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# **INDIAN JOURNAL OF PUBLIC AUDIT & ACCOUNTABILITY**

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## **INVITATION FOR ARTICLES**

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

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

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

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

## **EDITORIAL**

Recent comments on India's ailments have prominently highlighted its "Governance Deficit". This issue of journal containing five articles is devoted mainly to the theme of improving and upgrading the governance apparatus and how improved accounting and internal auditing contribute to better results from government spending.

P.K. Brahma gives us an overview of the coverage of the institution of Ombudsman in India, its weaknesses, strengths and a heart-warming sample of stories of resolution of grievances. These would certainly create strong echoes as lot of good work is being done sporadically at many places. The Ombudsman for Justice was first created in Sweden in 1809 as a quick remedy to citizens against maladministration. It has gained worldwide acceptance as an instrument of good governance but in India, as the author points out, the coverage has been half-hearted. In some cases like banking ombudsmen, there have been some retrograde developments as well after initial bold steps. The extreme topicality of the subject would not be lost upon discerning readers when the focus of public discourse is so much on corruption and maladministration.

J. Wilson brings forth a refreshingly new idea: the C&AG taking a lead in bringing Enterprise Risk Management Framework for Government Departments by letting the IAAD to be a pioneer! ERM is widely practiced in the corporate world. The author has taken great pains to sketch an outline of how ERM can be implemented by IAAD and made some useful suggestions. It would be a new template for systemic internal vigilance on risk areas.

Subhash Chandra Pandey explores the issue of systemic



internal vigilance from another angle and makes some practical suggestions on revamping the Internal Audit system in the government. He highlights some milestone developments in the area before coming to his prescriptions in the spirit of his 'best is the enemy of good' approach. The suggestions reflect his deep insight into the functioning of the government and his assessment as to what is feasible.

K. Mani in her article gives a synoptic overview of the vast subject of accrual accounting. One of the requisites of accountable governance is transparent accounting and appropriate disclosures. The author discusses the steps required in implementation of accrual accounting as part of a broader framework of good governance. Some important issues to be addressed during implementation are also briefly mentioned.

The Auditor's Notebook is expected to be discerning readers' delight. Dharam Vir insightfully discusses three extremely topical subjects in contemporary discourse on governance and public finance.

The '2G scam' has brought out the complexities of the relationship between a Secretary and his Minister in charge. His incisive analysis and pointers to the lessons to be learnt from the United Kingdom's experience is perhaps the first articulation on this sensitive subject.

Dharam Vir's comments on the 'Effective Revenue Deficit', a new addition to the lexicon of fiscal management made in the Budget 2011-12 raises serious concerns about the impact of such 'accounting' changes on the transparency and usefulness of accounts and budget. While the exclusion of grants-in-aid intended for financing creation of assets by grantees from calculation of 'Revenue Deficit' may make the current numbers look comfortable and thereby promote a 'feel

good' factor, the final position as per actual expenditure may well remain indeterminate. His incisive analysis can be usefully juxtaposed with an inquiry into the subject of Revenue – Capital expenditure contained in another Paper published in this Journal (vide “Perverse Incentives to Acquire Capital” by S C Pandey in Issue No. Vol IV – No.3&4).

Dharam Vir further informs us about Government initiatives on improving the Disclosure of Government Guarantees and other Contingent Liabilities and in particular the work done by the Government Accounting Standard Advisory Board (GASAB) functioning under the auspices of the CAG. He also suggests additional disclosures on the basis on which the amounts credited to the Guarantee Redemption Fund are calculated.

In the Document section, we are including a very pertinent and interesting document for our readers namely “The Right of Children to Free and Compulsory Education Act, 2009”.

We hope our discerning readers will find these articles informative and interesting.

**Disclaimer:**

The views and opinions expressed in the articles published in the journal are entirely those of the respective authors and do not necessarily represent the views of the Institute of Public Auditors of India.

## **THE OMBUDSMAN MOVEMENT IN INDIA - A STORY OF MISSED OPPORTUNITIES**

***P.K.Brahma\****

### **An Overview**

It took nearly two hundred years for the institution of Ombudsman to reach the shores of India in his journey from Scandinavia. The Government of Sweden had created an Ombudsman for Justice (Justice Ombudsman) way back in 1809. In India, Ombudsman was appointed for the first time for the Banking Sector by the Reserve Bank of India under Section 35A of the Banking Regulation Act, 1949 when it notified the Banking Ombudsman Scheme, 1995. The Banking Ombudsman created at each Regional Headquarters of RBI effectively started functioning from 1997. The pioneering move of the Reserve Bank provided an opportunity to the Central and State Governments to give momentum to the Ombudsman movement for creating the institution at the Central, State and Local levels to protect citizen's rights and provide better customer services. In the midst of the Governments' lukewarm attitude, the Ombudsman's movement remained a story of unfinished journey and lost opportunities. India is not even a member of the International Council of Ombudsman because India does not have an Ombudsman (i.e. Lokpal) at the national level.

According to the International Council of Ombudsman, *the role of the Ombudsman is to protect the people against violation of rights, abuse of powers, error, negligence, unfair*

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*\* Shri P.K. Brahma is a former Deputy Comptroller & Auditor General of India and is presently Adjunct Professor, IMT, CDL, Ghaziabad.*

*decisions and maladministration in order to improve public administration and make the government's actions more open and the government and its servants more accountable to members of the public.*

The Ombudsmen were initially instituted to provide a quick grievance redressal mechanism to citizens against governments. In due course, as governments have developed extended arms in the form of public sector undertakings, ombudsmen have been set up to cover consumers of public services as well. Some countries have Ombudsman offices at all levels of governance – national and sub-national levels such as Australia, Argentina, Mexico and Spain, while others have Ombudsmen only at the sub-national government level as in Canada and Italy. India has partial coverage at both Central and state level. Public Sector Ombudsman offices are now functional in many countries of Europe, North America, Latin America, the Caribbean, Africa, the Australasia & Pacific Region and Asia.

The roots of modern Ombudsman can be traced back to the *Justieombudsman* (Ombudsman for justice) of Sweden, which was established in 1809. The movement did not catch up with other countries until the twentieth century, when it was adopted in other Scandinavian countries - Finland (1919), Denmark (1955) and Norway (1962). The popularity of the Ombudsman's office increased tremendously in the 1960s, as various Commonwealth and other countries (mainly European) established the institution as Alternative Disputes Redressal Mechanism (ADR) like New Zealand (1962), United Kingdom (1967), most Canadian provinces (starting in 1967), Tanzania (1968), Israel (1971), Puerto Rico (1977), Australia (1977 at the federal level), France (1973), Portugal (1975), Austria (1977), Spain (1981), and the Netherlands (1981).

By mid-1983, there were only about twenty-one countries with Ombudsman offices at the provincial/state or regional levels. However, the transition of many countries to democracy and democratic structures of governance over the past few decades has led to the establishment of many more Ombudsman offices during recent periods. This transition to democracy accompanied by the reform of government, including creation of the Ombudsman and Human Rights offices, has been evident particularly in Latin America, Central and East Europe as well as in parts of Africa and the Asia-Pacific. Countries that have established national Ombudsman offices during this period include Argentina, Costa Rica, Columbia, Guatemala, Peru, Namibia, South Africa, Poland, some francophone African countries, Hungary, Lithuania, Slovenia, the Czech Republic, Thailand and the Philippines.

By 2003, the number of Ombudsman offices increased more than five times to encompass offices both in states with well-established democratic systems and in countries that are younger democracies. Furthermore, the European Union has created a *European Ombudsman* under the *Maastricht Treaty*. The first European Ombudsman was appointed in 1995.

### **The Indian Experience**

In India, the concept of Ombudsman has been implemented in a fragmented and lackadaisical manner. India has ombudsmen at sub-national government level in the form of Lok Ayukts in some States and Sectoral Ombudsman at Central level in four areas of Banking, Insurance, Power and Income Tax. The regulatory bodies like SEBI and TRAI as also the hierarchy of District, State and National level Consumer Forum discharge investor/consumer protection functions, which partake of ombudsmen character though not formally recognized as institutions of ombudsmen.

While Lok Ayukts, (a variation of Ombudsman offices) have been appointed in some States, they have hardly been effective and functional in redressal of any kind of public grievances due to inadequate empowerment and resources. The Central government has failed to pass the Bill of LOKPAL for more than four decades for the creation of the institution of a Central Ombudsman to deal with complaints of corruption at high places. While the Central Ombudsman scheme has not got off the ground, there has been some progress in certain sectors like Banking, Insurance, and Electricity etc. It is heartening to note that a high level drafting committee with participation from civil society has been set up to draft legislation for Lok Pal, widely perceived as a panacea against corruption and maladministration.

The first institution of Ombudsman was created in 1995 when the Reserve Bank of India appointed Banking Ombudsman in a few states. At present, 15 Banking Ombudsmen in various States, each having jurisdiction over one State or a group of States, have been functioning on regional basis for the redressal of all customer complaints in the banking sector. The Banking Ombudsman Scheme has generally been successful in creating awareness among the banks for better customer services and better customer support systems.

Similarly, a number of Insurance Ombudsmen were created in various States covering the whole country to look into the customer complaints against the Insurance Companies. Recently, a number of Electricity Ombudsmen have been appointed for the Power sector under the Energy Act to deal with customers' complaints against the distribution companies. The Ministry of Finance has also constituted Income Tax Ombudsman to look into the grievances of Income Tax payers against the Income Tax Department. It is likely that in future,

more and more Ombudsmen will start functioning in various other Sectors like Telecom, Pension, Health, Education etc.

The great advantages of Ombudsman Scheme being purely an Alternative Disputes Redressal Mechanism have been:-

- Ombudsman does not follow the lengthy and expensive legal processes and formalities.
- All complaints receive immediate attention and disputes are resolved through conciliation and consent.
- Justice is immediate, cost free and hassle free.
- There is no system of appeals against Ombudsman's order in the Court of law.
- There is generally full implementation of Ombudsman's orders.

### **Limitations of Sectoral Ombudsmen**

While Ombudsmen in different sectors like banking, insurance, power and income tax have served these sectors well and have largely been successful in delivering justice in cases of specific grievances received from the customers, it must be understood that they cannot be a substitute of the Central Ombudsman (Lokpal in India). The focus of the Lokpal would be corruption at high places; the sectoral Ombudsmen would deal only with customer complaints on the product or service provided.

The Central Ombudsman is expected to have enormous powers for investigation, prosecution and giving punishment to the perpetrators of corruption while the sectoral Ombudsmen cannot enter these areas. The Banking Ombudsman had been given the power to act as an Arbitrator under the Arbitration Act but this power was withdrawn when the Scheme was amended in 2006. The powers and independent status of the

Banking Ombudsmen were further diluted in 2007 when the system of appointing senior retired officers (Secretary-level officers from Government of India, Executive Directors from the Reserve Bank and CMDs from PSU banks) was scrapped and a system appointing only serving officers (General Manager Level of the Reserve Bank) was introduced. This seriously compromised the authority, independence and the quality of speaking orders of the Banking Ombudsmen. On the other hand, the institution of Insurance Ombudsman, patterned on the Banking Ombudsman Scheme, has steadily grown and with greater independence and clarity, the Insurance Ombudsmen have been able to make greater contributions to public welfare.

#### **Cases of Effective Intervention by Sectoral Ombudsmen**

A few illustrative cases where the Insurance and Banking Ombudsmen played a proactive role in delivering speedy justice to the affected persons are mentioned below.

- (1) A company executive who had a valid life insurance policy from the Life Insurance Corporation (LIC) for a reasonably good amount died in harness but his wife was never kept informed of the policy. The existence of the policy was discovered by his wife ½ years after his death from some details scribbled in his personal diary. The widow being the nominee immediately filed a claim with the LIC, which was promptly rejected on the ground that LIC rules stipulated that all such claims must be filed within 1 month following the death of the policy holder and therefore, the claim could not be entertained because of limitation of time.

The widow appealed against the LIC order to the Insurance Ombudsman. The Ombudsman, after hearing arguments from both the parties, was convinced about



the genuineness of the claim and went out of the way to interpret rules in the context of the Indian social system where an average housewife is mostly unaware and unbothered of the financial transactions of her husband. He passed a well-argued speaking order asking LIC to condone the delay and pay the entire insured amount to the widow within 15 days. The LIC did comply with the orders promptly.

- (2) An executive took a high-value life insurance policy from the LIC and made his living-in partner the sole nominee in spite of the fact that he had already been married and his wife was living with him in the same house. Unfortunately, the executive suddenly died leaving his wife to fend for herself.

Both his wife and the living-in partner filed claims with the LIC. The LIC rejected the claim of the widow and mechanically went by the papers available and did not bother to verify whether the deceased had a wife or between the two women, who was the real wife.

When the LIC was on the point of making the payment to the living-in partner, the aggrieved widow appealed to the Insurance Ombudsman. The Ombudsman fixed a quick meeting and heard all the concerned parties and chided the LIC for an illegal action in ignoring the real wife and giving legal recognition to an illegal relationship and the fraudulent action on the part of the living-in partner. He also invoked the Indian Succession Act. The matter was particularly serious and fraudulent when it was discovered that the living-in partner was none other than the maid-servant of the deceased. The Ombudsman passed an order asking LIC to pay the

insured amount to the real widow within 15 days. The LIC complied with the orders.

- (3) In 2002, a killer earthquake devastated the city of Bhuj and there was not a single house which was not damaged. The government prepared a scheme under which owners of properties would be fully compensated for the damages caused by the earthquake. The public sector insurance companies were to make immediate payments to the owners based on the estimates made by the authorized surveyors and all amounts so paid would be reimbursed to the insurance companies by the government. The purpose was to provide immediate relief to the affected persons who could start re-building their homes without delay.

A resident of Bhuj filed his claim along with all the relevant documents including the report of the surveyor to the insurance company. The company did not take any decision on the case for a long time and when pursued, sanctioned a much lower amount (50% of the estimate) on the ground that the damage had been over-estimated.

The claimant approached the Insurance Ombudsman against the decision of the insurance company. The Ombudsman heard the parties within a week and during the hearing, it was revealed that in this case at least, the insurance company had gone against the spirit of the scheme and also against the report of the authorized surveyor. An order was passed the same day asking the insurance company to pay the full amount within a week, which the insurance company complied with.

- (4) A small entrepreneur having a family business in diamond and jewellery took a loan of Rs. 6 lakh

from a public sector bank for which he offered his own flat as security. The flat was located in the prime commercial location of Ahmedabad and was worth more than Rs. 50 lakh that time. Owing to economic downturn and losses in business, the entrepreneur could not repay the loan amount on time.

The bank kept on adding penal interest on the outstandings which amounted to 15 lakh and was still increasing. The bank was quick to show the entire outstanding amount as NPA (Non-performing Asset) and initiated actions for recovery by auctioning his valuable flat under the provisions of Securitization Act. They had actually obtained the permission of the local Collector for invoking Securitization Act for the recovery of the outstanding loan.

The entrepreneur approached the Banking Ombudsman and appealed to him to prevent the bank from going ahead with auctioning process. He asked for some more time to start repayment. The Ombudsman called an emergency meeting with the bank. During examination of the case, it was revealed that the outstanding loan was not strictly eligible to be categorized as NPA and the bank had shown unusual haste in going for the auction route. Invoking the Securitization Act is a serious matter which should be done only as the last resort when all attempts to recover NPA fail. In this case, it appears the businessman was not given enough time and opportunity to salvage his situation. The bank was asked to reschedule his debt and give a last opportunity to repay the loan. The bank was also

asked to reduce penal interest charges to normal interest.

Timely intervention by the Ombudsman could save the family honor of the entrepreneur and restore his flat which had been his most precious possession.

- (5) A Specialist Orthopedic Surgeon of a Government Hospital at Ahmedabad complained to the Ombudsman that he was being harassed by a leading private sector bank for the last three months for alleged non- payment of credit card dues. The bank had also been sending their musclemen to his house threatening his wife and children. He had been slapped with a bill of Rs. 1 lakh as outstanding dues on a credit card which he did not possess. He also alleged that the bank had seriously tarnished his reputation as a doctor in the society. Considering the seriousness of the matter, the Ombudsman called a quick meeting in his office with the Bank and the Doctor. During the hearing, it was revealed by the Doctor that neither did he apply anytime to the bank for the issue of a credit card in his favour nor did he receive any card in his favour nor did he use any card for any purchase at any establishment. The bank denied all his charges and produced an application form where all the details of the Doctor were available and stated that the credit card had been sent to his residence. On closer scrutiny, it was revealed that the signature on the application form was not that of the Doctor and all the particulars had been collected by the credit card agent on telephone from the Doctor's wife. The bank could not produce any proof of the credit card having been received by the Doctor. The Ombudsman directed the bank to

cancel the credit card number, withdraw the outstanding bills and also issue a letter of apology to the Doctor, which the bank complied with.

- (6) In the banking sector, exorbitant charges (30% to 50%) on certain products like personal loans, credit cards etc., arbitrariness in flexible vs fixed rates of interest on housing loans, one-sided agreements (in fine prints) always favouring the banks, unilateral increase in service charges and fines, exploitation, unconstitutional methods adopted to recover dues from customers and various other deficiencies in service are decided upon daily by the Banking Ombudsman and by the year-end, hundreds of customer complaints get redressed. Taking together the banking, insurance, electricity, income tax and other sectors, thousands of complaints received from all groups of people are satisfactorily settled by the sectoral Ombudsmen without requiring the customers to make costly knocks at the doors of the courts of law. This is no mean achievement.

### **Need for Lokpal**

Countless times, the Lokpal Bill has been tabled in Parliament, withdrawn, sent to Select Committees, amendments suggested, drafted and redrafted; this process has been going on for the last few decades. It is rather a matter of great shame while the whole world has done it, India, the largest democracy in the world, even after 60 years of independence, could not create the institution of Lokpal i.e. the Central Ombudsman. This only indicates the lack of will and the extremely low priority accorded to the question of corruption by the law-makers and successive governments in power. Appointment of the Ombudsman at the national level i.e. Lokpal who will look into

corruption at high levels including ministers, legislators and administrators cannot brook further delay. Had there been a Lokpal, India could perhaps have escaped being branded as one of the most corrupt countries in the world. Perhaps, the process of generation of black money could have slowed down and India would not have been in a ridiculous situation of being a mute spectator to the phenomena of Indians stashing billions of dollars of national wealth in the Swiss banks and other tax havens.

While, the Parliament should immediately enact the long pending Lokpal Bill at the Central level, the States should also initiate a process of creating Rajya Lokpal at the State level to replace the existing Lok Ayukts. Insensible delay and lack of will of successive governments to get an effective Lokpal bill passed and non-appointment of a Lokpal tantamount to committing a fraud on the people of India because of the inability of the governments to protect the citizens of democratic India from gross abuse of powers, negligence, unfair decisions, maladministration and corruption. The Ombudsman Movement in India cannot achieve its objectives and receive international credibility unless the institution is created at the Central, State, Local Government and Public Sector Levels.

## Enterprise Risk Management Framework for Government Departments-Establishing context for Indian Audit and Accounts Department

J. Wilson\*

### Introduction

*ERM refers to designing and implementing capabilities for managing risks*

1. Globally, modern organizations have increasingly started placing reliance on the “Enterprise-Wide Risk Management Framework (ERM)” as the best means to realize their mission objectives. Celebrated corporate scandals such as Enron abroad and Satyam at home amply proved that the risks remaining untreated for prolonged periods can threaten the very basic foundations of the businesses. Even though the ERM gained its acceptability amongst the ‘profit-centric’ private businesses initially, governance experts caution that no entity in the private business or in the business of public service delivery- is free from risks.

*Risk is defined as the effect of uncertainty on objectives*

2. **Risk is defined as the effect of uncertainty on objectives.** It is characterised by **events** and **consequences**. Risks can be of financial or non-financial nature. Experience world-wide indicates that the risks manifest in non-financial form are too costly to be ignored. In order to increase the likelihood of achieving the organizational objectives, managements play a proactive role in identifying, analysing, evaluating and treating the risks with an appropriate control and monitoring mechanism. The need to recognise risk and seizing opportunities becomes more compelling as organisations have to operate in the face of abounding uncertainties.

*Risk exposure*

3. This paper attempts to present the relevance of ERM framework for the Government departments facing non-financial risks, with particular reference to the Indian Audit and Accounts Department (IAAD). From the risk exposure

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in IAAD is same as any other Government department.

view point, IAAD is treated at par with any other Government department enjoying significant budgetary support and large scale deployment of human resources in carrying out its mandate. Besides setting the context for an ERM, this paper goes on to suggest a 3-phase implementation programme for IAAD's field offices engaged in the five main audit specialties of Civil, Commercial, Railways, Defence, P&T and A&E function and training institutions.

### **Establishing the context for ERM in IAAD New Vision, Mission and Values**

CAG adopts new vision statement

4. In November 2010, Comptroller and Auditor General of India (CAG) has adopted a new vision statement for IAAD. According to it, the department now ***“strives to be a global leader and initiator of national and international best practices in public sector auditing and accounting and recognized for independent, credible, balanced and timely reporting on public finance and governance”***. The IAAD's mission is renewed to ***promote accountability, transparency and good governance*** through ***independence, objectivity, integrity and transparency*** as its guiding force.

Global leadership as a vision and transparency as a core value lets IAAD to external scrutiny

5. The IAAD's strategic objectives declared through this vision, particularly its aspiration to assume *global leadership*, combined with *transparency* as a core value, may challenge a vast majority of governance structures of public sector in India as well as its peer Supreme Audit Institutions (SAI) abroad. It raises a curiosity in the mind of an outsider to look for benchmarking practices that make this 150 year old institution so distinctly different from the rest. **ERM framework can be an effective tool in addressing these concerns besides realising the IAAD's long-term objectives.**

### **Key stakeholder expectations**

Prime Minister seeks CAG's guidance on

6. As institutions of eminence driven by independence and professionalism- national Governments the world over look towards their SAIs for a direction in the efficient delivery of public services. Prime Minister Manmohan Singh at his November 2010 address of the CAG's 150 years celebration observed that ***“our systems of governance and service delivery must***



efficient delivery of public services

ERM is a reform initiative. It helps executive accountability

of

need to change quickly to meet the new requirements of the situation. Traditional, time tested ways of doing things which lend credibility to an institution in the public eye may prove inadequate in the face of rising aspirations and mounting pressure for quick and efficient delivery of public services. While those in government grapple with different and better ways of doing things, **audit, with its vast experience and deep insight, can contribute significantly to revamping systems and procedures in government to meet the challenges of this 21st century.** We look forward to the institution of the Comptroller and Auditor General for such advice and guidance in the years that lie ahead.” **ERM addresses both the Government’s intention to reform its service delivery function as well as in meeting the CAG’s mandate to report upon the executive accountability.**

GoI positively responds to CAG’s proposal,

7. In February 2007 the former CAG, V.N. Kaul in a letter addressed to the Prime Minister underlined the “need to develop specialised skills for risk management in the Ministries/ Departments themselves and their subordinate offices” and added that “the Government should consider developing a comprehensive framework for risk assessment, analysis, mitigation, monitoring and review at all levels- strategic, programme and operational.”

But ERM needs a pioneer. CAG can lead by example.

8. The Govt. of India’s department of administrative reforms had responded to it by commissioning a pilot study to cover project-level risks. While this may be a good starting point, it does not address the strategic risks faced by the Government at its Ministry/Department level. In typical Government parlance, the hesitation appears to lie in the lack of ‘precedent’. Since the IAAD has the ‘know-how’, gained over time through audit of various Govt. programmes, CAG will be at an advantageous position to lead the other Government departments by setting an example of having an ERM framework for his own department first and then showcase it to the others.

### **Resources**

9. Going by the size and mandate, CAG is one of the largest SAIs in the world. Currently, the organisation has 690-strong professional civil service

*CAG is one of the largest SAI in the world*

cadre (IA&AS), about 26000 audit staff and over 18000 accounting personnel working on the rolls of its 129 field offices across the country. With an annual budget of over ₹ 2300 crore to run the establishment, IAAD also holds a large unvalued fixed asset base in the form of land and buildings situated in the prime locations of the national capital and the state capitals, equal to several thousand crore rupees at current market value.

### **Output**

*ERM can streamline our audit resources and help effective delivery of audit output*

10. These resources put together generate 31 Union audit reports, 90 State audit reports and 27 State accounts and a number of other standalone reports annually. But, unlike its counterparts in the UK or the USA, the IAAD is yet to develop objective measurement criteria to determine the extent of savings these resources should have returned to the tax-paying public in this country. **An appropriate ERM design, if integrated into IAAD's planning process has the capacity to streamline the audit resources, minimise operational surprises and help in efficient delivery of audit output.**

### **Role of Inspection Wing**

*SAIs advocate ERM for their government bodies, Internal Audits help set up ERM in their organisations.*

11. Just as SAIs the world over advocated ERM for their government departments, **internal audits help organisations accomplish their objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes.** As the internal audit arm of CAG, the Inspection wing services 129 Principal Accountants General/ Accountants General-led offices (PAG/AG) and 80 other sub offices. Inspection reports on these offices broadly cover compliance with regard to general financial rules and other HQ guidance on office procedure but there is no system of tracking risk mitigation initiatives undertaken by the individual PAsG/AsG. **ERM framework not only offers to report upon the risk management, but also the opportunities seized/ initiatives taken by individual offices to mitigate their risks.**

12. Although the IAAD's field offices are well-versed in dealing with

internal controls through performance audits etc., their evaluation criteria is often criticised to be based on subjective judgements. This is because controls are mistaken to exist in isolation but not as risk mitigating tools. The end product of any review of internal controls should be to assess their (controls) capacity to mitigate risks in meeting the targets/objectives.

**Risk-Control Relationship**

*Controls are to be seen as risk mitigating tools.*

13. It is, therefore necessary to establish a one-to-one relationship between risks and controls first (see Box 1). This may involve a separate research project to put together all the controls scattered in GFRs, CCS (CCA), Conduct Rules or FR/SRs etc. But once such a compilation is prepared, it can serve as a reference manual for risk practitioners within IAAD as well as to those process owners engaged in the decision making processes in the Govt. of India.

**Box 1: Risk-Control Relationship**

Function	Processes	Risks??	Current Controls*
ADMN	Finance & Budget	To be identified by field offices	GFR, R & P Rules, Delegation of Financial powers
	Discipline		CCS Conduct Rule
	Entitlement		FR /SR
	Leave		CCS Leave Rules
	Office Admn		OAD Manual, MSO (T) Admn
A & E	Accounts	To be identified by field offices	Account Code for AGs, MSO (A&E), State Try. Rules
	GPF		MSO (A&E) GPF Chapter, State GPF Rules
	Pension		MSO (A&E) Pension Chapter, State Pension Rules
AUDIT	All Audit Offices	To be identified by field offices	MSO –Audit,
	Civil		Civil Accounts Manual
	Commercial Audit		Revenue Audit Manual & Income Tax Laws, Audit Norms
	Railways		Railway Audit Manual, Railway Audit Norms.

	Defence		Manual of Audit Dept. Defence Service Vol-I Part A
	Autonomous bodies		Manual of Autonomous bodies
	Audit of PRIs		Manual of Instructions for Audit of PRIs
	Performance Audit		Performance audit guidelines
	IT Audit		Manual of Information Technology Audit

*\*Preventive controls only, other controls will need to be specified by risk owners.*

*Inspection Wing can facilitate ERM in IAAD*

14. To begin with, the Inspection Wing can work with 6 volunteer field offices who may champion the ERM cause and help set up their own ERM frameworks. After attaining some level of maturity, these offices can present themselves to a quality assessment review. Thereafter, this framework can be extended to all the IAAD offices.

### **ERM models and practices in other world bodies**

*Several ERM models with different nomenclature exist but ISO 31000 is all inclusive.*

15. Long before the publication of the COSO's ERM framework in 2004, several models on risk architecture (principles, framework and processes) and practice guidance on application of that architecture to particular risks had appeared on the horizon. Of these, the 2009 edition of ISO 31000 released by the International Organization of Standardization (ISO) emerged as a clear winner by its simplistic approach.

16. Government departments/ agencies in Australia, Canada, New Zealand, South Africa, Turkey and UK are already implementing ERM in varying degrees. Prominent private sector businesses and NGOs in India have also adopted the ISO 31000 framework in their governance structures.

*There is no 'one-size-fits-all' ERM model. Each organisation has a blend of its own.*

17. A review of various risk theories, models and practices, would indicate that there is no 'one-size-fits-all' ERM model. Interactions with the industry leaders engaged in ERM implementation in India, officials of the UN, World Bank, NAO, GAO and other leading professional institutions such as The Institute of Internal Auditors confirm further that each organisation has a blend of its own ERM framework.

### **ERM Model for IAAD**

18. The IAAD's risk architecture based on ISO 31000 would have the following features (see figure 1):

1. Principles
2. Framework
3. Process

*Risk mandate to set the tone at the top.*

Principles are the drivers for ERM framework. They provide the basis for IAAD's risk management policy. To set the tone at the top, and to make it IAAD-wide practice advisory, a risk management policy (mandate or charter) issued at CAG level will have better impact and compliance.

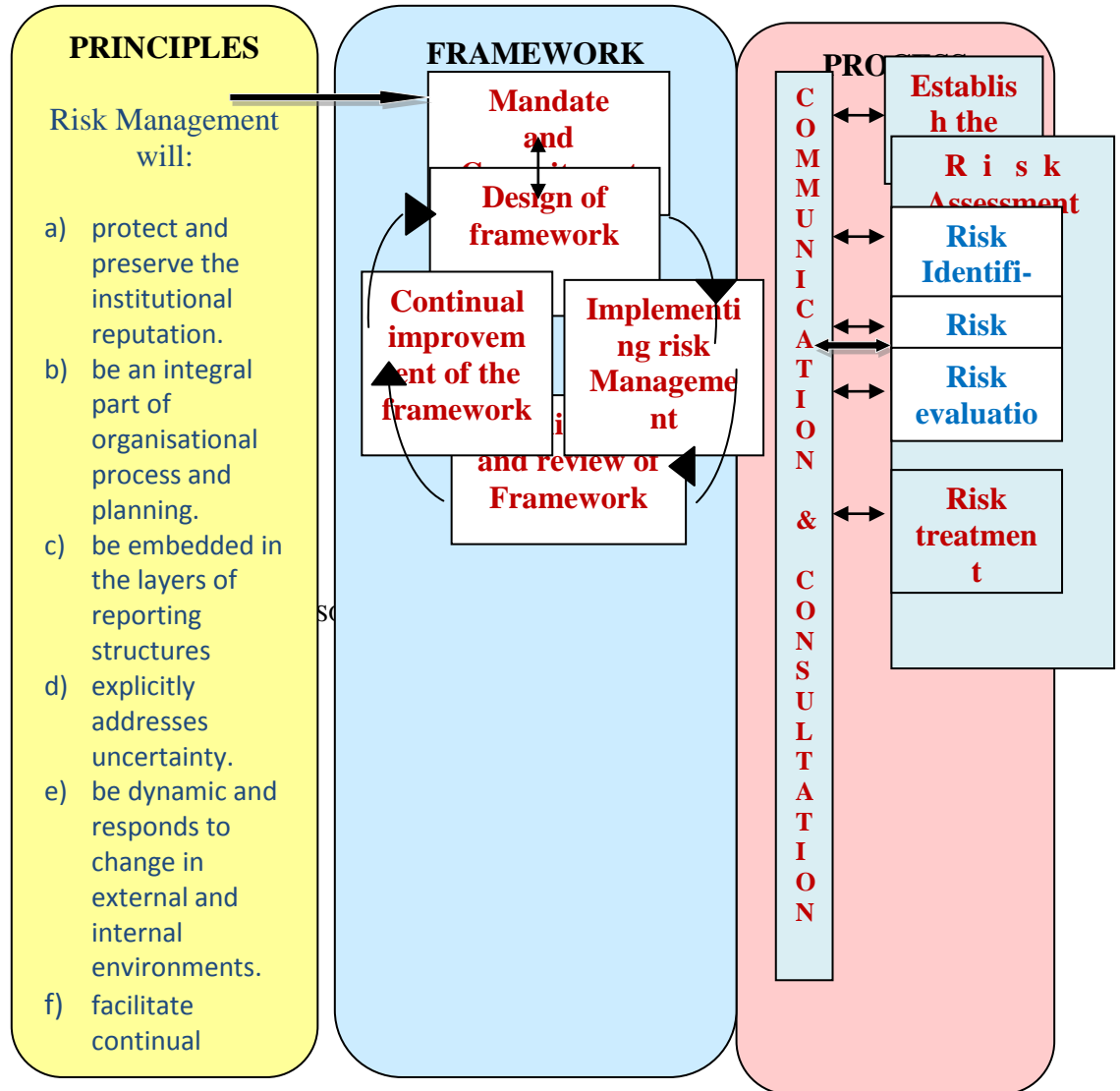
19. A risk framework built on 'risk management policy' will have the

following stages:

- a) mandate,
- b) design,
- c) implementation,
- d) monitoring and review,
- e) continual improvements.

20. Process stage is a key component and is the actual implementation part of ERM. It involves the context setting, risk assessment (identification, analysis, evaluation) and treatment. As shown in Figure 1, 'communication & consultation' provides lifeline while 'monitoring and review' helps refining risk treatment.

Figure 1: Risk Architecture for IAAD

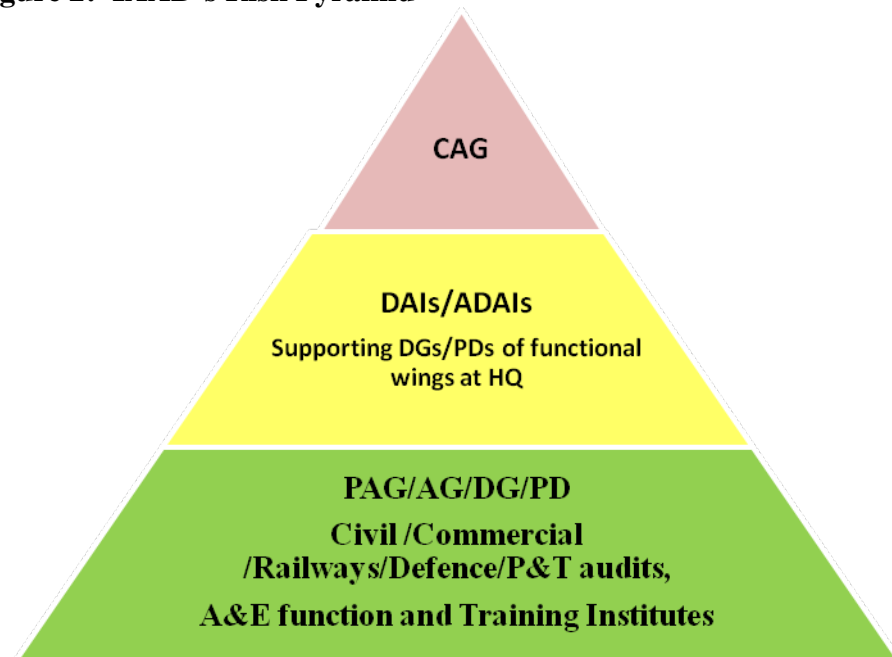


### Risk ownership

*Risk ownership will have to rest with the process owners*

21. For ERM to be an effective instrument in realising the organisational objectives, ownership of risk will have to rest with the process owners; in this case, the IAAD's field offices. Each PAG/ AG will need to involve him/ herself in identification, analysis, evaluation and treatment of risks faced by them. There can be several sub-pyramids within each layer of this organisational pyramid, which operate under the ownership of respective PAG/DG/ AG/PD. Such sub-pyramids will get integrated into the organisational risk pyramid in a manner shown in figure 2.

**Figure 2: IAAD's Risk Pyramid**



### Risk Committee

22. As the risk management process is a dynamic activity, it requires



constant monitoring by a duly constituted risk committee at the CAG's corporate HQ level as well as at the IAAD's field offices. The risk committee will take an oversight responsibility by its periodic assessment of the various processes within the organisation and the risk exposure levels. Depending upon the mitigation treatment given to the individual risks faced at process stage, the risk committee may decide to upgrade or downgrade a particular risk to be of 'high', 'medium', or 'low' in a manner shown at figure 3.

### Key Risks

23. Assuming that the IAAD's corporate level risk pyramid builds on the field offices' constituting base of the pyramid at level 1, an illustrative list of risks may include the following: (see box 2)

#### Box 2: Key Risks-an illustrative list

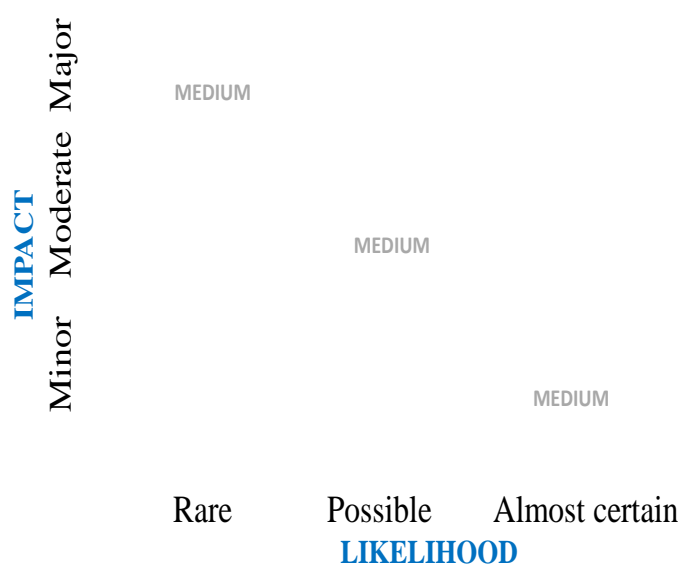
Level	At	Risks
Level 3	CAG	Safeguarding the organisational reputation
Level 2	DAI/ADAI	1. Inadequate scrutiny by the supporting HQ wings
		2. Delayed receipt of audit material from field offices
		3. Post-report media handling
		4. Inter-wing coordination and
		5. Inter-personal relationships
Level 1	PAG/DG/AG/PD (Audit Offices)	1. Improper audit planning
		2. Audit failure ( <i>inability to produce report-worthy material</i> )
		3. Delays in report finalisation
		4. Non cooperation of auditees
		5. Strike and unrest

	<b>PAG/AG (Accounts Offices)</b>	1.	Nonalignment of citizen charter with departmental objectives	
		2.	Inadequate service delivery (Pensions, PF)	
		3.	Improper compilation of accounts	
		4.	Incompatible IT infrastructure	
		5.	Strike and unrest	
	<b>DG/ Training Institutes</b>	<b>PD</b>	1.	Proficiency of faculty
			2.	Training not being a priority
			3.	Lack of support from feeder offices
			4.	Inappropriate training needs analysis
			5.	Lack of follow up

#### How to measure the risks?

24. Risks can be measured in terms of **'likelihood'** and **'impact'** and presented in a 5X5 or 3X3 risk matrix. For the sake of simplicity, a 3 X 3 risk matrix may be suitable in the context of IAAD (see figure 3). Risk events are rated as High, Medium or Low depending upon its assessment for impact and likelihood as under:

**Figure 3: Risk Matrix**



### Benefits of ERM in IAAD

25. The ERM framework in IAAD seeks to benefit the organisation by:

- giving global recognition to CAG's leadership;
- pioneering the cause of ERM in the Government of India;
- increasing the likelihood of achieving objectives;
- exploring new opportunities which add value to work;
- reinforcing stakeholders' confidence in CAG;
- establishing risk-control relationship;
- streamlining resources ;
- minimizing duplication of work, operational surprises and
- building *esprit de corps*.

### **3-phase ERM implementation programme**

26. An ERM can be put into practice through a 3-phase implementation programme as follows:

#### **Phase 1:**

1. Opinion survey
2. Preparation of draft ERM policy/mandate
3. Discussion of draft ERM Policy and in-principle approval to the draft ERM
4. Workshop of PAsG/AsG for 6 volunteer offices on pilot basis
5. Preparation & Finalisation of Risk Registers in 6 pilot offices.

#### **Phase 2:**

6. Formal ERM launch in 6 pilot offices

#### **Phase 3:**

7. Quality Assessment Review of the ERM implementation in 6 volunteer offices by Inspection Wing
8. Submission of review results to CAG
9. Brainstorming at a national seminar
10. ERM launch in the whole of IAAD offices (enterprise-wide).

### **Conclusions**

27. Risk management is a globally recognised, inter-disciplinary approach to assess identify, analyse, evaluate and treat risks faced at various layers of reporting structures. As in any other Govt. department, IAAD's external and internal environments call for an assessment of the organisational risks. As an organisation with high visibility at the national and international levels, IAAD should strive to safeguard the CAG's institutional reputation built over long years of research and innovation.

ERM has the capability of achieving the CAG's vision and mission objectives.

28. ERM implementation needs a pioneer. CAG has an opportunity to lead the nation by setting an example of having an ERM framework on home turf for his own department.

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## **INTERNAL AUDIT IS THE FIRST LINE OF DEFENCE AGAINST MALADMINISTRATION**

***Dr Subhash Chandra Pandey\****

*With no offence meant to anyone, may I present the quartet of Everybody, Somebody, Nobody and Anybody in somewhat lighter vein. They started deliberating on improving the Internal Audit system. Everybody said it was a very important mission and Somebody should do it. Anybody could have done it but he was unwilling and unsure of what exactly needed to be done. He proposed that Everybody should think about it and do it. Nobody knew what exactly was required to be done. So finally Nobody did it. Everybody is now unhappy with the outcome and wants that Somebody should be suitably trained, equipped, endowed and empowered to discharge this onerous responsibility.*

***“Internal Audit is the first line of defence against inefficiency and bureaucratic inertia in Government system of country.”, says the 2nd Administrative Reforms Commission.***

### **Introduction**

1. Public discourse in recent months has been intensely focused on issues of corruption, good governance, abuse of

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*\* The author is presently Additional Financial Adviser & Joint Secretary in the Ministry of Defence. He was a Permanent Invitee to the Advisory Group on Fiscal Transparency set up by a joint Committee of the Reserve Bank of India and the Ministry of Finance in 1999. He also represented Ministry of Finance as a member in the Task Force on Internal Audit set up by the C&AG of India in 2006 at the behest of Ministry of Finance. Both for a examined the aspect of internal audit as part of overall public financial management system.*



discretion, judicial activism, accountability to people, transparency in the affairs of State. There is growing impatience of media, judiciary and people with non-compliance of the regulatory framework by certain sections of the government machinery. This has given fillip to the dormant agenda of revamping the anti-corruption mechanism and internal audit.

2. Some sort of internal audit system exists in all Ministries/Departments. Internal audit reports are presented to Secretaries through their respective Financial Advisors. By their very nature, internal audit reports are meant to bring the deficiencies to the notice of the Head of the Department. These are not meant for the consumption of general public like the CAG reports. If there is a huge pile of CAG's reports to the Parliament awaiting follow up remedial action, one can only imagine the fate of internal audit reports.

3. That the Internal Audit system in the government needs to be strengthened has long been felt and even officially articulated in the 2<sup>nd</sup> Administrative Reforms Commission (ARC) in its 14<sup>th</sup> Report. Several Reports of the CAG presented to the Parliament confirm weaknesses of internal controls and internal audit. For some organizations, 'needs to be strengthened' is actually a euphemism to replace the bitter truth that the Internal Audit 'needs to be set up'. Worse, in some cases, 'strengthening' is the euphemism for saying that the Internal Audit stands subverted for want of resources, authority and attention of top management.

4. A number of important questions arise: Is internal audit weak? Why so? Is it so in all Departments? Who is judging the adequacy and against what benchmark? Are there any prescribed standards of internal auditing? Who has and who should prescribe such standards? Who should have oversight on the functioning of internal auditors? What are the standards of

conduct and reporting of audit by the CAG in relation to internal audit in any organization subject to CAG audit? Does Parliament get to regularly know through the CAG report as to how many internal audit objections are pending in a Department? Who all are interested in improving Internal Audit? Are they really able and willing to take up the initiative and responsibility? Ground situation appears to be that those who *can* are unable / unwilling to do and those who are able / willing to do it *cannot* do it. Discerning readers can connect how our lives are full of such moments when eyes cannot speak to describe and tongue cannot see an awe-inspiring beautiful sight. [For example, in *Ram Charit Manas*, Goswami Tulsidas thus describes the dilemma of Lord Ram when he first saw Sita in the rose garden. “*Siya sobha kimi jaye bakhnai, Gira bin bayan bayan bin bani*”: The eyes have no tongue and the tongue has no eyes so how do I describe the divine beauty of Sita! ]

5. CAG is perhaps the first (or at least amongst the frontline) stakeholder in seeing a strong Internal Audit system in place. He does not have adequate resources to do full justice to the vast mandate of auditing rapidly increasing quantum of receipts and expenditures as well as the diversifying modes of their implementation. 2G auctions have caught the nation’s attention. Occasionally some special cases do catch media attention every now and then but what lies unnoticed in the piles of unactioned CAG reports contains far more serious issues that cannot be captured and communicated in a capsule form as Breaking News. It is a pity.

6. Next important stakeholder is the Department of Expenditure, Ministry of Finance (DoE), which has the official mandate to ensure that the government’s financial management system is robust. As may only be inferred from the unactioned pile of CAG Reports, the DoE finds its role and effectiveness diluted over time. Its control is mainly through some (pre-

sanction) macro level scrutiny of major expenditure decisions and issue of general instructions. Formal feedback systems either do not exist or have fallen into disuse. It relies in good faith on the knowledge, resources and attitude of the Financial Advisors and the Secretaries heading various Ministries/Departments. The result is reflected in the observations of the 2<sup>nd</sup> ARC in its 14<sup>th</sup> Report.

7. Most Departments/Services handling Accounts, Finance, Budget and Audit are having critical manpower imbalances. This is adversely impacting their effectiveness in achieving their assigned charter. The manpower and other resources available with them have not expanded commensurate with the growth in public expenditure IAAD also needs additional manpower to effectively discharge its Audit mandate. Proper review and rationalization of manpower could not be undertaken for various reasons leading to ill-advised across-the-board recruitment bans as a poor alternative. This has left pre-ban manpower imbalances unaddressed and resulted in serious gaps in many cadres. Most cadres look like ice cream cones or have fancy shapes of bottles liquor or soft drinks. The will and resources for serious manpower research are missing with tell tale impact on governance.

8. Audit function has also fallen victim to this. Augmentation of manpower and their proper training is a long drawn affair. How much should be addition to permanent strength and how much should be contract manpower to handle temporary surges in workload needs very detailed planning. Manpower planning for effective audit is beyond the scope of this paper. The limited purpose of mentioning this was to draw the context for the pressing need to strengthen INTERNAL AUDIT within the government as observed by the 2<sup>nd</sup> ARC in its 14<sup>th</sup> Report.

### **Meaning of Internal Audit**

9. According to the Institute of Internal Auditors of UK and Ireland, "Internal Auditing is an independent, objective assurance and consulting activity designed to add value and improve an organisation's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes".

10. According to the Institute of Internal Auditors, New York, 'Internal audit is an independent, appraisal activity within an organization for the review of accounting, financial and other operations on the basis of service to the organization. It is a managerial control which functions by measuring and evaluating the effectiveness of other controls".

11. The International Organization of Supreme Audit Institutions (INTOSAI) has issued International Standards of Supreme Audit Institutions (ISSAI). ISSAI 1003 defines the Internal audit function as *"An appraisal activity established or provided as a service to the entity. Its functions include, amongst other things, examining, evaluating and monitoring the adequacy and effectiveness of internal control."*

12. The Institute of Internal Auditors has issued five Standards and Guidelines for the Professional Practice of Internal Auditing, consolidating previous guidance. The five standards cover: independence, professional proficiency (standards, due professional care), scope of work, performance of audit work (planning, testing, review) and management of the internal audit department. The Standards issued by the internal audit services of the United Nations Organisations cover the same five areas.

13. The International Standard on Auditing (ISA) 610 set by the International Federation of Accountants (IFAC) describe how external auditors should use the work of internal auditors.

#### **Advisory Group on Fiscal Transparency (2001)**

14. The need of improving Internal Audit has been felt since long. The first public acknowledgement of this appears to have been made in the 2001 Report of the Advisory Group on Fiscal Transparency. In the aftermath of the South East Asian Crisis, there was widespread international concerns about transparency in national fiscal and monetary systems. It was considered important for international institutions like IMF to evolve suitable systems for proper monitoring of potential brewing problems and handling them before they become unmanageable. The IMF had developed certain codes and manuals, which had been voluntarily adopted by a number of member countries including India. In this backdrop, the Governor of the Reserve Bank of India established (1999) a Standing Committee on International Financial Standards and Codes under the co-chairmanship of Dr. Y.V. Reddy, Deputy Governor and Dr. E.A.S. Sarma, then Secretary, Economic Affairs, to review developments regarding international standards and Codes that have come up in various areas and to assess the relevance of these Codes for India. The Standing Committee in turn established ten separate Advisory Groups to look into existing Codes and standards in specific areas. The Advisory Group on Fiscal Transparency is one of these groups, which was chaired by Dr. Montek Singh Ahluwalia, then member, now chairman of the Planning Commission.

15. The Report noted that the system of internal audit and controls in the case of India is very well defined and has been in operation for a number of decades. To quote, the Group observed: *There is a well established internal audit system in all central government departments. The system works with Internal Audit Cells under the guidance of Controller of Accounts and Financial Adviser of the ministries and departments. The effectiveness of the internal audit system is examined and commented upon by the Constitutional Audit*

*conducted by the Comptroller and Auditor General of India. Although the internal audit system is well established, it can be argued that not enough use is made of internal audit as a critical management information tool to appraise performance. ....A Committee which went into the functioning of the Civil Accounts Department, observed that more than 50 per cent of the staff and the officers employed in the work of internal audit and internal control functions did not have the requisite background, training or experience either of finance or of accounts. In its opinion, the work was also accorded a lower priority than what it deserved These observations suggest that the system of internal audit and internal control, which has been in place for a long time, needs to be renewed to make it more effective and meaningful as an instrument of internal management control. ((vide Appendix VIII - Internal Audit and Internal Control Systems in the Central Government ))*

16. The Advisory Group also noted: *The (IMF) Manual also emphasizes that an internal audit system should be established to ensure accountability of tax collection staff and system, and adherence to tax administration policies and procedures in their dealings with taxpayers. There is no such internal audit system and this is an important lacuna in the Indian system.*

#### **CAG's Task Force on Internal Audit (2006)**

17. In May 2006, the CAG drew the attention of the Ministry of Finance to the Audit Reports presented to Parliament bringing out weaknesses in the Internal Audit and Internal Controls in the Ministries. Thereupon the Ministry requested the CAG to set up a Task Force to benchmark the Internal Audit practices in the Central Government and recommend specific actions for systemic improvements. This

author was a representative of the Ministry of Finance on the Task Force. Since the Task Force Report is not in public domain, it cannot be quoted in full except to the extent quoted in the Administrative Reforms Commission's 14<sup>th</sup> Report. Suffice to say that the Report recommended the goal to be an institution akin to the statutory offices of the Inspector Generals in the USA but as an interim measure suggested a Board in the Ministry of Finance to lay down Internal Audit standards.

#### **Recommendations of 2nd ARC in its 14th Report (2009)**

18. While the Task Force report remained under consideration of the Ministry, the subject was taken up by the 2<sup>nd</sup> Administrative Reforms Commission as part of its mandate to improve governance in all its forms and dimensions. The Commission recognized: *“Internal Audit is the first line of defence against inefficiency and bureaucratic inertia in Government system of country.”* A study was commissioned by the Commission to Shri A K Ghosh, former Financial Adviser, Defence Services, with institutional support of the National Institute of Public Finance & Policy.

19. The Commission studied the present system of internal audit, its shortcomings, the suggestion of the CAG's Task Force; the practices followed in various counties and thereafter suggested the followings recommendations:

- a. An office of the Chief Internal Auditor (CIA) should be established in select Ministries/Departments to carry out the functions related to internal audit. Its independence, duties, functions, mechanism of coordination with CAG etc should be provided by a statute.
- b. CIAs should report to the Secretary of the Department.
- c. In the initial stages, personnel may be inducted from existing accounts cadre. Norms for recruitment and utilizing private

sector expertise in select tasks may be devised. Capacity building needs for proper functioning of this office should be identified in advance.

d. The modalities for ensuing non-duplication of work vis-a-vis the C&AG should be formalized. This should be aimed at assisting the C&AG in concentrating on carrying out specialized audit/tasks.

e. Standard for internal audit should be prescribed by the office of the C&AG.

f. The Accounting function should be completely separated from Internal Audit. The functioning and effectiveness of this new system may be examined after allowing a suitable period of operation. Based on the result of this examination, such office may also be instituted in other Ministries/Departments/Organizations.

20. A high level committee headed by Special Secretary (Expenditure) is working out the details of a new Internal Audit architecture for the Government of India.

#### **Internal audit vis-à-vis the statutory or Constitutional audit**

21. Although the goals, methods and areas of operation of the internal auditor and the statutory auditor are similar, their status, responsibilities, approach and scope are different. The internal auditor is responsible to the stakeholders of an entity and reports to them through or in addition to reporting to the top management of that entity. The nature and scope of his operations are determined by the management or the government and may differ from one organisation to another. On the other hand, the rights and duties of the statutory auditor are defined by law and are uniformly applicable to all legally regulated entities. The auditing standards are provided by a statutory professional body like the Institute of Chartered



Accountants of India. The Constitutional audit is provided under the Constitution, the supreme legislation governing the country, as an institution of governance and Parliamentary oversight on the functioning of the government. Its independence is guaranteed in the Constitution to carry out its tasks without fear or favour. CAG's (DPCS) Act, 1971 as amended from time to time and the Audit and Accounts Regulations 2007 provide the detailed legislative framework of Constitutional audit. In case of public sector enterprises, the scope of audit by Constitutional audit is laid down in sections 619 sub-section 3 and 4 of the Companies Act.

**Internal Controls are a prime concern under the Audit and Accounts Regulations 2007**

22. The Regulations have been issued by the C&AG of India under powers vested in him under the CAG's (DPCS) Act, 1971. These Regulations extensively stipulate the requirement of instituting and evaluating Internal Controls in the auditee organizations. Some extracts from the Regulations are self explanatory.

*13(3) The scope of audit includes the assessment of internal controls in the auditable entities. Such an assessment may be undertaken either as an integral component of an audit or as a distinct audit assignment.*

*24(4) The Government shall be responsible for establishment, development and enforcement of adequate information, control, evaluation and reporting systems within the Government to facilitate the accountability process.*

*24(6) The Government shall establish an adequate system of internal control to minimise the risk of errors and irregularities.*

*29(3) Examination and evaluation of internal control: The*

*auditor, in determining the extent and scope of audit, should examine and evaluate the reliability of internal control. Auditors should obtain a sufficient understanding of internal control to plan the audit and determine the nature, timing and extent of checks to be performed.*

*32(7) Auditors should report deficiencies in internal control that they consider significant.*

*32(8) Compliance audits, besides reporting on individual cases of non-compliance and abuse, also require reporting on weaknesses that exist in systems of financial management and internal control. The auditor should also report the results of examination of rules, regulations, orders and instructions and their consistency as well as significant irregularities and instances of fraud and corruption.*

*32(9) In the report on the financial statements, the auditor should inter alia either (a) describe the scope of the auditor's testing of compliance with laws, rules and regulations and internal control in preparation of financial statements and present the results of those tests or (b) refer to the separate report(s) containing that information. In presenting the results of those tests, the auditor should report fraud, corruption, illegal acts, other material non-compliance, and significant deficiencies in internal control over financial reporting.*

#### ***86 Audit of receipts and expenditure and review of internal controls and financial records***

*Audit of the receipts and expenditure of a substantially financed body or authority shall be conducted in accordance with the Regulations prescribed in Chapters 6 and 7 to the extent relevant. The Comptroller and Auditor General may also conduct a critical review of its system of internal controls and financial records as well as the tests performed by its auditor for expression of an opinion on its accounts.*

**123 Responsibility with reference to annual accounts**

*While the statutory auditor is responsible for forming and expressing an opinion on the annual accounts of the Government company or the deemed Government company, the responsibility for their proper preparation is that of the management of the company. The audit of the annual accounts does not relieve the management of its responsibilities relating to the maintenance of adequate accounting records, internal controls and safeguarding the assets of the company.*

**125 Preparation of programme of audit by statutory auditor**

*To conduct an effective audit in an efficient and timely manner, the statutory auditor should prepare the programme of audit in consultation with the company and the Accountant General (Audit) and plan his work to:*

- (1) obtain an understanding of the activities, accounting and internal control systems to plan the audit and develop an effective audit approach; and assess audit risk and design audit procedures to reduce the risk to an acceptable low level;*
- (2) obtain an understanding of the information technology systems and data available for use in audit;*

*152(7) The local fund auditor shall develop, in consultation with Accountant General (Audit), a system of internal control in his organisation.*

**160. Audit examination of IT systems at various stages**

*Audit may examine the IT systems at various stages such as feasibility study, system development, implementation and maintenance. This is to ensure that IT assets are safeguarded and that appropriate controls are in place to ensure (a) integrity of the system, (b) reliability, availability and confidentiality of the data and information and (c) compliance of the system with rules and procedures.*

**183. Meeting with officer in charge of the auditable entity at the commencement of audit**

*The inspecting officer may hold a meeting with the officer in charge as soon as the work of audit commences. In the meeting, the audit objectives and criteria, general state of internal controls and areas of focus, concern or high risk identified by Audit may be discussed.*

**Internal Audit distinguished from Internal Checks and Administrative Inspections**

23. When we stipulate that cheques of certain types and value shall be signed by two designated officers, it is Internal Check. When we stipulate that cheques of certain types and value shall be test checked [after they have been issued/paid], it is Internal Audit. To have a decision taken by a committee of officers rather than by an individual officer is Internal Check but review of decisions already taken by officers of the government is part of Internal Audit. The Internal Audit wing of Income tax Department has a system of Internal Audit of Assessment Orders. The Assessment Orders have to be made primarily by the Assessing Officer who has the legal responsibility to defend his assessment.

**The institution of Inspector General in USA**

24. In USA, statutory offices of Inspectors General (OIG) were created in almost all agencies under the 1978 Inspector General Act to audit the agency's operations with a view to detect fraud and waste. The IG has direct access to the head of the agency, although the latter is prohibited from preventing the IG from conducting any investigations he deems necessary. Under this Act, the IG is required to submit reports directly to the head of the agency and also is required to keep the Congress informed of its work. The IG is required to submit

half yearly reports on audit and inspections to the head of the agency, who, after adding his comments, must submit the report to Congress within 30 days. This compromises the decentralised view of internal audit as a service to management, and in reporting to Congress, albeit indirectly, it has assumed an external audit responsibility. Being a statutory office with reporting to Congress, OIG is not that 'internal' to the organization. In fact, it becomes a supplement to the Supreme Audit Institution of USA, the General Accountability Office (GAO) which is the investigative arm of the US Congress. Interestingly even the GAO's office also has a resident OIG which looks into the functioning of GAO's office and reports to Congress like any other OIG. This has been done under a 2008 amendment to the GAO Act. The following extracts are relevant:

*The Office of the Inspector General shall be headed by an Inspector General, who shall be appointed by the Comptroller General without regard to political affiliation and solely on the basis of integrity and demonstrated ability in accounting, auditing, financial analysis, law, management analysis, public administration, or investigations. The Inspector General shall report to, and be under the general supervision of, the Comptroller General.*

*“(2) The Inspector General may be removed from office by the Comptroller General. The Comptroller General shall, promptly upon such removal, communicate in writing the reasons for any such removal to each House of Congress.*

*“(3) The Inspector General shall be paid at an annual rate of pay equal to \$5,000 less than the annual rate of pay of the Comptroller General, and may not receive any cash award or bonus, including any award under chapter 45....*

25. We have to keep one important aspect in mind while trying to import the idea of OIG. In the USA' Presidential form

of government, public offices may be filled on partisan considerations. Therefore, there is need for some apolitical institutions to guard the interest of American taxpayers. The OIGs fill this need.

### **The German and Swedish model**

26. Some other models also appear to mix internal and statutory audit functions. For example, in Germany the internal audit is not part of a government agency's control system, but can be viewed as a component of statutory audit. While the internal audit cadre operates within agencies, they are subject to technical and professional guidance as well as supervision, by the German Supreme Audit Institution, the Federal Court of Audit. They report only to the supreme audit institution, and perform a 'pre audit' role rather than a traditional internal audit role. Similarly, the Swedish audit office occupies a somewhat ambiguous position, being part of the central government administration within the Ministry of Finance. Nevertheless it operates independently and has full independence in the selection of topics and in reporting.

### **What can be done in short, medium and long term to revamp Internal Audit?**

27. The CAG's Task Force Report and the 2<sup>nd</sup> ARC's 14<sup>th</sup> Report are under deliberation of the government. No concrete actions seem to have been announced or taken. It is a universally recognized truth that best is the enemy of good. In trying to work out the best internal audit system conforming to international standards and adopting global best practices, we may not be doing enough to do what is at least feasible within existing mandate, structure and resources. We have to get rid of paralysis of analysis. We do not have as many officers to fill up all those new posts that would need to be created for an expanded, formal Internal Audit structure. Here are some

suggestions to do something good rather than keep planning for the best.

***I. CAG Reports and Regulations***

- a) The CAG Audit Report should include a statistical summary of pending Internal Audit objections, with age-wise, agency-wise breakup
- b) The CAG may prescribe, as part of Audit and Accounts Regulations, 2007, the minimum level of documentation to be maintained by any auditee office and access to the departmental MIS (the reports and returns) that Audit expects. These can be precursor to evolving into more elaborate Internal Auditing standards in due course of time.
- c) Every year, one Ministry/Department should be selected for in-depth vertical audit purely from the viewpoint of adequacy of internal check, internal control and internal audit and the findings reported to the Parliament through a separate Audit report. Stand-alone reports on topics of prime interest are gaining currency. It improves flexibility in preparation/submission as well as its readability.

***II. Strengthening Administrative Inspections***

- a) **We should integrate attempts at reforming Internal Audit system with those formalizing and strengthening Internal Checks and Administrative Inspections. Excessive focus on Accounts & Finance cadres in the discourse on Internal Audit is counter-productive. Involving EXECUTIVE WING officers in internal audit is not only desirable due to staff shortages in Accounts/Finance cadres but also a necessity to build wider acceptability of Internal Audit. So long as Internal Audit is seen as the obsession of the ‘Finance guys’ to probably serve their own self-seeking agenda, the Executive’s response would continue to be**

**lukewarm.**

b) If we have to serve the primary case of good governance, the control instruments within the Executive Wings have to be activated first. Their systems of Internal Checks and Administrative Inspections should be reviewed in a formal, structured manner and appropriate checklists should be updated.

c) In most Departments, particularly in large departmental commercial undertakings like to Ministry of Railways and Department of Posts and Departments with wide geographical reach like Ministry of Defence, internal audit by Finance/Accounts officials is supplemented by 'administrative inspections' by administrative authorities. The inspecting teams from higher formations look into operational/financial risks besides purely administrative matters. **System of Administrative Inspections is quite rigorous in many Departments and organizations. For example, in the Indian Audit and Accounts Department and the in the Armed Forces, these drills are very elaborate. The focus is to see that the field units are following prescribed orders and maintaining records and equipments as intended. Administrative and Technical matters including 'performance' get covered in fair detail in such inspections. IAAD also follows a system of Peer Review of its field offices where the overall performance of the office is judged against constraints. The 'HQrs Inspection' templates especially in IAAD covers financial aspects as well. Such scrutiny of financial decisions and record-keeping can be further improved in the Ministries by periodically reviewing and updating proper checklists/templates. The Finance Wings can play very useful role in such an exercise and provide very useful aid to management. [In some cases, formal internal audits and inspections may be resisted by some Departments/Organizations because of the fear of**



**possible leakage and adverse publicity. This is where the Ministry of Finance has to play an active role.]**

**d) Involving Executive in Internal Audit system well before somewhat outsiders like the ‘Finance guys’ come into the ex-post review of records and decisions will provide indirect manpower supplementation to the ‘Finance guys’. This is like outsourcing of routine checks through meticulously evolved checklists by the Finance Wing to the Executive Wing. Manpower would be more optimally utilized. During Internal Audit by officers outside the Executive Wing, the checks carried out within the Executive Wing can be simply test-checked by the Internal Audit team.**

**e) Such a system will create a layered defense against corruption and misgovernance comprising Internal Checks, Administrative Inspections, Internal Audit and finally periodic Peer Reviews of a Department / Organization involving some rank outsiders.**

### ***III. Self-certification and declarations/positive confirmations by Executives***

**a) In tax administration, there is increasing reliance on self-certification by tax assesses. Breach of trust entails severe penalties – fines and prosecution. We can replicate a similar system of certain minimum checks and self-certification by CFAs. Apart from declarations and self-certifications for major projects/programmes, there may be general certificates to be filed annually. This *may* bring some internal checks and internal audit. **The checklists to be given to Executive Wing Officers for verification and recording certificates should be easy to understand by properly digitizing all tasks involved in a full-scale Internal Audit by professional auditors.****

b) Just Imagine the valued added to governance if the **Executive Wing Officers** are made to sign such certificates as follows:-

- I certify that the above mentioned list of sanctions is the complete list of sanctions accorded by me during the period xxx. I also certify that the requirements for issuing the above sanction arose at different times and that none of the sanction was split to avoid approaching my higher authorities for sanction.
- The above is a complete list of cheques issued during xxx, each exceeding Rs yyy. These were reviewed by me to check whether each of the payment was authorized by zzz. I did not check whether the authorizations given by zzz were correct or whether zzz was competent to give those authorizations. For the following cheques, authorization was doubtful because the amount authorized by zzz and the signature of zzz appeared on different pages and there is a clear risk of substitution of amount that was intended to be authorized by zzz.

#### ***IV. Crucial Role of Ministerial financial advisers in oversight on field executives***

28. The knowledge and skillsets required for carrying out payment, accounting, auditing, financial advice and vigilance functions have a fair degree of commonality. If all these functionaries work in tandem with the common objective of promoting good governance and prudent financial management, they can provide valuable assistance to the concerned chief executives. At present state of development of our governance structure, the financial advisor of a Ministry can be a kingpin of the whole effort of revamping internal audit, particularly in Ministries where there is large scale delegation to lower formations like the Ministry of Defence. Separate systems can be provided to look into decisions where

the financial adviser is a party to the decision.

29. In the present circumstances, the Financial Advisor of a Ministry/Department is best suited to oversee internal audit in that Department with increasing delegation of powers and resources to field formations and parastatal agencies. Any other arrangement, howsoever justified on paper, would be impractical to implement. It would lead to further fragmentation of available manpower pool and their sub-optimal utilization. In due course, we may even have statutory authorities like the OIG in USA but till then the FAs must be tasked to take charge of instituting a layered system of checks and balances incorporating Internal Checks, Internal Controls, Internal Audit, offsite regulation through MIS and Administrative Inspections. FA should guide the system build-up and be guided by MoF in the process.

30. The financial advisors in the Ministries should institute suitable MIS from field offices and a system of test check by the Ministry Finance and Executives to check if the delegated powers are being exercised properly. The importance of this can hardly be over-emphasized to send a message to the field offices that delegation of powers by the Ministry is not abdication of powers. Ministerial oversight has to be visible. If the financial advisor is able to institute an effective system of checks and balances (internal audit) of lower formations, it will be a great service to the cause of good governance. If satisfied with the adequacy of such a system, the CAG can then focus on Ministerial decisions.

31. Having an independent, statutory mechanism of internal audit having adequate resources, mandate and powers to question even the decisions of chief executives (Secretaries and Ministers) like the Inspectors General in USA may be a desirable goal. However, even if the Internal Audit Executives serve merely as 'eyes and ears' of the Chief Executive, short of

power to question the Chief Executive's decisions, it would be nevertheless advance the cause of good governance. The Chief Executives' decisions can be questioned by the Internal Audit of higher level executives and ultimately by the CAG.

32. The edifice of a strong internal check on maladministration requires and integration of internal checks, internal controls, internal audit, MIS and Administrative Inspections. It is too serious a business to be left only to finance and accounts people. The Executive Wing must also be roped in. A layered defence system involving a series of internal auditors at different levels, professionally guided by standard setting bodies and external review mechanism is a practical solution. What needs to be emphasized here is that most Ministries/Departments (except possibly the Scientific Departments) are headed by officers who may not have grown with it. They are thus expected to be perhaps more objectively interested in a strong and independent internal auditing system to provide necessary assurance to them.

33. The role of accounts and finance personnel in internal auditing of the government appears to have been de-emphasized by the Commission. Perhaps the Commission has not fully reckoned with the government system's resistance to external impositions. Independence of auditors, investigators and regulators can be secured through appropriate mechanism but for that very purpose they need not be sourced from the non-government sector. The vigilance of civil society manifests itself through NGOs activism, PILs, free media and RTI Act. For internal auditing functions, the personnel have to be principally sourced from within the government system. The accounts and finance personnel are key resource personnel. There is scope for manpower supplementation from outside but key responsibilities would continue to be with insiders in the system, with checks and balances to allow them fair degree of freedom.

**Internal Audit is not a substitute for statutory audit**

34. Before concluding, we may add that it would be fallacious to view Internal Audit as an Auxiliary Force of para auditors a la military and paramilitary forces to offload the burden of the CAG's office. Internal Audit can never be a substitute for independent statutory audit as the independence of internal auditors would always be perceived as weak in public perception unless statutory defenses are in place and that is a long shot.

### **Note on online resources**

The report of the **Advisory Group on Fiscal Transparency 2001** is available at the website of the Reserve Bank of India ([www.rbi.org.in](http://www.rbi.org.in)) and the reports of the 2<sup>nd</sup> Administrative Reforms Commission are available at ([www.arc.gov.in](http://www.arc.gov.in))

**Other useful** websites are International Standards of Supreme Audit Institutions [www.issai.org](http://www.issai.org) The Institute of Internal Auditors ([www.theiia.org](http://www.theiia.org)) International Federation of Accountants (IFAC) [www.ifac.org](http://www.ifac.org) Association of Certified Fraud Examiners. <http://www.cfenet.com/home.asp> AFROSAI –SADCOSAI Southern African Development Community Organisation of Supreme Audit Institutions – Assembly of English Speaking Supreme Audit Institutions in Africa. <http://www.idirtc.co.za/> CDD Centre for Democracy and Development. <http://www.cdd.org.uk/> CIPFA Chartered Institute of Public Finance and Accounting. <http://www.cipfa.org.uk/> COSO Committee of the Sponsoring Organisations of the Treadway Commission. <http://www.coso.org/> ECSAFA Eastern Central and Southern African Federation of Accountants. <http://www.ecsafo.org/> IDASA Institute for Democratic Assistance in Southern Africa. <http://www.idasa.org.za/> ICPAK Institute of Certified Public Accountants of Kenya. <http://www.icpak.com/news.htm> IFAC International Federation of Accountants. <http://www.ifac.org/> IIA Institute of Internal Auditors. <http://www.theiia.org/> IMA Institute of Management Accountants. <http://www.imanet.org/ima/index.asp> International Monetary Fund on Government Financial Statistics. <http://www.imf.org/external/pubs/ft/gfs/manual/gfs.htm> International Budget Project. <http://www.internationalbudget.org/themes/BudTrans/transp.htm> IFAC Internal Federation of Accountants. <http://www.ifac.org/> INTOSAI International Organisation of Supreme Audit Institutions. <http://www.intosai.org/> ODI

Overseas Development Institute. <http://www.odi.org.uk/>  
SAICA South African Institute of Chartered Accountants.  
<http://www.saica.co.za/> World Bank. [www.worldbank.org](http://www.worldbank.org)  
WorldBank on CFAA.  
<http://www1.worldbank.org/publicsector/cfaa.htm>

## ACCRUAL ACCOUNTING - MASTERING THE TRANSFORMATION

***K. Mani\****

Good governance has much to do with the values and ethics of society in general. It looks at the functioning of governments from the point of view of its acknowledged stakeholders, beneficiaries and customers and must be evaluated with reference to specific norms and objectives as may be laid down. Bad governance is being increasingly regarded as one of the root causes of all evil within our societies. Major donors and international financial institutions are increasingly basing their aid and loans on the condition that reforms that ensure "good governance" are undertaken.



Good governance has a few characteristics. It is participatory, accountable, transparent and effective. It assures that corruption is minimized. The marginalized sections are taken into account and the views of the most vulnerable are considered in decision-making. It also takes care of the present and future generations. Fiscal policy makers and public financial

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management practitioners agree on the positive impact of transparency and accountability on economic performance and on public trust. Providing this positive impact to the general public in a convincing manner is, however, often a challenge. One of the key factors in good governance is transparent accounting. It's gaining currency all over the world as the citizens are demanding more accountable and transparent governance.

### **The history of accounting**

Accounting is thousands of years old. The earliest accounting records, which date back more than 7000 years, were found in the Middle East. People of that time relied on primitive accounting methods to record the growth of crops and herds. Accounting evolved improving over the years and advancing as business advanced. When medieval Europe moved to a monetary economy in the 13th century, merchants started bookkeeping to oversee multiple and simultaneous transactions. One important breakthrough took place around that time - the introduction of double-entry bookkeeping, which is defined as any bookkeeping system in which there was a debit and credit entry for each transaction! The historical origin of the use of the words 'debit' and 'credit' in accounting goes back to the days of single-entry bookkeeping in which the chief objective was to keep track of amount owed by customers ([debtors](#)) and amounts owed to [creditors](#). 'Debit,' is [Latin](#) for 'he owes' and 'credit', Latin for 'he trusts'.

Kautilya, 4th century B.C. economist recognized the importance of accounting methods in enterprises. He realized that a proper measurement of economic performance was absolutely essential for efficient allocation of resources, which was considered an important source of economic development. Kautilya developed bookkeeping rules to record and classify economic data and realized the role of independent audit and

proposed the establishment of two important but separate offices. The Treasurer and Comptroller/Auditor increase accountability, and reduce the scope for conflicts of interest. With the establishment of East India Company, commercial accountancy too rooted in India. The company had an advanced system of Consultation Book and Account Books.

### **World picture and international best practice**

Accounting provides useful information to decision makers. As the business scenario is changing all over the world, so have the accounting standards that govern the presentation and disclosure of information. International Accounting Standards are central to this concept. International standards were first developed in the late 1960's. They have reached their zenith of importance in today's economic and business environment. It is also evident that governments and policymakers recognize this change. The benefits of international accounting standards can be financial, economic and political. The economic and political scenario in today's world suggests that companies, lenders, and investors would prefer a convergence of domestic accounting standards with international accounting standards to create a quality and comparable financial reporting framework.

The systems of preparing government accounts prevalent can be classified into four broad categories:

1. Cash Accounting
2. Modified Cash
3. Modified accrual
4. Accrual

### **Cash accounting**

The cash basis of accounting measures the flow of cash resources. It recognizes transactions and events only when cash is received or paid. Financial statements produced under the cash basis of accounting cover cash receipts, cash

disbursements and opening and closing cash balances. A cash accounting system has the advantage of being simple.

**Modified cash accounting**

The modified cash basis of accounting recognizes transactions and events that have occurred by year-end and are normally expected to result in a cash receipt and/or disbursement within a specific period after year end. Under this system, the accounting period includes a complementary period for payments (e.g. one or two months) after the close of the fiscal year. Receipts or payments over the complementary period that are related to the transactions of the previous fiscal year incurred during the fiscal year are reported as the revenue or expenditure of this previous fiscal.

**Modified accrual accounting**

The modified accrual basis of accounting (sometimes also called as expenditure basis) recognizes transactions and events when they occur, irrespective of when cash is paid or received. However, there is no deferral of costs that will be consumed in future periods. Physical assets that will provide services in the future are written off in the period acquired. Modified accrual and full accrual accounting have the same accounting framework. The major difference lies in the time between the acquisition of goods and assets and their utilization. Under modified accrual accounting, supplies are considered consumed and assets are written off as soon as they are acquired. Under full accrual accounting, changes in inventories are recognized and assets are progressively depreciated according to their useful life.

**Full accrual accounting**

Like modified accrual, the full accrual basis recognizes transactions and events when they occur irrespective of when cash is paid or received. Revenues reflect the amounts that came due during the year, whether collected or not. Expenses reflect the amount of goods and services consumed during the year, whether or not they are paid for in that period. The costs of assets are deferred and charged when the assets are used to provide service. Full accrual accounting is similar to the accounting systems for private enterprises (commercial accounting).

### **Governing body**

The International accounting standards, (The acronym "IAS") are set by the International Accounting Standards Committee (IASC). The IASC has different arms, the main one being the International Accounting Standards Board (IASB) which is the standard setting body of the IASC. The acronym "GAAP" stands for Generally Accepted Accounting Principles. The IASC does not set GAAP, nor does it have any legal authority over GAAP. The IASC can be thought of as merely an influential group of people who make accounting rules. When the IASB sets a new accounting standard, a number of countries tend to follow and fit it into their individual accounting standards. Each nation's accounting standards board tries to incorporate them what becomes GAAP for that particular country.

### **Accounting in India**

Government of India follows cash accounting. It is an accounting method where receipts are recorded during the period they are received, and the expenses during the period in which they are actually paid. This is in contrast with accrual accounting, where revenue and expenses are recorded when it is due. GAR21/GFR68 provides for cash basis. Article

150 of the Constitution of India stipulates that accounts of the Union and of the States shall be kept in such form as the President may, on the advice of the Comptroller and Auditor General of India, prescribe. Annual Financial Statements or the budget is a constitutional responsibility under Article 112 & 202. It is a statement of estimated receipts and expenditure of the Government of India, laid before Parliament in respect of every financial year. Revenue Budget consists of the revenue receipts of Government (tax revenues and other revenues) and the expenditure met from these revenues. Capital Budget consists of capital receipts and payments. The Governmental accounting system prevailing in India, though basically sound, is not very effective in giving any Management Information and in strengthening transparency. The main drawback of cash based accounting is that no attempt is made to match an expense with the revenue it generates. This means that the income statement and balance sheet may not be good pictures of recent business activity and present business conditions. Thus, it does not provide the complete picture and insight in to assets and liabilities. Information on current assets are sketchy. e.g. accrued income like outstanding royalty, fees, service charges, tax arrears etc. Through cash accounting, knowledge is not available about government liabilities (pensionary commitments, interest due, bills payable, etc). Unit cost and total cost of services provided by the Government departments like health, education, water supply, transportation etc. is not possible here. It ignores certain transactions by not recording expenditure already incurred but payment not made e.g. supplies made, salary, telephone charges etc. In keeping pace with the changing time, the government has decided to shift to accrual accounting. The Twelfth Finance Commission has made recommendations on these lines and Government of India has accepted it in principle to migrate to accrual basis accounting.

### **Problems of adopting a commercial model**

The nature and purpose of transactions of the government are such that we cannot readily shift to accrual accounting. Majority of the government transactions are not for profit motive. Public services like defense, law and order, natural resources are to be taken in to consideration in this new system of accounting.

### **Experience of other countries**

Many advanced nations have revamped their accounting system. United States of America, New Zealand, Iceland, Australia and Finland are among the first to implement accrual accounting in government. In addition to the above, Malaysia and Tanzania have also implemented accrual accounts but at local government level. Canada has adopted an accrual accounting with cash budgeting.

### **Accrual accounting**

An accounting method that measures the performance and position of an entity by recognizing economic events regardless of when cash transactions occur. The general idea is that economic events are recognized by matching revenues to expenses (the matching principle) when transaction occurs rather than when payment is made (or received). This method allows the current cash inflows/outflows to be combined with future expected cash inflows/outflows. This help to create a more accurate picture of the company's internal state of affairs. The basic need for this method arose out of the increasing complexity of business transactions and a desire for more accurate financial information.

### **Accrual Budgeting**

This is a full set of forecast financial statements, including assumptions used in preparing those statements. Formal budget appropriations (cash) to be consistent or linked with forecast financial statements. In accrual budgeting, estimates would reflect the complete liability based on expenditure for the year. Ideally, the difference should be minimal. In case of receivables, the entire revenue relating to the year is accounted in accrual budget and not merely the amount collected /collectible. Accrual budgeting is not a pre-condition for Accrual Accounting. It is feasible to report in terms of accruals and to budget on a cash basis. Many governments report finances in the accrual basis. Few governments budget on the accrual basis. Canada has Accrual Accounting with cash budgeting and USA has Modified Accrual accounting and cash budgeting. But Full benefits of accrual accounting can be gained only when it goes hand in hand with accrual budgeting.

### **Cash. vs. Accrual basis**

Accounting records prepared using the cash basis recognize income and expenses according to real-time cash flow. Income is recorded upon receipt of funds, rather than based upon when it is actually earned, and expenses are recorded as they are paid, rather than as they are actually incurred. Under this accounting method, it is possible to defer taxable income by delaying billing so that payment is not received in the current year. Likewise, it is possible to accelerate expenses by paying them as soon as the bills are received in advance of the due date. The cash method offers several advantages. It is simpler than the accrual method and provides a more accurate picture of cash flow. Income is not subject to taxation until the money is actually received.

Accounting of revenues and expenses under the cash method depends upon the timing and can sometimes provide a

misleading picture of a company's financial situation. Accrual basis spells income and expenses in the period to which they apply regardless of whether or not money has changed hands. Under this system, revenue is recorded when it is earned, rather than when payment is received, and expenses recorded when they are incurred, rather than when payment is made. For example, if a contractor performs all of the work required during the month of May and presents an invoice in June, he would still recognize the income from the contract in May because that is when it was earned even though the payment will not be received for some time. The main advantage of the accrual method is that it provides a more accurate picture of how government business is performing over the long-term than the cash method. The main disadvantages are that it is more complex than the cash basis.

Accrual Accounting can retain the advantages of the cash accounting system and overcomes its limitations by inclusion of Cash Flow Statement in the Financial Statement. Disclosure of the Accounting Policies used in the preparation of financial statement facilitate comparison with any similar entity at a global level. Liquidity position as well as information on the Financial Position i.e. assets and liabilities of government are better illustrated in this system. Procuring loans and its conditions, debt restructuring etc depending upon anticipated income inflow can be better managed in the new system. The management information and financial decisions thereon can incorporate asset liability positions and further modifications, if required. It gives disclosures on account of contingent assets and contingent liabilities. Subsidy details, its calculation can be extracted from accounts to streamline the process. Exact details of financial performance is available since it correctly depicts surplus/deficit as all expenses whether paid or not and all incomes whether received or not are accounted. Incorporation of receivables and payables, physical assets, capital work-in-



progress and depreciation, pension liabilities etc help to reduce the deficiencies of cash accounting.

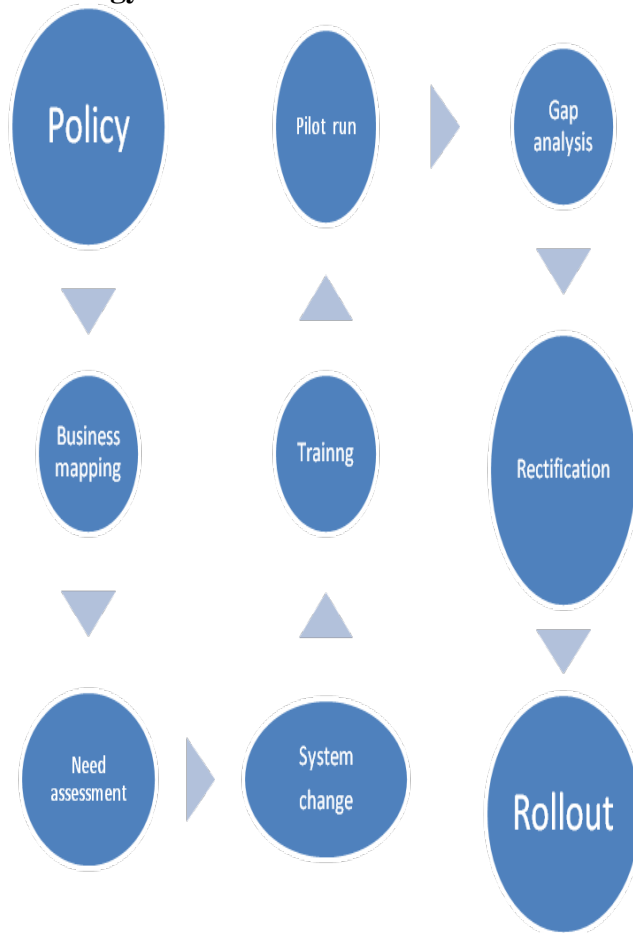
**Difficulties in accrual accounting**

Since the current scheme of book keeping is cash based, rules and procedures thereon for the proposed shift need to be rolled out. Accounting policies that determine principles of recognition, measurement and disclosure need to be defined and notified. The position of Audit also needs to be reinforced to ensure conformity. The risks involved in accrual accounting can be similar to the risks involved in the present cash accounting system. However, accrual accounting leads to greater lucidity in accounts resulting in easier exposure of frauds.

**Thrust for adopting a modified accrual concept**

The need for economic and rural growth force governments to adopt accrual concepts differently from private sector. Government's motive is to provide transparent and efficient administration to its citizen whereas private sector thrives on the principles of profit. Their aim is to amass maximum profit and expand business even at the expense of ethics at times. To reach this purpose, records are kept incorporating all details for managerial decisions and efficient use of resources. Further, the concept of net worth in government is not as important as in the private sector. The spotlight of accrual accounting in government is to ensure that the output and outcome of the spending are proportionate with the inputs and the long term fiscal sustainability of government.

**Adoption strategy**



**Policy initiatives**

**Accounting policies:**

There is a need to revamp the existing Accounting Manual to incorporate the proposed procedures. This concept would grow over a period of time. There is a need to clearly spell out

principles and criteria of recognition, measurement and classification applicable in the accrual accounting system in the new Accounting Manual and also policy on depreciation of physical assets. They will come in to existence as accrual based accounting standards for public sector. For this, setting up a committee to prepare draft policies and accounting standards is a pre requisite. The draft policies should be discussed in the ministries and departments before its final and formal notification.

**Budgetary and accounting reforms.**

Budgeting and accounting systems are directly connected to each other. In the long run it is desirable to have connected reforms in the budgeting systems. Full benefit of accounting reform will be achieved only when budgetary reforms are integrated in its accounting system. Putting into practice both the reforms simultaneously is easier said than done, and change management is tough to handle. Most countries like Canada and UK that embarked on reforms first undertook accounting reforms, followed by budgetary reforms within a few years.

**Business mapping and need assessment**

One of the first pre-requisite for reform is stock taking. Detailed process study is required for various activities and accounting practices to know the type and nature of accounting and financial information available and to assess the departure in terms of principles and points of recognition, classification and disclosures. This will also involve making an inventory of the agencies and sources of information and mapping their inter-linkages. It will be easier to start with agencies who are already on similar accounting principles. Such an exercise will initiate a road map for the task which can act as the base point from where other departments and agencies can take-off. Ministry of Railways, Department of Posts etc. are best

positioned to prepare the detailed road map for their respective jurisdictions. Under Fiscal Reforms and Budget Management framework, Central civil departments have listed their assets. The Receipt Budget, 2006-2007 of the Central Government contains a statement of Assets Register. The financial statements of the State in the form of Finance Accounts and appropriation accounts are prepared using a very robust system of compilation involving offices throughout the State. District Treasury Offices in the State carry out primary compilation followed by secondary and final compilation at the office of the Accountant General. The implementation of accrual accounting needs to take into account the existing accounting system. The existing annual accounts of the State Government contain most of the information with respect to accrual accounting e.g. Capital, Public debt, Loans, etc. Classification of the consolidated fund provides information on Expenditure heads (Capital Account), Public debt, Loans and Advances, etc. The data collection process may turn out to be a time consuming process if the requirements are not prioritized. The scope of data collection efforts should be told clearly prior to commencing data collection exercise.

Once the current business process is mapped, it is easier to make a business process re-engineering plan. In the present scenario, it is possible to prepare a Balance Sheet within the cash based system though it may not be a complete one. In single entry system, there is no provision to keep track of assets or liabilities within the accounting system. Information has to be kept separately outside the accounts. Such a system cannot be reliable, unless all the sources of information are audited and the linkages to the accounting system are checked as well. Further, if some expenses are incurred in creating an asset but the bills have not been paid, these will not be reflected in the accounts. These expenses will not be included in the total cost and the resultant value recorded will not reflect the true cost of

the asset. If a double entry book-keeping system as in place under the cash based system, then the Balance Sheet would be more reliable.

### **System Change**

The existing List of Major and Minor Heads needs to be recast as Chart of Accounts, which will need to include Object heads of classification to depict accrual transactions. The elasticity in operation of object heads at the States level gives no room for standardized list across the Union and the States. Object Heads across the States and the Union should be standardized, as recommended by the Twelfth Finance Commission. Necessary ledgers and other subsidiary books need to be devised at business points such as the PAOs/Treasury/DDOs/CDOs as the case maybe, to capture transactions at their point of origin. Preparation of robust finance account for the state is necessary as it will act as the basis for accrual financial statements, to be filled in the initial trail. Transactions like fixed asset accounting, long term liability accounting, non functional and contingent liabilities etc. should be taken care of. The requirements should be clearly specified in a detailed way. Other preparatory exercises like identifying the elements/components of financial Statements are necessary. The accrual Financial Statement will be filled in using the Finance Accounts prepared on cash basis. There is a need to lay down comprehensive accounting Standards for Government accrual accounting. Also a decision needs to be taken whether the government should follow IPSAS or design separate IGFRS for each area accounting Units. At present the accounting is carried out by the DDO and also by the Treasury offices. Since Treasury offices maintain complete accounting, the DDOs at time rely more on the treasury accounts. Some DDOs do not maintain their own books of account at all. Under the accrual accounting, the DDOs will get identified as the primary accrual

accounting units which would be required to maintain complete set of books and accounts on accrual basis. This would necessitate strengthening of accounting organization at the DDO Level. The capturing of accrual information would require a robust IT system to facilitate seamless transition and a need to create awareness on accrual accounting to facilitate its acceptance across the various functional departments.

### **Training**

Change management for the people involved is a significant part in the whole exercise. Involvement of effected employees should begin early, and not as an afterthought. Communication channels should be open and one need to know the following.

- what will happen
- when will it happen
- why it is being done
- what is the expected outcome

### **Inclusive progression**

There are several major HR issues that affect whether a system may ultimately succeed, at least to the fullest extent possible. The first of these issues is determining whether the employees are capable of adapting to the new system. Specifically, they may need to make ad-hoc decisions, and they may need to learn complex workflows, none of which they were required to do previously. If some employees are unable to make the leap to the demands of the new environment, performance of the system will be jeopardized.

### **Pilot Study**

Pilot studies should be launched in a few Ministries/ Depts. / State Governments with a view to assess the gaps and the problems in the existing system so that the transitional requirements could be worked out. This will be crucial for

process mapping. Ministries which have dedicated accounts services such as Railways, Defense and Posts, may select areas within their jurisdictions for pilot study based on feasibility and their requirements. It is of crucial importance that the Pilot Studies be identified and carried out with the active involvement of the executive branch concerned. Any changes leading to introduction of accrual accounting would have very significant impact on the working of the executive and recording of financial transactions.

#### **Pilot study in AP**

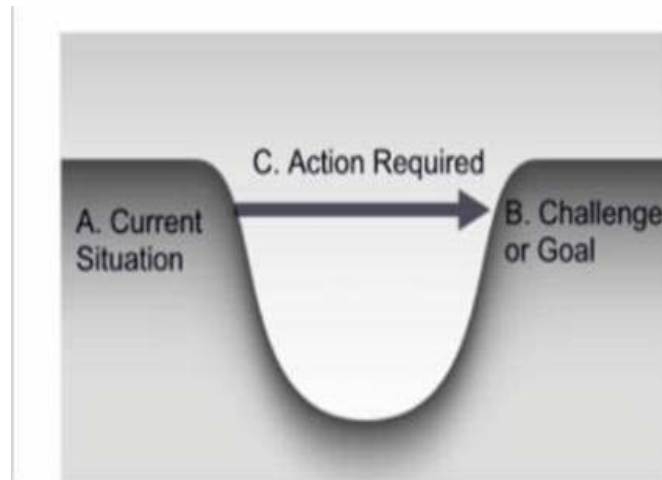
Since AP was one of the state which agreed to implement accrual accounting, a pilot study was organised in the state. The methodology adopted was to study and map the existing system to prepare accrual financial report. The Finance Accounts captured many of the information required for AFS. Conceptualizing formats for Annual Financial Statements(AFS) at the State level based on accrual accounting, filling in the model formats based on the existing cash based AFS, Piloting the preparation of AFS in the recommended formats at the select accounting office in each of the two identified Departments of the Government was undertaken. As a part of this project, the model conceptualized accrual Annual Financial Statements (AFS) formats have been designed based on Indian Government Financial Reporting Standards (IGFRS), International Public Sector Accounting Standards (IPSAS). These model formats have been filled in based on the existing cash based Finance Accounts for the Financial Year 2008-09 to the extent possible.

Apart from the above, many pilot studies are being commissioned and conducted by different organizations. Institute of Public Auditors of India, (IPAI) as a consultant has done a pilot study in Madhya Pradesh in three departments, i.e., PWD, Forest and Health. IPAI has made significant

contribution in terms of preparation of asset& liability statement, valuation of land at the average minimum rate of non-irrigated land etc. It had studied the treatment of assets created under Public Private Partnership (PPP) models like BOT, BOOT & BOLT.

Ministry of Railways has gone much ahead in their preparation with the appointment of a consultant. It had started compiling Asset Register in 2000-01 itself. Apart from this, existing accounting system of a commercial nature is an added advantage for Railways.

### **Gap Analysis**





Gap analysis provides a foundation for measuring further investment of time, money and human resources required to achieve a particular outcome. Gap analysis is a very useful tool for helping managers to decide upon strategies and tactics.

The pilot study in AP threw in some major gaps in implementation of accrual system. Non availability of the information resulted in reclassification of the available information. Classification of assets and liabilities as current and noncurrent were not available. There was no source to know about 'Receivables and Inventories'. Similarly, there was difficulty in obtaining Income accrued but not realized related to exchange and non exchange transactions and the expenditure incurred during the year and not paid. Various types of assets as land, building, plant and machinery, etc. are not available. Some of the items in cash accounting are classified in a manner which is not in accordance with the Generally Accepted Accounting Principles e.g. Investments were included in Capital outlay which needed adjustments while filling in the Accrual AFS. At present accounting in the State Government is budget based. The amount of disbursement is accounted for based on the budgets. On the other hand, the focus of accrual accounting is the occurrence of the transaction whether it is paid or not, and whether the same was budgeted or not. The books and records currently

maintained do not support the accrual accounting fully which requires identification and recognition of the transactions at the time of incurrence.

### **Rectification and Rollout**

The pilot study should act as the basis for further improvements. It may result in major revamp of the project plan starting from revisit of the policies initiated for this purpose. The key factor here is that if the business process is mapped adequately and rollout plan is conceptualized in a flawless way, further system correction need be marginal. It will reduce the time gap and further investment of time and resource in the project. The whole process of change over and stabilization will be a herculean task and would span over a decade.

The benefits of shifting to accrual accounting and then to accrual budgeting will be realized only in the long run. This exercise will surely improve governance and increase the confidence of all stakeholders. The benefits may not be strikingly or immediately visible, but the changes will be profound. As India is geared up to be the frontrunner in the new 'Asian century', the move to adopt accrual accounting is the perfect one to be in control of one's internal finances.

## AUDITOR'S NOTEBOOK

### *Dharam Vir\**

***(1) The Secretary and the Minister; (2) Indian Government Accounting Standard: Disclosure Requirements of Government Guarantees; (3) Effective Revenue Deficit: a Feel Good Parameter***

### **The Secretary and the Minister**

According to paragraph 4.5 of the Audit Report on 2G Spectrum<sup>1</sup>, when the Finance Member (Telecom Commission) and the Secretary, Department of Communications, recommended an indepth analysis of the issues relating to the determination of entry fee for grant of licences, the Hon'ble Minister over-ruled the officers as follows:

*“Officers have neither up to date knowledge of UAS (Unified Access Service) Guidelines nor have they bothered to carefully go through the file....These types of continuous confusions observed on the file whoever be the officer concerned does not show any legitimacy and integrity but only their vested interest.....The matter of entry fee has been deliberated in the department several times in the light of various guidelines issued by the department and recommendations of TRAI*

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\* Shri Dharam Vir is a former Deputy Comptroller & Auditor General of India.

<sup>1</sup> Performance Audit Report on Issue of Licences and Allocation of 2G Spectrum by the Department of Telecommunications Ministry of Communications and Information Technology, Report of the Comptroller and Auditor General of India Union Government (Civil) No.19 of 2010-11

*(Telecom Regulatory Authority of India) and accordingly decision was taken that entry fee need not be revised.”*

This is in marked contrast to the approach of Sardar Patel who had exhorted his Secretaries to feel free and be candid in the expression of their views and even told them that they might as well leave if they were afraid of expressing their views for fear of offending the Minister.

Incidentally, the advice of the Finance Member and the Secretary was in line with the views consistently expressed by the Ministry of Finance.

As reported in the media the Secretary recused himself from handling the case any further and retired from service soon thereafter; the Finance Member also put in her papers for voluntary retirement. Both the officers were called by the Public Accounts Committee (PAC) for evidence but their evidence may not be available in the public domain except to the extent it is reproduced or otherwise incorporated in the PAC Report.

However, the larger issues of the relationship between the Secretary and the Minister and their respective accountability remain.

The Minister is the political head of the Ministry while the Secretary is the head of the departmental hierarchy. Under Government of India (Transaction of Business) Rules, 1961, all business of a Ministry is required to be disposed of by or under the general or special orders of the Minister except where consultation with other Ministries or the approval of the Prime Minister or the Cabinet may be needed. The Rules also stipulate that the Ministry's Secretary shall be its administrative

head and he shall be responsible for the proper transaction of business and the careful observance of the rules in the Ministry. It is generally accepted that the Secretary provides the inputs for policy formulation but it is the Minister who is ultimately responsible for the policy while the Secretary oversees its delivery and implementation. But the lines between policy and its implementation can often be blurred, particularly with several big ticket transactions requiring the approval of the Minister or a Cabinet Committee or even the entire Cabinet.

In this background free, frank and uninhibited expression of views by the Secretary is the essence of healthy relationship between the Secretary and the Minister and indispensable to good governance. The Secretary should neither second guess the Minister, nor wait till the Minister has made up his mind and then make a case for what the Minister has already decided, but render apolitical, impartial, independent and professional advice guided solely by considerations of larger public interest and good governance. He should speak 'truth to power'

However, the duty of the Secretary to 'speak truth to power', casts a matching obligation on 'power' to listen to and be patient with 'truth'. As observed by the First Administrative Reforms Commission, Ministers should try to develop a climate of fearlessness and fair play among the senior officers and encourage them to give frank and impartial advice.

Incidentally, Sir Winston Churchill is reported to have actually eased out his Permanent Secretary since the latter did not formally record his opinion.

Under Government's Financial Rules, the buck literally starts from and ends at Secretary's table. The duties and responsibilities of the Secretary as the Chief Accounting

Authority of his Ministry formally codified and notified in 2005<sup>2</sup> make him fully responsible for the stewardship of the Ministry's finances from budget construction to implementation and the achievement of programme objectives besides ensuring proper maintenance of accounts. The essence of his responsibility lies in securing effective, efficient, economical and transparent use of the resources of the Ministry, whilst complying with performance standards.

The above corresponds more or less to the responsibility of the Permanent Secretary in the United Kingdom in his role as the Department's Accounting Officer. Broadly, 'the essence of an Accounting Officer's role is a personal responsibility for the propriety and regularity of the public finances for which he is personally responsible; for the keeping of the proper accounts; for the prudent and economical administration; for the avoidance of waste and extravagance; and for the efficient and effective use of all the available resources'. This is formally communicated in a Dear Accounting Officer letter which the Treasury Secretary writes to the Permanent Secretary and which the latter signs when he assumes charge.

Given the dissimilarity in their backgrounds, time horizons and the constituencies to which they are responsible there are bound to be occasions when the Secretary and the Minister may not find themselves on the same page. It is not as if financial profligacy is always associated with the Minister while such probity, virtue and wisdom exclusively reside in the Secretary and there can be an honest difference of opinion. But under the rules the Minister is not called to appear before the PAC and it is the Secretary who has so to say to hold the baby. This places the Secretary in the unenviable position of having to explain or defend a course of action to which he may have been personally opposed.

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<sup>2</sup> Rule 64 of the General Financial Rules, 2005

In the United Kingdom, if the Minister is contemplating a course of action that the Permanent Secretary feels he may not be able to justify when called upon to defend because it involves irregularity or impropriety or poor value for money, the latter is required to set out his views in writing and obtain the specific direction of the Minister to proceed. On receipt of such a specific direction from the Minister, the Permanent Secretary will apprise the CAG and also send copies of all documents to the CAG. The CAG will normally bring such a case to the notice of the PAC and the PAC is expected to recognize that the Permanent Secretary bears no responsibility in the matter even as the Permanent Secretary nevertheless projects the views of the Minister before the PAC<sup>3</sup>.

Currently, the Secretary may write to the Cabinet Secretary if he has a serious difference of opinion with his Minister and the latter may keep the Prime Minister informed. But this is only internal to Government; the matter may remain hostage to political considerations, which have only assumed heightened importance in the present era of coalitions, besides being hidden from the sunlight of public knowledge and scrutiny till it is too late for corrective action.

There is need for an institutionalized procedure whereby such cases get reported to an independent authority.

A valuable takeaway from the Audit Report may therefore be the introduction of a procedure similar to the one prescribed in the United Kingdom requiring the Secretary to promptly report to the CAG any order or decision of the Minister which involves significant violation of the applicable laws including subordinate legislation or procedures, or of the basic canons of financial propriety or which can result in poor value for money

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<sup>3</sup> Managing Public Money HM Treasury

to which the Secretary is opposed. Failure to send a report to the CAG should invite the presumption of complicity of the Secretary in such an order or decision rendering him accountable for its consequences.

Needless to say that this is expected to be judiciously invoked and only after the currently available departmental procedures have been exhausted. As observed by the First Administrative Reforms Commission the Secretary is expected show greater sensitivity and better appreciation of the Minister's difficulties and to discriminate between minor adjustments on the one hand and acts of political and other forms of accommodation compromising basic principles or having lasting repercussions on efficiency. In other words the provision is expected to be invoked in a judicious manner that can be associated with the maturity and wisdom of seasoned bureaucrats who ascend to the highest position in the hierarchy after years of experience. The provision authorizing the Secretary to write to the CAG may thus well remain a reserve or sleeping provision, but that does not diminish its effectiveness.

This will not merely promote good governance and facilitate pinpointing of accountability, but also provide a much-needed safety valve to the bureaucracy strengthening its backbone and at the same time deny it an alibi for an improper course of action on the plea of having acted under 'orders from above'. Besides having a preventive effect this will also facilitate early and timely exposure of cases of irregular, improper or wasteful use of public resources for remedial action, course correction and so to say for cutting the losses.

Hopefully, the PAC and the Joint Parliamentary Committee which are currently looking into the issue of licences and allocation of 2G Spectrum will address the issue.



### **Indian Government Accounting Standard: Disclosure Requirements of Government Guarantees**

Government has notified the Indian Government Accounting Standard relating to the disclosure requirements of Government guarantees in the Finance Accounts. The Accounting Standard has been framed and issued in the name of the President on the advice of the CAG in terms of Article 150 of the Constitution and published in the Gazette of India. The Accounting Standard takes effect from the financial year 2010-11 and applies to the Union as well as State Governments and the Union Territories with legislatures<sup>4</sup>.

Under the Accounting Standard a guarantee is defined as an accessory contract by which the promisor undertakes to be answerable to the promisee for the debt, default or miscarriage of another person whose primary liability to the promisee must exist or be contemplated. The Accounting Standard sets out the scope of the Standard; the roles and responsibilities; and the mandatory and desirable disclosures as well as the form in which these are to be made. Guarantees are categorized by 'class' as well as by 'sector'. Generally, 'class' denotes the party and the purpose of guarantee e.g. the Reserve Bank of India for loans, the multi-national financial institutions (the IMF, World Bank), for foreign institutional borrowing, for suppliers for orders placed etc; 'sector' specifies the economic sector for which guarantee is issued e.g. agriculture, power etc. The Standard makes it mandatory to disclose in the Finance Accounts the maximum amount for which guarantees have been given during the year, the amounts of guarantees invoked or discharged or not discharged during the year as well the opening amounts and the closing amounts of outstanding

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<sup>4</sup> Government of India Ministry of Finance (Budget Division) Notification dated 20<sup>th</sup> December 2010

guarantees along with the amount of guarantee fee and its realization.

The aforesaid information is required to be provided in the prescribed format as laid down in the Accounting Standard. While disaggregation class-wise is mandatory, sector-wise disaggregation is encouraged and thus optional.

Additionally, information relating to such vital aspects as the limit if any fixed on the amount of guarantee, existence of Guarantee Redemption Fund with details of opening balance, additions and withdrawals during the year and year-end closing balance is required to be given in the form of Notes. The Notes should also provide information regarding the amount of external guarantees, and details of Automatic Debt Mechanism (i.e. the arrangement by which the Government's cash balance is automatically affected on a specified date or on the occurrence of a specific event to meet obligations arising out of a guarantee) and Structured Payment Arrangement whereby Government is committed to transfer funds to the designated account in case the beneficiary entity fails to ensure availability of funds for the servicing of debt. The Notes should also state whether details of guarantees are disclosed in the budget documents and the name of the designated authority in Government which keeps track of guarantees.

The Accounting Authority is responsible for providing the information in the Finance Accounts based on the information made available to it by the designated Authority in Government responsible for preparation of statement of guarantees.

The Finance Accounts shall not be considered as complying with this Standard unless they comply with all its requirements.

The promulgation of the Accounting Standard is a welcome step towards greater transparency in Government financial management and accounts. The Accounting Standard will also

ensure that systems and procedures are put in place and implemented for issuance of guarantees and their proper accounting and thereby promote greater financial discipline.

The Accounting Standard settles the question of the authority competent to promulgate the Accounting Standards; this rests with the President acting on the advice of the CAG.

According to the Standard the details of external foreign currency guarantees are required to be given in terms of Indian Rupees as on the date of the Annual Finance Accounts. A three-way disclosure of such guarantees with the amount translated into Indian currency with reference to the rate of exchange (i) on the date of the guarantee (ii) on 31<sup>st</sup> March and (iii) on the date of accounts is expected to significantly enhance the usefulness of disclosure.

Another useful addition might be the disclosure of the basis on which the amounts credited to the Guarantee Redemption Fund are calculated. This will enable an assessment of the adequacy of balance in the Guarantee Redemption Fund with reference to the outstanding amount of guarantees. Such disclosure is considered important since years of financial and budgetary constraints might see a tendency to skip such transfers to the Guarantee Redemption Fund despite incurring of additional guarantees.

There is one more point. This relates to the accuracy and authenticity of the amounts of guarantees as shown in the Finance Accounts. For this confirmation needs to be obtained from the entities on whose behalf guarantees have been issued and incorporated in the Finance Accounts.

Hopefully, these aspects will be looked into by Government auditors.

Incidentally, Government Accounting Standard Advisory Board (GASAB) functioning under the auspices of the CAG has issued a separate exposure draft on Contingent Liabilities (other than Guarantees) and Contingent Assets. GASAB has also uploaded the Indian Government Financial Reporting Standard on property, plant and equipment for use in pilot studies on accrual accounting.

Union Government budget 2011-12 provides for the first time information regarding Liability on Annuity Projects in an Annexure to the Receipts Budget.<sup>5</sup>

### **Effective Revenue Deficit: a Feel Good Parameter**

A new parameter in the lexicon of fiscal management viz; the Effective Revenue Deficit has been introduced in the Union Budget 2011-12. The Effective Revenue Deficit is the amount of revenue deficit reduced by the amount of grants to State Governments and others (which are classified as revenue expenditure) for the creation of assets of a capital nature.

“ There has been some concern”, observed the Finance Minister in his budget speech, “expressed regarding the stickiness of Government’s revenue deficit in the post global crisis phase of the economy....In the past few years the transfers to States and other developmental expenditure have grown significantly. These are classified as revenue expenditure even though a considerable part of the expenditure from these transfers is in the nature of capital expenditure. In 2010-11 Rs. 90792 crore were in the nature of capital expenditure. Similarly, in 2011-12 grants-in-aid for creation of capital assets, which are now shown separately in the budget

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<sup>5</sup> Liability on Annuity Projects: Annexure 8 to the Receipts Budget 2011-12

documents, are about Rs. 1.47 lakh crore. Taking these into account, the effective revenue deficit is estimated at Rs.2.3 per cent of the GDP for 2010-11 and 1.8 per cent for 2011-12.”

A more detailed background is given in the Fiscal Policy Strategy Statement:

“Revenue expenditure of the Central Government also includes releases made to States and other implementing agencies for implementation of Government schemes and programmes. The outcomes of many of these schemes are not in the nature of outcomes related to revenue expenditure. In most of the cases these schemes are primarily in the nature of creating durable assets but these assets are not owned by the Central Government. Therefore in technical classification of revenue and capital account, the Central Government is not able to show expenditure on these schemes as capital expenditure.... However, these revenue expenditures cannot be treated as unproductive in nature. On the contrary they contribute to growth in the economy.”<sup>6</sup>

The budget estimates place the Revenue Deficit at 3.4 per cent of the GDP at Rs. 3.08 lakh crore. Thus 48 per cent of the Revenue Deficit of the Union Government is on account of transfers to States and others for capital expenditure. The details of the amount of Rs. 1.47 lakh crore are given in a separate Annexure to the Expenditure Budget Vol. I<sup>7</sup>

Under the Constitution the Annual Financial Statement (Budget) is required to distinguish between the expenditure on

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<sup>6</sup> Fiscal Policy Strategy Policy Statement placed before Parliament with the budget 2011-12

<sup>7</sup> Budget Provisions under the Head Grants for creation of Capital Assets: Annexure 6 to the Expenditure Budget Volume I

revenue account and other expenditure<sup>8</sup>. This carries with it the restriction on re-appropriation of the amounts provided in the budget; no amount can be re-appropriated between capital and revenue merely by executive orders. Thus the budget provision for 'other expenditure' (i.e. other than revenue expenditure) must be utilized only for capital expenditure or may either remain unutilized. The distinction between expenditure on revenue account and other expenditure has implications for inter-generation equity as well.

The expression 'capital' does not feature in the Constitution which merely refers to 'other expenditure' i.e. expenditure other than that on revenue account. Capital expenditure has been comprehensively defined in the General Financial Rules and basically any significant expenditure incurred for acquiring tangible assets of a permanent nature qualifies for being classified as capital expenditure. However, a critical factor in defining capital expenditure is the ownership of the assets created thereby. Since the ownership of assets created by amounts transferred to other jurisdictions and bodies does not vest in the Union Government such transfers have necessarily to show up under revenue both in the budget and the accounts<sup>9</sup>.

The issue of treatment of such expenditure with reference to its end-use has engaged the attention of Government in the past as well. The Thirteenth Finance Commission had flagged the issue in the context of classification of expenditure on account of Mahatma Gandhi National Rural Employment Guarantee Scheme as capital expenditure as well as exhibition of local

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<sup>8</sup> Articles 112 and 202 of the Constitution

<sup>9</sup> Under Rule 90 of the General Financial Rules 2005, expenditure on grants-in-aid can be debited to a capital head by special orders of the President issued on the advice of the CAG.

body grants as capital grants in several States. But it suggested no solution to the intricate question.

The issue is also engaging the attention of a Committee set up in April 2010 under the chairmanship of Dr. C. Rangarajan to suggest measures for efficient management of public expenditure, which has the following as one of the terms of its reference:

“To examine the classification of expenditure into Revenue and Capital in the context of the constitutional provisions, and requirements under the Fiscal Responsibility Acts, and to suggest measures to address the inconsistencies in our current system of classification so as to ensure rational and efficient public expenditure management. In this context, the Committee should consider the merit of classifying expenditure as revenue or capital depending on the end use”.

However, as explained by the Finance Minister in his budget speech this seems to be in the wider context of “the importance of service sector and the knowledge economy in our development”. Apparently, the Committee may even revisit the issue of classification of expenditure on salaries under heads like education etc incurred by Government as revenue expenditure<sup>10</sup>.

In introducing the concept of “Effective Revenue Deficit” Government seems to have gone back to the report of an Expert Group to Review the Classification System for Government Transactions (2004) headed by Dr. Ashok Lahiri which had recommended the classification of transfers meant for capital

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<sup>10</sup> For a perceptive discussion on classification of expenditure as revenue and capital see an excellent article by Dr. Subhah Chander Pandey ‘Perverse Incentives to Acquire Capital’ Indian Journal of Public Audit and Accountability Vols IV and V July-December 2010

expenditure by the transferee as Capital Grants in the Revenue Section of the books of the transferor. However, there are quite a few serious issues with this.

First, the Union Government can at any time reappropriate such provisions by executive orders to other revenue heads to meet expenditure not intended for creation of assets. Any reappropriation of budget provisions for creation of capital assets to other revenue heads should therefore be reported to the Parliament as is required to be currently done in the case of certain other categories of reappropriation of budget provisions which require to be reported to the Parliament with the ensuing batch of supplementary demands for grants.

This can be a fruitful area for inquiry by audit as well.

Second, very little information, if any is available in the budget documents regarding the assets expected to be created by the amounts of grants to States and others for capital expenditure.

Third, there is the issue of the actual end-use of such transfers by the transferee jurisdictions. This is important since unlike direct Government expenditure, the diversion of grants received by the transferee for capital expenditure for meeting revenue expenditure neither requires the approval of the Union legislature nor automatically gets reported to it.

Fourth, a significantly large proportion of the budget provisions is on account of expenditure to be incurred under the State Governments<sup>11</sup>. CAG's Audit Reports have repeatedly commented on the indeterminateness of actual expenditure against the amounts released to extra-departmental bodies

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<sup>11</sup> The expression 'under' has been deliberately used in view of the recent practice of disintermediating the State governments from the flow of Union Government funds for some of the flagship schemes.



bypassing the State Governments. A reliable mechanism to track actual expenditure against such transfers has yet to be put in place with the Central Plan Scheme Monitoring System announced in the budget 2007-08 still remaining work in progress<sup>12</sup>. Political sensitivities may also come in the way of any critical and searching inquiry being made in this connection. There is no foolproof procedure that provides assurance of utilization of grants for capital expenditure for the intended purpose.

Fifth, there is little assurance for the actual creation of capital assets against the expenditure incurred. The amount of Rs. 1.47 lakh crore includes nearly Rs. forty thousand crore for the implementation of the Mahatma Gandhi National Rural Employment Guarantee Scheme. The Scheme is demand-driven; the creation of assets of capital nature is not one of the legally mandated objectives of Scheme; only 4.7 lakh works out of a total of 53.3 lakh approved works are reported to have been completed so far.;<sup>13</sup> and serious concerns have been expressed about the quality of assets<sup>14</sup>. The Budget documents merely state that the durability of assets would be ensured through convergence with other programmes<sup>15</sup>. Government's Economic Survey 2010-11 also recognizes the 'scope for improvements like shifting to permanent asset creation and infrastructure building activities reducing transaction costs, better monitoring...' There are innumerable instances of

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<sup>12</sup> Fiscal Policy Strategy Policy Statement *ibid*. See also Dharam Vir 'Implementation of Central Sector Schemes Need for Reforms in the Architecture of Public Financial Management and Accountability' *Indian Journal of Public Audit and Accountability* *ibid*.

<sup>13</sup> According to the information on NREGA website

<sup>14</sup> Eighth Report of the Public Accounts Committee Fifteenth Lok Sabha March 2010

<sup>15</sup> Expenditure Budget 2011-2012 Volume II

leakages and waste occurring in the implementation of similar other schemes<sup>16</sup>.

While the exclusion of transfers for capital expenditure from the amount of Revenue Deficit may make the current numbers look comfortable and thereby promote the feel good factor, the final position as per actual expenditure may well remain indeterminate.

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<sup>16</sup> An amount of Rs. 1598 crore has been provided in the budget estimates under M P Local Area Development Scheme but as pointed out in a recent Performance Audit Report of the CAG (No. 31 of 2010-11) many of the works initiated under the scheme are abandoned after incurring large amounts. Also, there are concerns about the maintenance of assets.

**DOCUMENT:**

**THE RIGHT OF CHILDREN TO FREE AND  
COMPULSORY EDUCATION ACT, 2009**

[26<sup>th</sup> August, 2009.]

**An Act to provide for free and compulsory education  
to all children of the age of six to fourteen years.**

Be it enacted by Parliament in the Sixtieth Year of the Republic  
of India as follows:-

**CHAPTER I**

**PRELIMINARY**

1. (1) This Act may be called the Right of Children to free and Compulsory Education Act, 2009.  
(2) It shall extend to the whole of India except the State of Jammu and Kashmir.  
(3) It shall come into force on such date as the Central Government may, by notification in the Official Gazette, appoint.
2. In this Act, unless the context otherwise requires,--
  - a) "appropriate Government" means---
    - i. In relation to a school established, owned or controlled by the Central Government, or the administrator of the Union territory, having no legislature, the Central Government;
    - ii. In relation to a school, other than the school referred to in sub-clause (i), established within the territory of---
      - A. a State, the State Government;

- B. a Union territory having legislature, the Government of that Union territory;
- b) “capitation fee” means any kind of donation or contribution or payment other than the fee notified by the school;
  - c) “child” means a male or female child of the age of six to fourteen years;
  - d) “child belonging to disadvantaged group” means a child belonging to the Scheduled Caste, the Scheduled tribe, the socially and educationally backward class or such other group having disadvantage owing to social, cultural, economical, geographical, linguistic, gender or such other factor, as may be specified by the appropriate Government, by notification;
  - e) “child belonging to weaker section” means a child belonging to such parent or guardian whose annual income is lower than the minimum limit specified by the appropriate Government, by notification;
  - f) “elementary education” means the education from first class to eighth class;
  - g) “guardian”, in relation to a child, means a person having the care and custody of that child and includes a natural guardian or guardian appointed or declared by a court or a statute;
  - h) “local authority” means a Municipal Corporation or Municipal Council or Zila Parishad or Nagar Panchayat or Panchayat, by whatever name called, and includes such other authority or body having administrative control over the school or empowered by or under any law for the time being in force to function as a local authority in any city, town or village;

- i) “National Commission for Protection of child Rights” means the National Commission for Protection of Child rights constituted under section 3 of the Commissions for Protection of Child Rights Act, 2005;
- j) “notification” means a notification published in the Official Gazette;
- k) “parent” means either the natural or step or adoptive father or mother of a child;
- l) “prescribed” means prescribed by rules made under this Act;
- m) “Schedule” means the Schedule annexed to this Act;
- n) “school” means any recognized school imparting elementary education and includes---
  - i. A school established, owned or controlled by the appropriate Government or a local authority;
  - ii. An aided school receiving aid or grants to meet whole or part of its expenses from the appropriate Government or the local authority;
  - iii. A school belonging to specified category; and
  - iv. An unaided school not receiving any kind of aid or grants to meet its expenses from the appropriate Government or the local authority;
- o) “screening procedure” means the method of selection for admission of a child, in preference over another, other than a random method;
- p) “specified category”, in relation to a school, means a school known as Kendriya Vidyalaya, Navodaya

Vidyalaya, Sainik School or any other school having a distinct character which may be specified, by notification, by the appropriate Government;

- q) “State commission for Protection of Child Rights” means the state Commission for Protection of Child Rights constituted under section 3 of the Commission for Protection of Child Rights Act, 2005.

## CHAPTER II

### RIGHT TO FREE AND COMPULSORY EDUCATION

3. (1) Every child of the age of six to fourteen years shall have a right to free and compulsory education in a neighbourhood school till completion of elementary education.

(2) For the purpose of sub-section (1), no child shall be liable to pay any kind of fee or charges or expenses which may prevent him or her from pursuing and completing the elementary education:

Provided that a child suffering from disability, as defined in clause (i) of section 2 of the persons with Disabilities (Equal Opportunities, Protection and Full Participation) Act, 1996, shall have the right to pursue free and compulsory elementary education in accordance with the provisions of Chapter V of the said Act.

4. Where a child above six years of age has not been admitted in any school or though admitted, could not complete his or her elementary education, then, he or she shall be admitted in a class appropriate to his or her age;

Provided that where a child is directly admitted in a class appropriate to his or her age, then, he or she shall, in order to be at par with others, have a right to receive special training, in such manner, and within such time-limits, as may be prescribed;

Provided further that a child so admitted to elementary education shall be entitled to free education till completion of elementary even after fourteen years.

5. (1) Where in a school, there is no provision for completion of elementary education, a child shall have a right to seek transfer to any other school, excluding the school specified in sub-clauses (iii) and (iv) of clause (n) of section 2, for completing his or her elementary education.

(2) Where a child is required to move from one school to another, either within a State or outside, for any reason whatsoever, such child shall have a right to seek transfer to any other school, excluding the school specified in sub-clauses (iii) and (iv) of section (n) of section 2, for completing his or her elementary education.

(3) For seeking admission in such other school, the Head-teacher or in-charge of the school where such child was last admitted, shall immediately issue the transfer certificate.

Provided that delay in producing transfer certificate shall not be a ground for either delaying or denying admission in such other school;

Provided further that the Head-teacher or in-charge of the school delaying issuance of transfer certificate shall be liable for disciplinary action under the service rules applicable to him or her.

### CHAPTER III

#### DUTIES OF APPROPRIATE GOVERNMENT, LOCAL AUTHORITY AND PARENTS

6. For carrying out the provisions of this Act, the appropriate Government and the local authority shall establish, within such area or limits of neighbourhood, as may be prescribed, a school, where it is not so established, within a period of three years from the commencement of this Act.
7. (1) The Central Government and the State Governments shall have concurrent responsibility for providing funds for carrying out the provisions of this Act.
  - (2) The Central Government shall prepare the estimates of capital and recurring expenditure for the implementation of the provisions of the Act.
  - (3) The Central Government shall provide to the State Governments, as grants-in-aid of revenues, such percentage of expenditure referred to in sub-section (2) as it may determine, from time to time, in consultation with the State Governments.
  - (4) The Central Government may make a request to the President to make a reference to the Finance Commission under sub-clause (d) of clause (3) of article 280 to examine the need for additional resources to be provided to any State Government so that the said State Government may provide its share of funds for carrying out the provisions of the Act.
  - (5) Notwithstanding anything contained in sub-section (4), the State Government shall, taking into consideration the sums provided by the Central



Government to a State Government under sub-section (3), and its other resources, be responsible to provide funds for implementation of the provisions of the Act.

(6) The Central Government shall---

- a) Develop a framework of national curriculum with the help of academic authority specified under section 29;
- b) Develop and enforce standards for training of teachers;
- c) Provide technical support and resources to the State Government for promoting innovations, researches, planning and capacity building.

8. The appropriate Government shall---

- a) Provide free and compulsory elementary education to every child:

Provided that where a child is admitted by his or her parents or guardian, as the case may be, in a school other than a school established, owned, controlled or substantially financed by funds provided directly or indirectly by the appropriate Government or a local authority, such child or his or her parents or guardian, as the case may be, shall not be entitled to make a claim for reimbursement of expenditure incurred on elementary education of the child in such other school.

Explanation – The term “compulsory education” means obligation of the appropriate Government to ---

- i. provide free elementary education to every child of the age of six to fourteen years; and

- ii. ensure compulsory admission, attendance and completion of elementary education by every child of the age of six to fourteen years;
- b) ensure availability of a neighbourhood school as specified in section 6;
- c) ensure that the child belonging to weaker section and the child belonging to disadvantaged group are not discriminated against and prevented from pursuing and completing elementary education on any grounds;
- d) provide infrastructure including school building, teaching staff and learning equipment;
- e) provide special training facility specified in section 4;
- f) ensure and monitor admission, attendance and completion of elementary education by every child;
- g) ensure good quality elementary education conforming to the standards and norms specified in the Schedule;
- h) ensure timely prescribing of curriculum and courses of study for elementary education; and
- i) provide training facility for teachers.

9. Every local authority shall—

- a) provide free and compulsory elementary education to every child:

Provided that where a child is admitted by his or her parents or guardian, as the case may be, in a school other than a school established, owned, controlled or substantially financed by funds provided directly or indirectly by the appropriate Government or a local authority, such child or his or her parents or guardian, as the case may be, shall not

be entitled to make a claim for reimbursement of expenditure incurred on elementary education of the child in such other school;

- b) ensure availability of a neighbourhood school as specified in section 6;
- c) ensure that the child belonging to weaker section and the child belonging to disadvantaged group are not discriminated against and prevented from pursuing and completing elementary education on any grounds;
- d) maintain records of children up to the age of fourteen years residing within its jurisdiction, in such manner as may be prescribed;
- e) ensure and monitor admission, attendance and completion of elementary education by every child residing within its jurisdiction;
- f) provide infrastructure including school building, teaching staff and learning material;
- g) provide special training facility specified in section 4;
- h) ensure good quality elementary education conforming to the standards and norms specified in the schedule;
- i) ensure timely prescribing of curriculum and courses of study for elementary education;
- j) provide training facility for teachers;
- k) ensure admission of children of migrant families;
- l) monitor functioning of schools within its jurisdiction; and

m) decide the academic calendar.

10. It shall be the duty of every parent or guardian to admit or cause to be admitted his or her child or ward, as the case may be, to an elementary education in the neighbourhood school.

11. With a view to prepare children above the age of three years for elementary education and to provide early childhood care and education for all children until they complete the age of six years, the appropriate Government may make necessary arrangement for providing free pre-school education for such children.

#### CHAPTER IV

#### RESPONSIBILITIES OF SCHOOLS AND TEACHERS

12. (1) For the purposes of this Act, a school, ---

a) Specified in sub-clause (i) of clause (n) of section 2 shall provide free and compulsory elementary education to all children admitted therein.

b) Specified in sub-clause (ii) of clause (n) of section 2 shall provide free and compulsory elementary education to such proportion of children admitted therein as its annual recurring aid or grants so received bears to its annual recurring expenses, subject to a minimum of twenty-five per cent;

c) Specified in sub-clauses (iii) and (iv) of clause (n) of section 2 shall admit in class I, to the extent of at least twenty-five per cent. Of the strength of that class, children belonging to weaker section and disadvantaged group in the neighbourhood and provide free and compulsory elementary education till completion:

Provided further that where a school specified in clause (n) of section 2 imparts pre-school education, the provisions of clauses (a) to (c) shall apply for admission to such pre-school education.

(2) The school specified in sub-clause (iv) of clause (n) of section 2 providing free and compulsory elementary education as specified in clause © of sub-section (1) shall be reimbursed expenditure so incurred by it to the extent of per-child expenditure incurred by the State, or the actual amount charged from the child, whichever is less, in such manner as may be prescribed;

Provided that such reimbursement shall not exceed per-child-expenditure incurred by a school specified in sub-clause (i) of clause (n) of section 2:

Provided further that where such school is already under obligation to provide free education to a specified number of children on account of it having received any land, building, equipment or other facilities, either free of cost or at a concessional rate, such school shall not be entitled for reimbursement to the extent of such obligation.

(3) Every school shall provide such information as may be required by the appropriate Government or the local authority, as the case may be.

13. (1) No school or person shall, while admitting a child, collect any capitation fee and subject the child or his or her parents or guardian to any screening procedure.

(2) Any school or person, if in contravention of the provisions of sub-section (1),---

a) Received capitation fee, shall be punishable with fine which may extend to ten times the capitation fee charged;

b) Subject a child to screening procedure, shall be punishable with fine which may extend to twenty-five thousand rupees for the first contravention and fifty thousand rupees for each subsequent contraventions.

14. (1) For the purposes of admission to elementary education, the age of a child shall be determined on the basis of the birth certificate issued in accordance with the provisions of the Births, Deaths and Marriages Registration Act, 1886 or on the basis of such other documents, as may be prescribed.

(2) No child shall be denied admission in a school for lack of age proof.

15. A child shall be admitted in a school at the commencement of the academic year or within such extended period as may be prescribed.

Provided that no child shall be denied admission if such admission is sought subsequent to the extended period.

Provided further that any child admitted after the extended period shall complete his studies in such manner as may be prescribed by the appropriate Government.

16. No child admitted in a school shall be held back in any class or expelled from school till the completion of elementary education.

17. (1) No child shall be subjected to physical punishment or mental harassment.

(2) Whoever contravenes the provisions of sub-section (1) shall be liable to disciplinary action under the service rules applicable to such person.

18. (1) No school, other than a school established, owned or controlled by the appropriate Government or the local authority, shall, after the commencement of this Act, be

established or function, without obtaining a certificate of recognition from such authority, by making an application in such form and manner, as may be prescribed.

(2) The authority prescribed under sub-section (1) shall issue the certificate of recognition in such form, within such period, in such manner, and subject to such conditions, as may be prescribed:

Provided that no such recognition shall be granted to a school unless it fulfils norms and standards specified under section 19.

(3) On the contravention of the conditions of recognition, the prescribed authority shall, by an order in writing, withdraw recognition:

Provided that such order shall contain a direction as to which of the neighbourhood school, the children studying in the derecognised school, shall be admitted:

Provided further that no recognition shall be so withdrawn without giving an opportunity of being heard to school, in such manner, as may be prescribed.

(4) With effect from the date of withdrawal of the recognition under sub-section (3), no such school shall continue to function.

(5) Any person who establishes or runs a school without obtaining certificate of recognition, or continues to run a school after withdrawal recognition, shall be liable to fine which may extend to one lakh rupees and in case of continuing contraventions, to a fine of ten thousand rupees for each day during which such contravention continues.

19. (1) No school shall be established, or recognized, under section 18, unless it fulfils the norms and standards specified in the Schedule.

(2) Where a school established before the commencement of this Act does not fulfil the norms and standards specified in the Schedule, it shall take steps to fulfil such norms and standards at its own expenses, within a period of three years from the date of such commencement.

(3) Where a school fails to fulfil the norms, and standards within the period specified under sub-section (2), the authority prescribed under sub-section (1) of section 18 shall withdraw recognition granted to such school in the manner specified under sub-section (3) thereof.

(4) With effect from the date of withdrawal of recognition under sub-section (3), no school shall continue to function.

(5) Any person who continues to run a school after the recognition is withdrawn, shall be liable to fine which may extend to one lakh rupees and in case of continuing contraventions, to a fine of ten thousand rupees for each day during which such contravention continues.

20. The Central Government may, by notification, amend the schedule by adding to, or omitting therefrom, any norms and standards.

21. (1) A school, other than a school specified in sub-clause (iv) of clause (n) of section 2, shall constitute a School Management Committee consisting of the elected representatives of the local authority, parents or guardians of children admitted in such school and teachers;

Provided that atleast three-fourth of members of such Committee shall be parents or guardians;

Provided further that proportionate representation shall be given to the parents or guardians of children belonging to disadvantaged group and weaker section;



Provided also that fifty per cent of Members of such Committee shall be women.

(2) The School Management Committee shall perform the following functions, namely:-

(a) monitor the working of the school;

(b) prepare and recommend school development plan;

(C) Monitor the utilisation of the grants received from the appropriate Government or local authority or any other source; and

(d) perform such other functions as may be prescribed

22. (1) Every School Management Committee, constituted under sub-section 9 ) of section 21, shall prepare a School Development Plan, in such manner as may be prescribed.

(2) The school Development Plan so prepared under sub-section (1) shall be the basis for the plans and grants to be made by the appropriate Government or local authority, as the case may be.

(23). (1) Any person possessing such minimum qualifications, as laid down by an academic authority, authorised by the Central Government, by notification, shall be eligible for appointment as a teacher.

(2) Where a State does not have adequate institutions offering courses or training in teacher education, or teachers possessing minimum qualifications as laid down under sub-section (1) are not available in sufficient numbers, the Central Government may, if it deems necessary, by notification, relax the minimum qualification required for appointment as a

teacher, for such period, not exceeding five years, as may be specified in that notification;

Provided that a teacher who, at the commencement of this Act, does not possess minimum qualification as laid down under sub-section (1), shall acquire such minimum qualifications within a period of five years.

(3) The salary and allowances payable to, and the terms and conditions of service of, teachers shall be such as may be prescribed.

24. (1) A teacher appointed under sub-section 91) of section 23 shall perform the following duties, namely:-

(a) maintain regularity and punctuality in attending school;

(b) conduct and complete the curriculum in accordance with the provisions of sub-section (2) of section 26;

(c) complete entire curriculum within the specified time;

(d) assess the learning ability of each child and accordingly supplement additional instructions, if any, as required;

(e) hold regular meetings with parents and guardians and apprise them about the regularity in attendance, ability to learn, progress made in learning and any other relevant information about the child; and

(f) perform such other duties as may be prescribed.

(2) A teacher committing default in performance of duties specified in sub-section (1), shall be liable to disciplinary action under the service rules applicable to him or her;

Provided that before taking such disciplinary action, reasonable opportunity of being heard shall be afforded to such teacher.

(3) The grievances, if any, of the teachers shall be redressed in such manner as may be prescribed.

25. (1) Within six months from the date of commencement of this Act, the appropriate Government and the local authority shall ensure that the Pupil-Teacher Ratio, as specified in the Schedule, is maintained in each school.

(2) For the purpose of maintaining the Pupil-Teachers Ratio under sub-section (1) no teacher posted in a school shall be made to serve in any other school or office or deployed for any non-educational purpose, other than those specified in section 27.

26. The appointing authority, in relation to a school established, owned, controlled or substantially financed by funds provided directly or indirectly by the appropriate Government or by local authority, shall ensure that vacancy of teacher in a school under its control shall not exceed ten per cent of the total sanctioned strength.

27. No teacher shall be deployed for any non-educational purpose other than the decennial census, disaster relief duties or duties relating to elections to the local authority or the State Legislatures or Parliament, as the case may be.

28. No teacher shall engage himself or herself in private tuition or private teaching activity.

## CHAPTER V

### CURRICULUM AND COMPLETION OF ELEMENTARY EDUCATION

29. (1) The curriculum and the evaluation procedure for elementary education shall be laid down by an academic authority to be specified by the appropriate Government, by notification.

(2) The academic authority, while laying down the curriculum and the evaluation procedure under subsection (1), shall take into consideration the following, namely:--

(a) conformity with the values enshrined in the constitution;

(b) all round development of the child;

(c) building up child's knowledge, potentiality and talent;

(d) development of physical and mental abilities to the fullest extent;

(e) learning through activities, discovery and exploration in a child friendly and child-centered manner;

(f) medium of instructions shall, as far as practicable, be in child's mother tongue;

(g) making the child free of fear, trauma and anxiety and helping the child to express views freely;

(h) comprehensive and continuous evaluation of child's understanding of knowledge and his or her ability to apply the same.

30. (1) No child shall be required to pass any Board examination till completion of elementary education.

(2) Every child completing his elementary education shall be awarded a certificate, in such form and in such manner, as may be prescribed.

## CHAPTER VI

### PROTECTION OF RIGHT OF CHILDREN

31.(1) The National Commission for Protection of Child Rights constituted under section 3, or as the case may be, the State Commission for Protection of Child Rights constituted under section 17, of the Commission for Protection of Child Rights Act, 2005, shall, in addition to the functions assigned to them under that act, also perform the following functions, namely:-

(a) examine and review the safeguards for right provided by or under this Act and recommend measures for their effective implementation

(b) inquire into complaints relating to child's right to free and compulsory education; and

(c) take necessary steps as provided under sections 15 and 24 of the said Commission for Protection of Child Rights Act.

(2) The said Commissions shall, while inquiring into any matters relating to child's right to free and compulsory education under clause (c) of sub-section (1), have the same powers as assigned to them respectively under section 14 and 24 of the said Commissions for Protection of Child's Right Act.

(3) Where the State Commission for Protection of Child Rights has not been constituted in a State, the appropriate Government may, for the purpose of performing the functions, specified in clauses (a) to (c) of sub-section (1), constitute such authority, in such manner and subject to such terms and conditions, as may be prescribed.

32.(1) Notwithstanding anything contained in section 31, any person having any grievance in relation to the right of a child under the Act may make a written complaint to the local authority having jurisdiction.

(2) After receiving the complaint under sub-section (1), the local authority shall decide the matter within a period of three months after affording a reasonable opportunity of being heard to the parties concerned.

(3) Any person aggrieved by the decision of the local authority may prefer an appeal to the State Commission for Protection Child Rights or the authority prescribed under sub-section (3) or section 31, as the case may be.

(4) The appeal preferred under sub-section (3) shall be decided by State Commission for Protection of Child Rights or the authority prescribed under sub-section (3) of section 31, as the case may be, as provided under clause (c) of sub-section (1) of section 31.

33. (1) The Central Government shall constitute, by notification, a National Advisory Council, consisting of such number of members, not exceeding fifteen, as the Central Government may deem necessary, to be appointed from amongst persons having knowledge and practical experience in the field of elementary education and child development.

(2) The functions of the National Advisory Council shall be to advise the Central Government on implementation of the provisions of the Act in an effective manner.

(3) The allowances and other terms and conditions of the appointment of Members of the National Advisory Council shall be such as may be prescribed.

34. (1) The state Government shall constitute, by notification, a State Advisory Council consisting of such

number of Members, not exceeding fifteen, as the State Government may deem necessary, to be appointed from amongst persons having, knowledge and practical experience in the field of elementary education and child development.

(2) The functions of the State Advisory council shall be to advise the State Government on implementation of the provisions of the Act in an effective manner.

(3) The allowances and other terms and conditions of appointment of Members of the State Advisory Council shall be such as may be prescribed.

## CHAPTER VII

### MISCELLANEOUS

35. (1) The Central Government may issue such guidelines to the appropriate Government or, as the case may be, the local authority, as it deems fit for the purposes of implementation of the provisions of this Act.

(2) The appropriate Government may issue guidelines and give such directions, as it deems fit, to the local authority or the School Management Committee regarding implementation of the provisions of this Act.

(3) The local authority may issue guidelines and give such directions, as it deems fit, to the School Management Committee regarding implementation of the provisions of this Act.

36. No prosecution for offences punishable under sub-section (2) of section 13, sub-section (5) of section 18 and sub-section (5) of section 19 shall be instituted except with the previous sanction of an officer authorised in this behalf, by the appropriate Government, by notification.

37. No suit or legal proceeding shall lie against the Central Government, the State Government, the National Commission for protection of Child Rights, the State Commission for Protection of Child Rights, the local authority, the School Management Committee or any person, in respect of anything which is in good faith done or intended to be done, in pursuance of this Act, or any rules or order made thereunder.

38. (1) The appropriate Government may, by notification, make rules, for carrying out the provisions of this Act.

(2) In particular, and without prejudice to the generality of the foregoing powers, such rules may provide for all or any of the following matters, namely:--

(a) the manner of giving special training and the time-limit thereof, under first proviso to section 4;

(b) the area or limits for establishment of a neighbourhood school, under section 6;

(c) the manner of maintenance of records of children up to the age of fourteen years, under clause (d) of section 9;

(d) the manner and extent of reimbursement of expenditure, under sub-section (2) of section 12;

(e) any other document for determining the age of child under sub-section (1) of section 14;

(f) the extended period for admission and the manner of completing study if admitted after the extended period, under section 15;

(g) the authority, the form and manner of making application for certificate of recognition, under sub-section (1) of section 18;



(h) the form, the period, the manner and the conditions for issuing certificate of recognition, under sub-section (2) of section 18;

(i) the manner of giving opportunity of hearing under second proviso to sub-section (3) of section 18;

(j) the other functions to be performed by School Management Committee under clause (d) of sub-section (2) of section 21;

(k) the manner of preparing School Development Plan under sub-section (1) of section 22;

(l) the salary and allowances payable to, and the terms and conditions of service of teacher under sub-section (3) of section 23;

(m) the duties to be performed by the teacher under clause (f) of sub-section (1) of section 24;

(n) the manner of redressing grievances of teachers under sub-section (3) of section 24;

(o) the form and manner of awarding certificates for completion of elementary education under sub-section (2) of section 30;

(p) the authority, the manner of its constitution and the terms and conditions thereof, under sub-section (3) of section 31;

(q) the allowances and other terms and conditions of appointment of Members of the National Advisory Council under sub-section (3) of section 33;

(r) the allowances and other terms and conditions of appointment of Members of the State Advisory Council under sub-section (3) of section 34.

(3) Every rule made under this Act and every notification issued under sections 20 and 23 by the Central Government shall be laid, as soon as may be after it is made, before each House of Parliament, while it is in session, for a total period of thirty days which may be comprised in one session or in two or more successive sessions, and if, before the expiry of the session immediately following the session or the successive sessions aforesaid, both Houses agree in making any modification in the rule or notification or both Houses agree that the rule or notification should not be made, the rule or notification shall thereafter have effect only in such modified or annulment shall be without prejudice to the validity of anything previously done under that the rule or notification.

(4) Every rule or notification made by the State Government under this Act shall be laid, as soon as may be after it is made, before the State Legislature.

### THE SCHEDULE

(See section 19 and 25)

#### NORMS AND STANDARDS FOR A SCHOOL

Sl.No.	Item	Norms and Standards	
1.	Numbers of teachers:	Admitted	Number of
	(a) For first class to	Children	teachers
	fifth class	Up to Sixty	Two
		Between sixty-	Three
		one to ninety	Four
		Between	

	Ninety-one to one hundred and twenty	Five
	Between One hundred and twenty-one to two hundred	Five plus one Head-teacher
	Above One hundred and fifty children	Pupil-Teacher Ratio (excluding Head-teacher)
	Above Two hundred children	shall not exceed forty
(b) For sixth class to eighth class	(1) At least one teacher per class so that there shall be at least one teacher each for-	
	(i) Science and Mathematics	
	(ii) Social Studies;	
	(iii) languages;	
	(2) At least one teacher for every thirty-five children	
	(3) Where admission of children is above one hundred-	
	(i) a full time head-teacher	
	(ii) part time instructors for-	
	(A) Art Education;	
	(B) Health and Physical Education;	
	(C) Work Education	
2. Building	All-weather building consisting	

- of
- (i) At least one class-room for every teacher and an office-cum-store-cum-Head teacher's room;
  - (ii) barrier-free access;
  - (iii) separate toilets for boys and girls;
  - (iv) safe and adequate drinking water facility to all children;
  - (v) a kitchen where mid-day meal is cooked in the school;
  - (vi) Playground;
  - (vii) arrangements for securing the school building by boundary wall or fencing.
3. Minimum number of working days/instructional hours in and academic year
- (j) Two hundred working days for first class to fifth class;
  - (ii) two hundred and twenty working day for sixth class to eighth class;
  - (iii) eight hundred instructional hours per academic year for first class to fifth class;
  - (iv) one thousands instructional hours per academic year for sixth class to eighth class;
4. Minimum number of working hours per week for the teacher
- Forty-five teaching including preparation hours.

- |    |   |   |
|----|---|---|
| 5. | Teaching learning equipment               | Shall be provided to each class as required.  |
| 6. | Library                                   | There shall be a library in each school providing newspaper, magazines and books on all subjects, including story-books |
| 7. | Play material, games and sports equipment | Shall be provided to each class as required.  |
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