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EDITORIAL

Public Private Partnerships (PPP) are now the preferred choice of the Union Government as well as States for the execution of major projects / programmes. PPP has been defined as "innovative methods used by the public sector to contract with the private sector who bring their capital and their ability to complete projects on time and to budget, while the public sector retains the responsibility to provide these services to the public in a way that benefits the public and delivers economic development and improvement in the quality of life" In his article, which he presented as a paper in a Conference on "Managing Projects and Lessons from Audit – bridging the gap" co-hosted by IPAI recently with Project Management Association, T. Sethumadhavan has exhaustively dealt with various aspects of PPP Project and has specifically discussed the transparency and the accountability issues in PPP arrangements where the view point of various stake holders have been analysed.

With the hectic pace of infrastructure build-up in the country, Engineering Procurement and Construction (EPC) contracts are becoming the preferred mode of execution of such projects. Hence their importance. The article on EPC contract system by M.P. Gupta and S.C. Sharma is a lucid summary of all concepts, terminologies, processes and checklists involved in formulation and execution of such contacts. It draws attention to the likely pitfalls to be avoided and a must read for all those setting out to audit such contracts.

"Millennium Development Goals Report – Comparative and Analytical Survey" by Hemendra Kumar is a commendable exercise in compressing copious facts, issues and opinions concerning one of the most ambitious programmes undertaken under the aegis of the United Nations: Setting and Monitoring Millennium Development Goals (MDG). In particular, the author brings out variations in the contents and formats of

Indian data on MDGs and special issues connected with methodologies and systems of quantitative estimation of poverty levels in India.

“Perverse Incentives to Acquire Capital” by Dr. Pandey gives a detailed description of the basis and rationale of accounting of expenditure as Capital and Revenue and then presents some thought provoking ideas on its relevance in fiscal management. In particular, he analyses the underlying driving factors for renewed calls to review the existing Revenue – Capital expenditure, say in the case of grants-in-aid etc. It turns out that the issues involved go beyond simple questions of accounting to more fundamental questions of public policy on perception of good and bad expenditures.

Dr.Sadu Israel has explained issues and challenges encountered by the auditors in undertaking forensic auditing. His article discusses key issues of the subject and knowledge and skill levels of forensic auditors. The relation between forensic audit and statutory audit has also been dealt with clearly by the author. He concludes that Supreme Audit Institutions would need to have adequate mandate for such audit and will need expert help of knowledgeable people in the field as also use of advance technique for such audit. Clearly all this calls for a tremendous capacity building on the part of public audit authorities.

Continuing with special section titled “Auditor’s Note Book” in this issue, Dharm Vir has discussed three interesting case studies namely Follow up on Audit Reports: Action Taken Notes; Agencification in Government; and M P Local Area Development Scheme: Wise Men Differ

Wishing our readers a happy New Year.

Vijay Kumar
Editor-in-chief

Disclaimer

Views expressed in the articles published in the Journal are those of the respective authors and do not necessarily represent the views of the Institute of Public Auditors of India.

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.

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

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

Readers are aware that we have started from the last issue of the Journal a new section titled "Auditors Note Book". The idea is that in this section, we shall cover some of the interesting contemporary developments in the field of auditing and accounting. These will be in the nature of commentaries on such developments which are topical and current and reflect on the important aspects of accountability and goveranance. We extend invitation to our readers to send us suitable articles for this section.

Articles in Hindi are also welcome, which will be published in original. They should preferably be in simple spoken Hindustani language format without use of jargon and sanskritised Hindi. An abstract of the article in about 100 words be also given in English.

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PUBLIC PRIVATE PARTNERSHIP (PPP) AND ACCOUNTABILTY CONCEPTS

T. Sethumadhavan[*]

Introduction

United Nations Economic Commission for Europe (UNECE) in its guidelines on promoting good governance in Public Private Partnerships (PPP) defines PPP as "innovative methods used by the public sector to contract with the private sector who bring their capital and their ability to complete projects on time and to budget, while the public sector retains the responsibility to provide these services to the public in a way that benefits the public and delivers economic development and improvement in the quality of life". According to the relevant Government of India notification, PPP refers to projects based on a contract or a concession agreement between a government or a statutory entity on the one hand and a private sector company on the other, for delivering infrastructure services on payment of user charges. The main characteristics of PPP projects include longer term service provisions (running up to thirty years or even more), balanced sharing of risks (relating to financing, designs, construction and operation *etc*.) between the public and the private sector and the public sectors' continuing responsibility to provide targeted services of prescribed quality at reasonable costs to the needy public. Further, PPP projects involve the transfer of public assets to the private sector partner usually for the duration of the contracts and the delegation of the government's authority to recover user charges to the private sector partners. In certain cases, it also results in the private control of monopolistic services previously owned by the government.

Ingredients of PPP Projects

There are several important ingredients for PPP projects. To briefly clarify, they are the following:

i) Government departments, agencies or bodies and entities under them will enter into valid and legal contracts with

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(Based on a presentation given at the workshop on "Managing Projects and Lessons from Audit" conducted by the Project Management Association and the Institute of Public Auditors of India on 26th October,2010 at new Delhi.)

selected private sector partners for implementing the projects;

ii) Partnership between the two will be to provide long term public services and goods of the required quality at reasonable costs;

iii) Public sector unit will transfer the responsibility to design, construct and /or operate the project / facility to the private sector; but retain the overall responsibility to provide the service;

iv) Private sector partner will bring in the required finance for the contracted project either in full or substantially, but the public sector entity will transfer the right to collect revenue arising from the completed facility and / or provide viability gap funding, or annuity payments, as also may offer guarantees to the financiers to the project;

v) Public sector's assigning the right to collect revenues arising from the project to the private party will be for a defined period based on demand projections and cost estimates etc., or it may pay grants or annuities; the agreement will also provide for sharing of surplus revenues, if any, between the partners (sharing of risks and gains).

vi) Value for money will be the basic criterion for the PPP arrangements.

(Public Auditing Guidelines for Public Private Partnership in Infrastructure Projects: CAG of India; 2009)

Requisites for the success of PPP Projects

It will be appropriate at this juncture to consider the requisites for the success of a PPP project. Briefly, these include the following.

Legal and Institutional Framework: In order to implement PPP projects successfully, it is essential for the implementing government to put in place on priority basis, a well-conceived and strong legal and institutional framework. It must be remembered that by awarding a PPP contract, the responsibilities of the public sector agency do not become extinct; on the other hand, it will continue to have responsibility to oversee the efficient and effective implementation of the project and its successful operation, and achievement of value for money at all times. This calls for detailed planning

and the establishment of appropriate legal and institutional framework capable of discharging the responsibility satisfactorily.

The framework to be put in place to implement PPP projects should have built-in capability to develop and manage healthy contractual relationships and to react justly and adequately to meet unforeseen developments during the implementation. One of the most basic requirements of the framework should be to create *level playing fields* for all participants to the arrangement and the ability to respond to situations promptly and equitably.

Selection Process: The government departments and agencies initiating PPP should ensure that there is a fair and transparent selection process in place to identify the private sector partners. In its absence, not only the right partner may not emerge to undertake the tasks, but the entire exercise may get bogged down in avoidable disputes, litigations etc, which will impede the progress of the projects.

Value for Money: The reasons and justifications for entering into PPP by the governments are to secure value for money and if this objective is not achieved, the arrangement will have no legs to stand on in the first place. It is therefore essential to plan and design the partnership so as to achieve the value for money assurances and this must be the guiding factor for the government from the early stages onwards.

Improvement of Public Services: The outcome expected from the PPP arrangement should demonstrate visible and virtual improvement in the targeted public services. This aims at injection of qualitative improvements in the services to be made available at the end of the projects. Thus, quality of the design, construction, operation and maintenance of the facility should receive the highest consideration at all stages.

Need for Training: PPP is a comparatively new concept in most countries and the staff entrusted with initiating the PPP projects and implementing them may not have past experience in guiding and developing such projects. It is necessary to provide comprehensive training to all officials who deal with PPP projects in different capacities and promote professionalism in the management of PPP.

Incentives and Sharing of Risks: Private entrepreneurs show interest in PPP projects primarily because of the profit motive and this should be appreciated by their public sector partners. In the absence of adequate concessions and incentives, private sector will have no motivation to participate in PPP projects. Moreover, since the format of PPP involves a mutual sharing of risks by both sides, the scheme of PPP must provide for fair incentives to all parties who join the enterprise. In commercial terms, this calls for fair financial and economic returns on investments for the

private sector partners in proportion to the risks assumed by them; and the approach of the public sector partner must be appropriately accommodative. In designing the projects offered for PPP mode, the government departments and agencies concerned must also ensure that the completed projects are commercially viable and their operations would lead to commercial success. In case this would not be possible for any operational reasons, the design of the project package should provide for alternate incentives to the private partners by way of gap funding, annuities etc. of justifiable magnitude.

Dispute Resolution and Promptness in Resolving Problems: Another requisite is that the PPP teams in the departments and agencies concerned should be trained to carry out business-like negotiations at the contracting stage with the private sector partners and to arrive at judicious decisions. Similarly, the management structure should provide for an efficient and effective dispute resolution mechanism both during the construction stage as well as during the operations and maintenance stage so that delays and indecision do not slow the progress of the projects.

Designing the Projects: Care must be taken to design the PPP projects (on offer) with adequate and appropriate package of incentives to make them sufficiently attractive for reputed and competent private sector concerns to enter the field.

Assessment of Costs: In considering the suitability of a project for the PPP mode, important criteria will be the cost to the taxpayers. This will include the review of the total project costs as well as the cost of services to be paid by the users at large and tax revenue foregone, if any.

Contact Management Skills: As part of the training and capacity build-up exercise, the officials of the government departments and agencies undertaking the PPP projects must have sufficient contract management skills. In its absence, the project management at various stages may get drawn into wrangles and delays, causing avoidable time and cost overruns.

Advocacy and Overreach Skills: Another critical input for the successful management of PPP projects would be the competence of the officials concerned to build consensus from political, administrative and contractual angles through advocacy and overreach. This will have to evolve over time through experience, and keenness to undertake and successfully implement PPP projects in the country.

Transparency and Accountability: Cornerstone of PPP Arrangements

Governments do take several risks in awarding and managing PPP contracts and retain significant responsibility for public services despite the private sector assuming the task under a PPP arrangement. PPP contracts for

infrastructure development also entail heavy investments by way of concessions, viability gap funding, annuities etc. in addition to giving guarantees for the finances raised by the private sector partners. In view of these factors, and to provide reasonable assurance about the value for money aspects to the stakeholders, it is essential that the PPP contracts be concluded with adequate transparency and accountability.

The management of PPPs may face problems on several grounds, the foremost among them being lack of clarity about the partnership objectives themselves. The fundamental objective of PPP projects is to provide improved public services through balanced sharing of risks. The PPP arrangements should demonstrate value for money to the government in clear terms. There must also have ample scope for innovation as would result in cost effectiveness and high quality of services provided. This will call for precise and well-articulated business plans defining the framework of the projects under offer and should introduce rigorous governance over the selection of projects. The process must also generate adequate competition for enabling the award of contracts to the best and the most deserving partners.

Among the most important risks associated with PPP projects are the risks associated with negotiating an appropriate partnership for the project, coupled with the risks associated to a minority shareholder. This places the government in a less advantageous position as compared to the private sector partner and will call for well- drafted and rigid clauses in the contracts to be entered into as also expertise to continuously monitor the interests of the public sector partner. Another major risk involves the exposure of the government / agency in the event of difficulties faced by the partnership in completing the project successfully and the consequent delays in operation and maintenance of the facility.

The above factors and requirements would point to the need for an efficient mechanism to ensure adequate transparency and public accountability in various PPP transactions.

ExistingAaccountability Drivers in PPP Contracts in India

Though PPP is a comparatively recent concept in the country, the government has already put in place a reasonably comprehensive mechanism to consider, review and approve PPP proposals initiated by various ministries and departments, as also by State Governments. The nodal ministry for PPP arrangements is the Finance Ministry. The system for appraisal and approval of PPP proposals include the following:

i) A fairly well-designed organizational set up for the processing and approval of PPP proposals. For instance, there is a special cell in

the nodal ministry, namely, the Department of Economic Affairs (DEA), dedicated to PPP transactions. In parallel, there is a well-equipped appraisal unit (PPPAU) functioning in the Planning Commission, which works under the direct supervision of the Special Adviser to the Deputy Chairman.

ii) A Public Private Partnership Appraisal Committee (PPPAC) carries out due diligence of all proposals received for the approval of the central government, and has Secretaries of the Departments of Economic Affairs (Chairperson), Expenditure, Legal Affairs and Planning Commission apart from the Secretary of the sponsoring ministry/department as a members.

iii) A Committee on Infrastructure (COI) under the Prime Minister is responsible to establish the policy and procedures for PPP. It also approves individual proposals received for PPP mode for amounts above those delegated to PPPAC. (Currently, only National Highway projects costing above Rs.500 crores/other projects of more than Rs.250 crores are required to be brought up before COI for approval). The COI has Finance Minister, Minister in charge of the infrastructure portfolio concerned, the Deputy Chairman and two members of the Planning Commission as members.

It is also to be mentioned that the government has established a detailed procedure for consideration and approval of PPP proposals. This is supplemented with elaborate and project-specific Model Concession Agreements (MCA) such as for Central and State Highways, ports *etc*., which would provide guidance to the project authorities in the matter of negotiating and contracting, projects under the PPP mode.

The MCAs envisage the appointment of independent engineers and independent auditors for PPP projects who are responsible to verify and report periodically to the public sector partner on the construction, development, operation and maintenance of the projects. They are to be appointed from panels maintained by the Ministry and will have access to the records and data generated by the private sector partners. They are responsible to monitor the work and operations as also commercial aspects of the projects (such as total project cost, revenue generation etc.) and keep the public sector partners informed of all developments periodically.

Most importantly, the PPP projects fall within the purview of the public audit by the Comptroller & Auditor General of India (CAG). Though there are issues relating to the access to records by the CAG in such partnerships where the government / government agency is a minor partner, the CAG has

been undertaking the audit of PPP projects in the country and has brought out significant audit findings as a result of his performance audits of such projects.

Views of Private Sector Proponents on Extending Public Audit to PPP Projects

Concerns have been expressed by private sector protagonists about the wisdom of extending the audit of CAG to PPP projects on the ground that it may lead to nit picking and lead to risk averseness among managers involved in PPP projects. After the Public Auditing Guidelines of the CAG were issued into public domain, several articles and letters appeared in the print media raising such apprehensions. One view suggested that the public audit must be restricted to the process of selection of the private partner for the projects since corruption takes place through cronyism and once the selected partner enters the project, the subsequent activities must be excluded from the purview of the CAG and his staff. Another view is that the oversight of PPP projects' implementation and all commercial aspects should be left to be regulated by sector regulators and be kept outside the audit scrutiny of CAG.

PPP projects, as mentioned elsewhere, result in the transfer of the state's responsibility to provide public services of required quality to the public at affordable costs. It also transfers public assets and the right of the government to levy tolls and user charges for such services to the private sector partners. It is accepted that in the normal course, the costs of establishing PPP projects are substantially higher than those directly undertaken by the government and the public sector agencies since these agencies are able to raise finances and funds at a much lesser cost, and this raises the issue of value for money in such transactions. These concerns need to be addressed appropriately, which in turn necessitate their scrutiny by the public auditors.

Another crucial aspect of PPP projects is the integrity of the total project costs since the rate of user charges to be levied will depend on this cost. Not only must adequate care be taken to keep the total project cost to the minimum, but this also needs to be tested to the conviction of all stakeholders concerned. One general concern is about the possible over-engineering of the total costs and this needs to be addressed through meaningful audits, since the state's responsibility to provide services at reasonable cost cannot be compromised.

The fact that PPP contracts are of long terms, sometimes running up to 30 years or more, thereby alienating government's statutory right to collect tolls and service charges for long durations also call for close scrutiny by public

auditors. Similarly, it is necessary for the CAG to provide an assurance to the stakeholders that all established procedures and systems have been followed in the selection of the private sector parties, and in awarding the contract. He has also to ensure that the sharing of risks and gains from the project has been done according to established norms and guidelines and that these are equitable. Finally, the public auditors have also to verify and provide an opinion on the status of the delivery of the contracted items of goods and services to the public and to report any shortfalls and deviations to the stakeholders.

'Fiscal transparency' is a major issue in PPP contracts where a true and fair view of all explicit and hidden costs and liabilities to the public exchequer is not fully available. Public Auditors have a legitimate role in bringing this out.

Approach of the CAG to Public Audit of PPP Projects

Since PPP could take different forms such as concessionaires, joint venture projects, joint developers etc., the approach of public audit may not be uniform; but the basic principles and procedures will remain. The "Public Auditing Guidelines on Public Private Partnership in Infrastructure Projects" (2009) issued by the CAG contain the broad principles and procedures adopted by public auditors for the audit of PPP projects. The Guidelines emphasize that the basic objective of the audit of PPP projects is to " to provide unbiased, objective assessment of whether public resources are responsibly and effectively managed to achieve the intended results", namely, to verify the value for money aspects. The Guidelines point out that PPP arrangements attempt to marry the conflicting approaches of the two partners to the arrangement, namely, the responsibility of the public sector to provide services at reasonable costs to the public and the private sector's motive of maximizing profits. In terms of inputs, the public sector holds the authority and regulatory skills as against the management and technical skills of the private sector partners. The Guidelines advise that public auditors should appreciate the need to align the different strengths and capabilities of the partners to the arrangement for achieving the best results in public interest and that the scope for regularity and compliance audit in respect of PPP projects is limited. The focus of audit would thus be to verify the PPP arrangements to see that the government department and agency pioneering the PPP project 'has efficiently put in place a sound system to oversee the efficiency and competence of the project implementation, including construction, quality management, compliance with contractual conditions, and integrity of the targeted public service strictly in terms of the established norms and contract conditions.' Thus, the main thrust of the

public audit will be on the end results achieved rather than on how the private sector partner has gone about to achieve the contracted outputs.

It is relevant to note that the Public Auditing Guidelines also emphasize the need to avoid criticisms, which might inhibit innovative approaches by the partners to PPP contracts. Auditors are, in the process, guided to look at the big picture instead of focusing on smaller and non-material issues related to the PPP project implementation. This approach will indeed go to meet the apprehensions of the private sector proponents while at the same time, ensuring public accountability.

One related issue in this regard is the question of access of public auditors to the records and data available with the private sector partners / joint ventures implementing PPP projects. At present, in the normal course, public auditors have to depend on the documents available with the government departments and agencies, including the reports of independent engineers and auditors, to carry out their audit; but hopefully, a new Audit Act to replace the CAG's (DPC) Act, 1971, when brought into force, will address this problem.

Conclusion

In the final analysis, it would be abundantly clear that the need to ensure adequate transparency and accountability in respect of PPP arrangements cannot be compromised. This could be best achieved by means of the audit of PPP projects, carried out by the supreme audit organization (CAG of India). But it is important for public auditors to appreciate the delicate and distinctive roles to be played by the partners to the PPP arrangement and undertake their audit in a spirit of accommodation, and in a constructive manner, with their focus basically being to verify value for money aspects of the transactions.

MILLENNIUM DEVELOPMENT GOALS REPORT-COMPARATIVE AND ANALYTICAL SURVEY

Hemendra Kumar*

1 Background

1.1 It is seldom that the world community agrees collectively on some issue- especially if the subject is as important as the issue of human development. The turn of the last century witnessed such an unusual agreement, the adoption of the Millennium Declaration by the world leaders at the summit meeting of the United Nations General Assembly held between 6th and 8th September, 2000. The Declaration, available at the website www.undp.org and its links, is quite comprehensive, covering a wide area including human freedom, dignity, peace, social and economic development, respect for nature and shared responsibility of all. Based on the agreements arrived at various UN conferences during the nineties, the Declaration led to charting out a well- defined path for development. Eight broad goals, called the Millennium Development Goals (MDGs), were adopted. In addition, quantitative and time bound targets were also set. Taking 1990 as base year, most of the targets were to be achieved in 25 years. For some countries, a different time span was fixed. A few additional targets have been added since the 2000 summit. 21 targets for the 8 MDGs are currently specified and 60 indicators are used for measuring their progress.

2 Goals and Targets

2.1 The following are the eight goals and 21 targets.

Goal 1- Eliminate extreme poverty and hunger.

Target (i) - Halve, between 1990 and 2015, the proportion of people whose income is less than US $ 1.25 a day.

Target (ii) - Achieve, full and productive employment and decent work for all, including women and young people.

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Target (iii) - Halve, between 1990 and 2015, the proportion of people who suffer from hunger.

Goal 2- Achieve universal primary education.

Target (iv) - Ensure that, by 2015, children everywhere, boys and girls alike, will be able to complete a full course of primary schooling.

Goal 3 - Promote gender equality and empower women.

Target (v) - Eliminate gender disparity in primary and secondary education, preferably by 2005, and in all levels of education no later than 2015.

Goal 4- Reduce child mortality.

Target (vi) - Reduce by two thirds, between 1990 and 2015, the less than five mortality rates.

Goal 5- Improve maternal health.

Target (vii) - Reduce by three quarters, between 1990 and 2015, the maternal mortality ratio.

Target (viii) - Achieve, by 2015, universal access to reproductive health.

Goal 6- Combat HIV/AIDS, malaria and other diseases.

Target (ix) - Have halted by 2015 and begun to reverse the spread of HIV/AIDS.

Target (x) - Achieve, by 2010, universal access to treatment for HIV/AIDS for all those who need it.

Target (xi) - Have halted by 2015 and begun to reverse the incidence of malaria and other major diseases.

Goal 7- Ensure environmental sustainability.

Target (xii) - Integrate the principles of sustainable development into country policies and programmes and reverse the loss of environmental resources.

Target (xiii) - Reduce biodiversity loss, achieving, by 2010, a significant reduction in the rate of loss.

Target (xiv) - Halve, by 2015, the proportion of population without sustainable access to safe drinking water and basic sanitation.

Target (xv) - By 2020, to have achieved a significant improvement in the lives of at least 100 million slum dwellers.

Goal 8- Develop a global partnership for development.

Target (xvi) - Develop further an open, rule based, predictable, non-discriminatory trading and financial system (including a commitment to good governance, development, and poverty reduction, nationally and internationally)

Target (xvii) - Address the special needs of the least developed countries (including tariff and quota free access for exports of the least developed countries, enhanced debt relief for heavily indebted poor countries and cancellation of official bilateral debt; and more generous development assistance to countries committed to reduce poverty).

Target (xviii) - Address the special needs of land locked countries and small island states (through the programme of Action for the Sustainable development of the Small Island Developing States and the outcome of the 22nd special session of the General Assembly).

Target (xix) - Deal comprehensively with the debt problems of the developing countries through national and international measures to make debt sustainable in the long term.

Target (xx) - In cooperation with the pharmaceutical companies, provide access to affordable, essential drugs in developing countries.

Target (xxi) - In cooperation with the private sector, make available the benefits of new technologies, especially information and communications.

Complete listing of the MDGs, targets and indicators is available at the website http://mdgs.un.org and its links.

2.2 It would be seen that the prescribed time span for achieving some of the targets is less than 25 years. Interestingly, the target for bringing about a significant improvement in the lives of 100 million slum dwellers is to be achieved by the year 2020 and not 2015. Initially, the benchmark for income poverty was kept at 1 US dollar per day. Later, taking into account the data on purchasing power parity, it was revised to 1.25 US dollar per day.

3 Monitoring the Progress

3.1 The UN General Assembly had desired that there should be periodic assessment of progress towards the targets. Reliable and timely data is also required by the national governments for making any midcourse corrections in policies and programmes to achieve the time bound targets. It is also necessary that data collected in different countries is internationally comparable to enable the international bodies and individual countries giving development aid to take appropriate decisions. It is easy to visualize the difficulties in getting reliable, timely and comparable data from all the countries.

3.2 An elaborate system for monitoring the progress has been put in place by the UN. A group, comprising representatives of relevant UN and other international agencies, a few national and outside experts, led by the UN Department of Economic and Social Affairs, compiles the necessary data. This group is called the Inter-Agency and Experts Group on MDG Indicators (IAEG). The primary source of data is the official statistics on the variables relevant to the indicators collected by national governments and agencies. These are made available to the concerned international specialized agencies. Apart from delays, some times data is either not collected or not reported. In some cases gaps in data are left. If required, surveys are sponsored and carried out by the international agencies .In many cases data has to be generated by extrapolation or estimated on the basis of data available on related variables. Wherever necessary, international agencies make adjustments to the national data so that international comparability is ensured. It is quite possible that data provided by the international agencies differ from data available within the country. The UN and its agencies have taken steps to reconcile national and international data collection and monitoring systems so that differences in definitions and methodologies followed are eliminated, but problems still remain.

3.2 The wide range of data collected makes it possible to compare, country wise or region wise, status and progress, and wherever relevant, the data is broken up according to different income levels, rural and urban populations, educational status, age and gender etc. Complete country wise database can be accessed through the website http://mdgs.un.org and its links. An interactive online atlas of the MDGs is available at the website http://ddp-ext.worldbank.org allowing access to country wise data on various targets. The UN publishes every year a report on the progress towards the MDGs (UN report). The last report was published on 23rd June 2010. It presents

data for the world as a whole and for various regions. The broad grouping of the countries is (a) developing regions, (b) transition economies of the Commonwealth of Independent States (CIS), and (c) developed regions. The developing regions are subdivided further in sub-regions, namely (1) Northern Africa, (2) Sub-Saharan Africa, (3) Oceania, (4) South-Eastern Asia, (5) Eastern Asia, (6) Southern Asia, (7) Western Asia, and (8) Latin America and Caribbean. The sub-regional groupings of the countries are primarily based on UN geographical divisions with a few adjustments to make the group amenable to a meaningful analysis. The developed regions primarily comprise countries in North America, Western Europe, and some former communist countries, Japan, Australia and New Zealand. The UN report and the list of countries in the different UN sub-regional groups can be accessed through the website http://mdgs.un.org and its links. For convenience sake, the terms region and sub-region will be used interchangeably in subsequent paragraphs.

3.3 The world leaders meet every five years to review the progress and take necessary decisions for accelerating the progress, wherever necessary. The first such meeting was held at the UN between 14th and 16th September, 2005.The second meeting was held recently between 20th and 22nd September, 2010. This meeting assumed significance because it was held in the shadow of global economic slowdown, which had an adverse impact on the development progress.

4 Progress so far

4.1 The UN report gives a comprehensive account of the progress towards achieving the targets. Even though the latest available data in most cases is one to two years old- in some cases it is five years old, a clear picture of the pace of progress emerges. It brings out in sharp focus the areas in which progress is slow and special efforts are required for achieving the targets in the remaining period. In the following paragraphs,

a brief description of the salient features of the UN report has been given. Although some data used in this report have been changed subsequently, the changes have been ignored as these are of a minor nature.

4.2 For the first goal, eradicating extreme poverty and hunger, the first target is to halve the proportion of people who have income less than 1.25 US dollar per day. It is estimated that in the developing regions, 46 percent of the people had income less than the benchmark in the year 1990. This came down to 27 percent in 2005. If the present trend continues, it is estimated that the percentage will come down to15 by the year 2015. Thus, the target of halving the proportion of poor people by 2015 is likely to be achieved. However, data shows that the progress is not uniform everywhere. The progress made by the two most populous countries, China and India, has been a major contributory factor in the overall progress. Between the years 1990 and 2005, China reduced the proportion from 60 to16 and India from 54 to 42.On the other hand the corresponding figures for Sub-Saharan Africa region are 58 and 51, indicating slow progress. For some regions, even though the proportion of poor people is low, it has gone up instead of coming down. In CIS countries in Asia (e.g. Armenia, Azerbaijan, Kazakhstan etc), the proportion was 6 percent in the year 1990 and it went up to 19 in 2005. Similarly, the Western Asia region (Iraq, Lebanon, Syria etc), showed an increase from 2 percent to 6 percent in the corresponding period.

4.3 The second target for the first goal is to achieve full and productive employment. One of the indicators used here is the employment to population ratio. For the developing regions, this ratio was 63 percent in the year 1998 and it decreased to 62 percent in 2008. Northern Africa and Western Asia regions had the lowest employment to population ratio of 46 percent in 2008. The UN report highlights the impact of the global economic slowdown on the labour market. As jobs are lost,

more and more workers are forced to shift to vulnerable employment like own-account and contributing family workers. In the developing regions, the ratio of vulnerable to total employment declined from 65 percent in the year 1990 to 59 percent in 2008 but increased to 60 percent in2009 due to economic slowdown.

4.4 The third target for the first goal is to halve the proportion of people who suffer from hunger. Two indicators have been used for monitoring the progress. The first is the prevalence of underweight children under five years of age and the second is the proportion of population below the minimum level of dietary energy consumption. Data shows that in the year 1990, 31 percent of the children below five years of age in the developing regions were underweight. This figure came down to 26 percent in 2008. For Southern Asia region, which includes India, the corresponding figures are 51 and 46.Data on second indicator shows that during the period 1990-1992, the percentage was 20 for the developing regions and this came down to 16 in the period 2000-2002. Latest available statistics are for the period 2005-2007 and these show that there was no progress during the intervening period as the percentage remained at 16. The picture that emerges from the data indicates that a lot more is required to be done in this area.

4.5 The progress towards the second goal, that is achieving universal primary education, has been steady, though the pace has been lower than what is required to achieve the target. In the year 1998-99, the net enrolment ratio in primary education in the developing regions was 82 percent that increased to 89 percent in 2007-08. The corresponding figures for Sub-Saharan countries are 58 percent (1998-99) and 76 percent (2007-08). An extra push is required, especially in the Sub-Saharan region, if this target is to be achieved by the year 2015.

4.6 The third goal, promoting gender equality and empowering women, has a target that has two components,

gender equality at the primary and secondary levels of education to be achieved by the year 2005 and at higher levels by the year 2015. For the developing regions, girl's enrolment per 100 boys enrolment at primary education level, increased from 91 in the year 1998-99 to 96 in 2007-08.The corresponding figures for secondary education are 88 and 95. The first component of the target, thus, has not been achieved. The corresponding figures for higher levels of education in the developing regions are 82 and 97. It should not be difficult to achieve this component of the target. At the regional level, there are a few interesting variations. In the Oceania region, the ratio of girls to boy's enrolment at the primary school level actually went down between 1998-99 and 2007-08, from 91 to 89. Similarly, at the secondary school level, a decline in the ratio occurred in Sub-Saharan Africa region (83 to 79), Oceania (89 to 87) and CIS (101 to 98) during the same period. Two other indicators are being used to assess the progress towards empowering women. The first relates to the share of women in wage employment in non-agricultural sector and the second to the proportion of women in national parliament. In every developing region, except CIS, men outnumber women in wage employment. Moreover, more women are in informal and vulnerable employment than men. Most of the top-level jobs go to men. It is also seen that women are slowly getting more positions of political power and this has been helped by special measures like reservation and quotas.

4.7 The target for the fourth goal is to reduce the child mortality rate, which is defined as the number of children dying before attaining the age of five per 1000 live births, by two-thirds. Child mortality rates in the developing regions have been very high as compared to the rates in developed regions. In the year 1990, this rate was 100 in the developing regions as compared to 12 in the developed regions. The mortality rate in the developing regions declined to72 in the year 2008 while it came down to 6 in the developed regions. The Sub-Saharan

Africa region has the highest child mortality rate of 144 (year 2008) followed by Southern Asia region that has a rate of 72 for the same year. The progress achieved in reducing the child mortality rate during the period 1990-2008 is not encouraging and achieving the target of two-thirds reduction by the year 2015 will be quite difficult.

4.8 The fifth goal is to improve maternal health. There are two targets for this goal. The first target is to reduce the maternal mortality ratio, which is number of maternal deaths due to pregnancy and childbirth related causes per 100,000 live births, by three-fourths. The second target is to provide universal access to reproductive health care. The gap in the maternal mortality ratio in the developed regions and that in the developing regions is even more pronounced than the difference in case of child mortality rate. In the year 1990, the maternal mortality ratio in the developed regions was 11 and this reduced to 9 in 2005. The corresponding figures for the developing regions are 480 and 450. For the Sub-Saharan Africa region, the corresponding figures are as high as 920 and 900. For the Southern Asia region, the corresponding figures are 620 and 490 and for Oceania region, 550 and 430. One reason for the high maternal mortality ratio in the developing regions is that unskilled health personnel supervise a large number of the deliveries. While in the developed regions, the percentage of deliveries attended by skilled health personnel has been as high as 99 during the last few decades, in the developing regions, the percentage was 53 in the year 1990 and 63 in 2008.

4.9 Reproductive health care includes education, contraception and antenatal care etc. For antenatal care, it is recommended that pregnant women be attended at least four times by skilled health care personnel during the pregnancy period. In the developing regions less than half of the pregnant women are so attended and this proportion for pregnant women living in rural areas was only one third. The worst rural-urban

gap exists in Southern Asia, where the percentage for urban areas was 58 or but only 25 for the rural areas, during the period 2003-08.

4.10 The sixth goal of combating major diseases has three targets. The first is to halt and reverse the spread of HIV/AIDS. Data shows that the spread of HIV/AIDS has indeed been halted and reversed. The spread of HIV peaked in the year 1996 with 3.5 million newly infected cases. This number dropped to 2.7 million in 2008. HIV/AIDS related deaths figure also showed a decline, 2.2 million deaths took place in the year 2002 and declined to 2.0 million in 2008. Sub-Saharan Africa region is the most heavily affected region with almost 72 percent of the new cases in the year 2008.

4.11 The second target for the sixth goal is to provide, by the year 2010, universal access to the prescribed antiretroviral treatment to all patients of HIV/AIDS who need the treatment. Though there has been rapid expansion in the prescribed treatment facilities, new HIV infections are more than the expansion in the facility. In the developing regions during the year 2005, only 16 percent of those who needed the treatment, received it. The percentage improved significantly within three years, increasing to 42 percent in 2008. But still, if five people are newly infected, only two will be able to access the prescribed treatment. The problem has become more acute as the WHO revised last year its guidelines about who should start antiretroviral treatment, increasing the number of people requiring treatment. The target of providing universal access to prescribed treatment to all HIV/AIDS patients who need it is quite unlikely to be achieved.

4.12 The third target for the sixth goal is to halt and reverse the incidence of malaria and other major diseases, mainly TB. It is estimated that during the year 2008, about 243 million cases of malaria across the world resulted in nearly 8.6 lakh deaths. Out of these, nearly 89 percent of deaths occurred in

Africa. Complete data on incidence of malaria is not available, but the data available shows that out of 108 malaria prone countries, one third reported reduction in malaria cases by more than 50 percent during the period 2000-08. It is pointed out in the UN report that increasing use of insecticide treated bed nets in Africa has contributed to this reduction.

4.13 Incidence of TB is falling gradually and according to available data, the target of halting and reversing its incidence has already been achieved. The peak of incidence of TB was reached in the year 2004 with 143 cases per 100,000 population. This figure declined to 139 in 2008.However, the gap between developed regions and the developing regions in respect of incidence of TB, is still very large. In the year 1990, there were 310 cases of TB per 100,000 population in the developing regions and this decreased to 210 in 2008.The corresponding figures for the developed regions are 29 and 8.5 respectively.

4.14 The seventh goal is about ensuring environmental sustainability. There are four targets for this goal. The first target is to integrate the principles of environmental sustainability in country policies and programmes, and the second target is to reduce biodiversity loss. Several indicators like preservation of forest area, carbon dioxide emission, consumption of ozone depleting substances, conservation of fish stock and water resources, protection of species have been used to monitor the progress. Data shows that the global deforestation, which is mainly conversion of forestland to agriculture, is slowing. In the nineties, the conversion of forestland plus its natural loss amounted to 16 million hectares (mha) per year and it reduced to 13 mha in the last decade. During this period, South America and Africa had the largest net loss in forest area of 4 and 3.4 mha per year respectively while Asia gained 2.2 mha per year. Emission of carbon dioxide has been rising steadily and is major cause for concern. In the year 1990, total carbon dioxide emission in the world

was 21.9 billion MT, out of which developed regions contributed 10.9 billion MT. The corresponding figures for the year 2007 are 29.6 and 12.1 billion MT respectively. The expected economic growth in the developing regions is going to increase substantially the carbon dioxide emission in future and this may increase the risk of irreversible adverse effects on global climate system. For preventing damage to ozone layer, the global efforts to reduce the consumption of ozone depleting substances (ODS) have been very successful. Between the years 1986 and 2008, the global consumption of ODS has decreased by about 98 percent.

4.15 It is almost impossible to measure loss of biodiversity in a short period. The indicator used here is the proportion of land and marine areas protected to prevent biodiversity loss. Latest data indicates that nearly 12 percent of land area and 1 percent of sea area, which are key to preservation of biodiversity, are under protection but this is grossly inadequate. The loss of biodiversity continues as before. Nearly 17,000 species of plants and animals are facing extinction. It appears certain that the world will miss the target of achieving a significant reduction in the rate of biodiversity loss by the year 2010.

4.16 The third target for the seventh goal is to halve the proportion of population without sustainable access to safe drinking water and basic sanitation. For the world as a whole, the proportion of population having access to safe drinking water was 77 percent in the year 1990 and this improved to 87 percent in 2008. The corresponding figures for the developing regions are 71 percent and 84 percent respectively. The Oceania region had the lowest corresponding figures of 51 percent and 50 percent while Sub-Saharan Africa region was slightly better with corresponding figures of 49 percent and 60 percent. If the present trend continues, the target of halving the proportion of population not having access to safe drinking water will be achieved. In case of basic sanitation, the picture is not so promising. In the year 1990, 41 percent of the population

in the developing regions was using improved sanitation facilities. The percentage increased to only 52 in the year 2008. This means that almost half of the population in the developing regions did not have access to basic sanitation facilities. In absolute numbers, the figure is about 2.6 billion persons. In Southern Asia, only 36 percent of population had access to basic sanitation in the year 2008 and Sub-Saharan Africa was slightly better with a figure of 44 percent. The rural-urban gap in this regard in the developing regions is also quite significant. Against a percentage of 40 for rural areas, the percentage for urban areas was 68. If the present trend continues, it may not be possible to achieve the target set for providing basic sanitation facilities.

4.17 The fourth target for the seventh goal is to achieve significant improvement in the lives of at least 100 million slum dwellers. Improvement here implies gaining access to either improved water, sanitation facilities or durable and less crowded housing. The proportion of urban population living in slums in the developing regions was 46 percent in the year 1990 and it reduced to 33 percent in 2010.The Sub-Saharan Africa region had the highest proportion of 62 percent slum dwellers in the year 2010. Available data shows that about 200 million slum dwellers have already benefited and, hence, the target of 100 million has been achieved. The UN report points out that the original target of 100 million was based on unrealistic assessment of the slum population and the target should have been higher.

4.18 The eighth goal is to develop global partnerships for development. There are six targets for this goal. The first target is to develop an equitable trading and financial system. Despite protracted negotiations, a universally accepted trade agreement is still a distant possibility. The second target is to address the problems faced by the least developed countries and to provide adequate development assistance to the developing countries. Data shows that the least developed countries have gained from

the preferential access being provided to their goods and services by the developed countries. As regards development assistance, data shows that the net official development assistance to the developing regions was 119.6 billion US dollars in the year 2009, which is about 0.31 percent of the combined national income of the developed countries. This is a far cry from the previously agreed figure of 0.7 percent. Because of the global economic slowdown, the assistance is likely to be lower at 108 billion US dollars in the year 2010. The African countries, because of their special needs, were promised an additional assistance of 25 billion US dollars by the year 2010 at the G-8 summit in the year 2005, but are likely to receive only 11 billion US dollars. The third target is to tackle the problems faced by the land locked countries and small island developing states. Special development assistance was being provided to such countries earlier also and continues to be provided. The fourth target is to deal comprehensively with the external debt problems faced by the developing countries. There has been progress in this regard. Data shows that while13 percent of the export revenue of the developing countries was used up in external debt service during the year 2000 the figure came down to 3 percent in the year 2008.

4.19 The fifth target is to provide access to affordable essential drugs in developing countries in cooperation with pharmaceutical companies. There is absence of data in relation to this target. No global or regional data is available.

4.20 The sixth target is to make available the benefits of new technologies, especially information and communications, to the developing countries with the cooperation of the private sector. Available data shows that despite global economic slowdown, the use of information and communications technologies is increasing significantly in the developing countries. Use of mobile phones has grown substantially. In the year 2009, global figures for subscription to mobile phones had touched 4.6 billion that is one cell phone for 67 out of 100

people. It is estimated that there were about 30 subscriptions per 100 population in the developing countries during the year 2008. However, internet use, especially broadband, is limited in the developing countries. In the year 2008, 68 out of 100 people in the developed countries were using internet while the corresponding figure was only15 for the developing countries. It is estimated that in the year 2009, there were 23 fixed broadband and 38 mobile broadband subscriptions per 100 population in the developed countries while the corresponding figures for the developing countries were only 3 and 2 respectively.

5 The Indian Scene

5.1 A brief description of India's progress towards achieving the MDGs is given in the following paragraphs. It may be pointed out that there are a few differences in the data related to India in the UN database (http://mdgs.un.org) and that contained in the latest Govt. of India MDGs Report, 2009 (GOI report), available at the website of Ministry of Statistics and Programme Implementation and its links. In some cases, the indicators used in GOI report are different and in some, the periodicity and year of reporting are different. However, the differences are minor and do not affect the trend of progress indicated by both the set of data. In this paper, primarily the data contained in the GOI report is used, and wherever deemed necessary, figures from either the UN database or from both the sources are quoted.

5.2 The UN database shows that in India, the proportion of population below the benchmark of income of 1.25 US dollars per day was 54 percent in the year 1990 and the figure came down to 42 percent in 2005. The GOI report shows the proportion of population below the poverty line as 37.2 percent in the year 1990 and 27.5 percent in 2004-05. There has been widespread criticism of the GOI figures on the grounds that the methodology followed for computing the poverty figures is

faulty, leading to gross underestimation. It will be appropriate to digress here to make a brief mention of the methodology followed and recent changes in it. The Planning Commission has been assigned the mandate to measure and report on poverty related statistics. Traditionally, the poverty benchmark had been set on the basis of money required to buy food equivalent to 2100 calories in the urban areas and 2400 calories in the rural areas. Data collected by the National Sample Survey Organization (NSSO) on household consumer expenditure along with state wise rural and urban poverty benchmarks, is used for computing poverty figures for each state with rural-urban breakups. The UN figures are based on the benchmark of income of 1.25 US dollars per day. Following criticism of its methodology, the Planning Commission set up a committee under the chairmanship of Dr. Suresh Tendulkar last year to examine the issue. It recommended a modification in the methodology, suggesting that expenditure on non- food items like health, education etc should also be taken into account. Using the new methodology, it worked out a poverty percentage of 38 for the year 2004-05, which is more than ten percent higher than previous figure based on the old methodology. The recommendations of the Tendulkar Committee have been accepted in principle but differences within GOI ministries still persist. The N.C.Saxena Committee, set up by the Ministry of Rural Development in the same year, to look into the issue of identification of below the poverty line (BPL) families, came up with a figure of 50 percent for rural areas (Tendulkar Committee-41.8 percent). Recent press reports show that the Ministry of Housing and Urban Poverty Alleviation is not happy with the methodology used by the Tendulkar Committee to estimate the figures for urban poor and wants that it should be revised. In May 2010, the Planning Commission set up a committee under the chairmanship of Prof. S.R. Hashim to recommend methodology for identification of below the poverty line families in urban areas.

A criticism of the GOI figures on poverty is that the benchmark for poverty used is very low- it is only a benchmark of destitution. Per capita per month income levels of Rs.356 for rural areas and Rs. 539 for urban areas, used for estimating poverty figures for the year 2004-05, could enable one to buy food equivalent to only1820 calories, both in rural and urban areas, below the earlier accepted norm. It is beyond the scope of this article to go into details of the issues involved, but it may be pointed out that whatever methodology and benchmark are used for poverty estimation, their consistent application over time will give a fair idea of the direction and rate of change. If the benchmark is kept low, the rate of decrease in poverty figure is likely to be higher. Correct estimation of the poverty figures is, however, important for formulation of appropriate policies and programmes for addressing the problems of poverty and hunger. The proposed National Food Security Act, under which highly subsidized food grains will be supplied to a large proportion of the population, is a major step in tackling this problem. If the official data on poverty is accepted, India will, in all likelihood, achieve the target of halving the poverty figure by the year 2015.

5.3 The UN database indicates that the employment to population ratio in India declined from 58.3 percent in the year1991 to55.6 percent in 2008.These figures are only indicative and do not yield unemployment percentage. On malnutrition, The UN database shows that the proportion of underweight children below the age of five was as high as 53.4 percent in the year 1993 and it declined to 47.8 in 2005.Thus, almost half of the children in this age group were underweight. The proportion of people having less than minimum level of dietary consumption declined from 24 percent in the year 1991 to 22 in 2005.

5.4 The progress towards the goal of universal primary education appears to be satisfactory. The GOI report shows that the net primary enrolment was 83 percent in the year 2000 and

it increased to 95 percent in 2007-08. The Right of Children to Free and Compulsory Education Act, enacted last year, is going to help the country in achieving the target of universal primary education.

5.5 On gender equality, the GOI report shows that at primary education level, the ratio of girls to boys enrolment was 0.76 in the year 1990-91 and it increased to 0.94 in 2006-07. The corresponding figures for secondary education were 0.60 and 0.82 respectively. Thus the target of achieving gender equality in primary and secondary education by the year 2005 has been missed. The GOI report does not give any data for higher education level. The UN database gives corresponding figures for higher education as 0.54 (1991) and 0.70 (2007). According to GOI report, the share of women in wage employment in non-agricultural sector increased from 13 percent (1990-91) to 18 percent (2004-05). It also shows that the percentage of women parliamentarians rose from 9.7 (1991) to 10.3 (2009). We still have to go far to achieve gender equality. The lack of political consensus has held up legislation to ensure higher representation of women in parliament.

5.6 The child mortality rate has shown a gradual decline. The GOI report shows that this rate was 125 in the year 1990 and it fell to 75 in 2005-06. If the present trend continues, the target of two- thirds reduction will be missed. An improvement in the rate of reduction is necessary for achieving the target.

5.7 The maternal mortality ratio in India has been declining gradually but not fast enough to achieve the target of three-fourths reduction by the year 2015. According to the GOI report, this ratio was 437 during the year 1990-91 and declined to 254 during the period 2004-06. The target of its reduction to a figure of 109 is unlikely to be achieved. The progress in deliveries attended by skilled health workers is also slow. Only 33 percent of the deliveries were so attended in the year 1992-93 and this could improve to only 52 percent in 2007-08. If the

present trend continues, the target of universal access by 2015 will be missed.

5.8 Prevalence of HIV/AIDS is not a relatively serious problem in the country. According to the GOI report, prevalence of adult HIV/AIDS declined from 0.45 percent in the year 2002 to 0.34 percent in 2007. However, the target of universal access to the prescribed treatment is still far away. According to a recent WHO report, 3.2 lakh patients of HIV/AIDS were receiving the prescribed treatment in India during last year, but 2.6 lakh patients did not have access to it. The incidence of malaria has also shown a decline, from 1.74 percent in the year 2005 to 1.52 percent in 2009. India has the highest incidence of TB in the world. Almost one-fifth of the global incidence of TB is reported from India, but its incidence has shown a decline, from 586 per 100,000 population in the year 1990 to 283 in 2007. Thus the target of reversing the spread/incidence of these diseases has been achieved.

5.9 The forest cover in India has shown a marginal increase in recent times. The GOI report shows that in the last ten years, forest cover increased by 3.31 mha with an annual rate of increase of 0.46 percent. For preservation of species, the proportion of protected areas to total land area increased from4.74 percent in the year2006 to 4.83 percent in 2009. As the Indian economy is growing at a robust rate, carbon dioxide emission is also increasing. However, the per capita figure of 1.6 MT (year 2006) is far below the corresponding figure of 12.1 MT for the developed regions.

5.10 The target of providing universal access to safe drinking water by the year 2015 is likely to be achieved by India. According to the GOI report, 68.2 percent of the households had access to safe drinking water in the year 1992-93 and the figure improved to 84.4 percent (urban-95 percent, rural-79.6 percent) in 2007-08. However the position in regard to providing basic sanitation to all is not satisfactory. In the year

1992-93, 70 percent of the households did not have access to basic sanitation (toilet) and this figure declined to only 51 percent (urban-19 percent, rural-66 percent) in 2007-08. Thus, more than half the population was without access to basic sanitation. At present rate of improvement, it will not be possible to achieve the target of providing universal access by the year 2015. A census of slum dwellers was only carried out in the country during the year 2001. Data from 640 major towns showed that 23.1 percent of the population of these towns lived in slums. It is estimated that there were 46.26 million slum dwellers in the country in the year 1999 and currently this figure is about170 million- about 17 percent of the world's slum population.

5.11 India has shown significant progress in using information and communication technologies. According to the GOI report, combined figures of landline and mobile phone subscriptions increased from 22.8 million in the year 1999 to 467.7 million in 2009.Recent press reports indicate that this figure may have touched 700 million, out of which the mobile phones have about 90 percent share. The use of internet is growing but still far behind the level prevailing in the developed regions. It is estimated that there were 0.21 million internet users, using any mode, in the country in the year 1999. This figure increased to 45 million in 2009, which is less than 5 users per 100 population. The ratio of broadband internet users in India is quite low, about 2 per 100 population.

6 Beyond Numbers

6.1 The statistical data is useful for making an overall assessment of the progress but it does not tell us anything about some of the basic issues like suitability of the goals and targets and issues related to governance, budgeting and accountability etc. As far as goals and targets are concerned, these should be seen as an outcome of global consensus. These may not be considered to be ideal by some, but are fairly broad based and

address all the major issues. However, there are a few issues on which a sharper focus in terms of specific quantitative targets would have helped in narrowing regional gaps in development and hastening progress towards sustainability of development. Climate change, fast depleting natural resources and the plight of Sub-Saharan countries are a few such examples. It is not to say that these issues have not received global attention earlier or in the MDGs, but the fact remains that no specific plan of action with quantitative targets has emerged. Rising human population, rapid economic growth in many developing countries, existing high rates of consumption of natural resources, deforestation, increasing emission of greenhouse gases and pollution etc are threatening the planet and narrowing the margin of its safety. A global concrete plan to tackle these problems is overdue. The divergence of interest of the developing and developed countries has led to protracted negotiations without an agreement being reached. The MDG summits, held every five years, provide an opportunity to the world leaders to arrive at a consensus on these contentious issues, but it has not happened.

6.2 The countries in the Sub-Saharan Africa region that has the most number of least developed countries face serious problems. Statistical data shows that the progress of development in the region has been very slow and many of the MDG targets will not be achieved. The international community has to be more generous in providing aid to this region suffering from extreme poverty, hunger/malnutrition etc, otherwise we shall a pocket of suffering humanity there. As mentioned earlier, in the present economic slowdown, the African countries suffered most in terms of reduction in development assistance. More specific aid commitments for this region as part of MDGs would have helped.

6.3 In the context of India's progress towards MDGs, several issues related to policies, implementation of programmes and accountability etc arise. It has been seen

earlier that the official poverty figures have recently been revised upwards. Not only will this make higher funds allocation necessary for addressing the problem of poverty, but may also require changes in policies and programmes related to poverty alleviation. Despite high rate of growth of the Indian economy in the recent past, India is home to the largest number of poor in the world (about 40 crore), approximately half of our children are underweight-one of the highest in the world. The child mortality rate and the maternal mortality ratio are very high. About half of the population is without access to basic sanitation and the slum population in the country is as high as 17 crore. Some innovative policies, programmes and method of implementation of schemes may be necessary for achieving MDGs targets in areas where the progress has not been satisfactory so far.

6.4 The GOI report gives state wise data for all the major indicators. It shows that although the country as a whole may achieve the target of halving the proportion of poor people, yet some major states may not be able to do so. Similarly in other important areas like malnutrition, child mortality, maternal mortality, combating diseases etc, there are large inter state variations in the progress achieved. The Central Government provides major share of funds for the development schemes and State Governments implement most of the schemes. It is not easy to apportion blame for slow progress in any field, as adequate finances and proper implementation are both important. Moreover, in many cases, the states complement the central schemes.

6.5 Budgetary allocation for various development schemes related to the MDGs give some indication of adequacy of efforts towards achieving the targets. The GOI budget allocation for fighting major diseases has more or less stagnated at a figure of 0.2 percent of its total expenditure during the last three years. Tackling HIV/AIDS got a major share in the current year's budget (about 1300 crore) while

allocation for fighting other diseases like cholera, TB etc was lower than previous year. It may well be justified to increase allocation for tackling HIV/AIDS in view of the large gap in treatment facilities required and actually available. However, relevant question here is whether this amount is adequate to provide universal access to all the patients by the year 2010, according to the target. In view of the revised guidelines of the WHO about who requires treatment, this target will not be achieved.

6.6 Child mortality and maternal mortality are high in the country and one would have expected that budgetary allocations for improving the situation would have shown substantial increase over years. Unfortunately, this is not the case. Funds allocated for child health care and related schemes stagnated at 0.2 percent of the total GOI expenditure during the last three years while the corresponding figures for maternal health care schemes were 0.7 and 0.9. The GOI has recently announced a new scheme for improving maternal health under which cash will be given to pregnant and lactating mothers for a period of six months. The scheme, named Indira Gandhi Matritva Sahyog Yojana, is going to be launched in 52 districts as a pilot project. It shows that increasing attention is being paid on improving maternal health care, an area in which progress has been slow.

6.7 The funding of development schemes by GOI is only one aspect of the process of progress. The states are also allocating resources for development schemes. The private sector is also, directly and indirectly, helping in generating employment, creation of health, education, housing and other facilities, especially in the urban areas. It is the cumulative outcome of activities of all concerned that propels development. With economy growing at a rapid rate, higher quantum of funds will be available with all the players, and if properly used, the rate of progress towards the MDGs will improve. Whether the governments should spend money on

organizing games or setting up of parks and statues is a political decision. It is not saying that such things have no socio-economic implications. It is a question of priority, which the political leadership has to decide. Proper implementation of schemes is as important, if not more, as finding adequate resources for them. It is here that there is a vast scope for improvement.

6.8 Complaints about widespread irregularities and corruption in implementation of major schemes like rural employment guarantee scheme, targeted public distribution scheme; absence of teachers in rural primary schools, missing government doctors and other health care workers in rural areas, laxity of state government implementing agencies etc still abound. It is unfortunate that even involvement of panchayat functionaries in the rural areas did not help in eliminating irregularities and corruption. Reports indicate that a large number of deserving below the poverty line beneficiaries were left out in enumeration even though panchayat functionaries were involved in the process. One can give any number of examples of irregularities in implementation of schemes that are directly related to MDGs. Tardiness in implementation of national programme for providing supplementary nutrition to children can be cited as an example of laxity on the part of states. Some states simply ignored the prescribed minimum nutritional requirements of children. Disruption in supplies of nutritional materials occurred in many states. It appears that accountability has become a casualty in recent times. All the agencies involved in the development process must gear up their machinery if a significant improvement in the progress towards the MDGs is to be achieved.

PERVERSE INCENTIVES TO ACQUIRE CAPITAL

Dr Subhash Chandra Pandey[*]

1. Given the nature of this journal, it is improbable that I would be discussing military strategies on how to seize a capital following Kautilya's profound advice of first nibbling at surrounding mofussil areas. This paper is about more mundane issues about capital adequacies of nations and the financial engineering of classifying 'revenue' expenditures as 'capital', by corporate and governments alike. It is interesting how such an exercise soon develops into a good-bad expenditure classification. It is hoped that this paper would be of interest to both accountants as well as public finance analysts.

2. The balance sheet of a commercial concern records all capital expenditures and all revenue expenses are recorded in the profit and loss account. Failure to distinguish the difference between revenue expenses and capital expenses can lead to a misleading picture of both the financial performance during a period and financial status as on a date being reported or presented to the users of accounting information. Misclassification may be simply an inadvertent error or deliberate. It is not uncommon to find firms resorting to creative accounting to deliberately misclassify revenue expenditure as capital expenditure to fool the investors.

3. Revenue expenditure is outlay or expenses incurred in the day to day running of a company. In most cases revenue expenditure involves the procurement of services and goods that will be used within a financial year. Revenue expenditure does not improve or increase the income generating abilities of a company; at best it leads to the maintenance of the current

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organisational revenue generating capacity. All expenses of a revenue nature are recorded in the profit and loss account as either operating expenses, marketing and selling expenses and administrative expenses. Revenue expenses are routine and recurring in nature and some examples of revenue expenditure include payments in staff wages and salaries, heating and lighting, depreciation, legal and professional fees, travel and subsistence, insurance, administrative expenses, most of marketing and public relations expenses, audit fees, office supplies, staff training costs, staff recruitment costs and minor or immaterial items of equipment.

4. Capital expenditure represents outlay on fixed assets. Capital expenditure can be outlay of resources on the investment of long-term income generating capability of the company. Investment in fixed assets will lead to an increase or improvement in the investing company's revenue generating capacity. Capital expenditure can also be in the form of significant acquisitions or purchases of more expensive items of equipment that will last longer than a financial year. All capital expenditure is recorded on the balance sheet. Capital expenditure will be depreciated or amortised annually to ensure that an expense is charged to the profit and loss account to reflect the capital expenditure's usage by the company.

5. In finalising the accounts of a given year, the company takes into account only the revenue items. From the income, revenue expenditure is deducted to arrive at the profit. Capital items result in benefits not merely for the current year, but also for future years and so it would not be fair for the current year to 'suffer'' for the whole of the expenditure, when a fair portion of the benefits is going to be enjoyed in future years.

6. A standard charge on revenue accounts is maintenance and depreciation of plant and machinery. Among many other alternative methods of charging depreciation, the Reducing Balance Method or the Written Down Value method (WDV

method) is also quite popular. The charge on account of depreciation will be heavier for the earlier years and will come prog ressively down as the useful life increases. This is the method of depreciation is generally followed under the Income-Tax rules though accelerated depreciation may be allowed as a tax incentive. The system has its logical base from the fundamental hypothesis that any capital expenditure is of maximum value in the initial years and has lesser and lesser value as the years go by. The charge is proportionate to this assumed value. There is a further logic to the Written Down Value Method. The repair and maintenance expenditure of any asset is likely to be lower in the initial years and will be higher as the years progress. Under the WDV Method, depreciation is highest in the initial years and comes down as the year's progress. The two charges together -- repairs and depreciation -- constitute the total ``expenditure'' to the company on the asset for any year. By following differing patterns, the total charge on this count will remain more or less the same for all the years under the Written Down Value Method.

7. Deferred revenue expenditure : Sometimes expenditure may be predominantly revenue in nature, but its benefits could be enjoyed by subsequent years. Expenses incurred by companies on Research & Development and/or Public issue of shares or debentures are cases in point. The amounts incurred are fairly large and it is conceivable that a portion of the benefit of these expenses will be enjoyed by subsequent years. It is conventional to treat such items as capital expenditure and amortise them over a number of future periods. However, prudent accounting demands that when it is realised that an expenditure will have no further benefit to give beyond the current year, it must be treated as revenue and written off.

8. One of the earliest and still a useful definition of capital expenditure was quoted by Viscount Haldane in John Smith & Son v Moore [1921] 12TC266, at page 282, referring to the work of the famous economist, Adam Smith: “My Lords, it is

not necessary to draw an exact line of demarcation between fixed and circulating capital. Since Adam Smith drew the distinction in the second book of his 'Wealth of Nations', which appears in the chapter on the division of stock, a distinction which has since become classical, economists have never been able to define much more precisely what the line of demarcation is. Adam Smith described fixed capital as what the owner turns to profit by keeping it in his own possession, circulating capital as what he makes profit of by parting with it and letting it change masters."

9. The classic definition in the body of the decided cases comes from Atherton v British Insulated and Helsby Cables Ltd [1925] 10TC155. The company claimed the cost of a contribution that it had made to setting up the nucleus of a pension fund for the benefit of its clerical and technical salaried staff. At pages 192 and 193 Viscount Cave gives his much quoted definition: …when an expenditure is made, not only once and for all, but with a view to bringing into existence an asset or an advantage for the enduring benefit of a trade, I think that there is very good reason (in the absence of special circumstances leading to an opposite conclusion) for treating such an expenditure as properly attributable not to revenue but to capital.

10. It is not possible to draw up a list of items, the cost of which is capital. nor is it possible to draw up a list of items, the cost of which is revenue. The classification, capital or revenue, is not uniquely determined by the nature of the item involved, rather it is determined by the circumstances of the transaction and the company's size and scale of operations. A huge corporation may prefer to treat even the cost of any ordinary desktop computer as revenue, even though it could be used for future years, while a small company might capitalise even a tool box and spread the expenditure to the useful life of the tools.

11. The above comments are more relevant from the commercial accountancy worldview. After a study of some Income-tax Tribunal decisions, Shri D. Murali, a veteran in the community of government accountants, concluded as follows: It is easier to tell a donkey from an elephant than capital from revenue. He recommends the flower petal game used by indecisive people, pulling out the petals one by one, with a binary question such as `He loves me, he loves me not,'! Flipping a coin would be more environment-friendly than making pretty flowers bald.

12. There are stronger incentives (tax liability in cash or dividend payout or success of an impending IPO or a high level inquiry) to manipulate commercial accounts. After noticing the misuse of the accounting practices for leased assets, it is understood that the International Accounting Standards Board (IASB) and America's Financial Accounting Standards Board (FASB) are mulling over inclusion of capital or operating leases in the balance sheets. Hence, the discussion, would be confined to government accounts in India, where there had been no perverse incentives to misclassify expenditures until perhaps the advent of the Fiscal Responsibility and Budget Management Act.

13. To begin with the beginning, the provisions of the Government of India (Audit and Accounts) order, 1936 as adapted by the India (Provisional Constitution) Order, 1947 and Article 149 of the Constitution of India, have cast responsibilities on and vested powers in the C&AG of India in relation to the accounts of the Union and the State Governments. A number of instructions were issued from time to time by the C&AG for the guidance of the Civil Audit Offices responsible for compiling accounts, In several cases, the connected accounting procedures were prescribed along with audit procedures as the work was handled by the same office.

14. The Parliament passed the C&AG's (Duties, Powers, & Conditions of Service) Act in 1971 under Articles 148 (3) and 149. Article 150 was amended in 1976 and again in 1978 to empower the President to prescribe, on the advice of the C&AG, the form in which the accounts of both the Union and the States, even though the C&AG had been relieved of the responsibility for compiling the Union accounts.

15. Art 112 of the Constitution mandates the President to have the annual financial statement - a statement of the estimated receipts and expenditure of the Government of India - (budget in common parlance) - laid before both the Houses of Parliament. This statement is required to "distinguish expenditure on revenue account from other expenditure."

ALLOCATION OF EXPENDITURE BETWEEN CAPITAL AND REVENUE

Accounts Code and Civil Accounts Manual

16. Whether public expenditure shall be met from current revenues or from borrowed moneys is a policy decision of the Executive approved by the Legislature. C&AG can bring to notice of the Government cases in which the classification of expenditure between revenue and capital or its distribution between current revenues and loan funds appears to be contrary to the dictates of sound and prudent financial administration. As per Para 4.6 of the Civil Accounts Manual issued by the Controller General of Accounts, which are in line with provisions earlier contained in C&AG's standing instructions incorporated in the Accounts Codes, the following principles have been prescribed for allocation of expenditure between capital and revenue:

(a) Capital expenditure may be generally defined as expenditure incurred with the object of either increasing concrete assets of a material and permanent character or of reducing recurring liabilities.

(b) It is not essential that the concrete assets should be productive in character or that they should even be revenue producing. A productive asset may be considered as one which produces sufficient revenue to afford a surplus over all charges relevant to its functioning. It may on rare occasions be necessary and justifiable to treat as capital a scheme not commercially remunerative but involving large expenditure, say for the construction of a new city.
(c) It is inherent in the definition of capital expenditure that the assets produced should belong to the authority incurring the expenditure. Expenditure by Government on grants-in-aid to local bodies or institutions for the purpose of constructing assets which will belong to these local bodies or institutions cannot legitimately be considered as capital expenditure.
(d) Expenditure on a temporary asset cannot ordinarily be considered as expenditure of a capital nature.
17. When it has been decided that the expenditure on a scheme for creation of a new or additional asset shall be classed as 'Capital' the following are the main principles applicable to the treatment of expenditure in the accounts:-

(a) Capital bears all charges for the first construction of a project as well as charges for intermediate maintenance of the work while not yet opened for service and bears also charges for such further additions and improvements as may be sanctioned under rules made by competent authority.
(b) Subject to (c) below, revenue bears all subsequent charges for maintenance and all working expenses. These embrace all expenditure on the working and upkeep of the project and also on such renewals and replacements and such additions, improvements or extensions as under rules made by competent authority are debitable to the Revenue Account.
(c) In the case of works of renewal and improvements which partake both of capital and revenue nature, it is impracticable to draw a hard and fast line between what is properly debitable to capital or revenue. Allocation in such cases is made by detailed

rules and formulae devised by the executive authorities, which are applied in estimates and accounts to determine the allocation of expenditure between capital and revenue. These rules and formulae must necessarily be based upon some general principle of sound finance, which should aim at an equitable distribution of burdens between present and future generations.

(d) In theory, it is legitimate to make capital bear the charges for interest on money borrowed to finance the construction of a new project before the project becomes revenue earning. In fact, a Government project is only part of the operations of Government and it may be sound financial administration to meet interest charges from other revenue during the process of construction. The charge of interest to capital in Government accounts is justified only when there would be undue disturbance in the Government's budgetary position by taking interest to revenue. The writing back of capitalised interest should be the first charge on any capital receipts or surplus revenue derived from a project when opened for working.

(e) Capital receipts in so far as they relate to expenditure previously debited to capital accruing during the process of construction of a project should be utilised in reduction of expenditure. Thereafter, their treatment in the accounts may depend on circumstances, but except in the case of recovered stores in Railways and the Posts and Telecommunications Departments or as otherwise provided in the rules of allocation applicable to a particular Department, they should never be credited to the ordinary revenue account of the undertaking.

18. The financial and accounting conception of capital expenditure is imported from commercial theory and practice, and an essential feature is that expenditure of a capital nature is not met from the revenue or profits of a concern. In the sphere of Government accounts, the classification of expenditure as capital expenditure affords prima facie justification for recording it outside the Revenue account of Government. The

essential purpose of the opening of capital heads of account is to facilitate the exhibition of the financial results of any special undertaking on the basis of generally accepted commercial principles or in some more simple conventional manner, either that the cost of a service may be ascertained or that the full financial implications of any policy may be made clear.

19. Expenditure debitable to capital may be financed from the following sources:- (a) Revenue (b) Borrowings, either (i) specific for a particular purpose; (ii) non-specific for all Government purposes; (iii) unfounded; and (c) Sources other than revenue and borrowings e.g. accumulated balances. For the purpose of accounts (b) and (c) are grouped together the capital expenditure met from these sources being described as outlay financed outside the Revenue Account and being quite apart from treatment from expenditure met from Revenue. On the other hand expenditure of a capital nature met from revenue is accounted for under the appropriate major head within the Revenue Account as any other expenditure of a revenue nature.

20. Although it is the function of Government to determine the source from which capital expenditure shall be financed, C&AG can bring to the notice of the government cases in which their decision seems contrary to the principles of sound financial administration.

21. The principle of prudent finance was once enunciated by the Government of India in the following terms:- Two conditions must be fulfilled before it would be justifiable for Government of India to spend loan funds on unproductive purposes. These are firstly that the objects for which the money is wanted are so urgent and vital that the expenditure can neither be avoided, postponed nor distributed over a series of years and secondly that the amount is too great to be met from the current revenues. And it may be said generally that the cost of all comparatively small schemes whether productive or unproductive ought to be met from Revenues.

22. It must be remembered of course that although it may seem to be sound and prudent finance to meet any expenditure whether of a capital nature or otherwise from Revenue it must be a corollary of this action that the revenue derived from taxation and other revenue sources is sufficient to cover the expenditure debitable to it otherwise the debit to borrowed funds is merely disguised since in normal circumstances, revenue deficits must be financed from borrowings.

23. It is the duty of the authorities responsible for preparation of government accounts to see that commonly accepted accounting or commercial principles are not infringed; that the accounts exhibit the true financial facts and that transgressions of generally accepted principles of public finance are highlighted for attention of the government and legislature. In cases where it is decided to write down capital, such writing down should be approved by the competent authority for valid reasons in accordance with commonly accepted principles, both of commercial accounting and legislative financial control.

24. The above general principles / criteria to be used for classifying an expenditure as 'Revenue' and 'Capital' need more detailed instructions by individual Departments especially the Ministries of Defence, Railways, and Telecommunications, which have traditionally followed distinctive accounting norms/policies than applicable to what are commonly known in accounting circles as 'Civil' Departments. Reasons are more historical, not that there is anything uncivil about Railways, Defence and Telecom. In fact, Defence Ministry's budget and accounts has asizeable 'Civil Estimates' as distinct from 'Defence Services Estimates'. The Civil Accounts Manual issued by the Controller General of Accounts contemplates

General Financial Rules 2005

25. A major revision of General Financial Rules which contain general financial principles applicable to all

Ministries/Departments was effected in 2005. Erstwhile Rule 291 contained the above basic principle of capital expenditure being expenditure incurred with the object of increasing concrete assets of a material and permanent character, where the assets so created belong to the government incurring the expenditure. In a significant shift of emphasis and coverage of capital expenditure, Rules 79, 90, 91 and 92 of GFRs 2005 provided as follows:-

26. The capital expenditure should be broadly defined as "significant expenditure incurred with the object of acquiring tangible assets of a permanent nature (for use in the organisation and not for sale in the ordinary course of business) or enhancing the utility of existing assets". Subsequent charges on maintenance, repair, upkeep and working expenses, which are required to maintain the assets in a running order as also all other expenses incurred for the day to day running of the organisation, including establishment and administrative expenses shall be classified as Revenue expenditure. Expenditure on a temporary asset or on grants-in-aid cannot ordinarily be considered as a capital expenditure and shall not, except in cases specifically authorised by the President on the advice of the Comptroller and Auditor-General of India, be debited to a Capital Head. Expenditure of a capital nature, as defined above, shall not be classed as Capital expenditure in the Government Accounts unless the classification has been expressly authorised by general or special orders of Government.

27. In the case of works of renewal and replacement, which partake expenditure both of a capital and revenue nature, the allocation of expenditure shall be regulated by the broad principle that Revenue should pay or provide a fund for the adequate re- placement of all wastage or depreciation of property originally provided out of capital grants. Only the cost of genuine improvements, which enhance the useful life of the asset whether determined by prescribed rules or formulae, or

under special orders of Government, may be debited to Capital. Where under special orders of Government, a Depreciation or Renewals Reserve Fund is established for renewing assets of any commercial department or undertaking, the distribution of expenditure on renewals and replacements between Capital and the Fund shall be so regulated as to guard against overcapitalisation on the one hand and excessive withdrawals from the Fund on the other.

28. Expenditure on account of reparation of damage caused by extraordinary calamities such as flood, fire, earthquake, enemy action, etc., shall be charged to Capital, or to Revenue, or divided between them, depending upon whether such expenditure results in creation/acquisition of new assets or whether it is only for restoring the condition of the existing assets, as may be determined by Government according to the circumstance of each case.

29. The allocation between capital and revenue expenditure on a Capital Scheme for which separate Capital and Revenue Accounts are to be kept, shall be determined in accordance with such general or special orders as may be prescribed by the Government after consultation with the Comptroller and Auditor-General.

30. A primary reason why booking of expenditure as 'capital expenditure' should be tightly controlled is that the Finance Accounts exhibit cumulative capital expenditure as a proxy for the asset base of the government, which is then compared with cumulative liabilities of the government to work out asset liability mismatch. This is summation of nominal values (book values) of capital expenditure without any adjustment for depreciation, appreciation, destruction of assets etc. Hence, it may lead to wrong conclusions. For example, cumulative capital expenditure would include the cost of even such Air Force aircrafts which may have got destroyed in accidents.

31. It would be noted that the thus 'life enhancing' expenditure on major renovation of an asset was explicitly recognized as capital expenditure in GFRs 2005. Further, the possibility of even expenditure on grants-in-aid being classified as capital expenditure has been opened on the advice of the C&AG. No such orders have been issued so far. It is significant to note that GFRs 2005 was notified after the government had brought into force the Fiscal Responsibility and Budget management Act, 2003 w.e.f. 5th July 2004. One area that needs further consideration is the classification of government R&D expenditure as revenue or capital and its proper amortization. Another major accounting issue is the long absence of sinking fund contributions being charged to revenue account. Presently, all debts and liabilities are being refinanced only through fresh liabilities, perennially rolled over.

32. The statutory targets for capping and rolling back Revenue Deficits contained in the FRBM Act would imply that the government should either raise more taxes and non-tax revenues or cutback on revenue expenditure. Fiscal consolidation strategy would involve whether Revenue Deficit reduction programme would be revenue-led or expenditure-led. A Committee on FRBM implementation led by Dr Vijay L. Kelkar advised the government to go for a revenue –led fiscal correction. It would be a digression from the main subject here to go into details of the fiscal consolidation proposals given by the Kelkar Committee and subsequently expanded in the reports of the 12th and 13th Finance Commissions, the later being chaired by Dr. Kelkar himself.

33. The revenue expenditure portfolio of Central government includes salaries, pensions, grants-in-aid, defence revenue expenditure, grants-in-aid. An expenditure compression programme should fairly and normally distribute the burden of adjustments. There would be policy choices to spare certain types of expenditures from deeper cuts or differentially restrain their future growth. The importance of

this statement can hardly be over-emphasized. The expenditure cutbacks seldom entail reductions from absolute levels already achieved. (The present United Kingdom government is working on such an agenda under severe fiscal distress.) Most often, expenditure cutback means slower expenditure growth in absolute terms. What to do when the normal adjustment burden on expenditure portfolio is aggravated by a policy to effect deep structural re-allocations? When the policy choice is for government expenditure portfolio to shed physical asset creation in favor of increased outlays on human capital or social capital formation?

Share of capital expenditure has been coming down in the Central government budget

34. Budget 2010-11 provides for total expenditure of Rs.1108,749 crore of which Rs.958,724 crore (84.5%) is revenue and Rs.150,025 crore (15.5%) is capital. Major components of revenue expenditures are Interest Payments (Rs.248,664 crore); Grants to States/UTs (Rs.156,649 crore – non-Plan: Rs.46,001 crore, Plan: Rs.110,648 crore); Subsidies (Rs.116,224 crore); Direct transfer of Central Plan assistance to State/District level autonomous bodies/implementing agencies (Rs.107,552 crore); Defence revenue (Rs.87,344 crore); Pensions(Rs.42,840 crore) and Debt relief to farmers (Rs.12000 crore).

35. Of the total grants to States/UTs, bulk is under Plan (Rs. 110,648 crore). Balance Rs.46,001 crore is under non-Plan, mainly for grants under Finance Commission award - Rs. 32639 crore and grants to compensate for revenue losses due to phasing out of CST - Rs.10000 crore). Significantly, the grants to States have been the fastest growing component of revenue expenditure and overtaken Defence and subsidies to be lower only to the Interest Payments. Plan Revenue expenditure of Rs.315,125 crore is at record high as a share in total Plan expenditure and even total expenditure. Out of this, Rs.218,200

crore is revenue transfers to States/UTs (Rs.110,648 crore as Plan grants direct to States/UTs and Rs.107552 crore as direct transfer to parastatal byepassing the State/UT budgets).

36. Major components of capital expenditure are Rs. 60,000 crore for Defence capital; Rs.15,000 crore for recapitalization of public sector banks against world bank loan, Rs.34,750 crore for Plan capital investment in public sector (Rs.15,875 crore for Railways; Rs.9,552 crore for National Highways being two principal items).

37. Last 25 years of trend analysis, ever since the liberalization started, shows a very pronounced trend of declining capital expenditure in Central budget. The trend is even more pronounced in Plan expenditure. In 1986-87, capital expenditure was 35% of total expenditure and 64% of Plan expenditure. In Budget 2010-11, these figures stand reduced to 13.5% and 15.5%, respectively. This gives a rather negative impression that the Central Government has been deliberately reducing capital expenditure as part of fiscal adjustment. This is not the full perspective on the issue of capital expenditure and investment policy. Since a substantial part of fiscal deficit is used up in financing revenue deficit, the availability of resources for capital expenditure has been limited. In fact, time bound elimination of revenue deficit to create fiscal space for more capital expenditure is one of the prime objectives leading to the enactment of the Fiscal Responsibility and Budget Management Act, 2003.

38. The changes in the investment policy and the profile of Revenue Capital mix of expenditure portfolio calls for a detailed analysis. Two major reasons for decline in share of capital expenditure are debt intermediation and increasing Plan revenue transfers to States and other parastatal.

39. A major offloading of loans from Central budget was effected when in 1993, the policy of disintermediation of external aid to Central Public Sector Undertakings was

adopted. If the external aid to CPSUs were to be routed through the Budget, the capital expenditure of the Central Government would have been higher by way of equity and loans investment. Then in 1999-2000, the loans to States against small savings collections were offloaded from the Consolidated Fund. Instead a system of investing the accretions in the National Small Savings Fund in State and Central securities was started. Budget 2005-06 carried forward this process of debt disintermediation. No provision is being made in the Central budget since 2005-06 for Plan Loans to States except for externally aided projects. Following the12th Finance Commission's accepted recommendation, States are required to raise loans directly from the market without budgetary intermediation of the Central Government.

40. Plan Grants to States have been increasing year after year and since the assets created from such financing support belong to the State Government, there is capital expenditure but in the books of the State Government.

41. The policy of disintermediation of external aid to CPSUs and loans to States and a steady rise in the level of grants to States may have been facilitating the incurrence of capital expenditure but for diversion of Central funds by the States and parastatal for unintended purposes. Since these assets belong to States and CPSUs and not to the Central Government, the expenditure does not show up as Central government's capital expenditure. Plan grants to States are revenue expenditure of the Central Government, but these are intended to finance the capital expenditure and social sector developmental expenditure of the States. Therefore, low share of the capital expenditure in Plan is not necessarily indicative of any lack of productivity or capital efficiency of the overall Plan expenditure of the Centre. When general government fiscal accounts are aggregated, the inter-governmental transfers cancel out and true picture of using government (Central+State) resources to create assets could emerge. Unfortunately, mere

aggregation of Central and State government accounts would not suffice for this purpose because of the central government's increasing resort to byepass the State budgets and directly transfer funds to district and State level parastatal agencies.

42. Since the early years of Independence, the investment profile has considerably changed. While earlier, direct capital formation from Central budget used to be the norm, gradually the capital expenditure shifted to States, Central Public Sector Enterprises and other parastatals, changing the nature of Government investment from direct creation of physical assets to financial assets in the form of equity and loans. Equity investments have also progressively declined as the public sector enterprises gradually began to finance their capital expenditure by raising resources directly from the market. The process received a further boost when in 1993 the Government switched over to the policy of 'disintermediation' of external assistance to Central PSEs under which Central PSEs are now allowed to access external funding directly rather than through the Central Budget. Budget 2005-06 carried forward this process of debt disintermediation. These developments have contributed to a decline in capital expenditure/ investment of the Central Government due to the very nature of the development cycle, the disintermediation policy and the preemption of nearly half of Government's net borrowings by the need to finance current expenditures. All these developments have led to a substantial decline in the Plan Capital expenditure of the Central Government. Public Private Partnership is the new paradigm for Government catalyzed rather than fully Government-funded investment. To experiment with newer institutions in this area, the Government is using Special Purpose Vehicles for arranging 'viability gap funding' to facilitate financing for critical infrastructure projects by the financial sector.

43. It would be seen that the trend for past 20 years or so has been through disintermediation of loans, offloading of

capital expenditures to PPP policy choice is for government expenditure portfolio to shed physical asset creation in favor of increased outlays on human capital or social capital formation It is such policy changes that have renewed the debate on Revenue-Capital expenditure classification, otherwise a boring topic fit for discussion only amongst accountants and auditors. Today such a debate has changed the policy discourse to the extent of declaring – with invisible ink – capital expenditure as good and revenue expenditure as bad, a most undesirable outcome of targeting revenue deficits. Instead of serious re-examination of yesteryears' financial decisions – especially those creating long terms budgetary commitments, the focus seems to be relabeling the expenditures.

44. One such serious relabeling exercise concerns classification of 'grants-in-aid'. A point is often made that we should have different accounting treatments for grants given for asset financing. The suggestion is that these should be classified as capital expenditure or capital grants. If the asset created does not belong to the entity incurring the expenditure then it is not wise to treat it is an asset creating expenditure of that entity. The right course of action in the context of central government grants to States and other parastatals is to consider the general government revenue balance and fiscal balance. That will net out all such transfers and reveal the true extent of asset creation by the government. It is a verifiable fact that we have a consolidated revenue deficit for the Centre and the States, which is more than the Centre's revenue deficit. It clearly shows that there is actually no asset creation from Central grants due to diversion of Central funds by the States, often also commented in the C&AG's Audit reports.. Incidentally, if we classify some grant as capital just because it has been ostensibly given for asset creation (first of all the grants do not have such a linkage e.g. block grants under CPA) then we must also be ready to classify many expenditures by way of loans or equity contribution to sick PSUs, which we

know are only going to be used to finance the working capital or operating deficit. If there is Central funding for State/district/village roads, or schools or hospitals, it is theoretically possible to stipulate that the ownership of these assets belong to the Central government and treat it as a capital expenditure. This will answer technical question but the substantive question will remain: Ideally borrowings should be linked to productive investment where the financial rate of return exceeds the financial cost of borrowing whereas such assets do not yield sufficient direct financial returns. Expenditure on social sector (especially education and health) to build 'human capital' is a primate candidate for such relabeling exercise. The effect is to create productive assets for future. The argument has a strong emotional appeal. It is OK for a parent to finance child's education by borrowing if there are reasonable prospects that the child will earn and repay the loan.

45. If a bit of frivolity on my part, with the express purpose of dramatizing for effect, is condoned by discerning readers, I would like to pose some questions: If expenditure incurred to enhance the productive capacity being 'capital' becomes the touchstone of expenditure classification, then salaries, dearness allowance, leave encashment, LTC, medical reimbursement all would shift to 'capital'. All foreign trips would be first charge on 'capital' because these are necessarily undertaken with a view to acquire capabilities, personal and organizational. Expenditure on all schemes of augmenting income or spending capacity - whether through direct cash transfers or subsidies / under recoveries – would become 'capital'. Purists would then want to purge such a capital expenditure portfolio of expenditures whose beneficiaries are on the wrong side of 60 or whatever is defined by the government on the advice of accountants to be the age of cessation of productive capacity. It would launch another debate – inter generational – about the quality and quantum of work output.

46. Since 1.4.1987, Ministry of Defence is following a simple criterion to consider an expenditure as 'capital': If the expenditure is incurred in acquiring an item which has a value of at least Rs.10 lakhs and the item has a life of minimum 7 years. For land and civil works, 'life' has more certainty than the rest of war machinery but there is no way to factor that uncertainty except switching over to a variant of deferred revenue expenditure by writing off over a certain number of years. Relatively liberal budgeting on 'capital' side is creating incentives to shift expenditures from 'revenue' to 'capital'. Further, revenue/capital classification norms on government R&D expenditure in general and defence R&D expenditure in particular need review. Cost of an aircraft could be 'capital' or 'deferred revenue'. Cost of a missile used in development test firing may be 'revenue' [if life is known to be less tha 7 years at the time it is assembled] or 'capital' [if it is delivered to an Armed Force with declared life of more than 7 years. Cost of successful Defence R&D may be capitalised as part of production cost of developed weapon system but then cost of unsuccessful R&D has to be charged to revenue, irrespective of life – cost criterion. We may go by the spirit of classifying the capital expenditure being significant expenditure on acquiring concrete/tangible assets of material and permanent character even if these belong to the 'grantee' bodies and thus 'increase' otherwise depleted capital expenditure due to debt disintermediation, PPP etc. However, simultaneously a big chunk would then have to be taken out from defence capital etc and put on deferred revenue route by the same logic. Also, endless financing of the debt repayments from fresh borrowings would also have to cease. Sinking Fund contributions charged to reveue accounts would have to be created at least for specific portfolios like oil and food bonds. Loans given to sick PSUs for payment of salaries and wages, rather than creation of durable physical assets, would also then have to be charged to revenue.

47. If we go back to the fundamentals, expenditures resulting in benefits confined to the current year should be charged to current revenues (profit & loss account). Every expenditure now has some benefit for future. There is no future if present is not taken care of. Once viewed from this perspective, it can be seen that the revenue capital debate is a proxy for a more subtle debate on quality of public expenditure and its financing pattern: whether and to what extent should the present generation go on spending beyond means on low productivitiy expenditures, continuously roll over debt obligations, defer taxation, subsidize inefficieny and corruption, borrow for current consumption and resultantly load the future generations with debt burdens without enough valuable assets.

48. Another dominant trend in recent years has been sharp increase in transfers to States and sub-State parastatal, which is at record high of Rs. 264,200 crore (23.8% of total expenditure) in Budget 2010-11. For Plan transfers, the trend is even more pronounced: Rs.218, 200 crore (58.5% of total Plan expenditure). It is a pointer to a structural shift in the Central government's expenditure profile, with rising share of discretionary transfers to States and sub-State parastatal. It shows a dominant role of the Central budget in redisribution of national resources, which can have salutary effect on public finances if properly linked to issue of quality of public expenditure, fairness, equity and good governance.

A NOTE ON EPC CONTRACT SYSTEM

M.P. Gupta and S.C. Sharma[*]

1. What is EPC?

1.1 EPC is an acronym for Engineering, Procurement and Construction. It places the duty to design and construct solely on the contractor. The other terms in use are 'turnkey' arrangement (also known as the 'package deal', 'design and build', 'cle-en-main', 'design and construct'). However, there is no accepted definition for each of these terms in the construction field.

Whether a contract EPC, or design-build, or called by any another name, the core feature is single point responsibility for design and construction of the works. The employer receives a completed work in accordance with the design criteria and performance standards laid down by him under the Employer's Requirements.

2. The existing item-rate system for construction of infrastructure projects

2.1 We take a highway organisation as an example to state our understanding of the existing system (also known as "item rate" system) for the construction and maintenance of highways. Its essential features are:

(a) The Governments meet the entire cost of creation of highway assets and their maintenance through their highway organisations.

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(b) To discharge its responsibilities, most of the highway organisations generally outsource all their major activities as follows:

(i) Private consultants conduct field surveys and prepare detailed project report (DPR). DPR follows the specifications for the highways, and estimates the costs based on field surveys, quantities of various items involved and the prevalent rates.

(ii) Many highway organisations do not have in-house expertise or adequate manpower either for field surveys and DPR preparation, or for peer reviews of DPR. All the defects in DPR coming to notice during construction and resulting in higher costs are the risks that the Government accepts. Majority of disputes with the contractors relate to variations or changes in specifications arising from inadequate investigations. These lead to time and cost overruns, upsetting financial discipline.

(iii) Quality of the work, among others, depends upon the quality of the designs prepared by the consultants. And the fact is that the roads often do not last their expected life owing to design deficiencies, coupled with inadequate maintenance.

(c) Contractors construct the highways as per the DPR. They own no responsibility for faults in the highways, or bridges arising from shortcomings in investigation and design.

(d) Governments accept and bear all the additional costs arising from:

(i) Price adjustment due to increase in cost of input.

(ii) Cost of variations/specifications ordered during the construction.

(iii) Cost of all additional quantities over and above the estimated quantities.

(iv) Cost of delays in handing over possession of construction sites.

(v) Cost of higher rates for changed specifications and variations. The rates must be acceptable to the contractor; otherwise, he refers it to arbitrators.

(vi) Cost of additional quantities above a specified percentage. This again calls for new rates, acceptable to the contractor; otherwise, this results in arbitration cases.

(vii) Costs of Dispute Review Boards, arbitration, litigation in the High Courts and the Supreme Court.

(viii) The interest cost of arbitration awards.

Little published data exist to form any estimate of the above costs. Our understanding is that these may significantly add up to contract price, apart from the inflation costs. The item-rate contract system has given rise to plethora of disputes. For example, NHAI's annual report 2005-2006 states that for 63 arbitration cases, its contingent liability is Rs. 1,584 crores; and that it does not know the liability for other claims / legal cases.

2.2 Disadvantages of the existing item-rate system

2.2.1 Contractor has the wrong incentive to increase the quantities of items for more profits.

2.2.2 Supervision of construction activities is also outsourced. Supervision consultants are appointed and the employer accepts the financial risks of shortcomings of supervision.

2.2.3 Wherever maintenance of highways is out-sourced, there is inadequate check on performance, as evidenced by public outcry of poor quality of road maintenance.

3. Features of EPC

3.1 The EPC system:

(i) transfers the entire work of surveys, designs, construction, supervision of construction activities to one contractor instead of three different agencies at present.

(ii) results in certainty of cost for the construction barring inflation costs and any variations ordered. All other risks are borne by the contractor.

(iii) does not pay the contractors for "inputs". Instead, the payment relates to achieving specified performance levels of the construction.

(iv) grants to the contactor the freedom to (i) what to do, (ii) where to do it, (iii) how to do it, and (iv) when to do it.

3.2 The employer's role becomes enforcing the contract by verifying compliance with the agreed performance levels and laws.

3.3 The EPC system results in a win-win situation for both the Government and the contractor as follows:

(i) The contractor designs the roads with an open mind as to using the best practices to save on time, material and labour costs.

(ii) The Government protects itself from the rigidity of a single design of its consultant who has no responsibility to minimize the costs.

(iii) The more the contractor works according to the schedule of work, or ahead of it, the more he saves

on inflation costs. The Government gets works completed in time.

(iv) Brings in financial discipline both for the contractor and the Government and minimizes disputes.

3.4 EPC offers more incentives to the contractor when construction of highways is combined with maintenance. It requires the contractors to compete among each other by essentially proposing fixed lump-sum prices for constructing and maintaining an infrastructure project to a certain performance level. The contractor knows that it gets no money for its "inputs" or physical works (which they will undoubtedly have to carry out), but for achieving specified performance levels, i.e., the construction to pre-defined standards representing outputs or outcomes.

3.5 EPC provides the contractor a strong financial incentive to be both efficient and effective. To maximize profits, he must reduce his activities to the smallest possible volume of intelligently designed interventions, which nevertheless ensure that pre-defined performance levels are achieved and on time. This requires the Contactor to have a good management capacity.

3.6 EPC does not restrict bidding to "traditional" works contractor. It invites bids from any type of firm or business venture having the necessary technical, managerial and financial capacity to fulfill the contract.

3.7 The book Understanding and Negotiating Turnkey and EPC Contracts by Joseph A. Huse brings out the need for the employer's supervision on EPC contracts as follows:

"The contractor will want to execute the works within the parameters of the employer's requirements for the least cost possible. The contractor in a turnkey or EPC contract may be tempted to under-design the project in order to cut his

costs and save on time. Therefore, under the turnkey or EPC model, the employer will still need to provide supervision of the construction, to ensure that the contractor's performance satisfies the contract requirement.

Indeed, where the nature of the project is such that design changes are likely to be necessary (and yet where the contractor will not be entitled to an increase in the contract price) the employer should be aware that the ultimate maintenance costs and long-term performance of the project's structure may be negatively affected. Some employers try to offset this risk by requiring the successful bidder to operate and maintain the facility for a period of time after construction, thereby providing the contractor with the incentive to produce an efficient, low maintenance product."

4. Standard EPC Contracts

4.1 At the international level, the FIDIC (International Federation of Consulting Engineers) has brought out two documents on conditions of EPC contracts. These are:

(i) Plant and Design-Build Contract 1st Ed (1999 Yellow Book)

(ii) EPC/Turnkey Contract 1st Ed (1999 Silver Book)

4.2 At national level, the Planning Commission has put out a document: Draft Model Agreement for EPC Contract for Highways, prepared by the National Council of Applied Economic Research for discussion.

4.3 The Dedicated Freight Corridor Corporation, Indian Railways is finalizing its bidding document for EPC contract Civil,-Structures and Track Works for about 300 km route in the eastern corridor.

5. Design responsibility

5.1 In an EPC contract, the contractor does the investigation, surveys, and design work. The employer reviews/approves the design. His comments on the design are restricted to deviations and non-conformities from the Employer's Requirements stated in the Contract. While the design is to be approved/reviewed by the employer, the contractor remains responsible for the soundness of the design.

5.2 The usual system is to require the contractor to have:

(i) Independent quality control.

(ii) A proof consultant appointed and paid either by the employer, or appointed by the contractor in consultation with the employer.

6. Fit for the purpose

6.1 The EPC contracts require the contractor to ensure that the final product is fit for the purpose for which it is meant. This term is omnibus and goes beyond specifications and standards that may have been inadequately included in the tender documents.

7. Certainty of Cost and Risks

7.1 The more risks the employer accepts, the more uncertain becomes the final cost. The more risks the contractor bears, higher becomes the contract price, but it is a certain price.

7.2 Let us look at the PPP (public-private partnership) projects in the highway sector. The concessionaire gets the right to design and build a highway and collect tolls for a specified period to recover his investment. He ties up with financiers who have to ensure that the project costs are completed within the estimated costs and time; else they risk recovery of the amount lent. Hence, both the concessionaire and the financiers, independently of

each other, are keen on certainty of cost and time. Therefore, the financiers also appoint their own experts to ensure the project is completed within the estimated time and cost.

7.3 The above scenario is difficult to visualize in the item rate system. Government carries most of the risks. The contractor, none at all.

8. Risks vs. certainty of price and completion period

8.1 The following are the seven recognized risks in implementing civil works contracts on EPC model:

(i) **Errors in Employer's Requirements** resulting in time and cost over runs and variations if not properly addressed,

(ii) **Setting Out**: Errors in setting out, EPC contractor's scope of supply,

(iii) **Interpretation of Site Data**,

(iv) **Unforeseeable conditions,**

(v) **Time and cost implications of probable future events**,

(vi) **Extension of Time for Completion** for exceptionally adverse climate conditions, and shortages in goods or persons due to epidemics or Government action, and

(vii) **Risk of any operation of the forces of nature** against which an experienced contractor could not have taken precaution**,**

8.2 Exception to the risk is: Man-made obstacle like underground cables, sewers, utilities which are not specified in the Employer's Requirements. The employer has to bear these risks always.

9. Employer's Administration

9.1 In Government the practice is for the employer to appoint an Engineer with adequate powers, subject to restrictions, requiring employer's approval in cases of change of scope, extension of time etc. where either the price or the time of completion will be affected.

10. Interim Payments

10.1 Interim payments are not based on measurement unlike the item-rate contracts. Payments are related to achievement of specified milestones or stages of completion.

For infrastructure works, there exist no formats for assessing the interim payment. Since EPC contract does away with the concept of measuring quantities of work done, each contract has to devise project specific method. For example, for the highways, the procedure may be adopted as follows:

Weightages in the Contract Price of the Design, Construction and Maintenance of the Project Highway is:

Item	Weightage in percentage to the Contract Price for the Project Highway	Stage / Component	Percentage weightage for the stage / component	Payment Procedure
1	2	3	4	5
Design Works	[3]	Survey Geotechnical/ Hydrological Investigations Preliminary Design Definitive Design Setting out Completion Drawings/ As-Built Drawings	[**] [**] [**] [**] [**] [**] [**]	See Note 1

Road Works	[*****]	(1) Earth Work (2) Granular Work (3) Bituminous or Cement Concrete Work (4) Culverts and minor bridges	[**] [**] [**] [**]	Note 2
Bridge Works and Structures	[*****]	(1) Foundation (2) Sub-structure (3) Super-structure	[**] [**] [**]	Note 3
Other Works	[*****]	In equated monthly installments spread over the time for completion of Project Highway		
Maintenance	[10]	1st Year [**], 2nd Year [**], 3rd Year [**], 4th Year [**] and 5th Year [**]		

Note 1. Unit of measurement is linear length. Payment of each stage will be made on pro rata completion of linear length as per the weightage given in this Schedule.

Note 2. Unit of measurement is linear length. Payment of each stage will be made on pro rata basis on completion of a stage in a length of not less than 10 (ten) percent of the total length as per the weightage given in this Schedule.

Note 3. Cost of each bridge will be determined on the basis of total linear length of the bridges on prorata basis. Payment of each stage for a bridge will be made on completion of the relevant stage as per the weightage given in this Schedule.

11. Sub-contractors

11.1 Sometime, the contractor has full freedom to appoint the sub-contractors. However, in infrastructure projects, this contractor is allowed to appoint sub-contractors up to about one-third of the amount of the contract price.

12. Treatment of delays in handing over site

12.1 In Government contracts for highways, it happens, and happens quite often, that possession of the parts of the site is not given to the contractor in time. The contractor

cannot plan its programme in an efficient manner for staggered stretches of roads. Government departments are unable to help in the matter. The contractor gets compensation only if he proves he has suffered any loss, if at all.

12.2 The model EPC agreement for highways, developed for the Planning Commission, prescribes the amount of compensation to the contractor for each day of delay for each km. If the contractor considers the compensation amount inadequate, he can compensate it in the bid price, which is a lump sum price.

12.3 However, the employer has to disclose in the bidding documents the details of the stretches of site in its possession, and the expected dates of handing over the remaining stretches to the contractor.

12.4 Annexure 1 is the extract from the model agreement for EPC contract for highways.

13. Variations

13.1 In item rates of work, the recourse to Variation orders is quite common. Many Variations are related to change in specifications. This results in both higher costs, and longer periods for completion.

13.2 Therefore, the term variations have to be defined to restrict it to change of scope of the work. The change in specifications should be restricted to changes in codes.

13.3 Suggested definition of variation is:

Variations shall include:

(i) changes in mandatory codes;

(ii) omission of any work from the Employer's Requirements; and

(iii) any additional work, Plant, Materials or changes in the Employer's Requirements, including any associated Tests on Completion.

If the contractor's Documents or Works are not in accordance with the Contract, the alteration and/or modification shall not constitute a Variation.

14. Valuation of variations

14.1 In item rate contracts, valuation of variations often leads to disputes in all cases where the variation is not similar to an item of work already included in the bill of quantities which is part of the contract. The reason: the contract does not specify the procedure for valuation. It leaves it to the Engineer to determine it; and if the contractor disagrees with the determination by the Engineer, the arbitrators step in. More than half the disputes of the National Highway Authority of India arise on this account.

14.2 It is for the first time that the Model EPC Agreement for the Highways lays down the procedure for valuation of variations. Its details are at Annexure 2.

15. Predetermined mutually agreed liquidated damages

15.1 The settled law, until recently, had been that the employer was entitled to liquidated damages of the amount of the actual loss he suffered, and subject to a limit of ten percent of the contract price. However, the Supreme Court has held that in cases like the construction of roads it is not feasible to prove the loss to the Government. Therefore, it upheld the legality of a clause of pre-determined mutually agreed liquidated damages in such cases.

16. Performance Security

16.1 The Model EPC Agreement for Highways allows the contractor to provide performance security in several stages, and it does away with the retention money. The performance security is deposited as follows:

Percentage of the Contract Price	Specified time for furnishing Performance Security
2.5	Within twenty-one (21) days of the Issue of LOA
2.5	Along with the claim for interim payment when the cumulative payment due to the contractor exceeds 15 (fifteen) percent of Contract Price.
2.5	Along with the claim for interim payment when the cumulative payment due to the contractor exceeds 30 (thirty) percent of Contract Price
2.5	Along with the claim for interim payment when the cumulative payment due to the contractor exceeds 45 (forty-five) percent of Contract Price.

The last two performance securities are released when the work is completed. The others are released when the defect notification period is over.

16.2 The Model EPC Agreement for Highways also introduces the concept of appropriation of the Performance security in the following cases:

The Employer shall not make a claim under the Performance Security, except for amounts to which the Employer is entitled under the Agreement in the event of:

(i) failure by the contractor to extend the validity of the Performance Security as described in Clause 7.2, in which event the Employer may claim the full amount of the Performance Security,

(ii) failure by the contractor to pay the Employer an amount due, as either agreed by the contractor or

determined under Sub-clause 21.4 or Article 27 (Dispute Resolution), within 42 days after the agreement, determination, date of coming into effect the recommendation of the Board, or the Award.

(iii) failure by the contractor to remedy a default within 42 days after receiving the Employer's notice requiring the default to be remedied, or

(iv) circumstances which entitle the Employer to termination of the Agreement under Sub-clause 24.1 (Termination for Contractor Default), irrespective of whether notice of termination has been given.

The Employer shall indemnify and hold the contractor harmless against and from all damages, losses and expenses (including legal fees and expenses) resulting from a claim under the Performance Security to the extent to which the Employer was not entitled to make the claim.

17. Payment on termination on account of default of the contractor

17.1 The recent trend is to recover the 20 to 30 percent of the balance amount of work not done and close the matter. There is no forfeiture of performance security; and no liquidated damages. This is considered sufficient deterrent for good contractors.

18. Institutional arbitration

18.1 Government has started laying greater emphasis on institutional arbitrators.

19. Price adjustment

19.1 No long term contract without a clause for adjustment of price is feasible in view of the difficulties to foresee the rise in prices. In India, a few years back, Governments had to revise the contract conditions on

price adjustment when the steel prices rocketed as the inflation index failed to do justice to this particular case.

19.2 In the EPC contract, there is no quantity measurement of work done. Therefore, some special formula have to be devised.

19.3 The World Bank suggests to take midpoint of the project period and apply the percentage of increase in prices taken from the base date (28 days prior to the last date of tender submission) to the mid-point and with reference to one particular index.

19.4 We have been recommending price adjustment for labour, steel, cement, POL, and others on the basis of their assumed percentage share in the cost of the works. But this is an issue that requires more discussion.

20. Bibliography (Annexure - 3)

Annexure 1

Clause in Model EPC Agreement for Highways on handing over possession of site to the contractor

Note: Authority stands for employer.

8.1 The Site

8.1.1 The site of the Project Highway (the Site) shall comprise the real estate described in Schedule-A in respect of which the Right of Way shall be provided by the Authority to the Contractor. The Authority shall be responsible to the Contractor for:

(a) acquiring and providing physical possession of the Site free from all encroachments and encumbrances, and free access thereto for the execution of the Agreement; and

(b) obtaining licences and permits for environment clearance for the Project Highway.

8.2 Compensation for delay in handing over the Site

8.2.1 The Authority shall provide the Right of Way to the Contractor:

(i) on the date(s) stated in Schedule-A; and

(ii) In the event Schedule-A does not specify any time schedule for providing the Right of Way for any part of the Site , the Authority shall provide to the Contractor the Right of Way to such part(s) within 30 (thirty) days of the Start Date.

8.2.2 If Right of Way of a part of the Site is not given within fourteen days of the date specified in Sub-clause 8.2.1 for any reason other than Force Majeure or breach of this Agreement by the Contractor, the Authority shall pay Damages to the Contractor in accordance with the provision of Sub-clause 8.2.3.

8.2.3 For any period of delay in giving the Right of Way to the Contractor exceeding 14 (fourteen) days but not exceeding ten percent of the Construction Period of the Project, the Contractor shall be entitled to Damages in a sum calculated in accordance with the following formula:

Amount of Damages Rs. per day = 0.05 (RW + BS) x 1/30

Where RW means cost of Road Works in the part of the Site for which handing over the possession was delayed.

RW =(Crw /Lrw) x LA rw

Crw = Total cost of Road Works in accordance with Clause 20.1

Lrw = Total length of the Project Highway in kilometres.

LArw = Length in kilometres of the affected part of the Site for which handing over the possession was delayed.

BS means cost of major bridges and structures in the part of the Site for which handing over the possession was delayed.

BS = (Cbs/Lbs) x LAbs

Cbs =Total cost of bridges and structures in accordance with Clause 20.1

Lbs = Length of the major bridges and structures in the Project Highway in running metres, listed in the Schedule-A

LAbs =length of major bridges and structures in running metres of the affected part of the Site for which handing over the possession was delayed.

8.2.4 For the period of the delay in handing over the Right of Way beyond ten percent of Construction Period, the Contractor shall be entitled to the Damages in a sum calculated at the rate of one and a half times the Damages determined on the basis of the formula stated in Sub-clause 8.2.3.

8.2.5 In all cases covered by Sub-clauses 8.2.3 and 8.2.4, the Contractor shall be entitled to extension of Construction Period in that particular stretch in which the handing over the Right of Way of the part of the Site was delayed. The period of extension shall be equal to the period of delay in handing over the possession of the Site; provided that if delays involve time overlaps, the overlaps shall not be additive.

8.2.6 Notwithstanding the provisions of Sub-clause 8.2.3 to 8.2.5, the Authority may withdraw such affected works for which the Right of Way has not been acquired and handed over to the Contractor subject to the condition that the aggregate value of the works withdrawn, as determined by the Engineer, does not exceed 5 (five) per cent of the Contract Price for the Design and Construction of the Project Highway. The Contract Price shall be reduced by the value of the work withdrawn and the Contractor shall not be entitled to any Damages or compensation for the reduction in the scope of the Project Highway.

Provided the Authority exercises this right not later than two months after the Scheduled date of handing over the Right of Way has expired.

8.2.7 The Schedule-A states the present status of the environment clearances obtained or awaited, as the case may be, indicating the expected dates of obtaining clearances.

8.2.8 The Contractor shall allow access to and use of the Site and/or the Construction Works for laying/installing telegraph lines, electric lines or for such other public purposes as the Authority may require.

Provided that if such access or use results in material adverse effect, the Contractor shall use its best endeavor to ensure that the impact thereof upon the Construction Works is minimized. In the event of any physical damage to the Site and/or the Construction Works on account thereof, the Contractor shall provide all information and assistance as the Authority may reasonably require for seeking compensation or damages from such user of the Site in accordance with applicable Laws.

8.2.9 It is expressly agreed that trees on the Site are property of the Authority.

8.3 Procurement of the Site

8.3.1 After the signing of the Agreement, the Authority Representative and the Contractor shall, on a mutually agreed date and time, inspect the Site and prepare a memorandum containing an inventory of the Site including the vacant and unencumbered land, buildings, structures, road works, trees and any other immovable property on or attached to the Site. Such memorandum shall have appended thereto an appendix (the "**Appendix**") specifying in reasonable detail those parts of the Site to which vacant access and Right of Way has not been given to the Contractor. Signing of the memorandum, in two counterparts (each of which shall

constitute an original), by the authorised representatives of the Parties shall be deemed to constitute a valid evidence of giving the Right of Way to the Contractor during the Construction Period under and in accordance with the provisions of this Agreement and for no other purpose whatsoever.

8.3.2 On and after signing the memorandum referred to in Sub-clause 8.3.1, and until the issue of the Taking Over Certificate, the Contractor shall maintain a round-the-clock vigil over the Site and shall ensure and procure that no encroachment thereon takes place,

8.3.3 The Authority shall make best efforts to provide the Right of Way to the Contractor in respect of all land included in the Appendix, and in the event of delay for any reason other than Force Majeure or breach of this Agreement by the Contractor, it shall pay to the Contractor Damages in a sum calculated in accordance with Clause 8.2

8.4 Site to be free from Encumbrances

Subject to the provisions of Clause 8.3, the Site shall be made available by the Authority to the Contractor pursuant hereto free from all Encumbrances and occupations and without the Contractor being required to make any payment to the Authority on account of any costs, compensation, expenses and charges for the acquisition and use of such Site for the duration of the Construction Period. For the avoidance of doubt, it is agreed that existing rights of way, easements, privileges, liberties and appurtenances to the Site shall not be deemed to be Encumbrances.

8.5 Protection of Site from encroachments

8.5.1 During the Construction Period, the Contractor shall protect the Site from any and all occupations,

encroachments or Encumbrances, and shall not place or create nor permit any Sub-contractor or other person claiming through or under the Contractor to place or create any Encumbrance or security interest over all or any part of the Site or the Project Assets, or on any rights of the Contractor therein or under this Agreement, save and except as otherwise expressly set forth in this Agreement. In the event of any encroachment or occupation on any part of the Site, the Contractor shall report such encroachment or occupation forthwith to the Authority and undertake its removal at its cost and expenses.

8.5.2 During the Maintenance Period, the Contractor shall keep a vigil over the Site and shall ensure that no occupations or encroachments thereon take place; and in the event of any encroachment or occupation on any part of the Site, the Contractor shall report such encroachment or occupation forthwith to the Authority.

8.6 Special/temporary right of way

The Contractor shall bear all costs and charges for any special or temporary right of way required by it in connection with access to the Site. The Contractor shall obtain at its cost such facilities on or outside the Site as may be required by it for the purposes of the Project Highway and the performance of its obligations under this Agreement.

8.7 Access to the Authority and Engineer

8.7.1 The Right of Way given to the Contractor hereunder shall always be subject to the right of access of the Authority and the Engineer and their employees and agents for inspection, viewing and exercise of their rights and performance of their obligations under this Agreement.

8.7.2 The Contractor shall ensure, subject to all relevant safety procedures, that the Authority has un-restricted access to the Site during any emergency situation, as decided by the Engineer.

8.8 Geological and archaeological finds

It is expressly agreed that mining, geological or archaeological rights do not form part of the Agreement with the Contractor for the Construction Works, and the Contractor hereby acknowledges that it shall not have any mining rights or interest in the underlying minerals, fossils, antiquities, structures or other remnants or things either of particular geological or archaeological interest and that such rights, interest and property on or under the Site shall vest in and belong to the Authority or the concerned Government Instrumentality. The Contractor shall take all reasonable precautions to prevent its workmen or any other person from removing or damaging such interest or property and shall inform the Authority forthwith of the discovery thereof and comply with such instructions as the concerned Government Instrumentality may reasonably give for the removal of such property. For the avoidance of doubt, it is agreed that any reasonable expenses incurred by the Contractor hereunder shall be reimbursed by the Authority. It is also agreed that the Authority shall procure that the instructions hereunder are issued by the concerned Government Instrumentality within a reasonable period.

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Annexure 2

Clause in Model EPC Agreement for Highways on valuation of Variation (called Change in Scope)

Note: Authority stands for employer

13.2 Procedure for Change of Scope

13.2.1 In the event of the Engineer determining that a Change of Scope is necessary, it shall issue to the Contractor a notice specifying in reasonable detail the works and services contemplated thereunder (the "**Change of Scope Notice**").

13.2.2 Upon receipt of a Change of Scope Notice, the Contractor shall, with due diligence, provide to the Authority such information as is necessary, together with preliminary documentation in support of:

(a) the impact, if any, which the Change of Scope is likely to have on the Project Completion Schedule if the works or services are required to be carried out during the Construction Period; and

(b) the options for implementing the proposed Change of Scope and the effect, if any, each such option would have on the costs and time thereof, including the following details:

(i) break down of the quantities, unit rates and cost for different items of work.

(ii) proposed design for the Change of Scope.

(iii) proposed modifications, if any, to the Construction Period of the Project Highway.

13.2.3 The Contractor's quotation for the Change of Scope shall be based on the detailed design and the rates for various items of work as derived on the basis of

MoSRTH Standard Data Book and the prevailing market rates for the various items.

13.2.4 For items which are not included in the Standard Data Book suitable rate or price shall be agreed upon between the Engineer and the Contractor.

13.2.5 Upon reaching an agreement, the Authority shall issue an order (the "**Change of Scope Order**") requiring the Contractor to proceed with the performance thereof. In the event that the Parties are unable to agree, the Authority may, by issuing a Change of Scope Order, require the Contractor to proceed with the performance thereof.

13.2.6 The provisions of this Agreement, insofar as they relate to Construction Works and Tests, shall apply *mutatis mutandis* to the works undertaken by the Contractor under this Article 13.

Annexure 3

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FORENSIC AUDITING – ISSUES AND CHALLENGES FOR AUDITORS

Dr.Sadu Israel[*]

1. Introduction

The word 'forensic' comes from the Latin word meaning "public" or "forum", the later being where ancient Romans gathered to do business and settle disputes. In modern usage 'forensic' relates to courts of law and legal concerns. More specifically Forensics is the application of science to legal matters, especially criminal matters.

Forensic auditing may, therefore, be defined as *application of accounting methods to the tracking and collection of forensic evidence usually for investigation and prosecution of criminal acts such as embezzlement or fraud.*

Forensic audit involves examination of legalities by blending the techniques of propriety (performance related), regularity, investigative and financial audits. The objective is to find out whether or not true business value has been reflected in the financial statements; whether any fraud has taken place and if so, naming the persons involved in order to take legal action.

This paper brings out a review of the concept of 'Forensic Audit' and lists out various key issues on the subject. The introduction is followed by an outline of the knowledge and skill levels expected of Forensic Auditors. The third section looks at some differences between Forensic Audit and Statutory Audit on certain key parameters. The fourth section is about the audit mandate while the fifth section brings out the various key

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phases in Digital Forensics. In the sixth and the seventh sections, a review of various detection methods and techniques has been brought out. The penultimate section lists out some key issues for consideration in the time to come for conducting a full-fledged Forensic Audit by the External Auditors. The conclusion sums the discussion.

2. Characteristics of Forensic Auditors

Many forensic auditors have an accounting background. In some cases, forensic auditors are employed primarily in the audit function of their organizations. Forensic auditors are viewed as a combination of an auditor and private investigator. Their desired ability is to sift the relevant facts from a mass of masking data and draw meaningful conclusions in a legally tenable report, one that can stand the scrutiny of a Court of Law. Knowledge and skills required for forensic auditors would thus include the following:

- investigation skills,
- research,
- law,
- quantitative methods,
- finance,
- auditing,
- accounting and
- law enforcement officer insights.

Detection methods and techniques will be covered later in the paper. Knowledge and skills required to analyse organizational behaviour and use applied psychology tools and techniques are also essential.

In the Indian context, forensic auditors have been working with the States Police Departments, Central Bureau of Investigation (CBI), Government Examiners of Questioned Documents (GEQD), Serious Fraud Investigation Office (SFIO) and other

government agencies. Outside of Government employment, big employers of forensic auditors include financial intermediaries such as banks and insurance organizations etc., Forensic auditors often testify in civil and criminal Courts of Law. In this capacity, they function as expert witnesses, presenting evidence as necessary.

3. Traditional/Statutory Audit vs. Forensic Audit

Though forensic auditors and traditional auditors (both internal and external) often share same goals, their roles, knowledge and skills may differ. Traditional audit is recurring in nature, which includes general examination of financial data, whereas forensic audit is need-based, which is generally conducted to probe specific allegations. While traditional audit aims at expressing opinion whether the financial statements give a 'true and fair' view of the company's finances and/ or commenting on the issues of economy, efficiency and effectiveness of public expenditures and/or commenting on the adequacy of the systems of revenue realization. By nature, these examinations are supposed to be holistic and not get influenced by transactional aberrations. On the other hand, a forensic auditor's primary task is to focus on questionable transactions separately identified a priori or to generally probe all transactions to locate those with high risk of fraud. A forensic auditor is to determine whether any fraud has actually taken place and if so, who are the persons responsible for it. The methods and techniques of evidence collection also differ to a great extent. To assist in the process of identifying suspects and criminals, forensic auditors use physical evidence, testimonial evidence, documentary evidence and demonstrative evidence. They may search the premises of crime and seize the evidence for further analysis. This may not be the case with the traditional auditors, whose findings are by and large result of examining the auditees' papers.

4. Mandate Issues

a) International scenario

Excepting for a very few SAIs, it is the case in almost all other countries that there are other agencies responsible for investigating fraud and corruption. Among the INTOSAI member countries, GAO, USA and NAO, UK have specialized forensic investigation teams. GAO monitors instances of fraud, waste, and abuse through tips received through the FraudNet hotline maintained by them for this purpose. The GAO's Forensic Audits and Special Investigation teams comprise,

- auditors with forensic audit experience,
- analysts with experience in health care, law, and criminal justice issues
- data mining and systems integration experts,
- criminal investigators (federal agents) with substantial prior federal law enforcement experience,
- investigative analysts, and
- quality control staff including communications analysts.

As pointed out in section 3 of this paper, forensic audit may involve search and seizure of documents/hardware/ software for further analysis and defending the evidence in the court of law, if required. Often, unless the evidence collection procedures include obtaining third party evidence, either oral or documentary, it is not possible to prove criminal mala fide. The audit mandate of the SAI should have an explicit provision in support of such audit procedures, which is not the case with most of the SAIs.

It is pertinent to mention here that according to para 1.13 of ASOSAI Guidelines on Fraud and Corruption, if an SAI feels constrained in its investigation of suspected fraud or corruption cases in the performance of its normal audit work, it should seek reinforcement of its audit mandate. It further states that

this reinforcement could be in the shape of a regularity provision specifying that the SAI would be notified in all cases where fraud or corruption are suspected or reported.

b) Indian context

Traditionally, focus of SAI has been more upon risk based planning and executing audits with significant emphasis on systemic vulnerabilities to abuse that may include forensic aspects, and reporting such findings in a manner that places the onus for further investigation very clearly on the executive. Detection of fraud has traditionally been considered an incident rather than the objective of audit. In a paradigm shift, in the XXIV conference of the Accountants General held in December 2008 decided, among others, to propose appropriate amendments to the CAG's DPC Act to seek additional mandate for taking up full-fledged forensic audits.

5. Digital Forensics

As computer technology advances, governments are becoming increasingly dependent on computerised information systems to carry out their operations. Ensuring the completeness, accuracy and integrity of data resident in digital databases through a mix of substantive and compliance testing and fraud investigation in such environment has become a challenge for the auditor. It calls for great ingenuity on the part of the forensic auditor to size up situation, log every detail, conduct a structured survey and assess the possibility of ongoing undesirable activity.

There are several definitions and different schools of thought for this field of investigation, but such investigations typically involve four phases: the seizure phase, the image acquisition phase, the analysis phase, and the reporting and testifying phase. These are discussed below in brief.

Seizure Phase

In the seizure phase, it is important to understand whether the auditor has the authority to seize the digital equipment as well

as knowledge of the proper methodology to use so that evidence is not destroyed or tainted.

Image Acquisition Phase

The image acquisition phase involves the use of decision-making processes to determine the best method for acquiring an image of the suspect system and the proper use of software and hardware tools to facilitate the image capture. The examiner has to be sure that the image is created and preserved in a manner that will withstand legal challenges to the evidence gathered by him.

Analysis Phase

The analysis phase is the most time consuming phase, especially for a financial crime or fraud investigation. This phase involves the use of specialized tools designed to give the examiner the means to locate and extract artifacts that will be used as evidence in the investigation. The evidence can serve to incriminate the subject of investigation or it can be exculpatory by disproving the subject's involvement.

Reporting and Testifying Phase

The reporting and testifying phase is where the hours of analysis are reported fairly and objectively. In this phase, a qualified computer forensic expert may be asked to render an opinion about the use or misuse of the system. This is where the experience and training are tested and where the examiner must know with certainty that their opinion is based on their research, knowledge, and experience and that an opposing expert will not find fault with their conclusions.

Each phase requires a degree of mastery before moving on to the next as one develops into a forensic examiner of computer systems. The analysis phase generally takes the longest amount of time to master. The seizure phase is one of the most critical of the processes.

6. Detection Methods

Fraud symptoms (red flags) are investigated by analyzing documents and document-related items for financial record symptoms. Forensic auditing should, therefore, focus on significant transactions – both as reflected in financial statements and off balance sheet items. They may include analysis of financial statements, books, records, etc. mainly to find out:

- Trend-analysis by tabulating significant financial transactions.
- Unusual debits/credits in accounts normally closing to credit/debit balances respectively.
- Discrepancies in receivable or payable balances/ inventory as evidenced from the non-reconciliation between financial records and corresponding subsidiary records (like physical verification statement, priced stores ledgers, personal ledgers, etc.).
- Accumulation of debit balances in loosely controlled accounts (like deferred revenue expenditure accounts, mandatory spares account – capitalized as addition to respective machinery item, etc.).
- False credits to boost sales with corresponding debits to non-existent (dummy) personal accounts.
- Cross debits and credits and inter-account transfers.
- Weaknesses/inadequacies in internal control/check systems, like delayed/non-preparation of bank reconciliation statements, etc.

7. Detection Techniques

Traditionally auditors pursue the above tests through Computer Assisted Audit Techniques (CAATs) by manipulating volumes of data for such purposes. These tests perform mathematical computations for reconciliation purposes - and are based on simple analytical techniques, where known parameters,

variables and amounts are tested on limited volumes of data. CAATs have traditionally been limited to performing data interrogation using simple tools and techniques. Some advanced techniques used in Forensic investigation are discussed below

Data Mining

Data mining, which practitioners are already using to discover previously hidden patterns and attributes in data, pointing not only to fraudulent transactions but to new markets and products, is the new challenge for Information Systems auditors. Data mining should be considered as part of the battery of techniques available in the CAAT approach to audit of client data stores.

Case Based Reasoning Tools

The technique essentially involves the diagnostic benchmarking of an organisation or transactions against collated knowledge of other comparable sectors using "near neighbour" matches and inductive" analysis. Details of organisational characteristics, for example, can be collected by questionnaire and maintained in a database. Strengths, weaknesses and best practices can be identified from past experiences of fraud, control frameworks and financial performance, to rate and compare organisations. This is a powerful counter-fraud technique, which can answer questions such as: What made an organization vulnerable to fraud? What good practice tools from a particular organization can be put in place to mitigate the consequences of fraud?

Data Matching

Data matching is the crosschecking of data, either concurrently or retrospectively, looking for duplication and/or inconsistencies between data streams. It can be used to detect transactions that match all or part of existing transactions. It is used widely in the private sector to detect, for instance,

duplicate insurance claims, multiple share applications and mortgage fraud.

8. Challenges ahead

While the paper traverses some distance in providing clarification on various issues on the subject, there are many areas that are still unclear. Furthermore, much more work needs to be done before a clear picture emerges about this green-filed area of auditing. Some of the areas that need to be addressed before embarking on the subject are discussed below.

(i) Audit mandate

It is clear from the paper that the most important requirement for conducting forensic audit by a SAI is clear audit mandate. While the respective SAIs' legislative framework and mandate determine the policies and audit practices adopted, each SAI should actively consider adopting a formal policy or strategy for reinforcing the mandate, wherever found inadequate, for adoption and practicing forensic auditing.

(ii) Entities' profiling

Traditionally our audits are planned to cover only a selected sample of offices based on an analytical review of accounts and results of past audits. Entity profiles developed using data mining and data matching techniques greatly facilitate us to studying the patterns of their revenue receipts or expenditure and draw conclusions based on the transactions that deviate from predefined norms and predict the likely outcome. For this, developing entity wise profiles based on pre-determined criteria is pre-requisite.

(iii) Need for well-defined relationship with investigating agencies:

The rules for requisitioning records by the investigative agencies should be clearly understood by our staff and management as well as in those of the investigative agencies.

These issues could be addressed mutually through discussions. The need for a set of orders laying down the prescribed procedures in an easily comprehensible manner, and circulating them widely could be considered.

(iv) Position of the Auditor in criminal investigations

As there is a possibility of auditors being questioned in a manner akin to that employed for suspects, there is a need to provide clear and binding instructions about the manner in which audit staff are required to provide information to the investigative agencies. Appropriate guidelines in clear and unambiguous manner with regard to the modalities of such relationships are to be brought out.

(v) Rules for methods of evidence gathering

Forensic auditors need to gather evidence through various procedures that include obtaining third party evidence, either oral or documentary. Detailed procedures for gathering, analysis and presentation of such evidence in line with SAIs evidence gathering standards are essential.

(vi) Structured Training Modules

Structured Training Modules that aim to train the staff and officers of the SAI on the broad framework of Forensic audit with emphasis on the art and science of evidence collection, marinating the chain of custody (evidence handling) and analysis need to be prepared and executed.

(vii) Separate cadre of manpower

Forensic auditors, besides auditing techniques, need to be well conversant with investigative techniques, use of IT, Law etc. Considering the specialized knowledge and skills required, a separate cadre of officers recruited through a separate examination merit consideration. Appropriate job definition for various categories of forensic audit staff and officers and their role vis-à-vis other auditors also require elucidation.

(viii) Infrastructure for evidence preservation and analysis

Digital evidence is very volatile. Forensic auditor should handle it with extreme care and should not result in inadvertent manipulation of original evidence. Today such evidence collected by the auditors is analyzed with the help of various government agencies such as Police Forensic wings, GEQD etc. Considering the probable delays and the degree of assurance required a Central Forensic Laboratory exclusive to the department could be considered.

9. Conclusions

Forensic auditing is a specialized filed of auditing that requires a combination of audit and investigative knowledge and skills. Considering the scope and methodology of job involved, SAIs with adequate mandate can plan and execute such audits with the help of various advance techniques such as data mining; data matching and case based reasoning tools, besides CAATs. Nevertheless, various capacities building issues and detailed norms that clarify the role of auditor vis-à-vis other investigative agencies would continue to dominate the arena till they are addressed appropriately.

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AUDITOR'S NOTEBOOK

(i) Follow up on Audit Reports: Action Taken Notes;
(ii) Agencification in Government;
(iii) M P Local Area Development Scheme: Wise Men Differ

Dharam Vir [*]

(1) Follow up on Audit Reports: Action Taken Notes

Government departments are mandated to send *suo moto* Action Taken Notes (ATNs) to the secretariat of the PAC/COPU within four months after presentation of Audit Reports to the Parliament. The ATNs are vetted by Audit; and Audit has been authorized to categorize the ATNs as 'Accepted', 'Partially accepted' and 'Not accepted' for the information of the PAC/COPU with detailed briefs on "Not Accepted' cases clearly indicating the reasons for non-acceptance as well as the points of difference.

In consequence of the ever-increasing magnitude of Government activities with concomitant increases in Government expenditure and receipts, the pervasive and persistent decline in the level of financial discipline, the advancements in the theory and practice of public audit and the heightened and wider demands and expectations of public accountability from the stake holders, there has been a massive explosion in the number of audit comments that have shown up in the increased number and size of Audit Reports.[1] In order to cope with the system overload, the PAC/COPU discusses only

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[1] In Canada under the law the number of Audit Reports shall not exceed 10 in a year.

a limited number of paragraphs of the Audit Reports; and in the remaining cases the final action rests with the ATNs.[2]

The closure of the Audit paragraphs with the submission of ATNs has always been considered as an imperfect substitute for the detailed examination of audit observations by the PAC/COPU that involves summoning of departmental officials for evidence and culminates in a report to the legislature. Detailed examination of the Audit paragraphs is one of the most onerous forms of civil service direct accountability to the legislature since the fear of being summoned for a personal appearance before the PAC/COPU has been perceived as one of the strengths of the PAC/COPU that supposedly promotes accountability, even if in practice this may seem to be exaggerated. Also, as observed by a former CAG[3], PAC (and COPU) examination of an audit comment acts as a great corrective force on Audit as well; the benefit of this is lost if the final action rests with an ATN only.

Be that as it may, Government departments do not even send the *suo moto* ATNs to the Committees' secretariats for years. The PAC has been extremely unhappy at this state of affairs and as observed by it in its Hundred and Fifth Report 1995-96 (Tenth Lok Sabha) it 'negated the very object of ensuring timely and effective Parliamentary control over Government's financial activities and all executive actions relating thereto'. Distressed at the persistent delays in submission of the ATNs, the Chairman, PAC 2008-09 (Fourteenth Lok Sabha) also sought the personal attention of the Prime Minister in the matter.

The PAC 2009-10 (Fifteenth Lok Sabha) undertook a comprehensive review of the position and also examined in detail a few selected cases on which ATNs had not been

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[2] In Australia the PAC is required by law to discuss all Audit Reports.

[3] Shri S. Ranganathan, CAG (1966-72) in his evidence before the Joint Parliamentary Committee on the CAG's DPC Bill.

submitted by Government departments. A perusal of some of the related reports of the PAC reveals as under:

- There are wide variations in the figures reported by the Monitoring Cell, Department of Expenditure, which is the nodal agency, and the Office of CAG relating to pending Action Taken Notes in various Ministries/Departments. Monitoring Cell: 2827; Audit 3450.[4]. In some of the cases the relevant details of the pending paragraphs were not available with the Ministries or the files were stated to have been misplaced.

- In some cases, the Ministries had not sent even the first replies to the Audit paragraphs for years. For example, the Ministry of Railways had not sent even the first replies in as many as 198 out of the 481pending cases. Additionally, in as many as 150 cases, the ATNs had to be returned by Audit to the Ministry and had not been received back from the Ministry. Curiously, the Ministry did not forward ATNs in respect of 63 cases to the PAC Secretariat although these had been finally vetted by Audit[5].

- None of the Ministries had ever fastened accountability for delay or default in sending the ATNs.

- In response to the recommendations contained in the Hundred Fifth Report of the PAC !995-96 (Tenth Lok Sabha), the Ministry of Finance had assured that cases of persistent delays would be

[4] Eleventh Report 2009-2010 Fifteenth Lok Sabha

[5] Sixteenth Report 2009-2010 Fifteenth Lok Sabha. Although the PAC does not seem to have followed up this, it can be surmised that at least in some of these cases, Audit did not give unqualified vetting observations and the ATNs were graded as 'Not Accepted' or 'Partially Accepted' with which the Ministry did not feel comfortable.

placed before the Committee of Secretaries (headed by the Cabinet Secretary) but this had not been done. During oral evidence before the PAC, the Secretary (Expenditure) admitted that she was not even aware of this[6].

- Although ATNs are required to be furnished to the Committees' secretariats within the prescribed period of four months in all cases, the Ministry of Defence did not send the ATNs in a few cases on the plea that the relevant Audit paragraphs had been selected for detailed examination by the PAC. This betrayed the ignorance of the Ministry on a basic requirement of the Parliamentary Committee at the highest bureaucratic level[7].
- There existed no effective internal mechanism within some of the Ministries to ensure timely submission of ATNs. For example, the Ministry of Finance (Central Board of Direct Taxes) admitted that strict adherence to the time lines had so far been lacking because of incorrect appreciation of the system and infrastructural constraints.

Some of the Ministries like the Ministry of Finance (Department of Revenue), and the Ministry of Railways etc attributed the delays in sending ATNs to the need for collection of the relevant information/details from the field offices all over the country which took time[8]. However, the Ministry of Finance had not sent even the first replies in respect of 206 cases (Direct Taxes) pending since 1999-2000. Likewise the total number of pending cases of the Ministry of Railways (481) also indicates that some of the cases had been outstanding for years. The plea taken by Ministries would appear to be

[6] Eleventh Report 2009-2010 Fifteenth Lok Sabha
[7] Twelfth Report 2009-2010 Fifteenth Lok Sabha
[8] Fifteenth Report and Sixteenth Report 2009-2010 Fifteenth Lok Sabha.

nothing but an alibi for their lackadaisical approach in the matter.

The plea is anyhow not understandable since (i) the Audit paragraphs are developed over a period of time in a highly transparent manner with the full awareness and involvement of the executive at all stages; (ii) copies of the finalized paragraphs are made available to the Government well before these are included in the Audit Report; and (iii) there is always a time lag between the date of the Audit Report and the date of its presentation in the Parliament (from which the period of four months is reckoned for submission of ATNs). The factors (ii) and (iii) thereby provide additional time for the submission for the ATN beyond the stipulated four months.

The PAC detailed examination of some of the pending cases revealed as under:

- The Ministry of Commerce (Director General of Foreign Trade) initiated penal action against seven importers which had defaulted in the fulfillment of the prescribed obligations under the Advance Licensing Scheme, after a delay of twelve years and that too only after the Audit paragraph had been selected for detailed examination by the PAC. The Audit paragraph related to the CAG's Report of 1998 and the amount involved aggregated to about Rs 700 crore.[9]
- The Ministry of Finance had failed to find a satisfactory solution to the problem of loss of revenue on account of classification of coconut oil as edible oil (attracting nil excise duty) when it was being sold as hair oil (attracting excise duty at the rate of 8 per cent) packed in small bottles and sachets and marketed along with other cosmetics. The issue had been raised in the CAG's Audit Report 2008 but during the hearing, the Secretary,

[9] Fifteenth Report 2009-2010 Fifteenth Lok Sabha

Revenue Department, sought time of one month to come back to the PAC thereby indicating that the matter had not engaged his attention even for nearly two years after it had been flagged by Audit[10].

- Some of the Ministries initiated remedial and corrective action only after the relevant Audit paragraph had been selected for detailed examination by the PAC.
- The PAC examination invariably resulted in significant value addition including recommendations for systemic and other improvements. For example, while examining the Audit paragraph on ‘Procurement of Special Clothing and Mountaineering Equipment’ the PAC recommended framing of the General Qualitative Staff Requirements for special items of clothing and equipment for the troops stationed at high altitudes and creation of capacities for their manufacture within the country[11]. In its examination of the system of Disaster Management on Indian Railways, the PAC observed that the State Governments, which have a vital role in disaster management, had not prepared their Disaster Management Plans. Accordingly, the PAC recommended institutionalization of a coordinating arrangement with the State Governments, the District Authorities, civil/private hospitals, military and para-military forces and other concerned agencies so as to effectively leverage their infrastructure and resource for putting up synchronized efforts while responding to train or any other related disasters[12].
- The PAC examination also resulted in enlargement of the scope of the subject beyond what was covered in the

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[10] Fifteenth Report 2009-2010 Fifteenth Lok Sabha
[11] Twelfth Report 2009-2010 Fifteenth Lok Sabha
[12] Sixteenth Report 2009-2010 Fifteenth Lok Sabha

Audit paragraph. For example, while examining the Audit Paragraph on “Revenue Loss due to delay in the levy of toll fee” (Ministry of Road Transport and Highways) the PAC also considered a few other issues like highway safety, delays in completion of projects etc. and made valuable recommendations..

The above inevitably leads to the conclusion that in respect of paragraphs not selected for detailed examination, not merely is the benefit of wider experience of the Parliamentarians is denied but also, the executive often follows the game of ‘wait and see’ till the Audit paragraph dies a natural death.[13] Several sensitive and important cases like the above-mentioned case of huge loss of revenue to Government on account of failure to comply with the conditions of the Advance Licensing Scheme would at best remain buried as a mere statistical figure in the ever mounting aggregation of the over all pendency of ATNs.

According to the Second Administrative Reforms Commission, the ATNs tend to be largely formal rather than substantive.[14]

There is also the nagging feeling that sheer fatigue both in the PAC Secretariat and the CAG’s organization may result in sub-optimal quality of follow up action on cases not selected for detailed examination.

Government has initiated several steps aimed at timely rendition of the ATNs. The Secretaries have been made personally responsible for the timely submission of the ATNs to the PAC/COPU Secretariat. The submission of ATNs has been included as one of the targets in the Results Framework Document, a recent Government initiative towards a performance oriented administration. Orders have also been

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[13] R K Chandrasekharan The Comptroller and Auditor General of India : An Analytical History 1947-89

[14] Fourteenth Report: Strengthening of Financial Administration

issued for establishment of Standing Audit Committees in all Ministries with the main objective of ensuring timely follow up on Audit paragraphs including fixing of responsibility in the event of delays and defaults.

However, these measures are unlikely to cure the basic and inherent weaknesses of the system of closure of Audit paragraphs on the basis of ATNs only. The selective approach of discussing only a limited number of Audit paragraphs inevitably creates an anomalous situation that whereas the CAG's Audit Reports are in the public domain, very little is known about the action taken by Government departments on cases that are not taken up for detailed examination by the PAC/COPU and, consequently, on which there is no PAC/COPU report to the Parliament. The anomaly becomes all the more glaring since cases not selected for detailed examination constitute an overwhelming majority of the cases included in the Audit Reports. Also, in such cases generally no recommendations are made and there is no follow up watch on the action taken by Government. Public accountability may be further undermined if the Action Taken Notes are rated as 'Partly Accepted' or 'Not accepted" by the CAG's organization but these are nevertheless forwarded to the secretariat of the concerned committee. In such cases the final outcome of the Audit paragraphs remains indeterminate and perhaps unknown even to the CAG.

In its Fourth Report Ethics in Governance the Second Administrative Reforms Commission has recommended that each office should make an annual public statement regarding pending audit queries. However, neither the nature of queries nor the manner of such public statement has been specified. Although the Report had promised to elaborate on the recommendation in a subsequent report of the ARC on financial systems, the latter Report on Strengthening Financial Systems makes no reference to the same.

Nevertheless the recommendation provides a clue as to what can be done.

It should be made mandatory for the Government departments to present an Action Taken Report on *selected* cases included in the Audit Report within four months (the period currently prescribed for submission of *suo moto* ATNs to the PAC/COPU secretariat) of its presentation to the legislature or as soon as the legislature meets thereafter.

For this, the PAC may select and identify the Audit paragraphs on which Government should present Action Taken Reports to the Parliament. Thus there will be three-way selection of Audit paragraphs: Audit paragraphs which the PAC will discuss in detail; Audit paragraphs on which Government will present Action Taken Reports to the Parliament; and Audit paragraphs on which the final action may rest with the submission of ATNs to the PAC/COPU Secretariat.

Since the Audit Reports are based on test check of selected cases only, the Action Taken Report should also disclose the result of Government's review of similar other cases besides the corrective action taken to remedy the underlying system deficiencies and disciplinary action where warranted.

This will have several advantages.

First, it will ensure that the Government departments do in fact follow up the Audit Reports with appropriate remedial and corrective action. The Parliament's Committee on Papers will chase the Government if the Action Taken Report is not presented in time and ask the Government to explain its position.

Second, the Ministry's/Department's Action Taken Report would require approval and authentication of the Minister before it is presented to the Parliament. This would contribute to greater earnestness and rigour in the quality of departmental response to Audit Reports vis a vis the quality of

the of *suo moto* ATNs which are required to be approved by the Additional/Joint Secretary. This will also ensure the remedial and corrective action by providing the commitment of the Minister.

Third, and as a corollary to the above, the PAC/COPU system, modelled on the British pattern, is essentially an instrument of civil service accountability to the legislators, since the Minister is accountable on the floor of the House and is not called before the PAC/COPU. This again is postulated on the assumption that while the Minister is accountable for policy, the accountability for implementation is that of the civil service. But the compartmentalization between policy and implementation has never been watertight, more so in India and high value transactions or cases having sensitive implications have invariably required the approval of the Minister or even the Cabinet. This sometime places the civil servant in the awkward position of being called upon to defend a position or explain a decision to which he may have been opposed. In such cases the presentation of Action Taken Report to the Parliament would ensure the much needed input of the Minister in the executive response to the audit paragraph.

Fourth, it widens the constituency and audience for ensuring effective action on Audit Reports, which will no longer remain the concern of only the small number of legislators who constitute the PAC/COPU.[15] It also opens up the possibility that an alert and interested legislator may raise the matter on the floor of the House if the action taken on the Audit Report is inadequate or unsatisfactory.

Fifth, it will impart the much-needed transparency to the accountability process and provide assurance to the civil

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[15] Even this limited constituency is not available since according to anecdotal evidence the Audit paragraphs not selected for detailed examination are generally closed at the level of the Secretariat of the PAC/COPU.

society and the stakeholders that Government is alert and responsive to the concerns expressed in the Audit Reports. It may also generate healthy discussion in the civil society duly informed by both sides of the picture, that of Audit as well as that of Government.

(2) Agencification in Government

In its Thirteenth Report on Organizational Structure of Government of India (April 2009), the Second Administrative Reforms Commission has recommended establishment of executive agencies for policy implementation with appropriate operational autonomy and flexibility the role of the Ministries being limited to policy formulation. Each agency whether a new body or an existing departmental undertaking/body/special purpose body that is to function as an executive agency must be semi-autonomous or autonomous and professionally managed under a mandate. The right balance `should be struck between autonomy and accountability. This could be achieved through well-designed performance agreements, Memorandum of Understanding, Contracts etc. Broadly, the company form of structure could be adopted for Government organizations whose activities are in the business environment while the society form of organization would be more appropriate for the social sector.

The Commission had made a similar recommendation in its Tenth Report on Refurbishing of Personnel Administration November 2008) as part of its recommendations for enactment of the Public Service Law wherein it had recommended such agencification under the over all rubric of the said law.

Government has accepted the Commission's recommendation as made in its Thirteenth Report.

According to the Commission currently the line departments are often not in a position to optimally deliver government services largely because of the overwhelming

nature of centralized controls they are subjected to and the lack of operational autonomy and flexibility. Centralized controls as they exist now reinforce a focus on inputs rather than results and are a great stumbling block to performance.

On the other hand according to the studies made by the Commission agencification in several other countries like Australia, Japan, New Zealand, Sweden and United Kingdom has led to significant economies of expenditure, improved employee performance, better service delivery and greater accountability besides innovative thinking, better risk management and greater transparency in administration.

Unfortunately, the Commission did not examine the working of any of the existing autonomous bodies under the Union Government (numbering over five hundred as per the Government website) for the efficiency or effectiveness of autonomous bodies as instruments of programme delivery or the structural deficiencies in their functioning with suggestions and recommendations for improvement. In fact the only comprehensive study on autonomous bodies conducted by the Expenditure Review Commission in 2001 had disclosed serious deficiencies. The overall perception that emerged was that the institutions were functioning like attached offices of Government, without at the same time being subject to the rigour of close scrutiny of the other wings of the Government. In many bodies reduced accountability and non-reporting seemed to have been construed as essential element of autonomy[16].

Successive Audit Reports of the CAG have also highlighted serious deficiencies in the working of the autonomous bodies including those in such essential and basic matters as preparation of accounts and internal control. It would appear that the autonomous bodies have done no better in

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[16] Government of India, Report of the Expenditure Reforms Commission, 2001.

matters of programme delivery or providing value for taxpayer's money. Although in terms of a requirement of the revised GFRs, autonomous bodies that receive budgetary support of Rs. 5 crore or more in a year should enter into performance contracts in the form of MOUs with Government; this does not seem to be happening.

The Commission has also recognized the difficulties in preparing and enforcing such performance contracts between the Ministries and the proposed agencies and observed that this would require 'considerable upgradation of capacity' in the Ministries.

The paradigm shift witnessed in recent years in Government's strategy for implementation of centrally sponsored schemes that assigns a larger role to extra-Government entities for programme delivery in place of Government departments and offices has already led to serious concerns being raised about the accountability deficit for Government funds as discussed in an earlier article.[17] Currently, a High Level Expert Committee set up under the aegis of the Planning Commission and headed by Dr. C. Rangarajan, Chairman of the Economic Advisory Council to the Prime Minister, is examining *inter alia* the accountability concerns arising out of the direct transfer of the funds to the States/district-level bodies under Centrally Sponsored Schemes for suggesting appropriate mechanism to guard against dilution of accountability. But there are several other issues in agencification as well.

From the budgetary and accounting angles, the basic concern arises out of the divergent basis on which Government accounts and accounts of autonomous bodies are compiled. The accounts of autonomous bodies are compiled on mercantile

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[17]Dharam Vir, Implementation of Central Schemes: Need for Reforms in the Architecture of Public Financial Management and Accountability, Indian Journal of Public Audit and Accountability, January-June 2009

principles on accrual basis whereas the Government accounts are essentially based on cash basis and there will be severe difficulties in the preparation of 'whole Government accounts' incorporating the accounts of the policy making formations as well as the implementing agencies. Consequently, on account of agencification of implementing departmental offices only the extent of budgetary support (if any) can be exhibited as a single entry in the budget and accounts in respect of each agency in place of the structured exhibition of head-wise details.

Additionally, agencification will inevitably result in understatement of the amount of capital expenditure in Government accounts since expenditure of capital nature incurred by agencies will necessarily have to be classified as revenue expenditure.

All this will lead to diminution in the transparency and comprehensiveness of accounts and budget severely impairing their usefulness as instruments of control and accountability.

There are also issues connected with management and staff that extend beyond merely the problems of a transitional nature inherent in any migration to agencification. These relate to the creation of organizations for further recruitment, training, capacity enhancement, placement and promotions. There are also issues of security of tenure, particularly of the top management.

An essential prerequisite to the agencification is a careful definition of the functions of the Ministries. According to the Commission, the Ministries should concentrate on policy analysis, planning, policy making and strategic decisions; budgeting and legislative work; monitoring of implementation; appointment of key personnel; coordination and evaluation. While accepting this recommendation, Government has decided that the Performance Management Division of the Cabinet Secretariat would prepare the indicative terms of reference and a common format which could be suitably

adopted by ministries for conducting a review of their functions and identifying the functions that should be performed by them.

Apparently, there are miles to go; also there is need to tread carefully.

(3) M P Local Area Development Scheme: Wise Men Differ

The Constitutional validity and legality of the M P Local Area Development Scheme under which a sum of Rs. two crore[18] is placed at the disposal of every member of the Parliament each year for being spent on local area development works, have been under the scanner almost ever since the scheme was instituted in the nineties[19]. The works recommended by the M Ps for execution under the scheme are essentially the domain of the State Governments and local government institutions. The Constitution Review Commission headed by Hon'ble Justice Venkatachallia had recommended the immediate discontinuous of the scheme as being inconsistent with the spirit of the Constitution. According to the Commission it militates against the demarcation of responsibilities between the legislature and the executive; goes against the spirit of federalism and distribution of powers between the Union and the States; and treads into areas of local government institutions[20].

Several other constitutional experts and legal luminaries have also pointed out the unconstitutionality of the scheme. According to a report, " MPLADS: Concept, Confusion and

[18] Initially Rs 5 lakh (1993-94); raised to Rs. one crore from 1994-95 and to Rs.2 crore from 1998-99

[19] The Central scheme has spawned similar schemes at the State and local Government levels.

[20] Government of India Report of the National Commission to Review the Working of the Constitution

Contradictions"[21] written by Era Sezhiyan, a former Chairman of the PAC, the scheme has distorted the role of the MPs in the federal system and also given rise to conflict of interest because of the legislators taking up the role that essentially belongs to the executive.

More recently, the Second Administrative Reforms Commission considered the issue in its Fourth Report on Ethics in Governance (January 2007) in the context of disqualification visited on legislators for holding office of profit and came to the conclusion that giving discretionary powers to legislators to sanction or to approve public works is clearly an exercises of executive function. Accordingly, the Commission recommended discontinuance of the scheme.

Notwithstanding the above, a five member Constitution Bench of the Supreme Court has recently upheld the Constitutional validity of the scheme in Bhim Singh versus Union of India and Others.

In a comprehensive judgment ranging over the entire gamut of issues connected with the scheme, the Apex Court has held that the scheme does not violate the Constitutionally mandated demarcation of powers and responsibilities between the executive and the legislature since under the scheme the role of the MPs is restricted only to making recommendations for specific works for being taken up for implementation. The MPs neither receive nor handle money (which is remitted direct to the District Authority) while the final decision whether a particular work should or should not be taken up for execution rests with the District Authority. It is the District Authority who prepares the necessary cost estimates, obtains technical and administrative sanctions and gets the work executed and is responsible for rendering completion certificate, accounts of expenditure and utilization certificate. In view of this the MP

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[21] Referred to in the Fourth Report of the Second Administrative Reforms Commission Ethics in Governance.

has no executive role and there is no conflation or conflict of executive and legislative functions.

According to the judgment the scheme does not in any way undermine or encroach upon the role of the institutions of local Government and thereby offend against the provisions of the Constitution as amended by the 73rd and 74th amendments by taking over the functions of the Panchayat Raj Institutions and Urban Local Bodies. This is because while the District Authority has been given the power to identify the agency through which a recommended work has to be executed, the Panchayat Raj Institutions and the Urban Local Bodies have been mandated to be the preferred implementing agencies. In view of this the Panchayat Raj Institutions and the Urban Local Bodies have not been denuded of their role or jurisdiction by the scheme since due place has been assigned to them in the implementation of works.

The Apex Court has also held that the scheme does not result in any unfair advantage to the sitting members of the Parliament and does not amount to a corrupt practice. According to the judgment the scheme merely makes funds available to a sitting MP for developmental work; if the MP utilizes the funds properly, it would result in his better performance; and if that leads to people voting for the incumbent candidate, it 'certainly does not violate any principle of free and fair elections'.

Finally, and this is of special interest to the students of federal finance, the Apex Court judgment provides an exhaustive exposition of the provisions of Article 282 of the Constitution in terms of which "the Union or a State may make any grants for any public purpose, notwithstanding that the purpose is not the one with respect to which Parliament or the Legislature of the State as the case may be, may make laws".

Basically, there were three issues before the Apex Court in this context: whether Article 275 of the Constitution is the

only authority for regular and permanent transfer of funds from the Union to the States and whether the scheme is a valid grant under Article 282; whether the scheme falls within the meaning of 'public purpose' as envisaged under Article 282; and whether an independent substantive enactment is required for making grants for a purpose that is beyond the legislative power of the Parliament and hence the executive power of the Union as envisaged under Article 282.

The Apex Court has held that owing to the quasi-federal nature of the Constitution and the specific wording of Article 282, both the Union and the States have the power to make grants for a purpose irrespective of where the purpose resides in the Seventh Schedule to the Constitution; both Article 275 and Article 282 are sources of spending funds; and the power under Article 282 to sanction grant is not restricted. Incidentally,this also provides the Constitutional validity for the so-called Planning Commission grants i.e. Union transfers under Article 282 outside the Finance Commission transfers under Article 275.

The Apex Court has also held that the scheme falls within the meaning of 'public purpose' since by virtue of the nature of works on which the funds can be spent it aims at the fulfillment of the development and welfare of the State as reflected in the Directive Principles of State Policy.

Lastly, a specific or special law is not necessary for the purpose of Article 282. The 'laws' mentioned in Article 282 include the Appropriation Act that provides the over-all authorization for incurring expenditure from the Consolidated Fund every year.