaction is recorded just once either as an income or expense. The system does not record assets, inventory and revenues, except in memorandum form. The advantage of the single-entry method of bookkeeping is that it is simple, easy to understand and requires little training. The existing cash basis, single entry system seeks to measure actual expenditure and receipts with reference to budget as an index of performance of ULB.

The Twelfth Finance Commission has also observed:

"The cash-based system of accounting provided room for fiscal opportunism, as tax revenues can be collected in excess during a period followed by high incidence of refunds, payments can easily be deferred and passed on to future periods, revenues due in the future could be compromised by providing for one time payments, etc."

Thus the cash based single entry system is deficient to the extent that neither does it reflect true and fair view of the financial position of ULB nor does it provide inputs for efficient decision making which is at the core of functioning of any civic agency.

Reforming Accounting Systems

To mitigate the disadvantage of the cash-based, singly entry system we need to move to a new system of accounting. Every organization whether government, private or social has to have three characteristics namely efficiency, transparency and accountability. A sound accounting system is the basic instrument for achieving these three objectives; Sound accounting helps to make the right decisions, which leads to efficiency, and appropriate financial reporting brings in transparency. Given its special character, the ULB needs a sound accounting system more than any other organization.

Accrual Basis of accounting attempts to record the financial effects of the transactions and other events of an enterprise in the period in which they occur rather than recording them in the period in which cash is received or paid by the enterprise. Double entry book keeping gives an accurate picture of the financial status of the organization for a particular period as it includes dues payable and revenues accrued and to that extent it builds the commitments of ULB into the financial statements.

System Recommended by Task Force

The Task Force has recommended Accrual Based Accounting System as it would help in creation of accounting controls for inventories, debtors, creditors, loans and advances. Emphasis is also placed on proper recognition of income and expenditure to have a clear picture of receivables and payables. The Task Force has prescribed annual budget format with a three tier codification and classification alongwith list of major and minor heads corresponding to the 18 functions envisaged to be entrusted to the ULB's as per 12th schedule to the Constitution. It envisaged preparation of following sets of statements:

a) Receipts and payments accounts

b) Income and Expenditure Statement

c) Balance Sheet

d) Monthly Accounts

In addition, the Task Force also recommended preparation of cost sheet for each major activity as an aid to the formulation of managerial policies and preparation of budget variance report as part of MIS. The Task Force also observed that:

"in order to ensure the best services at the lowest cost and to measure the effectiveness with which each rupee is spent, Urban Local Bodies should have cost accounting as an integral part of the accounting system. Ascertaining cost of each unit of important utility and service being provided by ULB's will help the management in taking crucial decisions. A proper segregation of both income and expenditure of each service/utility is a pre-requisite for cost analysis."

Accounting System Envisaged in NMAM

The National Municipal Accounts Manual (2004) claims adherence to the CAG Task Force Report and has taken Maharastra Accounting Manual as a starting point. The manual is based on the concept of accrual basis of accounting. It provides for budgeting and accounting systems to enable better control. The comprehensive manual contains the required forms, formats, procedures, accounting entries, periodical statements reconciliation procedures etc. covered in 34 chapters in the manual.

As per the NMAM the Annual Report of the ULB shall include the following:

a) Financial Statements consisting of

   i) Balance Sheet;

   ii) Income and Expenditure Report;

   iii) Statement of Cash Flows (a summary of an enterprise's cash flow over a period of time);

   iv) Receipts and Payments Account(detailed as per account heads);

   v) Notes to Accounts; and

   vi) Financial Performance Indicators

b) Report to the Municipal Chief Auditor

c) Municipal Commissioner's Report on the Annual Financial Statements and the qualifications and comments made in the Report of the Municipal Chief Auditor; and

d) Standing Committee's Action Taken Report on the qualifications and comments made in the Report of the Municipal Chief Auditor and the Report of the Municipal Commissioner.

In addition, the NMAM also provides for Budget Variance Report (BVR) and Management Information Systems Reports, it states that "Management Information System reports are necessary in ULBs for measuring its activities in a more meaningful and transparent manner. MIS not only provides information on accounting and financial aspects but also covers non-financial aspects/information in an integrated mode. The object of development of MIS reports is to provide the performance details/statistical data of the activities of the ULBs in various forms. MIS report serve as critical inputs for any decision making on any of the conducts of the ULBs."

The Twelfth Finance Commission in its report has noted that the report of the Task Force set up by C&AG for devising the budget and accounts formats has been accepted by all states for uniform implementation.

Further MOUD has also informed the Standing Committee of the Ministry as under:

" The National Municipal Accounts Manual is very illustrative in nature and can serve as a professional guide to the States. However, for any technical clarification, the States may contact this Ministry/Office of the C&AG of India.

As regard punitive measure for defaulting ULBs, no such proposal is there as municipality is a State subject. However, under the proposed National Urban Renewal Mission, implementation of certain urban reforms including municipal accounting reforms would be made conditional for availing Central assistance".

Thus the municipal accounting reforms undertaken so far reiterate the fact that Accounting Reforms are the starting point in any reform process as they facilitate decision making and financial analysis. The entire exercise of municipal accounting reforms is based on the presumption that double entry system of accounting is far superior to single entry system of accounting. Based on recommendations of Task Force the Accrual Based Accounting system has been made the backbone of the reforms. As municipality is a state subject and the NMAM is expected to service as a professional guide to the state, the whole responsibility of making the reforms a success story revolves around the initiative and interest taken by the State Government and the ULB. The broad framework has been laid down by the Task Force which was further amplified by the NMAM. However, the crux of the matter lies in real implementation of the reform agenda.

Section-III

Issues in transition to new accounting system

Major issues in transition from cash based accounting to accrual accounting system can be categorized in two categories namely:

a) Preparatory issues

b) Implementation issues

Preparatory issues include:

I. Review of legislative framework by the State Government as ULBs are a state subject.

II. Development of Accounting Manual

III. Manpower and Training

Implementation issues include :

IV. Verification of assets and liabilities

V. Valuation of assets and liabilities

VI. Computerization

VII. Parallel Run

I) Review of legislative framework

As ULBs are a state subject review of legislative framework is a necessary precondition for municipal accounting reforms. It is noticed that substantial work has been done in this respect. Model Municipal Law (MML) aims to strengthen current municipal laws and assist ULBs in areas of accounting reforms, resource mobilization and private sector participation. MML inter-alia aims at simplification of municipal byelaws, introducing specific provisions on financial management of ULBs, municipal revenue, urban environmental infrastructure and services and regulatory jurisdiction. MML was circulated to all the states in October 2003. The Ministry has been impressing States/Union territories the need for implementation of provisions of the MML as well as adoption of double entry accounting system by ULBs.

While the twelfth report of Standing Committee on Urban Development (2005-2006) applauds measures taken by the Union Government in areas of municipal accounting reforms and enactment of the MML for strengthening ULBs in pursuance of Constitution (74^{th} Amendment) Act, it also mentions that their proper implementation is also desired, otherwise such initiatives may remain sterile.

A study by NIUA in 2007 has revealed that implementation of urban reforms has progressed considerably in Western and Southern states, whereas other states have been slow in implementing the reforms.

II) Development of Accounting Manual

The Accounting Manual would bring about procedure to be followed in preparation of accounts statements, the accounts and documents required to be maintained and the form, contents and periodicity of various accounting reports to be generated.

As already brought out in Section-II above the National Municipal Accounting Manual has been prepared and circulated to State Governments for adoption/ implementation by MOUD.

III) Manpower & Training

Success of the accounting reforms depends on skills and attitude of the accounting personnel. It is therefore, desirable that they are involved in the process of transition right from the beginning and are explained the necessity and importance of such transition. They need to be provided extensive training so that reform process is internalized and not hijacked by a select group. It may also be mentioned that NIUA has prepared National Municipal Accounting Training Manual 2007 as a follow up of the National Municipal Accounts Manual under INDO-USAID FIRE (D) Project.

IV) Verification of assets and liabilities

The entire exercise about municipal accounting reforms described above would result in the most visible final product popularly known as “Balance Sheet”. Most crucial components of Balance Sheet are:

Assets

a) Fixed Assets

b) Current Assets

Liabilities

a) Long term Liabilities

b) Current Liabilities

Typically, a single entry, cash based system of accounting does not required preparation of Balance Sheet. Therefore, the first requirement for transition to accrual based double entry system of accounting is the mechanism for preparation of Balance Sheet. This obviously, translates into identification of Assets and Liabilities and their valuation.

Verification of assets and liabilities continues to be the most crucial and controversial area in the context of municipal accounting reforms. The Task Force has flagged this issue and very categorically stated that some of the assets/liabilities remain unrecorded. In case of fixed assets, documentary evidence of their cost, quantity etc. may not be readily available.

Experience shared at various forums across the country clearly highlighted the fact that historically no opening balances are maintained by ULBs. The Asset Registers/Stock Registers etc. giving details of assets, date of acquisition/construction, cost of acquisition/construction are simply not available. In absence of basic information, question of proper classification/grouping of fixed assets maintained does not arise. Thus the first challenge before the ULB is to identify the existing fixed assets.

The NMAM has given detailed guidelines for preparation of opening balance sheet which interalia include classification of fixed assets into six categories namely Land, Building, Road-Streets-Lanes, Bridges-Culverts etc. and Furniture & Fixture etc. It also suggests that physical verification of assets may be carried out which should be cross verified with existing records. In real life it is not very uncommon to come across cases where physical verification is entrusted to very junior functionaries thereby defeating the very purpose, mismatch between existing records and physical verification, double counting of assets or total omission of some assets putting a question mark on reliability of information. This not withstanding opening balance sheet must be prepared because a perfect opening balance sheet is a desirable but not essential precondition for reforms.

V) Valuation of Assets

Valuation of fixed assets normally depends upon the cost of acquisition/construction and cost of improvement, if any. NMAM provides that in case the cost of acquisition/construction is not available, an estimate of cost that would have been incurred for the acquisition/construction should be provided. In ULB the details regarding cost of acquisition are rarely available. Cash basis of accounting hardly contained information on cost of improvement of specific assets. Under such circumstances estimation of cost/value of fixed assets is a huge task. Some ULBs resorted to valuation of all such assets at nominal value of Rs.1 for opening balance sheet, thereby defeating the very purpose of accrual accounting i.e. transparency, reliability and accountability.

This also raised a fundamental issue i.e. valuation of infrastructure like roads, water and sewerage lines which strictly speaking are not tradable commodities. Further, the norms and rates for depreciation of fixed assets also need to be disclosed. The NMAM also mentions that a Task Force is being set up to prescribe life and ratio of depreciation for different types of assets of ULBs.

Current assets which interalia include sundary debtors/receivables also need to be examined very carefully in context of ULBs. Given the socio-political milieu and nature of function of ULB, they have huge amounts of arrears on account of property tax, licence fee etc. Most of the ULBs are not maintaining yearwise/ agewise break up of such arrears. Many of these arrears are also disputed and are pending in various courts of law or have been remanded back to the ULB. An exercise needs to be done to assess how much of these arrears are recoverable and accordingly reflected in the Balance Sheet. The Task Force has recommended that annually 50 percent will be provided on all outstanding beyond 3 years. The NMAM has also provided that in respect of the demand outstanding beyond specified years, provision shall be made to the extent of income of the ULB in the demand, based on the provisioning norms.

Treatment of current assets which include receivables on account of arrears of property tax, licence fee etc. are very crucial in context of ULBs for two reasons. Firstly, these are major sources of revenue for the ULB and secondly many times arrears are on account of dispute on interpretation of rules/regulations etc. Therefore, ULB needs to do a realistic assessment of what is actually recoverable. That assessment interalia may be based on agewise analysis of arrears. However, other relevant factors also need to be looked at and arrears should be perhaps segregated with reference to amount under litigation, under stay and cases remanded back to ULB.

On the liability side the major issue which needs to be addressed is the pension fund. Most of the ULBs like government make provision for pension for their ex-employees in budget. There is a need to conduct actuarial studies to know the dimensions of pensionary liabilities of the ULB in the short term, medium term and long term.

VI) Computerization

The Task Force recommended that after the accrual based accounting system stabilizes the ULB may go in for computerization. It is generally perceived that computerization is a necessary precondition for success of municipal accounting reforms. Many ULBs are trying to switch over to accrual based accounting in the computerized environment only.

VII Parallel Run

The Task Force recommended for a parallel run for smooth switch over from old system of single entry to accrual based accounting system. In practice the ULBs have resorted to shortcuts e.g. the new account being prepared by Consultants as a stand alone exercise. ULBs instead of preparing the accounts on accrual basis by compilation of vouchers have also resorted to convergence of accounts by simply using the convergence tables. The accounts so prepared actually neither reflect true and fair view of the entity nor do they highlight the issues that may actually be encountered while compiling the accounts on accrual basis from the vouchers.

Conclusion

Municipal Accounting Reforms are gradually moving from a dream of 74th Constitutional Amendment Act to reality of NMAM based on recommendations of Task Force set up by the Comptroller and Auditor General of India in 2002. Over last 5 years lot of successful initiatives have been taken up by the Government at various levels and the Standing Committee of Ministry of Urban Development has also expressed satisfaction over the progress. Bases on the recommendations of Task Force the detailed procedures prescribed in NMAM provide a sound theoretical background and structure for the reforms. However, the nitty gritty of implementation i.e. actual training of staff, preparation of a balance sheet which reflects true and fair view of the ULB parallel run and computerization are the challenges that lie ahead.

In absence of empirical study, it is not possible to indicate the extent of implementation of these reforms in nearly 4000 ULBs i.e. how many ULBs have finally switched over to the new system or how many are at various stages of transition. Last but not least the ULBs should look at the exercise of municipal accounting reforms as an aid to management facilitating more informed and efficient decision making and not merely a cosmetic change involving preparation of financial statements as the end product.

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3) Report of the Eleventh Finance Commission

4) Report of the Twelfth Finance Commission

5) Technical Guide on Accounting and Financial Reporting by Urban Local Bodies, the Institute of Chartered Accountants of India.

6) Urban Finance Quarterly Newsletter NIUA Vol. 10 No.2 April-June 2007 issue.

7) Twelfth Report of Standing Committee on Urban Development (2005-2006), Ministry of Urban Development, Government of India.

8) The Myths and Realities of Municipal Accounting Reforms by Dr. Ravikant Joshi, Advisor, Crisil Infrastructure Advisory.

Financial Sector Oversight: issues and challenges

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Introduction

As the high and mighty of the financial world struggle to fight the latest and perhaps the biggest crisis ever to hit the financial sector, discussions have ranged from ideology (market capitalism vs. socialism) to business ethics (greed of market players, vices of leveraging-domino capitalism etc), politics and regulatory failures (pitfalls of financial engineering and risk management). It is a time for serious introspection, and critically examine whether our institutions, policies and practices are equipped to not only handle such crisis situations but also to foresee and prevent them. India is in the process of reforming and integrating its financial sector with the rest of the world, which throws up enormous challenges-challenges of policies, practices and products, of regulatory and supervisory issues, of compliance with international best practices, and of the need to observe prudence so that shocks originating from imprudence, greed and even politics do not endanger the financial system and the economy.

In this paper we set out to examine the genesis of the current crisis, and its implications in the context of our efforts to reform the financial sector and its oversight architecture, and to establish a system of accountability. The paper concludes that the Comptroller and Auditor General of India (CAG)-one of the main institutions for accountability- has an important role to play in the envisioned system of accountability in the financial sector oversight.

Genesis of the current crisis

Before we discuss our concerns about the oversight of the financial sector, it would be appropriate to briefly look into the reasons of the current crisis. We live in a world of high finance, increasing by the day in sophistication and complexity. History has shown that sophistication and complexity of products, when combined with greed and indiscretion, can lead to catastrophe. We have some illustrious cases in the recent past like the LTCM (a hedge fund that failed in 1998 despite having two Nobel laureates on its board), the Enron, and the WorldCom, not to mention the spate of failures of many institutions in the recent crisis. Who could have imagined a year earlier that the housing finance policies in the USA and the associated derivative instruments would lead to failure of haloed investment banks (Bear Stearns, Lehman Brothers), insurance monoliths (AIG), housing finance giants (Fannie Mae and Freddie Mac), not to mention the write down of hundreds of billions of dollars in losses by the financial institutions world over, and crashing of the stock markets all around that has thrown the whole world into turmoil and intense pain?

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The housing bubble

The roots of the current crisis clearly lie in the sub-prime housing loans in the US, driven mainly by the political considerations of making housing loans available to anyone who was interested, irrespective of his capacity to repay. This defied conventional finance, where prudence has been the watchword in lending and investment operations. The result was that housing loans were available even to the persons with no- income- no- job- no assets (the so called NINJA loans). In the early years of the century, housing loans to people with poor creditworthiness ballooned, creating excess supply of credit to the housing sector and inflation of asset prices, driven by speculation. The financing mechanism for such loans was as follows:

- the banks would extend mortgage loans to the individuals; the mortgages would be bought by other financial institutions, primarily by the government sponsored housing finance giants like Fannie Mae and Freddie Mac;
- the mortgages would be pooled together and converted into marketable securities (through a process called securitization), known as mortgage backed securities or MBS, which will be distinct securities from the underlying pool of mortgages
- The common pool of the mortgages will be divided into different slices, called tranches, of varying risk and payment profiles to suit different investment preferences; the resulting MBS would be rated by the rating agencies, and sold off to different customers as fixed income securities i.e., with defined stream of cash flow.

Inasmuch as the MBS were sold by Fannie Mae and Freddie Mac, perceived as being backed by the guarantee of the US government, and offered higher returns than the US government bills and bonds, they became a popular investment vehicle for institutions looking for extra return for less risk. In fact, the highest ranking tranches, rated AA by the rating agencies were being lapped up by the banks, which would otherwise be required to risk weight their assets for the purpose of determining the regulatory capital. This process of securitization was further complicated by another instrument of structured finance, the credit default swaps or the CDS, which were sold by the insurance companies (like AIG) to guarantee against the possibility of default of the borrowers (an estimated $62 trillion of CDS are believed to have been written).

The fact however remained that the underlying pool of assets (that is, the sub-prime loans i.e., the loans to persons with little or no creditworthiness) was nearly worthless. What was achieved, by sophisticated looking financial engineering with a lot of mathematical modeling thrown in, that worthless assets ended up being rated investment grade and landed up in the books of banks, investment banks and insurance companies, through the instrumentality of MBS and CDS (Warren Buffet, the legendary American investor, once called the CDS as financial weapons of mass destruction, and the recent events have shown that he was not off the mark!). The resulting cycle of oversupply of cheap credit to the housing sector (leading to housing asset price bubble driven by speculators) and transmission of this risk to banks, investment and insurance companies, built a vicious circle of imprudence and peril. When the first time buyers got priced out of the market, there was slackening of demand; and when the loans started defaulting, the asset prices dived, starting a series of panic actions. The housing bubble burst as the prices crashed. The holders of the MBS were badly with substantial erosion in their asset values and had to write down hundreds of billions of dollars in sub-prime losses. There was a severe liquidity crisis, and institutions had to be liquidated or bought over. The insurance giants AIG which had major exposures in CDS, and Fannie Mae and Freddie Mac, which had major holdings of the MBS, had to be taken over by the US government as they were left with little or no liquidity. The contagion led to crashing of the stock markets all over the world and to the attendant pain and misery. John Maynard Keynes had famously said that the inevitable never happens; it is the unexpected always. For once, however, the inevitable had happened, proving the great man wrong this time around.

What are the lessons?

A few things are quite clear:

- In an increasingly integrated world of finance, even the individual financial products, emanating from a country can pose systemic risk to the whole world.
- Regulatory and supervisory oversight faces major challenges in identifying the products and institutions that pose systemic risks
- Developing an integrated and coordinated approach to an early warning system must be an integral part of the countries' regulatory and supervisory regimes
- Apart from the forces of a free market economy the legal system must ensure stiff disincentive to the recklessness of the individuals and firms that expose the economies and unsuspecting population to suffering and pain.

An important question that begs attention is how the world missed out on the problem of such gigantic proportions. The US boasts of a very comprehensive system of regulation and supervision of the financial sector. While its banks are supervised at three levels (state level supervisors, the Office of Comptroller of Currencies (OCC) at the national level and the Federal Reserve System, for banking holding companies etc), the SEC supervises the securities sector. The insurance companies are supervised by the respective state insurance supervisors. The US plays a dominant part in the determining the world standards on financial sector supervision and regulation and loses no time in criticizing the respective regimes of other countries. How did it lose sight of a burgeoning problem in its own backyard? How did the multilateral agencies like the IMF and the World Bank-which have taken upon themselves the responsibility of surveillance of the countries' financial sectors and promote stability, miss the cues? In a recent article, the Managing Director of the IMF, Dominique Strauss-Kahn, wrote[3]: "To put it bluntly, this crisis is the result of regulatory failure to guard against excessive risk taking in the financial system, especially in the United States." There cannot be a more explicit admission of the failure of the regulatory system.

The regulatory acquiescence

A clear idea of the regulatory acquiescence is provided in the writings of Alan Greenspan, the former Chairman of the Federal Reserve System, in his book The Age of Turbulence. Writing on the housing boom, he notes that the consumer spending

[3] The Economic Times, 30 September 2008

carried the economy through the post-9/11 malaise, and what carried consumer spending was housing; by early 2003, thirty year mortgages were below 6 percent, the lowest since the sixties, and by 2006, nearly 69 percent of households owned their own home, up from 64 percent in 1994 and 44 percent in 1940. Greenspan notes that a part of the housing wealth showed up in demand for other goods and services, from cars and refrigerators to vacations and entertainment, and that the evidence of speculation became hard to miss, so much so that by 2005, about 28 percent of the homes were being bought by speculators or the "flippers". Of the nearly $3 trillion of home mortgage originations in 2006, a fifth were sub-prime and another fifth were so called Alt-A mortgages, taken out by people with good credit histories, but whose monthly payments are often interest only and whose documentation regarding income etc. is poor. As the first time buyers got priced out of the market by the speculators, the prices started cooling off holding back the speculators, and starting a price spiral.

The following quote from Alan Greenspan is instructive:

"I was aware that the loosening of mortgage credit terms for sub-prime borrowers increased financial risk, and the subsidized home ownership initiatives distort market outcomes. But I believed then, as now, that the benefits of broadened home ownership are worth the risk. Protection of property rights, so critical to a market economy, requires a critical mass of owners to sustain political support."[4]

It is clear that the downside risks were clearly known but were glossed over. The bubble, made by over 300 percent increase in housing prices since 1999, was only waiting to burst.

Role of IMF

The IMF engages in multilateral and bilateral surveillance of its member countries. The **Bilateral Surveillance** is the process of regular dialogue and policy advice that the IMF is mandated to provide to its members, covering macroeconomic and financial developments and policies in their countries, particularly through the Financial Sector Assessment Program (FSAP). The FSAP, which is a joint IMF-World Bank initiative to provide member countries with a comprehensive evaluation of their financial systems, was launched in 1999, partly in response to the Asia crisis and calls by the international community for intensified cooperative efforts to monitor financial systems. The FSAP aims to alert national authorities to likely vulnerabilities in their financial sectors and also provides assessments of observance of various internationally-accepted financial sector standards, set within the broader institutional and macro-prudential context.

As of end-April 2008, about 140 countries, three-quarters of the IMF's membership, have participated or are participating in the FSAP. About two-thirds of the countries that have completed the process agreed to post associated Financial System Stability Assessments (FSSAs) on the IMF's website.

It is interesting to note that the USA has not been subjected to FSAP so far. Through much of the nineties and the post -2000 years, the IMF has spent considerable resources on evaluating the financial sector vulnerabilities of the smaller countries, especially the so-called offshore centres through its Offshore Financial Centre (OFC) initiative. Whatever the reasons, and people do not discount political factors, the

[4] Alan Greenspan: The Age of Turbulence (2007)

vulnerabilities of the institutions and practices in the country with the biggest financial sector having the potential to precipitate an international crisis escaped assessment by the IMF under the FSAP.

More recently, however, in a December 2006 paper[5], the IMF recognized the risks in the US sub-prime sector and noted that the shift in recent years towards more risky mortgages may make segments of the mortgage credit markets more vulnerable to the deceleration in housing prices and predicted that default rates in the sub-prime sector were likely to rise. Observing that the proliferation of securitized mortgage structures makes it hard to identify the ultimate holders of this heightened mortgage credit risk, the IMF concluded that the wide distribution of risk could mitigate the impact of potential losses. Unfortunately, the subsequent events have proved just the opposite as the impact of the losses has shaken the whole world. It is obvious that both the US regulators and the IMF were fully aware of the risks but rather sanguine about the consequences.

The Indian context

India has not remained untouched by the US crisis. A little more than a year ago, when the first news of the sub-prime crisis broke, the Indian stock market was hitting the stratosphere, buoyed up by the exuberance of high growth rate, large funds flow into the capital market by the foreign institutional investors, never mind the beating the Indian currency took in the process, and a charged up Indian investor, preening on its recent exploits of the capital market. The capital market regulator at that time saw no effect of the sub-prime crisis (still in its infancy at that time) on the Indian financial system (decoupling was the buzzword then). In a span of about a year the Sensex has crashed from the level of nearly 21,000 to sub-11,000 levels, and the financial system is facing severe liquidity crisis as well as crisis of confidence. It is time to initiate a discussion on the way forward- how to protect the Indian financial system from such systemic risks that can undo the economic gains of years of hard work.

Financial Inclusion and the attendant risks

Financial inclusion is increasingly being seen as an important vehicle for future growth strategy in India. As the credit expansion takes place, bringing into its fold the borrowers who are not so creditworthy or have poor credit record, the systemic risks will also increase, just as the US sub-prime experience has shown. Our policies and practices therefore have to be sufficiently informed by the international experience. There is thus an urgent need for independent and professional review on a continuous basis of the policies and practices that pose systemic risks.

The Committee on Financial Sector Reforms (CFSR)

The draft report of the CFSR[6], under the chairmanship of Prof. Raghuram Rajan, has made a number of recommendations for the financial sector regulation. These include:

[5] Financial Market Update December 2006, Monetary and Capital Market Departrment

[6] Government of India, Planning Commission, April 2008

- Creation of a growth friendly regulatory environment, including a better risk management process for regulators and the regulated, while allowing the innovation needed to spur growth.
- A more streamlined regulatory architecture that reduces regulatory costs, overlaps, silos, and gaps.
- Better coordination between regulators so that systemic risks are recognized early and tackled in a coordinated way.
- A coordinated process to protect consumer interests as well as raise literacy levels.
- Better frameworks for reducing the level of financial risk—for example, through prompt corrective action.

Some of the specific recommendations of the Committee in respect of regulatory architecture are as follows:

Review of corporate accounts: The Ministry of Corporate Affairs (MCA) should review accounts of unlisted companies, while SEBI should review accounts of listed companies.

Clear demarcation of regulatory remit: The supervision of all deposit taking institutions must come under the RBI, while that of all trading activities must come under the purview of SEBI. RBI should play an important role in the joint supervision of conglomerates and systemically important NBFCs.

Principles based supervision: There should be a change from rule based regulation to principles based regulation.

Consolidated Supervision: One of the most important recommendations of the Committee is setting up by statute of a **Financial Sector Oversight Agency (FSOA),** which will have a supervisory focus and monitor the functioning of large, systemically important, financial conglomerates; it will address and defuse inter-regulatory conflicts, and look out for the build-up of systemic risks. The FSOA should be comprised of chiefs of the regulatory bodies and the Finance Secretary. The discussions of the FSOA with the management of systemically important institutions will be "principles-based", and this will initiate the process of gradually implementing more "principles-based" regulation throughout the system. It will be important that the FSOA add value by substituting for some existing processes instead of adding another layer, while bringing collective regulatory views to bear.

Financial Development Council: The Committee recommends setting up a Financial Development Council (FDC) with the Finance Minister as the Chairman. The main focus of this council would be macro-risk assessment and developmental issues. The FSOA will be the secretariat for the Council.

Office of the Financial Ombudsman (OFO): The Committee has recommended setting up an Office of the Financial Ombudsman (OFO), incorporating all such offices in existing regulators, to serve as a "one stop" source of redress for complaints. The ombudsman can also monitor the selling of different products, the degree of transparency about their pricing, and their suitability for targeted customers. Finally, given that household debt loads are increasing, the ombudsman can provide a neutral forum (and possibly act as an arbitrator) for out-of-court negotiated settlement of debt.

Regulation and accountability

While addressing the issue of accountability of the independent regulators, the Committee recommends that all financial regulators should be subject to a periodic external evaluation. Emphasizing that in a parliamentary system of government, the ultimate locus of accountability is the parliament, the committee states that:

- All financial regulators should be accountable to a standing Committee of parliament (possibly, the Standing Committee on Finance).
- Once in five years, a body of reputed outside experts (including possibly regulators elsewhere) would be constituted to propose guidelines for the evaluation of the regulator for the next five years, given the legislative mandate.
- Based on the report of experts, the government, in consultation with the Parliamentary Committee and the regulator would finalize the specific principles (the "remit") the regulator would be held accountable for, including any parameters for annual evaluation.
- The regulator would submit an annual report to parliament. This report would include the progress on pre-agreed evaluation parameters and would be discussed in the parliamentary Committee.
- The parliamentary Committee would be guided by the remit in its discussions with the regulator.
- The annual report, the statement of the regulator to the Committee, and a transcript of the Committee discussions with the regulator should be made widely accessible to the public.

Accountability and the role of CAG

While the Committee has given due importance to the parliamentary accountability of the regulators, it is rather unspecific how this will be enforced. In order for the parliamentary accountability to be enforced effectively, the parliament has to be assisted by an independent, professional and apolitical organization to make the evaluations on predetermined parameters. The CAG, a constitutional authority created mainly to provide oversight of government and government sponsored organizations, and report to the legislature, is a natural choice for the purpose. The CAG is also the auditor of the regulatory agencies (barring the banking supervisor, the Reserve Bank of India) and its remit includes performance audit of the organizations it audits. Thus the role of an evaluating agency, on the lines envisaged by the CFSR, would not only be natural but complementary to the task being performed by the CAG. Unfortunately, the concept of accountability is yet to take firm roots in our governance process and the institutions tend to shun accountability on one pretext or other. It is not unusual to hear a regulator viewing it as an encroachment on his autonomy, without thinking that autonomy, in a democratic setup is not absolute, and can never exclude accountability.

There are some strong arguments in favour of CAG being involved in the evaluation of regulators, as envisioned by the CFSR:

- The countries world over, submit to periodic assessments of their regulatory and supervisory systems by the IMF, both as part of the Article IV consultations and under the FSAP, under which the IMF prepares Reports on Standards and Codes (ROSC) on the extent of observance by the countries of international standards recognized by the IMF. In respect of the financial sector the relevant standards are the Basel Core Principles (banking), Insurance Core Principles (laid down by the International Association of Insurance Supervisors-IAIS), and the principles laid down by the International Organization of Securities Commissioners-IOSCO. Such reviews by the IMF of the countries' regulatory and supervisory regimes are never viewed as threat to regulatory autonomy.
- The Government Accountability Office (GAO), which is the US counterpart of the CAG, makes periodic assessment of the financial sector and its regulators, under the authority of the Comptroller General or the respective laws, and in the process of assisting the Congress through its testimonies.
- With the phenomenal growth in the financial sector independent evaluations of the regulatory and supervisory regimes is critically important. The banking, insurance, securities and pension regulatory and supervisory regimes have never been subjected to systemic reviews.

The GAO is a good example

The GAO has been performing an appreciable role in reviewing the issues related with financial sector oversight, including the prudentially regulated sectors of security, insurance and banking. A search of the GAO website on financial institutions showed up 138 reports produced by the GAO since 2000. These reports cover the functioning of the regulators (Federal Reserve, SEC, OCC, Commodities Futures Trading Commission, NAIC etc), the regulated (banks, insurance companies, hedge funds, private equity firms, credit unions, mutual funds and security companies, investment banks), and issues related to market discipline and performance (credit derivatives, anti money laundering, bank failures etc.). A review of these reports shows that issues of substantial importance, ranging from regulatory functioning to the risks posed by the financial products and practices to the financial system, have been raised by the GAO from time to time. A few examples in the context of the present day crisis will be in order.

GAO's reports on mortgages and housing GSEs

- In its report of July 2002, on mortgage financing through the Federal Housing Authority (FHA)-insured loans, GAO reported that factors not fully captured in the model GAO used may be affecting the performance of recent FHA loans and causing the overall risks of FHA's portfolio to be somewhat greater than previously estimated.7

[7] Mortgage Financing: Changes in the Performance of FHA-Insured Loans; GAO-02-773 July 10, 2002

- In its testimony to assist the Congress in reviewing the adequacy of GSE oversight, GAO pointed to the fragmented regulatory arrangements for the housing GSEs including the Fannie Mae and Freddie Mac, and reported that it was not clear that the housing GSEs' large holdings of mortgage-backed securities benefit borrowers.[8]
- In its report of February 2005 on managing the risks from new mortgage loan products, GAO recommended stricter underwriting criteria and other techniques for mitigating risks.9
- In its April 2005 testimony to the Congress, GAO while recommending changes in the oversight structure of the housing GSEs, reported that due the large size of the GSEs, potential existed that financial problems at one or more of the GSEs could have destabilizing effects on financial markets, and that the HUD may not have sufficient resources and technical expertise to review sophisticated financial products and issues.10
- In its November 2005 report, GAO analysis indicated that FHA-insured loans with down payment assistance have higher delinquency and claim rates than do similar loans without such assistance.11
- In its September 2006 report, GAO pointed out that Alternative Mortgage Products (those that allow borrowers to defer repayment of principal or part of the interest for the first few years of the mortgage and eventually lead to a "payment shock" at a later time) were offered to less creditworthy and less wealthy borrowers, and that delinquencies and default could rise.12

GAO's reports on financial sector regulation

- In its report of October 2004, GAO examined the adequacy and appropriateness of the regulatory architecture in the USA.13
- In its reports of March 2007, GAO, under the Comptroller General's Authority, reviewed the consolidated supervision programs at the Federal Reserve System (Federal Reserve), Office of Thrift Supervision (OTS), and Securities and Exchange Commission (SEC) and noted that it was difficult to

[8] Government-Sponsored Enterprises: A Framework for Strengthening GSE Governance and Oversight; GAO-04-269T February 10, 2004

[9] Mortgage Financing: Actions Needed to Help FHA Manage Risks from New Mortgage Loan Products; GAO-05-194 February 11, 2005

[10] Housing Government-Sponsored Enterprises: A New Oversight Structure Is Needed; GAO-05-576T April 21, 2005

[11] Mortgage Financing: Additional Action Needed to Manage Risks of FHA-Insured Loans with Down Payment Assistance; GAO-06-24 November 9, 2005

[12] Alternative Mortgage Products: Impact on Defaults Remains Unclear, but Disclosure of Risks to Borrowers Could Be Improved; GAO-06-1021 September 19, 2006

[13] Financial Regulation: Industry Changes Prompt Need to Reconsider U.S. Regulatory Structure; GAO-05-61 October 6, 2004

collaborate within the fragmented US regulatory system and made a series of recommendations concerning the SEC, OTS, and Federal Reserve System.14

- Similarly, in January 2008 and September 2008, GAO produced reports on hedge funds and leveraged buyouts (LBO) by private equity funds, focusing on the regulatory arrangements in place for their supervision and the systemic risks posed by them. GAO recommended that the heads of the Federal Reserve, Office of the Comptroller of the Currency, and SEC should give increased attention to ensuring that their oversight of leveraged lending at their regulated institutions takes into consideration systemic risk implications raised by changes in the broader financial markets, as a whole.15

The above gives a flavour of the range of issues reported by the GAO, whose importance can be well appreciated in light of present day developments. A similar arrangement in India, in which the CAG reviews the operations of the financial system and the regulators, will be an important step forward in bringing the systemically important issues to focus and mitigating systemic risks.

Redefining the role of CAG

CAG's role in respect of the government and government sponsored entities must be informed by the role and work done by its US counterpart, the GAO. CAG must be perceived as an important agency in the accountability process, and not a mere auditor of financial statements. The accountability concerns go much beyond the certification of accounts. The existing constitutional framework permits this, though the existing laws, especially the CAG's DPC Act, and practices may require some fine tuning to provide an unambiguous mandate and framework of operation. Of course, this would also involve ensuring that the CAG's review of the institutions, systems and procedures etc is conducted in a framework of predefined and agreed parameters; that the regulators do not feel pinned down by unnecessary or interfering oversight is a legitimate concern.

Some of the important ingredients of the CAG's review process could include the attributes identified by the CFSR, including:

- the risk management process for regulators and the regulated, the environment in which they operate, and the way they tackle risks,
- The regulatory costs, overlaps, and gaps
- Coordination among regulators for identification and management of systemic risks and framework for reducing the level of financial risks.
- Protection of consumer interests

[14] Financial Market Regulation: Agencies Engaged in Consolidated Supervision Can Strengthen Performance Measurement and Collaboration; GAO-07-154 March 15, 2007

[15] Hedge Funds: Regulators and Market Participants Are Taking Steps to Strengthen Market Discipline, but Continued Attention Is Needed; GAO-08-200 January 24, 2008 and Private Equity: Recent Growth in Leveraged Buyouts Exposed Risks That Warrant Continued Attention; GAO-08-885 September 9, 2008

- Implementation of prudential international standards on banking, insurance, securities and pension (prescribed by the Basel Committee on banking Supervision, IAIS, IOSCO, and OECD Core Principles of pension regulation)
- Adequacy of regulatory and supervisory practices as well as of the regulators' examination of regulated entities and the quality and level of assurance

CAG's interface with parliament

At present CAG's interface with parliament is limited to discussions by PAC and COPU of CAG's reports. There is need to enlarge this interface to include all issues and matters of accountability to parliament. The useful role played by the GAO in assisting the US Congress in enforcing accountability can serve as a guide, and the fact that the CAG is not an officer of parliament, unlike its US counterpart, does not in any manner diminish this role. In an article on the ongoing financial crisis published in January 2008, Paul Krugman, who later won the Nobel Prize for economics for 2008, wrote as follows:

"The real sin, both of the Fed and of the Bush administration, was the failure to exercise audit supervision over markets running wild."[16]

There cannot be a stronger case for the appropriate audit supervision of the financial sector in India. All stakeholders in the accountability process need to be sensitized of this issue to flesh out an institutional arrangement that makes CAG the agency of natural choice, wherever independent evaluations and opinions are warranted in the process of parliamentary accountability.

Conclusion

The continuously increasing sophistication and complexity of the modern day finance, the range of financial services and the increasing role of the financial services sector in the developmental paradigm throw up major challenges for accountability, which must be regarded as crucial for stable growth and development. The institution of CAG, with its constitutional independence, professionalism and apolitical nature, must play a major role in this process, by reporting under its constitutional and legislative mandate, and through assistance to the parliament in a manner akin to the GAO of the US. The government, parliament and other sections of the society must be sensitized and the CAG must take a proactive lead in fine tuning this expanded role, and effect institutional changes to fulfill this responsibility. The CAG's reports so far have hardly commented on the range of issues in the financial sector covered by the GAO. With the world moving towards defined standards for prudential regulation, consolidated supervision and cross border cooperation among the supervisors, and increasing emphasis on disclosures, transparency and risk management, the stage is set for the CAG to play a more proactive and meaningful role in the oversight of the financial sector. The current turmoil gives us an opportunity to start the process.

[16] Don't Cry for Me, America: Paul Krugman, New York Times, 18 January 2008.

Performance Audit of Implementation of National Rural Employment Guarantee Act (NREGA)

K.R. Sriram*

All India Performance Audits

The audit of programmes funded by the Central Government and implemented by the State Governments poses a special challenge for the IA&AD, in view of the need for co-ordinated audit and dual reporting responsibilities to both the Central Parliament and State Legislatures. For such programmes, the IA&AD has evolved a system of "All India Performance Audits" co-ordinating the efforts of the Principal Audit Offices of the Central Government and the State Principal Accountants General/ Accountants General (Audit). This approach to All-India Performance Audits has been well appreciated by different stakeholders – the Legislators at the Central and State levels, top management in the Central and State Governments, the media and the public at large.

Further, in order to ensure consistency with contemporary best practices in the field of performance auditing, the CAG of India evolved a comprehensive set of Performance Auditing Guidelines in 2004. These guidelines outlined principles, techniques and procedures for performance audit, with special focus on strategic planning in pursuit of the SAI's strategic goals and objectives, risk-based planning and selection of subjects, closer interaction with the auditees, attainment of the ultimate objective of value addition to management, and strengthening of quality assurance systems and procedures.

National Rural Employment Guarantee Act (NREGA) – An Introduction

While the Government of India has been implementing schemes for providing employment in rural areas for more than two decades, the National Rural Employment Guarantee Act (NREGA) represents a paradigm shift towards providing a legal guaranteed right to work, and thus enhancing livelihood security. The Act guarantees 100 days of employment in a financial year to any rural household, whose adult members are willing to do unskilled manual work. This work guarantee can also serve other objectives: generate productive assets, protect the environment, empower rural women, reduce rural-urban migration, and foster social equity.

The Act was initially notified in 200 districts in the country from February 2006, and has subsequently been extended in phases to cover all the rural districts in the country with effect from April 2008. Once the Act comes into force, each State Government is required to formulate a State Rural Employment Guarantee Scheme conforming to the minimum features specified in the Act. Rural households have a right to register themselves with the local Gram Panchayats, and seek employment. Work is to be provided within 15 days of the date of demand, failing which the State Government would have to pay unemployment allowance at stipulated rates.

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The Act is a flagship programme of the current Government. The expenditure on the programme is borne by the Central Government, except for 25 per cent of the cost of material and wages for semi-skilled and skilled labour, unemployment allowance and certain administrative expenses, which are borne by the State Government. Since the primary objective of the Act is provision of rural employment, it stipulates that wage costs should not be less than 60 per cent of the total expenditure. Further, use of contractors is prohibited, and as far as practicable, tasks shall be performed by using manual labour, and not machines.

The Act is also unique in that it empowers ordinary people to play an active role in its implementation through meetings of village-level bodies, social audits, and grassroots-level participatory planning.

Detailed operational guidelines have been issued by the Government of India. Together with the provisions of the Act, they prescribe:

- the types of works that can be covered under the Act;
- the minimum entitlements of labour;
- the roles and responsibilities of different functionaries right from the Central and State Government to the District and lower level officials, including those of the local self-government bodies;
- the detailed procedures for planning, financial management, registration of households, allotment of employment, execution of works, and payment of wages and unemployment allowance;
- the detailed records to be maintained at different levels; and
- the mechanisms for social audit, as well as monitoring and evaluation of outcomes.

Request for Audit

In August 2006, the Ministry of Rural Development requested the SAI to undertake a performance audit of the implementation of the Act, in view of the importance of the Act and the rural employment guarantee programme, and to provide assurance that the processes under the Act were put in place, and were being adopted effectively by the State Governments. After a risk assessment of the programme, the request of the Ministry was accepted, and a performance audit of the implementation of NREGA, covering the initially notified 200 districts, was initiated during 2007-08.

Audit Methodology

Pilot Studies

Before drawing up the detailed audit guidelines, pilot studies were undertaken in two districts in two States. In addition, detailed scrutiny of background information with the Government of India, as well as on the Internet, on NREGA and its implementation was conducted.

Audit Sampling

A multi-stage statistical sampling approach was adopted. In each State, 25 per cent of the districts were selected using Simple Random Sampling Without Replacement

(SRSWOR[17]). Below the district level, two blocks were chosen using SRSWOR in each sampled district, and in each sampled block, four Gram Panchayats were chosen using Probability Proportionate to Size (PPS[18]) sampling. The size measure for PPS was the number of NREGA-registered households, failing which the number of households below the poverty line was used. Thus, records relating to 68 districts, 141 blocks, and 558 villages in 26 States were selected for detailed audit examination.

Audit Guidelines and Checklists

After careful consideration, we decided to prepare separate detailed audit checklists at the Central, State, district, block and village levels, as we felt that the checklist format would be better suited to drawing generalized conclusions across the sampled population throughout the country, which was preferable to a compilation of individual State-specific findings. The audit checklists were so designed that the vast majority of questions involved yes/no answers. For audit areas not involving compliance issues, a supplementary analytical checklist involving detailed audit analysis and free-form responses on a limited set of issues was also devised.

After the finalization of the audit guidelines, we held an entry conference with the Government of India, where the audit scope, objectives, criteria and guidelines were explained in detail and discussed. At this conference, the Ministry also made a detailed presentation on the status of implementation of NREGA.

Use of Information Technology

In order to simplify the process of consolidation of findings from different audit offices into a single Audit Report for the Central Parliament, and also ensure availability of detailed audit findings at a granular level, we decided to automate the process of capture and consolidation of audit findings using Information Technology (IT). An electronic database application was developed in-house on Microsoft Access 2003 specially for capturing audit findings for each checklist level from the State down to the Gram Panchayat level; this was circulated to all State Principal Accountants General/ Accountants General, who were requested to send their databases, duly filled in with their responses, back to us.

Exit Conference and Finalisation of Audit Report

Key and important findings from the consolidated database of audit findings were identified and then discussed with the Ministry of Rural Development in an exit conference in December 2007. These were then consolidated into a draft Audit Report which was formally issued in December 2007 to the Government of India for comments. Responses from the Government of India, including responses on State-specific issues from 22 State Governments, were received in February 2008. Further, the Ministry also made a presentation in February 2008, highlighting their concerns relating to the issues covered in the draft report.

Subsequent to the original audit, a limited scrutiny of record maintenance for one month was conducted in February and March 2008 in order to assess the improvement in maintenance of records as a result of the performance audit. The results of this

[17] SRSWOR is a statistical sampling method, under which each item is chosen randomly and by chance, such that each item has the same probability of being chosen at any stage during the sampling process. During this process, the possibility of selecting any item more than once is deliberately avoided.

[18] PPS method is a statistical sampling method where the probability of selection of an item is proportional to its size measure.

limited scrutiny, as well as the responses from the Government of India and the State Governments, were included, as appropriate, in the final audit report.

Major Audit Findings

The Performance Audit Report on Implementation of NREGA was tabled as the CAG's Performance Audit Report No. 11 of 2008 (Union Government (Civil)). The major findings of the audit were as follows:

- The NREG Act is a unique laudable Act of Parliament which enabled the rural households to demand upto 100 days of employment as a matter of their statutory right.
- It was crucial to maintain proper records of employment demanded and provided, entitlement for employment allowance etc. However, the maintenance of basic records, particularly at the village and block level, was poor, as a result of which the authenticity of figures of employment demanded and provided, number of days of employment generated etc. could not be verified. Further, there is a high probability of only partial capturing of the demand for work.
- There were significant deficiencies in the setting up of the implementing machinery, particularly at the block and village levels, in terms of appointment of dedicated manpower. This had a consequential adverse impact on the maintenance of records, especially at the village level, which made it difficult to verify compliance with the legal guarantee of 100 days of employment in a year on demand.
- There were several cases of delayed payment of wages, for which no compensation was paid. Further, as the applications for demand for work were not documented or dated, and dated receipts for such applications were not issued in most cases, the eligibility of rural households for unemployment allowance in such cases was unverifiable.
- There were deficiencies in the planning process, particularly in the preparation of the five year District Perspective Plans.
- The systems for financial management and tracking were deficient, with significant cases of failure to conduct monthly squaring and reconciliation of accounts. Several instances of diversion and misutilisation of funds and non-rendering of utilization certificates and expenditure details were noticed.
- The status of inspection of works at the State, District and Block levels was poor, and most States had not designated State and District level quality monitors. Also, in most cases, village meetings, which were to be held twice a year to conduct social audit forums, were not held.

An electronic copy of the audit report is available on the CAG of India's website at http://www.cag.gov.in .

Post-script

Pursuant to the conduct of audit of implementation of NREGA in the first 200 districts, the Government of India made a further request in July 2008 to the SAI for an audit of implementation of NREGA in the remaining districts, which were notified subsequently. We are now in the process of planning the second round of performance audit of NREGA.

Reform in Government Accounting

P.N. Koul*

1. Background

1.1 The present government accounting model is what was developed years ago when the role of government was much smaller. Despite phenomenal growth of receipts, outlays and debt over the years, during last over five decades, except reform in the classification structure which was introduced in the accounts in 1974-75, further refined in July 1987, there has been no major reform in government accounting. The principal objective is to enforce compliance with the budget. The primary users of the financial information are the administrators and the legislators.

1.2 The accounting system recognizes transactions only when cash is received or paid. The accounts report cash transactions of government. Receipts are classified and sub-classified by reference to their source and payments by reference to functions. The accounts are based on the single entry system and the double entry system is applied only in regard to the maintenance of a set of technical accounts in order to bring out in a scientific way the balances of accounts in regard to which government acts as a banker or remitter or borrower or lender. These balances are worked out in regular accounts but their accuracy is verified with balances brought out in the double entry system.

2. Financial Reporting by Government

2.1 Annual Accounts prepared under the cash basis of accounting are incomprehensible set of numbers. These result from processing the transactions that are structured by being aggregated. The financial statements provide information about the sources of cash received during the year, its application (how cash was used) and how it compares with budgeted amount for the reporting period. There is no information on receivables, payables, non-cash assets, accrued revenues and expenses, commitments and contingent liabilities of government.

2.2 Finance Accounts bring together all receipts and expenditure and by themselves do not reveal any of the management control related information. Statements in part-I of the Accounts are independent information tabulated from various accounting and non-accounting sources. Statement on financial results of schemes is fed from data supplied by outside sources. Data relating to guarantees are not accounting data nor do these flow from accounting records but are separately collected and incorporated. Statement on debt position does not give any clue to the debt management. Except for recoveries in arrears, the statement of Loans and Advances by Government does not reveal the degree of irrecoverabilty or the likely volume of bad debt. The statement of Balances does not give the complete record of the financial position of government as the balances reported do not take into account all the physical assets nor any accrued dues or outstanding liabilities which are not brought to account under the existing accounting framework. The revenue surplus or

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deficit is only on cash basis. In the present form the statements give details of receipts and disbursement for the financial year, account of public debt and assets and liabilities as worked out from the balances recorded in the accounts. The financial statements do not disclose full cost of resources consumed. There may be understatement of resources consumed as accrued expenses and cost of using assets would not be included. There may be overstatement of resources consumed as the statements would include the full cost of capital items in the year of their acquisition even though the assets will be consumed in future years and include items which do not relate to the cost of services delivered in a reporting period.

2.3 Government does not produce a Balance Sheet. Even if it is produced, it can not be full. Illustrated below is the Statement of assets and liabilities in the existing accounting framework drawn from the information available in Finance Accounts.

Government of
Balance Sheet as on 31st March 2003

(Amount in Rs.)

Liabilities		2002-03	Assets		2002-03
Debt			**Loans & Advances**		
Internal Debt	219,976,423,752		Loans	46,115,339,001	
Loans & Advances from Central Govt.	115,647,398,188	335,623,821,940	Advances	68,449,299	
			Advances with foreign countries	9,167,292	46,192,955,592
Small Savings & Other Funds			**Capital Assets**		
NSS Fund	2,416,558,170		Opening Balance	96,264,896,290	
Provident Fund	64,277,533,784		During the year	15,969,698,104	
Trusts & Endownments	252,148	66,694,344,102	Depreciation	—	112,234,594,394
Contingency Fund		1,500,000,000			
Other Funds			**Share Capital in statutory corporations, Govt. companies, etc**		
Reserve Funds	130,226,366		Opening Balance	29,621,706,142	
Sinking Funds	3,607,990,473		During the year	305,707,0000	29,927,413,142
Development & Welfare Funds	1,662,951,659				
Other Reserve Funds	835,612,124	6,236,780,622	**Security Deposits by Government**		888,983,424
			Investment of Earmarked Funds		
			Sinking Fund Investment A/c	*330,660,894	
			Famine Relief Fund Investment A/c	875,000	331,535,894
Deposits			**Inter State Suspense**		6,216
Security Deposits	7,509,465		**Departmental Balances**		
Deposits of Local Bodies	5,772,838,690		Civil	12,121,212	
Deposits of Companies Corporations	6,887,254,148		Cash Imprest	59,041,791	71,163,003
Civil Deposits	17,070,706,529				
Other Deposits	1,189,794,252	30,928,103,084	**Cash Balance**		1,622,385,269
Suspense & Misc.					
Suspense	1,397,182,348		**Cumulative Excess of Expenditure over Receipts**		
Cheque & Bills	4,996,291,966	6,393,474,314	Opening Balance	216,801,993,456	
			Add: Excess of Expenditure over Receipts	41,360,385,727	258,162,379,183
Remittances		2,054,892,055			
Total		**449,431,416,117**	**Total**		**449,431,416,117**

Notes:

		(Rs. in Lakh)
(i) Sums guaranteed outstanding as on 31.03.2003		
	Principal	855905
	Interest	11836
(ii) Guarantee commission receivable as on 31.03.2003		3296
(iii) Loans and advances recovery in arrears as on 31.03.2003	Principal	28533
	Interest	1208
(iv) Commitments on account of incomplete capital works		202335

*Market Value Rs.394,262,820

(Source: Finance Accounts, Government of Tamil Nadu — 2002-03.)

3. Shortcomings in the present system

3.1 The focus of the accounting system is mainly on bookkeeping and expenditure control. The system does not capture output nor is designed to measure cost.

3.2 Evolution of specialized accounting standards for governments has not received adequate attention; a constraint to evaluate financial capability of governments.

3.3 Cash balance of government is common for both the Consolidated Fund and the Public Account. Though the moneys in Public Account are used for disbursement from the Consolidated Fund and should constitute borrowing by government, no formal transfer of money to the Consolidated Fund is made in accounts. It is argued that Public Accounts liabilities carry government guarantee and therefore, deemed a contingent charge on the Consolidated Fund.

4. Common abuses

4.1 Despite simple accounting system, its inappropriate application results in distortion in accounts which could be avoided with the legitimate use of these accounting operations. Given below are a few illustrations:

(i) Operation of Suspense Account is intended to accommodate expenditure on purely temporary basis pending location of head(s) of account to which the expenditure should be posted. Due to non-availability of information, the amounts continue to remain unadjusted over the years. The expenditure is made, the budget is not effected and the account heads not debited. Thus, through the illegitimate use of an accounting operation, the spending authorities in effect exceed their budget and circumvent expenditure control. This could be avoided by the legitimate use of accounting operation. The continued outstanding not only vitiate the accounts due to exclusion of this expenditure but also tend to conceal irregularities and defalcations.

(ii) Balances under Suspense and Remittance heads are either due to government or due from government, to be cleared in the same manner as Debtor or Creditor account is settled; but continue to remain unsettled mostly due to awaited funds. Appropriately these charges have to be cleared before the end of the financial year assuming provision for the expenditure exists.

(iii) The funds lapse at the end of the financial year. A large number of spending departments tend to draw unspent funds at the end of the financial year and place them in Personal Deposit Account within Public Account opened in government treasury and show these grants as spent. Through the manipulation and operation of Personal Deposit Account, the lapse of funds at the end of the year is thus, circumvented. This practice can be remedied, may be, by resorting to multi year budgeting.

(iv) While the Constitution distinguishes expenditure between revenue and capital, in practice both revenue and capital expenditure is broken into plan and non-plan. This breakup overlays the scheme of classification. Expenditure generally on new schemes during a plan period including expenditure towards salaries and other administrative purposes, which strictly speaking is of revenue nature, is categorized as plan. Money spent on the same scheme even after the plan period is treated as non-plan expenditure.

(v) While the classification of expenditure and receipts are objective-wise, the criterion of capital and revenue expenditure and receipts depends not wholly on the nature of assets its tends to create but also on the source of its financing i.e. whether met form receipts of a capital, debt, deposits or banking character as distinguished from the ordinary revenues like taxes, duties, fees, fines and similar items of current income. Even after the creation of the assets, the maintenance, renewals and replacements and any other additions, improvements and extensions would be debited to revenue account, if so prescribed by government. Apparently the allocation of expenditure to capital and revenue except at the initial project stage does not follow any scientific financial precept.

Even though grants and loans (revenue expenditure) are used for capital formations by the recipients, its classification in accounts is not affected by the end use.

(vi) Minus balances in accounts under Debt, Deposit and Remittance heads is yet another typical example of accounting errors arising due to wrong or mis-postings or mis-classification and not on account of a systemic deficiencies.

5. Need for Reform

5.1 With these limitations, the financial position and assets and liabilities of government as depicted in financial statements cannot reasonably be true and fair. Financial reports are less reliable. In view of the conflicting principles and structural limitations, the existing financial reporting and the entire accounting system behind it, is not capable of meeting the needs of the modern management. The government account has no choice but to get a major structural change as a long term option.

6. Government Accounting Standards Advisory Board

6.1 With the creation of Government Accounting Standards Advisory Board (GASAB) in August 2002 by Government of India financial accounting and reporting is poised for a reform in the near future. Establishment of GASAB is an evidence for an authoritative action in the future and a major advance in the development of accounting standards to enhance transparency in financial reporting in governments. The Board has already embarked upon accounting and reporting reforms in governments. Several Exposure Draft on government accounting principles and practices have been issued implying the changes in the manner of reporting government activities in financial statements.

7. Migration to Accrual Accounting

7.1 Recognizing the deficiencies in the present cash basis model, the accounting profession has for sometime past began to work on application of accrual basis of accounting to government to provide complete and accurate information on government finances, assets and liabilities to the users. A more recent impetus for application of accrual basis is the recommendation of the 12th Finance Commission which has been accepted by Government of India in principle. Many State Governments have agreed to migrate to accrual accounting.

7.2 GASAB has issued a report on road-map and transition path and operational frame work in May – June 2006. Reform period will however, depend upon commitment, availability of human and financial resources and effective coordination and management. Going by the current pace of work migration is likely to take a long time.

7.3 Given the higher level of required skills and complexities of accounting, accrual accounting is a tough challenge and therefore, should be a long term option. To improve financial reporting and to derive some of the benefits afforded by accrual accounting, the immediate approach could be to purge the existing system of the common abuses, adjust the existing cash based accounting system by incorporating information on revenue and expense arrears and supplement financial statements with information about the stocks of non-financial assets and their valuation at a reporting date. Initially it may not be comprehensive but could be progressively developed. The cash based financial statements could be provided with disclosures and explanatory notes to provide information about the basis of accounts, accounting polices applied and also such details which are not presented in the financial statements because of limitations of cash accounting but are necessary for fair presentation and to enhance accountability.

Documents:

Tenth Report
Second Administrative Reforms Commission
Refurbishing of Personnel Administration – Scaling New Heights

SUMMARY OF RECOMMENDATIONS

1. (Para 5.3.6) Stage of Entry into the Civil Services

(a) Government of India should establish National Institutes of Public Administration to run Bachelor's Degree courses in public administration/ governance/ management. In the long run it is expected that these specialized centres of excellence (National Institutes of Public Administration) would evolve as major sources of civil services aspirants.

(b) Selected Central and other Universities should also be assisted to offer such graduate level programmes in public administration/ governance/ public management which will produce graduates to further expand the pool of eligible applicants to the civil services.

(c) The courses offered in these universities should include core subjects such as the Constitution of India, Indian legal system, administrative law, Indian economy, Indian polity, Indian history and culture apart from optional subjects.

(d) Graduates of the above mentioned special courses from the National Institutes of Public Administration and selected universities would be eligible for appearing in the Civil Services Examinations. Further, graduates in other disciplines would also be eligible to appear in the Civil Services Examination provided they complete a 'Bridge Course' in the core subjects mentioned above. The Bridge course should be run by the same selected national institutes/universities, which conduct the graduate level courses stated in (c) above.

(e) Liberal need-based scholarships should be provided to students admitted to the Institutes/ Universities.

(f) An 'Expert Committee' should be appointed immediately by the Government in consultation with UPSC to develop the curricula and determine the admission policy to these selected institutes/ universities. This Committee should inter alia have the following terms of reference:

- (i) Lay down norms for identification universities and institutes where the said courses would be conducted.
- (ii) Design the content of the curricula for the said courses in public administration.

(iii) Prescribe the modalities for admission to these courses.

(iv) Prescribe the modalities and design of the bridge courses.

The Commission strongly recommends that the Expert Committee be appointed straightway so that the new courses could be started in some of these institutions/universities from the coming academic year. The Commission also feels that the bridge courses and their effectiveness should be reviewed based on the experience of five years.

(g) Since this is a major reform relating to an important area of governance and will need coordinated guidance, especially in the initial years, a high-level oversight/coordination committee with the Prime Minister as Chairman may be constituted to meet once in three months and give guidance to the implementing agencies and concerned institutions.

(h) The reforms to the scheme of the examination system as recommended in paragraph 5.5 may be taken up immediately. Examination and Recruitment reforms following the introduction of public administration/governance management as a full-fledged degree course in National Institutes of Public Administration and selected universities would take some time to be operationalised. Till then, the existing system, where students from all disciplines can appear for the competitive examinations, may continue.

(i) Students who have acquired a graduation degree in the above-mentioned course would have option to join any other career of their choice either in the public or private sector.

2. (Para 5.4.17) Age of Entry and Number of Attempts

(a) The permissible age for appearing in the Civil Services Examination should be 21 to 25 years for general candidates, 21 to 28 years for candidates from OBC and 21 to 29 years for candidates from SC/ST as also for those who are physically challenged.

(b) The number of permissible attempts in the Civil Services Examination should be 3, 5, 6 and 6 respectively for general candidates, candidates from OBC, candidates from SC/ST and physically challenged candidates respectively.

(c) The present cut-off date for determining the eligibility in terms of age (i.e. 1st of August in the year of the examination) may continue.

3. (Para 5.5.5.3) Structure of the Civil Services Examination

(a) *Structure of Examination:* Either of the following two models may be adopted for compressing the examination cycle.

(i) The Preliminary and Main Examinations for the Civil Services Examination would be conducted together on two to three consecutive days. Evaluation of papers for the Main Examination should be done in case of only those candidates who have secured a threshold level of marks in the Preliminary

Examination. The personality test would follow thereafter.

OR

(ii) Based on the results of the Preliminary Examination, candidates eligible for taking the main examination and the personality test would be short listed in accordance with their rankings. Only these short-listed candidates would be eligible for appearing in the Main Examination, which would be conducted within two months of the Preliminary Examination. The short list would be limited to about two to three times of the number of vacancies available. Thus it would be possible to start the Personality Test and the Main Examination almost simultaneously.

(b) *Content:*

(i) The Preliminary Examination should consist of an objective type test having one or two papers on general studies including the Constitution of India, the Indian legal system, Indian economy, polity, history and culture. There should be no optional subjects.

(ii) The Main Examination should consist of two papers only in the compulsory subjects. These compulsory subjects may include Constitution of India, Indian legal system, Indian economy, polity, history and culture etc. The question papers should be of the conventional descriptive type. Besides, there should be a separate essay paper as a part of the Main Examination.

(c) Steps may be taken by DOPT in consultation with the UPSC to finalise the syllabi of compulsory subjects for the both the preliminary and main examination, for the recruitment cycle 2010. This could later on be dovetailed with the recommendation of the "Expert Committee" suggested in Paragraph 5.3.6.

4. (Para 5.7.5) Other Modes of Induction into the Civil Services

(a) The induction of officers of the State Civil Services into the IAS should be done by the UPSC on the basis of a common examination.

(b) UPSC should conduct such an examination annually for officers from the State Civil Services who have completed 8 to 10 years of service in Grade 'A' posts. The eligibility criteria should also include norms such as an upper age limit of 40 years etc. On the basis of this examination, the UPSC should provide the State Governments with an eligibility list. e State Governments should fill up their quota for promotion to the IAS on the basis of this eligibility list. A maximum of two attempts should be allowed to an eligible candidate for taking this examination. To ensure that the existing officers in the State Civil Services are not denied adequate opportunities, the examination in the next two years may be conducted for all such eligible officers and the upper age limit of 40 years may be introduced, thereafter.

(c) The mechanism mentioned above should also be applied in case of induction into other All India Services at the State level.

(d) Induction by way of promotion into Group 'A' Central Services should, in addition to consideration of ACRs, also be done through conduct of examination on the basis of the criteria as mentioned above. The nature of the examination, ratio of posts to be filled by promotion etc. should be decided by the concerned departments in consultation with the UPSC.

5. (Para 5.8.6) Allotment of Cadres to the All India Services

(a) The following amendments should be made in the new Cadre Allocation Policy (2008) for allocation of Cadre to candidates selected for the IAS:

(i) At least one vacancy each year in each of the cadres of AGMUT (only for the State of Arunachal Pradesh) Manipur, Meghalaya, Mizoram, Nagaland, Sikkim and Tripura may be allotted to a successful candidate domiciled therein provided he/she has opted for his/her home State. This may be done even if there is no 'insider' vacancy in these cadres.

(ii) In case there is more than one eligible candidate, then the allotment may be done in the order – ST, SC, OBC and General candidates, as applicable to each state.

(iii) Once the home State quota of the above-mentioned North Eastern States is filled up, further allocation may be done as per the Cadre Allocation Policy (2008), after making adjustments necessitated by the changes recommended above.

6. (Para 5.9.6) The Union Public Service Commission

(a) Promotion of officers through Departmental Promotion Committees (DPC), upto the level of Selection Grade may be delegated to the concerned Departments. The UPSC should supervise the functioning of these DPCs through periodic reviews, audit etc.

(b) In the case of disciplinary proceedings, consultation with the UPSC should be mandatory only in cases involving likely dismissal or removal of a government servant.

7. (Para 6.8) Capacity Building

(a) Every government servant should undergo a mandatory training at the induction stage and also periodically during his/her career. Successful completion of these trainings should be a minimum necessary condition for confirmation in service and subsequent promotions. Mandatory induction trainings should be prescribed for Group D staff also before they are assigned postings.

(b) A monitoring mechanism should be setup for overseeing the implementation of the National Training Policy (1996).

(c) The practice of having a ‘Common Foundation Course’ for all Group ‘A’ Services – generalist, specialized and technical, should continue. For Group ‘B’ and ‘C’ Services, the Institute of Secretarial Training and Management (ISTM) may be developed as the nodal agency for design and delivery of common Foundation Courses.

(d) All civil servants should undergo mandatory training before each promotion and each officer/official should be evaluated after each training programme. Successful completion of the training programmes should be made mandatory for promotions.

(e) The objective of mid-career training should be to develop domain knowledge and competence required for the changing job profile of the officer. To this end, mid career learning opportunities relevant to specific domains or specializations should be made available for officers.

(f) Public servants should be encouraged to obtain higher academic qualifications and to write papers for reputed and authoritative journals.

(g) A strong network of training institutions at the Union and State levels needs to be built up to cater to the training requirements of civil servants. However, instead of spreading resources over a large number of institutions, a few institutions should be identified for capacity building and upgradation.

(h) The composition of governing bodies of the national training institutions such as the LBSNAA, SVPNPA, IGNFA and also the State Administrative Training Institutes should be broadened by inducting eminent experts.

The governing bodies should be adequately empowered to enable them to discharge their functions efficiently.

(i) A national institute of good governance may be set up by upgrading one of the existing national/state institutes. This institute would identify, document, and disseminate best practices and also conduct training programmes.

8. (Para 7.3.3) Recruitment at Group ‘B’ Level

(a) Each Department, dealing with both the general as well as specialized Services (Group B), may set up committees to examine what changes are required in the system of recruitment and promotions to these posts. Prima- facie the Commission is of the view that in order to infuse fresh thinking, a certain percentage of vacancies (say 25% every year) at the level of Section Officer as well as for other specialized Group ‘B’ posts, should be filled through ‘Direct Recruitment’.

9. (Para 7.5.7) Recruitment at Graduate Level (Group 'B' non-gazetted and Group 'C')

(a) The age limit for all positions (Group 'B' non-gazetted and Group 'C') – requiring a graduate degree - should be 20-25 years for general candidates with a relaxation of three years for OBC and five years for SC/ST and physically challenged candidates.

(b) The examination system should be based on a well designed objective type question paper.

(c) There is no need to conduct separate examinations for posts (Group 'B' non- gazetted and Group 'C') which require a graduate degree. There should be a common examination and thereafter, the candidates should be allowed to apply for various posts with this examination score.

10. (Para 7.6.6) Recruitment for LDCs

(a) The Commission endorses the stand taken by the Government that recruitment of LDCs should be phased out.

(b) In case it is felt necessary to recruit LDCs in certain organizations/ departments, especially in field offices, their recruitment should be done through the Staff Selection Commission. The existing recruitment process needs to be modified on the following lines:

(i) The minimum qualification should be class 12th pass or equivalent.

(ii) The test should comprise of objective type questions.

(iii) Short listed candidates should be administered a skills test. This should be conducted on computers so that the capability of the candidates to use word processing softwares is also assessed.

11. (Para 7.7.10) Training for Group 'B' and 'C' Employees

(a) Unless a government employee undergoes mandatory induction training he/ she should not be assigned any regular post.

(b) Successfulcompletionofprescribedtrainingcoursesshouldbeapre-condition for all promotions.

(c) All training programmes should be concluded with an evaluation of the trainees' performance, and this should be an input while assessing their annual performance.

12. (Para 7.8.6) Group 'B' and 'C' Employees: Promotions

(a) The posts of Assistants under the Central Secretariat Service should be filled in the ratio of 40 per cent by promotion from UDCs of Central Secretariat Clerical Service Cadre, 40 per cent by Direct Recruitment and 20 per cent through Limited Departmental Competitive Examination.

13. (Para 7.9.6) Group 'B' and 'C' Employees: Performance Appraisal

(a) The Appraisal Form should provide the Reporting Officer with multiple options on the level of performance against which he/she would indicate numerically the level at which the officer reported upon has performed.

(b) The proforma of the Confidential Reports of Group Band C posts may include a column wherein the area/field of interest of the official reported upon (i.e. Health, Information Technology, Finance, Transport, Defence etc) is indicated, which may be considered for future postings.

c. A mechanism of acknowledging the receipt of the ACR proforma at various stages may be adopted so that delays are avoided and an element of accountability is introduced.

13. (Para 8.7) Placement at Middle Management Level

(a) In posting officers in Government of India, the primary consideration should be to select the most suitable person for the post that is on offer.

(b) Domains should be assigned by the Central Civil Services Authority (the Commission has recommended the constitution of this Authority in paragraph No 9.8 of this Report) to all officers of the All India Services and the Central Civil Services on completion of 13 years of service.

(c) The Central Civil Services Authority should invite applications from all officers who have completed the minimum qualifying years of service, for assignment of domains. The applications should specify the academic background of officers, their research accomplishments (if any) and significant achievements during their career, relevant to the domain applied for. A consultative process should be put in place where the officers should be interviewed and their claims to specific domains evaluated. The Authority should thereafter assign domains to the officers on the basis of this exercise. In case some domains do not attract applicants, the Authority should assign these domains to officers with the relevant knowledge and experience.

(d) All vacancies arising at the level of Deputy Secretary/Director during a financial year should be identified well before the beginning of that financial year, by the Department of Personnel and Training (DOPT). The Ministries concerned should also give a brief job description for these positions. All these posts and their job description should be notified to the cadre controlling authorities of the concerned All India Services and Central Services. On receipt of nominations from the cadre controlling authorities, the DOPT should try to match the requirements of various positions with the competencies of the officers in the 'offer list'. The DOPT should then seek approval for the entire list from the Competent Authority.

(e) The Central Civil Services Authority should be charged with the responsibility of fixing tenure for all civil service positions and this decision of the Authority should be binding on Government.

(f) Officers from the organized services should not be given 'non-field' assignments in the first 8-10 years of their career.

(g) State Governments should take steps to constitute State Civil Services Authorities on the lines of the Central Civil Services Authority.

14. (Para 9.8) Placement at Top Management Level

(a) The present empanelment system for short listing officers for posting at (a) The present empanelment system for short-listing officers for posting at the SAG level and above should be replaced by a more transparent and objective placement procedure.

(b) At higher levels in government, it is necessary to ensure that the tasks assigned to a public servant match his/her domain competence as well as aptitude and potential.

(c) Ministries should classify all of their SAG level posts according to their relevant functional domains.

(d) There is need to introduce competition for senior positions in government (SAG and above) by opening these positions in Government (including attached and subordinate offices) to all Services. This principle would apply to all posts including those that are presently encadred with the organised Group 'A' Services. In order to operationalise this, government should make the continued participation of any of the organised civil services in the Central Staffing Scheme, contingent upon the implementation of this principle in those Departments/Cadres.

(i) For the positions at the Joint Secretary/SAG level and above, the Central Civil Services Authority would invite applications from amongst all the eligible officers from the All India Services and Group 'A' Central Services which are participating in the scheme.

(ii) For positions at the HAG level and above, the Central Public Service Authority would, in consultation with Government, earmark positions for which outside talent would be desirable. Applications to fill up these posts would be invited from interested and eligible persons from the open market and also, from serving eligible officers.

(iii) While carrying out this exercise, the Central Civil Services Authority would stipulate the eligibility criteria, the required domain expertise as well as the requirements of qualifications, seniority and work experience. The Authority would conduct interviews to short-list suitable officers for these posts. Government would make the final selection on the basis of this shortlist.

(e) A Central Civil Services Authority should be constituted under the proposed Civil Services Bill. The Central Civil Services Authority shall be a five-member body consisting of the Chairperson and four members (including the member-secretary). The Authority should have a full time Member-Secretary of the rank of Secretary to Government of India. The Chairperson and members of the Authority should be persons of eminence in public life and professionals with acknowledged contributions to society. The Chairperson and members of the Authority shall be appointed by the President on the recommendations of a Committee consisting of the Prime Minister and the Leader of the Opposition in the Lok Sabha. (Explanation:- Where the Leader of the Opposition in the Lok Sabha has not been recognized as such, the Leader of the single largest group in the Opposition in the Lok Sabha shall be deemed to be the Leader of the Opposition).

(f) The Central Civil Services Authority should deal with matters of assignment of domains to officers, preparing panels for posting of officers at the level of Joint Secretary and above, fixing tenures for senior posts, deciding on posts which could be advertised for lateral entry and such other matters that may be referred to it by the Government.

(g) A similar procedure should be adopted for filling up vacancies at SAG level and higher in the central police agencies. For example, in the Central Para-Military Forces the senior positions should be opened to competition from officers of the CPMFs, IPS and the Armed Forces (including those completing their Short Service Commissions). Similarly for the intelligence agencies officers from the armed forces as well as the CPOs with experience in the field of intelligence should be considered for postings at higher levels in the intelligence agencies.

15. (Para 10.12) Deputation of Civil Servants to Organizations Outside Government

(a) In drawing up the list of external organizations to which government servants can be permitted to go on deputation, the primary consideration should be the objectives and activities of such organizations and not merely its organizational structure. For the present Government should permit deputation of civil servants only to such organizations that are engaged in non-profit making activities.

(b) This policy may be reviewed after three years.

16. (Para 11.15) Performance Management System

(a) A good employee performance appraisal system is a pre-requisite for an effective performance management system. The existing performance appraisal system should be strengthened on the following lines:

- Making appraisal more consultative and transparent - performance appraisal systems for all Services should be modified on the lines of the recently introduced PAR for the All India Services.

- Performance appraisal formats to be made job specific - the appraisal format prescribed for civil servants should have three sections i.e. (i) a generic section that meets the requirements of a particular service to which the officer belongs, (ii) another section based on the goals and requirements of the department in which he/she is working, and (iii) a final section which captures the specific requirements and targets relating to the post that the officer is holding.

- *Performance appraisal should be year round:* provisions for detailed work-plan and a mid-year review should be introduced for all Services.

- *Guidelines need to be formulated for assigning numerical rating:* DOPT should formulate detailed guidelines to guide the reporting and reviewing officers for assigning numerical ratings for their subordinates. Training modules for implementing performance management systems should be designed and introduced for training programmes for civil servants.

(b) Government should expand the scope of the present performance appraisal system of its employees to a comprehensive performance management system (PMS).

(c) In implementing PMS in government, it must be emphasized that the PMS should be designed within the overall strategic framework appropriate to the particular ministry/ department/ organization. It is also necessary to link individual contributions to strategic objectives of the organization. It will therefore be necessary for each ministry/ department/ organization to customize its PMS relevant to them, while incorporating the general features described in Chapter 11.

(d) Annual performance agreements should be signed between the departmental minister and the Secretary of the ministry/heads of departments, providing physical and verifiable details of the work to be done during a financial year. The actual performance should be assessed by a third party – say, the Central Public Services Authority – with reference to the annual performance agreement. The details of the annual performance agreements and the result of the assessment by the third party should be provided to the legislature as a part of the Performance Budget/Outcome Budget.

17. (Para 12.5) Motivating Civil Servants

(a) There is need to recognise the outstanding work of serving civil servants including through National awards. Awards for recognizing good performance should also be instituted at the State and district levels. It must be ensured that selection for such awards is made through a prompt, objective and transparent mechanism because the value of such awards should not get compromised by either subjectivity or lack of transparency. Further, all organizations should evolve their own in-house mechanism for rewarding good performance from simple, verbal and written appreciation to more tangible rewards.

(b) Selections for foreign assignments referred to in Paragraph 12.4.3.2 should be made, based on the recommendations of the Central Civil Services Authority. The Authority should follow the due process of inviting applications from eligible candidates and preparing a panel of officers who are most suitable for such assignments.

(c) It should be the responsibility of the head of the office to examine the job content of each person working in the organization to ensure that the job content is meaningful and challenging so that the employee derives a sense of satisfaction in performing the tasks assigned to him/her. The head of the office could seek the assistance of a professional agency for this purpose.

(d) Each head of office should ensure that a congenial work environment is created in the office. His/ her success in this should be an element in evaluating his/ her performance.

18. (Para 13.4) Accountability

(a) A system of two intensive reviews – one on completion of 14 years of service, and another on completion of 20 years of service - should be established for all government servants.

(b) The first review at 14 years would primarily serve the purpose of intimating to the public servant about his/her strengths and shortcomings for his/ her future advancement. The second review at 20 years would mainly serve to assess the fitness of the officer for his/ her further continuation in government service. The detailed modalities of this assessment system would need to be worked out by government.

(c) The services of public servants, who are found to be unfit after the second review at 20 years, should be discontinued. A provision regarding this should be made in the proposed Civil Services Law. Besides, for new appointments it should be expressly provided that the period of employment shall be for 20 years. Further continuance in government service would depend upon the outcome of the intensive performance reviews.

19. (Para 14.6) Disciplinary Proceedings

(a) In the proposed Civil Services law, the minimum statutory disciplinary and dismissal procedures required to satisfy the criteria of natural justice should be spelt out leaving the details of the procedure to be followed to the respective government departments. The present oral inquiry process should be converted into a disciplinary meeting or interview to be conducted by a superior officer in a summary manner without the trappings and procedures borrowed from court trials. This would require that the CCS (CCA) Rules, 1965 be repealed and substituted by appropriate regulations.

(b) No penalty of removal and dismissal should be imposed, except by an Authority, which is at least three levels above the post which the government servant is holding. Other penalties – apart from dismissal and removal – may be imposed by an Authority which is at least two levels above the current post of the government servant. No penalty may be imposed, unless an inquiry is conducted and the accused government servant has been given an opportunity of being heard.

(c) The two-stage consultation with the CVC in cases involving a vigilance angle should be done away with and only the second stage advice after completion of the disciplinary process, should be obtained. In addition, for cases involving a vigilance angle, no consultation with the UPSC should be required.

(d) Consultation with the UPSC should be mandatory only in cases leading to the proposed dismissal of government servants and all other types of disciplinary cases should be exempted from the UPSC's purview.

20. (Para 15.6) Relations between the Political Executive and Civil Servants

(a) There is a need to safeguard the political neutrality and impartiality of the civil services. The onus for this lies equally on the political executive and the civil services. This aspect should be included in the Code of Ethics for Ministers as well as the Code of Conduct for Public Servants.

(b) The Commission would like to reiterate its recommendation made in its Report on "Ethics in Governance" while examining the definition of corruption under the Prevention of Corruption Act, 1988, wherein it has been recommended that "abuse of authority unduly favouring or harming someone" and "obstruction of justice" should be classified as an offence under the Act.

(c) It is essential to lay down certain norms for recruitment in government to avoid complaints of favouritism, nepotism, corruption and abuse of power. These norms are:

   (i) Well-defined procedure for recruitment to all government jobs.

   (ii) Wide publicity and open competition for recruitment to all posts.

   (iii) Minimisation, if not elimination, of discretion in the recruitment process.

   (iv) Selection primarily on the basis of written examination or on the basis of performance in existing public/ board/ university examination with minimum weight to interview.

These principles could be included in the 'Civil Services Bill' as recommended by the Commission in Chapter 17.

21. (Para 16.17) Civil Services Code

(a) 'Civil Services Values' and the 'Code of Ethics' should be incorporated in the proposed Civil Services Bill.

(b) Conduct Rules for civil servants need to be redrawn based on the values and code of ethics as outlined in this Chapter (Chapter 16).

22. (Para 17.5) The Civil Services Law

A new Civil Services Bill may be drafted. The following salient features may be included in the proposed Bill:

I. *Title of the Bill*: The Bill may be called 'The Civil Services Bill'.

II *Definitions*: "Civil Services" shall comprise of all personnel holding civil posts under the Union.

III *Civil Service Values*: The Civil Services and the Civil Servants shall be guided by the following values in addition to a commitment to uphold the Constitution, the discharge of their functions:

(i) Absolute integrity at all times

(ii) Impartiality and non-partisanship

(iii) Objectivity

(iv) Dedication to public service

(v) Empathy towards weaker sections

The Heads of Departments shall be responsible for promoting these values in their organizations. The Central Civil Services Authority may from time to time review the adoption, adherence to and implementation of the Civil Service Values in the departments or organizations under the Union.

IV. *Code of Ethics*: e following should be included in the Code of Ethics for civil servants:

(i) Integrity: Civil servants should be guided solely by public interest in their official decision making and not by any financial or other consideration either in respect of themselves, their families or their friends.

(ii) Impartiality: Civil servants in carrying out their official work, including functions like procurement, recruitment, delivery of services etc, should take decisions based on merit and free from any partisan consideration.

(iii) *Commitment to public service*: civil servants should deliver services in a fair, effective, impartial and courteous manner.

(iv) *Open accountability*: civil servants are accountable for their decisions and actions and should be willing to subject themselves to appropriate scrutiny for this purpose.

(v) *Devotion to duty*: civil servants should maintain absolute and unstinting devotion towards their duties and responsibilities at all times.

(vi) *Exemplary behaviour*: civil servants should treat all members of the public with respect and courtesy and at all times should behave in a manner that upholds the rich traditions of the civil services.

V. *Recruitment and Conditions of Service*: Recruitment and conditions of service of persons appointed to the 'Public Services' shall be governed by Rules made under this Act. The following principles of recruitment should be included for all appointments not routed through the UPSC or SSC:

(i) Well-defined merit based procedure for recruitment.

(ii) Wide publicity and open competition for recruitment to all posts.

(iii) Minimisation, if not elimination, of discretion in the recruitment process.

(iv) Selection primarily on the basis of written examination or on the basis of performance in existing public/board/university examination with minimum weight-age to interview.

An independent agency should audit the recruitments made outside the UPSC and SSC systems and advise the government suitably. This audit should be conducted under the supervision of the UPSC.

VI. *New Conditions of Appointment*: (1) A civil servant, not being a civil servant recruited or inducted for a short-term appointment, shall hold office for twenty years from the date of initial appointment. (2) The relationship between the Civil Servant and the Government of India during the time he/ she holds office shall also be governed by the rules made in this regard. All public servants shall be subjected to two intensive reviews on completion of 14 years and 20 years of service respectively. Their further continuance beyond 20 years will depend on the outcome of these reviews. It should be expressly provided that all new recruitments shall be for a period of 20 years and their continuance beyond 20 years would depend on the outcome of the intensive reviews.

VII. *Appointment to Senior Positions in Government*: All positions in Government (including in the attached and subordinate offices) at the level of Joint Secretary and above would constitute the 'Senior Management Pool'. This would apply to all posts including those that are presently encadred with the organised Group A Services. All appointments to positions in this pool shall be made on the recommendations of the Central Civil Services Authority, which would go into the past performance and also evaluate the future potential of an officer. The Central Civil Services Authority should recommend a panel of officers suitable for a position in the Government and Government should choose an officer/person from this panel.

VIII. *Fixation of Tenures*: All senior posts should have a specified tenure. The task of fixing tenures for various posts may also be assigned to this independent agency - Central Civil Services Authority.

IX. *Widening the Pool of Candidates for Selection to Senior Positions*: Candidates outside the government system should be allowed to compete for certain posts at senior levels (Additional Secretary and above). The task of identifying these posts should be entrusted to the Central Civil Services Authority.

X. *Dismissal, Removal etc. of Civil Servants*: After the repeal of Articles 310 and 311 (as recommended in the Report on 'Ethics in Governance'), safeguards against arbitrary action against government servants should be provided in the new law. These safeguards should include:

(i) No penalty of removal and dismissal should be imposed, except by an authority, which is at least three levels above the post which the government servant is holding.

(ii) Other penalties – apart from dismissal and removal - may be imposed by an authority which is at least two levels above the current post of the government servant.

(iii) No penalty may be imposed, unless an enquiry is conducted and the accused government servant has been given an opportunity of being heard.

(iv) The Head of an organization should have powers to lay down the details of the enquiry procedure, subject to the general guidelines which may be issued by the Government from time to time.

XI. A performance management system should be mandatory for every organization in the government.

XII. *Constitution of the Central Civil Services Authority*:

(i) The Central Government shall, by notification in the Official Gazette, constitute a body to be known as the Central Civil Services Authority to exercise the powers conferred on, and to perform the functions assigned to it, under this Act.

(ii) The Central Civil Services Authority shall be a five-member body consisting of the Chairperson and four members (including the member-secretary). The Authority should have a full time Member-Secretary of the rank of Secretary to Government of India. The Chairperson and members of the Authority should be persons of eminence in public life and professionals with acknowledged contributions to society. The Chairperson and members of the Authority shall be appointed by the President on the recommendations of a Committee consisting of the Prime Minister and the Leader of the Opposition in the Lok Sabha. (Explanation:- Where the Leader of the

Opposition in the Lok Sabha has not been recognized as such, the Leader of the single largest group in the opposition in the Lok Sabha shall be deemed to be the Leader of the Opposition).

XIII. *Functions of the Central Civil Services Authority*: e Central Authority shall discharge the following functions:

(i) Review the adoption, adherence to and implementation of the Civil Service Values in the departments or organizations under the Central Government and send reports to the Central Government.

(ii) Assign domains to all officers of the All India Services and the Central Civil Services on completion of 13 years of service.

(iii) Formulate norms and guidelines for appointments at 'Senior Management Level' in Government of India.

(iv) Evaluate and recommend names of officers for posting at the 'Senior Management Level' in Government of India.

(v) Identify the posts at 'Senior Management Level' in Government of India which could be thrown open for recruitment from all sources.

(vi) Fix the tenure for posts at the 'Senior Management Level' in Government of India.

(vii) Submit an annual report to Parliament.

XIV. *Creation of Executive Agencies in Government*: Government should be authorized to create or reorganize some or all of existing Departments into 'Executive Agencies'. The role of the Ministries should primarily be on policy formulation while implementation should be left to the Executive Agencies.

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