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May 31, 2005

INDIA

POLICY NOTE

ON

PUBLIC FINANCIAL MANAGEMENT AND ACCOUNTABILITY

IN

CENTRALLY SPONSORED SCHEMES (CSS)

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The World Bank ('WB') with the approval of the Department of Economic Affairs has conducted a study on Financial Accountability Systems in Centrally Sponsored Schemes. This report was prepared by Mohan Gopalakrishnan (SARFM) with the help of Subhash Mittal (SMA Management Services (P) Ltd) and under the overall guidance of Ivor Beazley (SARFM). Timely and valuable advice on a regular basis from Vinod Sahgal (SARFM) is also acknowledged.

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The study was carried out through a process of review and analysis of publicly available material, reports and field visits covering certain Bank funded projects in three states and discussions with various stakeholders both at the state and ministries involved in the implementation of the CSS. In addition discussions were also held with officials in the state finance department and Accountant General's office officials in the Ministry of Finance, Financial Advisors in the ministries, Controller General of Accounts and the Comptroller and Auditor General.

We gratefully acknowledge the valuable and extensive contributions of each official in the various ministries and states for their valuable assistance in facilitating this study.

LIST OF ACRONYMS

alphabetically listed

AAS	Auditing & Assurance Standard
AG (A & E)	Accountant General (Accounts and Entitlement)
AS	Accounting Standard
C-DAC	Center for Development of Telematics
CAG	Comptroller and Auditor General of India
CCA	Chief Controller of Accounts
CFMS	Computerized Financial Management Systems
CGA	Controller General of Accounts
CPMU	Central Project Management Units
CSS	Centrally Sponsored Schemes
DPC	Duties and Powers of CAG Act
DPR	Detailed Project Report
DRDA	District Rural Development Agency
EFC	Expenditure Finance Committee
EU	European Union
FA	Financial Advisors
GASAB	Government Accounting Standards Board
GO	Government Order
GOI	Government of India
ICAI	Institute of Chartered Accountant of India
IFD	Integrated Finance Division
INTOSAI	International Organisation of the Supreme Audit Institutions
IPAI	Institute of Public Auditors of India
IRR	Internal rate of return
JS	Joint Secretary
MIS	Management Information Systems
MoF	Ministry of Finance
MOHFW	Ministry of Health and Family Welfare
NACP	National AIDS Control Program
PAO	Pay & Accounts Officer
PER	Public Expenditure Review
PMGSY	Pradhan Mantri's Grameen Sadak Yojana
PRI	Panchayati Raj Institutions
PSU	Public Sector Units
RCH	World Bank assisted Reproductive and Child Health Project
RCH	Reproductive and Child Health
ROSC	Report on Observations of Standards and Codes
SSA	Sarva Shiksha Abhiyan
US	Under Secretary
USAID	United States Agency for International Development
UT	Union Territory
WCD	World Bank assisted Women & Child Development Project (ICDS-III)
WHO	World Health Organisation

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EXECUTIVE SUMMARY

Introduction

1. Centrally Sponsored Schemes (CSS) are specific purpose transfers from the Government of India (GOI) to states to influence expenditure in areas that are the constitutional responsibility of the states. These are formulated and largely financed by the GOI, with implementation responsibility resting with the states. The objective is to address issues of national priority with focus on human development, poverty alleviation and rural backwardness. The GOI's budget outlay in the year 2005-06 towards such schemes is close to Rs 500,000 million. This represents approx 24% of the total transfers from GOI to the states from various sources including devolution of taxes based on recommendations of the Finance Commission and allocation of central assistance for state plans by the Planning Commission. The budget outlay for CSS has shown a significant increase in 2005-06 as compared to the previous year figure of Rs 395,000 million with increased allocation for rural roads, rural employment, education and nutrition support for pre-school children. At present there are more than 200 such schemes in operation, of which about a dozen account for more than 2/3rd of the outlay. Given the limited scope for the states to significantly raise their internal resources within the existing fiscal framework and coupled with a high wage bill in many states crowding out development expenditure, CSS are likely to remain relevant and an important source for development funds.

2. Given its nature and design many of the large CSS are characterized by a large number of implementation units, including Panchayati Raj Institutions (PRIs) and Community based organizations (CBOs) which have relatively low capacity and awareness of the schemes. CSS are also characterized by funds flow constraints as funds have to pass through many intermediate level institutions. In addition while GOI provides the funds it does not have direct control over implementation which rests with the states and lower level implementing units, leading to diffused accountability. All these factors contribute to significantly increase the inherent financial management risk

3. The Comptroller and Auditor General (CAG) in one of the performance review of a rural self employment CSS identified that out of the amount test checked the expenditure on the program was only 47 percent, while 53 percent was excess reported diverted, misused or irregularly spent. Various studies and audits by Comptroller and Auditor General of India (CAG) have identified numerous shortcomings with the formulation, design and implementation of CSS. The overview in CAG Union audit report 1999 summarized the major constraints in CSS as design defects, no co-relation between inputs, outputs and outcomes, absence of criteria for evaluation, benefits either not reaching the target population or unsubstantiated claims of benefits, excess reporting of financial and physical performance by the states and failure of the ministries in verification of their correctness and almost total absence of accountability procedures.

Objectives, Scope and Approach of the study

4. The objective of the study is (i) to provide a better overall understanding of the financial management issues and identify areas for improvement in the existing Public Financial Management and Accountability (PFMA) framework and systems governing CSS; (ii) identify good practices across projects; and (iii) summarizing issues relevant in the context of increasingly greater reliance sought to be placed by the Bank on government's own financial management arrangements and the use of Sector Wide Approaches and pooling of funds by various development partners in their support of different CSS schemes. It is hoped that the study would also contribute to the initiatives of the GOI to improve the accountability arrangements in CSS. As the design and implementation arrangements of CSS have a significant bearing on the PFMA, the study also attempts to identify issues and suggest recommendations on the above two aspects, which can contribute to improving the PFMA framework.

5. The study focuses on identifying areas for improvement/ strengthening The PFMA in the context of the existing arrangements of CSS and it does not seek to address the issue of whether CSS should continue or not. Also it does not seek to suggest the preferred mode of transfer of funds i.e. treasury or society, though the financial accountability issues relating to both modes of implementation have been discussed.

6. This study has been carried out through a combination of desk review of reports and studies that have been undertaken on CSS, field visits covering a sample of three Bank funded projects across three states which included the Tuberculosis Control Project (TB), Women and Child Development Project (WCD) and the Reproductive and Child Health Project (RCH). Understanding of the issues has been developed, from the practical perspective of implementation, discussions with officials implementing the CSS, both in the ministries and in the states and discussions with officials in the Ministry of Finance (MOF), Planning Commission, Controller General of Accounts (CGA), CAG and the Institute of Chartered Accountants of India (ICAI).

Current PFMA arrangements: Challenges and some evolving good practices

7. **Design of Schemes: (a) a top down approach with limited flexibility:** design plays a critical role in determining ownership, accountability and performance of any program. In the context of CSS, the traditional designs suffer from the following limitations: a) a top down approach with development of uniform cost norms applicable across the country, b) limited flexibility to amend the norms in light of actual implementation experience and c) focus on adherence to norms rather than outputs. This has tended to reduce the ownership and accountability of the states and created a 'principle' and 'agent' relationship rather than one of partnership between the GOI and the states. In addition small schemes tend to loose sight of the overall program objectives. This has also resulted in the down stream issues like implementation, financial management and monitoring and evaluation failing to get adequate attention. **(b) inadequate focus on accountability issues during formulation and appraisal of schemes**: The guidelines issued by MOF for formulation and appraisal of schemes do not provide for PFMA issues

to be explicitly assessed and appropriately addressed during project formulation, appraisal and approval process. There are, however some positive developments with certain ministries consolidating/ merging smaller CSS into a larger and integrated programs, SSA and RCH-II being good examples, giving states the flexibility to design programs reflecting the state specific needs. The ministries, in turn, are focussing attention on appraisal of state plans, agreeing on outputs/ targets and strengthening the program and financial management framework.

8. **Implementation Arrangements – management capacity:** Two basic models of funds flow and implementation, which also impact the PFMA arrangements have evolved in CSS: a) **treasury model**: where the funds flow through the state treasury and project is implemented through the state departments; and b) **society model**: where funds flow directly from GOI to designated societies at state or district level by passing the state treasury. The society model has evolved due to fiscal stress faced by many states resulting in delays in fund release and is now appears to the preferred mode for many large CSS. In certain projects the society has been used essentially as a funds flow mechanism and not necessarily an implementing unit. Such societies are staffed with a limited number of consultants resulting in inadequate controls and oversight. While creation of society as a ‘funds flow’ mechanism may be a necessity, but it is not a sufficient condition for effective program implementation and for utilisation of funds.

9. **Budget and Annual Work Plans:** The states and districts are largely unaware of the annual allocation and the quantum of funds likely to be received from GOI. This makes the planning and budgeting exercise at state, district and the PRI largely an academic exercise with disconnect between the budgets and allocation from the GOI. Under the treasury model inadequate provision in the state budget results in funds flow bottlenecks to the implementing units even when funds are transferred by GOI to the states. However with certain projects moving to state annual work plan based financing which are approved by GOI at the beginning of the financial year there is some certainty in the likely resource transfer to the projects.

10. **Funds Flow constraints:** One of the primary focus in GOI has been to streamline the funds flow to the implementing units, almost in detriment to other financial management issues. The funds flow in CSS is impacted by the approval process, a large number of implementing units, including PRIs, intermediate levels that the funds have to flow though and the physical mode of transfer. While the creation of state and district societies in many projects has addressed the issue of fiscal stress faced by certain states and consequent delay in release of funds, it is still constrained by the approval process at GOI, the lack of adequate financial delegation, especially to state societies to process transfers to districts and the failure to take advantage of rapid advances in banking, information and communication technology to speed up the transfer of funds. The issue of fund release to bank accounts of societies in two instalments has also led to concerns on idle funds and the lack of systems to track and monitor the level of such funds. Certain projects in the rural development sector e.g NFFWP have developed a clear set of conditions to be complied with, for release of funds, which links releases to financial and physical progress. The Ministry of Rural Development (MORD) has also developed IT based systems which enable tracking the funds position. In the RCH- phase II program there is an on-going

initiative to develop an e-banking model which will not only facilitate faster transfer of funds, but also provide information, in real time, the funds position at various levels.

11. **Gaps in Accounting framework:** Fund releases by GOI to the states for CSS are recognised as "Grant in Aid' in the accounts of GOI and is reported to the Parliament as expenditure. The down stream financial management aspects, such as funds utilization, financial reporting and audit assurance essentially comes under the realm of financial monitoring, which have received inadequate attention. This accounting policy coupled with the risk of lapse of budget has created an in-built incentive for ministries to '**spend'** the budget. Similar policy of accounting releases as expenditure, pressure to spend and report expenditure to GOI is faced by projects under the treasury model. Such projects are also not required to prepare financial statements, but only a statement of expenditure which are often not reconciled with the accounting records of the state Accountant General leading to concerns on the accuracy of the reported expenditures. Under the society model there is no clear institutional framework either in the GFRs, 1963 or in the Societies Registration Act, which governs the accounting policies, format of financial statement and disclosure requirement for projects implemented through the society model. These appear to have evolved more by practice and experience and vary across projects and states/ districts in terms for accounting policies and disclosures. The use of the society model has also meant that the state budgets and financial statements do not reflect these 'off budget' transfers.

12. **Internal Control, Internal Audit and progress reporting:** Compliance with internal control procedures is not robust. While the state financial rules and accounting manuals of societies provide a framework for internal controls, the actual compliance remains weak. The internal audit function, both in departmentally implemented projects and by state societies is either weak or non existent. The quality and timeliness of periodic financial reports is also variable with the inherent risk of over-reporting due to a) the cash basis of accounting followed by the states under the treasury model and b) the lack of clear accounting policies distinguishing between expenditure and advance under the society model; and c) the pressure to attain certain minimum expenditure levels to obtain subsequent releases. The development and use of IT based accounting packages has been mixed with successful implementation linked to greater ownership with the line ministries and staff capacities in the states and districts. The Utilization Certificates, as required per the GFR, 1963, only serves the purpose of a control or fiduciary document and not one which could be a basis for financial monitoring. There are however many initiatives in newer generation CSS to build a framework for independent management reviews such as: independent management audit with elements of public expenditure tracking in *Sarva Siksha Abhiyan* (SSA), a risk based approach to audit or internal reviews based on a set of financial management indicators in RCH – II, independent monitoring by district level monitors of physical progress, which includes physical verification of projects/ beneficiaries in the rural development projects and a good quality monitoring mechanism in the Prime Minister's *Grameen Sadak Yojana* project (PMGSY). These initiatives reflect some of the recommendations of the steering committee on monitoring and evaluation of social sector projects.

13. **External Audit, external reporting and transparency- absence of performance reporting mechanism:** The framework for external financial audit, performance reporting and transparency in CSS is weak. Under the treasury model CAG is required to provide an audit certificate on statements of expenditure submitted by the states to the GOI. However the CAG reports indicate a large backlog (52%) in the issue of such audit certificates due to failure of the implementing departments to provide statements of expenditure. Under the society model the weakness arises from a) the lack of independence in the appointment of chartered accountants as auditors; b) auditors often preparing the financial statements due to lack of staff capacity thereby undermining their audit function and c) absence of 'terms of reference' for audit. The follow up mechanism on audit observations is almost non-existent both at the GOI and the state level. The performance audit by the CAG is often the only independent report available to the Parliament and the state legislature. There is no systematic performance reporting framework for CSS. The ministries do prepare performance budgets, but these are required to be tabled in the parliament along with the demand for grants. Given the inherent time-lag between funds transfer, utilization and reporting this time frame does not permit the actual results (financial and physical outputs) to be reported against the planned targets. Similarly there is no performance reporting to the state legislature and the state and district societies are also not required make public their annual report and financial statements. The efforts by the MORD on putting information of various programs on the website including fund release and sanctions, staffing vacancies, financial and physical status, backlogs in reporting with details of defaulting districts etc is a good initiative. Some of the projects such as NFFWP and SSA have instituted a mechanism to track and report compliance on audit observations.

14. **PRIs in the context of CSS:** Specifically from a CSS perspective the conclusion that can be drawn from the PFMA study on PRIs is that there are a large number of schemes which require the PRI's to maintain separate bank accounts at the Gram Panchayat (GP) level and submit audited separate UC's. However these UCs are issued and audited in isolation of entity accounts; are often submitted on a provisional basis, particularly at year-end, to comply with requirements for drawing the second instalment under the CSS even though expenditures may not have been incurred. There is inadequate capacity for financial management (skills and numbers) and controls weaknesses. There is also a low level of awareness among the rural population about various development schemes including CCS and regarding the release of funds. This state of affairs adversely affects the level of fiduciary assurance. To strengthen financial management and accountability in PRIs, there are a series of on-going initiatives at the central and state level which have the potential for altering the accountability landscape. Furthermore there are several success stories notably in Rajasthan and Karnataka giving the community access to information and introducing social audits at the *Gram Sabha* which help to ensure transparency. Two fundamental tools, the Right to Information Act, now passed in many states and social audits at the Gram Sabha level provide the framework for increasing community awareness.

15. **Lack of financial management capacity**: The role of financial management in CSS has been traditionally been one of accounting and control function rather than one that can support and facilitate effective program implementation. This is best amplified by the

wordings in rule 151 (2) in the GFR 1963 which reads '…… the ministries will **watch** for utilization certificates'. At the state and district level also it has been limited to accounting. There is a distinct lack of capacity to effectively manage financial management aspects of a project in the districts and more so at the PRI level which has a bearing on the fiduciary assurance. The 12th Finance Commission has also commented on the need to professionalize the accounting function within the government system. This however appears to be changing: in certain ministries and programs e.g. RCH-II, a role for financial management at the design stage and the need for adequate financial management capacities at all levels to support program implementation and ensure effective control is being recognized. There are on going initiatives to build capacity in PRIs through extensive training and hiring of accountants.

Some recent Developments and Initiatives of the Government

16. In addition to the initiatives of individual departments there are certain on going initiatives to improve the monitoring of CSS. These include a) a review by the Planning Commission of the CSS schemes to merge schemes with common focus or small outlays and transfer of schemes to states; b) creating a separate division in the Planning Commission called 'Programme Outcome and Response Monitoring Division' with the objective of monitoring performance of government programs including CSS; and c) recommendation of the task force for review for GFRs that CSS be designed with focus on outputs rather than on expenditure and giving states adequate powers to change the details of the schemes.

Way Forward

17. The way forward identifies certain initiatives which the Ministry of Finance, GOI, can build on, in consultation with the various ministries and the CAG to strengthen the financial management and accountability arrangements in CSS. The suggestions are built on certain 'good practices' already being followed in individual scheme which need to be institutionalized within the overall framework. In addition suggestions to address gaps identified in financial reporting, audit assurance and performance reporting have been highlighted.

18. **Design of schemes:** a) **reduce the number -** expedite the process of review by Planning Commission for merger and closure of small and unviable schemes; b) **decentralize planning** - ensure that the design principles recommended in the proposed GFR for CSS are adhered to i.e CSS are based on state and eventually district plans reflecting their priorities with the role of the GOI being broad policy formulation, resource allocation, appraisal of state plans with agreements on output/ outcomes, setting up mechanisms for monitoring financial and physical progress. To facilitate this transition, GOI could set up a facility/ funding mechanism for providing technical and capacity building support to states and districts; and c) **provide a framework for PFMA issues at appraisal stage – *i***ncorporate, in the MOF's 'Guidelines for Formulation and Appraisal of projects' a requirement that PFMA arrangements are explicitly addressed during the design and appraisal of CSS.

19. **Implementing arrangements- address management capacity**: the program design should not encourage the creation of society merely as a funds flow mechanism, more important is to assess and ensure that management capacity and financial framework, including financial delegation are appropriate and commensurate with the size of the program to ensure effective implementation.

20: **Budgeting and Annual Work plans-communicate likely allocation and decentralize**: the likely resource allocation based on budget estimates should be communicated to the states. This would enable the state plan and prioritize activities which are dovetailed to the quantum of funds likely to be received from GOI and prevent plans from being a wish list. Over time such an approach should be devolved to the districts and eventually to the PRI in line with their increasing capacity to plan and manage projects.

21. **Funds Flow: streamline approval process and adopt new technologies**: GOI should: a) review the sanction and fund release process within the ministries in order to reduce the time taken for fund release. CSS should develop clear guidelines for funds release to states to bring in transparency and objectiveness in the review and approval process; b) states should also be encouraged to adopt similar guidelines for CSS projects where funds flow though the treasury and develop financial delegation for state and district level project implementing units; c) develop a road map for use of e-banking facility, which is increasingly available for transfer of funds to states and districts and eventually to the PRIs and for costs effective Management Information Systems (MIS) through which funds could be monitored.

22. **Accounting Framework: address gaps in institutional framework** a) develop, in consultation with the CGA and ICAI, a framework for standard financial reporting, with uniform and consistent accounting policies and disclosure requirements for the state and district societies; b) require projects implemented through state treasury also to prepare financial statements (a statement of sources and uses of funds) with appropriate disclosures of the accounting policies used to prepare the financial statements and on pending UCs etc; c) in the medium to longer term consider amending the Societies Registration Act, 1860 to incorporate provisions regarding: maintenance of accounts and disclosure requirements, compliance with Indian Accounting Standards, filing of accounts, appointment of auditors and constitutions of audit committee; d) consider creating a non lapsable fund or '*kosh'* for major CSS which could reduce the pressure to spend the budget; and e) request CAG to address the issue of off budget financing and commodity grants from GOI in the process of developing government accounting standards, which would provide for appropriate disclosures both in the budget and in the annual financial statements of the states.

23. **Strengthen Internal Control, internal audit and reporting**: build on these initiatives of various ministries and: a) consider de-linking release of funds to achievement of certain minimum expenditure levels. Releases should be based on projected requirement of funds and review of the progress against the approved work plan ; b) consider having a system of management audit or a risk based audit mechanism as an integral part of the

design of the scheme; c) the use of low cost off the shelf accounting package, which can also be web-enabled must be encouraged for use in the societies which would not only enable uniform and consistent reporting, but also facilitate monitoring of cash balances; and d) make the proposed rule in GFR for preparation of UC for central autonomous bodies (which requires distinguishing between physical funds available and advances which do not constitute expenditure at that stage) also applicable for CSS- both treasury and society model. c) build in greater transparency in the monitoring and in 'action taken mechanism' on lines similar to the arrangements in the PMGSY project;

24. **Strengthen the audit assurance and external reporting framework**: in view of risk of diversion of funds of CSS by states as highlighted in the CAG audit reports, GOI should address a) the issue of backlog in submission of audit certificates and set up mechanisms for monitoring timely submission audit certificates from the states; b) in consultation with the CAG, strengthen the process appointment of auditors for state and district societies to bring in an element of independence and develop a standard 'Terms of Reference' for auditors of state and district societies and d) de-link performance report on CSS from performance budget which will enable reflection of actual outputs and fund utilization achieved. This would not only provide a mechanism to report to the parliament but also shift focus from fund release to actual financial and physical outputs and also provide an impetus to improve the quality of monitoring; Similar report could be submitted to the state legislature on the performance of the CSS relating to the state; and e) require the state and district societies to prepare an annual report reflecting the performance for the year; All such reports should be made public and be hosted on the web sites.

26. **PRI's and CSS:** Going forward, it is important build on various successful initiatives in states like Rajasthan, Karnataka etc to increase the awareness of rural populations regarding the usage of public funds. Communities need to be made familiar with the importance and procedures for social audits and their right to information and transparency.

27. **Strengthening capacity for financial management**: the perception about the role of financial management needs to change, from one of accounting to one essential to support program delivery; this is also increasingly relevant in the context of decentralized planning and budgeting. In addition capacity building and training of the finance staff should seen as an integral part of any program and more particularly at the PRI level where increasingly larger resources are expected to flow.

Conclusions:

28. CSS by their nature with a large number of implementing units at central, state and PRI level, each having its own constitutional and financial management framework, varying quality of governance, low capacity in financial management, especially at the district and PRI level and diffused accountability, inherently carry a high level of fiduciary risk. The top down planning, with uniform norms across the country has tended to reduce the level of ownership and accountability of the implementing entities. As implementation

responsibility largely rests with the states, the down stream PFMA issues have also not received adequate attention.

29. There are however some positive changes wherein new programs have consolidated various small schemes into larger programs, especially in the education and health sector. These are also moving to a decentralised planning with focus on outputs and outcomes, with GOI providing technical and management support to the States with lower capacities. For such an approach to take root and succeed GOI needs to provide active support to the states by way of capacity building in technical, managerial and financial management.

30. There is a need to address the critical gaps in the institutional framework relating to financial reporting and external audit assurance and enhancing transparency by way of improved performance reporting.

31. As the PRIs play a significant role in many CSS, enhancing their capacity, in terms of increasing awareness of the development programs, their right to information and social audit and capacity building in financial management, as part of the decentralization agenda of the GOI will also play a critical role in strengthening the overall Public financial Management and Accountability Arrangements in CSS.

I. BACKGROUND AND APPROACH

1. Centrally Sponsored Schemes (CSS) are specific purpose transfers from the GOI to states to influence expenditure in areas that are the constitutional responsibility of the states. These are formulated and largely financed by the Government of India (GOI), with implementation responsibility resting with the states[1]. The objective of CSS is to address issues of national priority with focus on human development, poverty alleviation and rural backwardness. The GOI's budget outlay towards such schemes in the year 2005-06 is close to Rs 500,000 million.[2] The GOI transfers resources to the states via three routes; devolution of state's share in central taxes based on recommendations of the Finance Commission (FC), central assistance for state plans by the Planning Commission (PC), and the Centrally Sponsored Schemes (CSS) of GOI Ministries. The table below gives the approx share of the three sources in the year 2004-05 and 2005-06.

Table I

Resources Transferred to States and Union Territories

Rs million

Source of Funds[3]	**2004-05** (Revised Budget)	**2005-06** (Budget Estimates)
Finance Commission (incl grants for non plan expenditures)	934,450 (50%)	1,289,120 (61%)
Central Assistance to state plans	548,580 (29%)	331,120 (16%)
Centrally Sponsored schemes	395,000 (21%)	500,000 (24%)
Total	**1,878,100 (100%)**	**2,120,240 (100%)**

As is evident from the above table CSS is a forms sizable part of the resources transferred to the states in the form of tied funds. At present there are more than 200 CSS in operation, of which about a dozen account for more than 2/3rd of the budget outlay. A list of CSS with budget outlays for the year 2004-05 is given in annexure I and a list of large CSS is given in annexure II. In addition to CSS, part of the funds transferred by the PC is in the form of Additional Central Assistance (ACA) where the distribution amongst various schemes is determined by the nature of the schemes and share many common features with CSS as these entail control over flow of funds with the central ministries. Considering limited scope for the states to raise their own resources and generate funds of this magnitude within the existing fiscal framework and a high wage bill in many states which crowds out

[1]As per the Baijal Committee Report, April, 1987, CSS have been defined as those schemes which are funded directly by the central ministries/departments and implemented by states or their agencies, irrespective of their pattern of funding. In most CSS, states are also required to make varying contribution to individual CSS.

[2] Based on budget estimates for the financial year 2005-06. GOI's budget document on resource transfers to states (pg 15 of the budget at a glance) only reflects CSS transfers to state consolidated fund (account code 3601 and 3602) and not CSS where the funds are transferred directly to state / district societies. Quantum of transfers to state/ district societies has been arrived at based on budget provision in individual demand for grants for large CSS and has an element of approximation.

[3] The data has been extracted from the budget document for the year 2005-06. The Central assistance for state plans has decreased in the year 2005-06 pursuant to the GOI accepting the FC recommendations that the state be given the flexibility to raise the loan component of central assistance for state plans.

development expenditure, CSS are likely to remain relevant and an important source for development funds, especially for the poorer and revenue strapped states.

2. The World Bank is currently supporting ten CSS, primarily in the health, family welfare and the education sectors aggregating to a total credit of USD 2.3 billion. The Bank funded CSS have in general, been affected by low utilization of funds resulting in extension of the implementation period. Other financial management issues have been delays in submission of audit reports leading to periodic suspension of disbursements by the Bank, varying quality and inconsistency in financial reporting and audit assurance.

3. The objective of the study is (i) to provide a better overall understanding of the financial management issues and identify areas for improvement in the existing Public Financial Management and Accountability (PFMA) framework and systems governing CSS; (ii) identify good practices across projects; and (iii) summarising issues relevant in the of context of increasingly greater reliance sought to be placed by the Bank on government's own financial management arrangements and the use of Sector Wide Approaches and pooling of funds by various development partners in their support of different CSS schemes. It is hoped that the study would also contribute to the initiatives of the GOI to improve the accountability arrangements in CSS.

4. The GOI has indicated its commitment to CSS programs through significant increases in the budget outlays for the year 2005-06. Through various pronouncements the GOI has also indicated its focus on improvement in the implementation of CSS. In his budget speech, the Finance Minister stated "outlays do not necessarily mean outcomes. The people of the country are concerned with outcomes". *He further added* " the Prime Minister has repeatedly emphasized the need to improve the quality of implementation and enhance the efficiency and accountability of the delivery mechanism". Some of the recent initiatives also convey the GOI's commitment in this regard. For example, the Planning Commission is currently reviewing rationalization of CSS schemes by way of merger of schemes with common focus or small outlays, transfer of schemes to states[4]. Also a Program Outcome and Response Monitoring Division is being created in the Planning Commission with the objective of monitoring performance of CSS.[5]

5. These initiatives of the GOI also recognise the concerns voiced by the office of Comptroller and Auditor General of India (CAG) on the performance of the CSS. The CAG, which regularly reviews different government programs, has been highlighting the weaknesses in CSS. In one of its reports, it summarized the major constraints as design defects, no co-relation between inputs, outputs and outcomes, absence of criteria for evaluation, benefits either not reaching the target population or unsubstantiated claims of benefits, complex execution structure, excess reporting of financial and physical performance by the states and failure of the ministries in verification of their correctness and almost total absence of accountability procedures. [6] A summary of the findings from

[4] Report in the Economics Times, Delhi Edition dt. 27 Jan'05
[5] Report in the Economics Times, Delhi Edition dt. 27 Apr'05
[6] Overview in Comptroller & Auditor General's Union Audit Report 1999 (http://cagofindia.delhi.nic.in/cag/reports/union/rep2000/civil_performance/overview.pdf)

two performance audit reports issued by the CAG indicate a high incidence of irregular expenditure, large unutilized funds, inflated reporting and funds retained as deposits.

Table II
Details of Irregularities identified in CAG audits

Scheme	Amount test checked	Irregularities identified	Percentage breakup of irregularities Identified			
			Deposits reported as expenditure	Inflated reporting	Irregular expenditure	Diversion , etc.
	Rs in million	%	%	%	%	%
SGSY(1999-02)	9,884	53	23	20	43	14
Rural Housing (1997-2002)	36,857	31	58	26	1	5

7. The study brings out the areas for improvement in the existing PFMA framework governing CSS. As the design and implementation arrangements of CSS have a significant bearing on the PFMA, the study also attempts to identify issues and suggest recommendations on the above two aspects, which can contribute to improving the PFMA framework.

Approach & Methodology

8. This study has been carried out through a combination of desk review of a reports and studies that have been undertaken on CSS, field visits covering a sample of three Bank funded projects across three states- Rajasthan, Tamil Nadu and Uttar Pradesh. While most of the existing studies do not focus on Financial Management aspects per se, various conclusions reached in these studies are quite relevant and have been considered. In addition, audit reports of different CSS, General Financial Rules, 1963 (GFRs) of the GOI and other publicly available material on a number of other projects have also been referred to. A complete list of studies and reports referred to is given as Annexure II.

9. The basic principle in the selection of the projects for field visits[7] was to be able to cover different implementation arrangements, i.e funds-flow arrangements, through state treasuries and societies which are impact the financial management arrangements and accountability framework. Another key determinant of financial accountability in CSS are the Panchayati Raj Institutions (PRIs) which are involved in the implementation of many CSS in the rural development sector. Currently in bank supported CSS project funds are not flowing to the PRIs, except in the Sarva Siksha Abhiyan (SSA) program where funds flow to Community Based Organizations (CBO's) like village education committees. Since the field visit was limited to bank funded projects, the financial management and accountability arrangements in PRI has been based on secondary data and from a parallel synthesis study by the Bank on PFMA in PRI's. The three Bank projects covered in the field visits were:

[7] Field visits were limited to Bank funded projects.

Table III
List of projects covered in state visits

S.No	Project	Funds Flow
1	Women & Child Development	Through State Treasury.
2	Tuberculosis Control Project	State and District Society
3	Reproductive & Child Health Project I/ II	State treasuries and State/ District Societies.

10. Understanding of issues so identified was developed from the practical perspective of implementation, discussions with officials implementing the CSS, both in the GOI level and in the states and discussions with officials in the Ministry of Finance (MoF), Planning Commission, Controller General of Accounts (CGA), and CAG and the Financial Advisors (FA) and the Chief Controller of Accounts (CCA) in the ministries.

Scope Limitations

11. The study primarily focuses on the financial management framework to identify areas for improvement/ strengthening in the context of the existing implementing arrangements of CSS. It does not attempt to address the issue of:

- whether CSS should continue rather than being transferred to the states or devolved to the PRI entities by dissolution of the existing mechanism such as the District Rural Development Agencies (DRDA's) and other societies created at the state & district levels.

- the preferred mode of transfer of funds i.e. whether funds to the states should necessarily be routed through the state treasury or societies, though the financial accountability issues relating to both modes of implementation have been discussed.

12. The findings and suggested way forward to improve financial accountability systems in CSS needs to be viewed in the light of varying diversity in the quality of the governance across states and the fiscal stress faced by certain states both of which have an overarching influence in the performance of any government program, including CSS.

II. INSTITUTIONAL FRAMEWORK

1. The Institutional Framework for the CSS is fairly complex as funds flow through various tiers of the government i.e GOI, state governments, state level implementing entities and the rural local bodies, each of which has separate institutional framework. These consist of the following:

- **General Financial Rules, 1963 -** A large number of rules have been formulated by the Government under powers vested in it through the Constitution. The General Financial Rules, 1963, the Fundamental Rules and Supplementary Rules form the basis of all main activities that the various central ministries undertake. Other important rules are the Delegation of Powers Rule 1978, which provide financial powers to various Government officials. Main rules which formulate how Government accounting should take place are included in the Government Accounting Rules 1990, Accounting Rules for Treasuries and Account Codes. Similar rules have been made separately by each State Government which also govern the CSS.

- **Guidelines for Formulation, Appraisal and Approval**[8]: The Plan Finance II Division under Dept. of Expenditure of Ministry of Finance has prepared guidelines for formulation, appraisal and approval of the planned schemes / projects by the Expenditure Finance Commission (EFC) and the Union cabinet. All CSS are subject to these guidelines. The approval of the CSS by the EFC forms the basis of norms for expenditure, new posts/ positions that can be created under the project, financial delegation and guide the IFD within each ministry in their sanction of release of funds.

- **Societies Registration Act 1860**: In many of the CSS the funds are routed through a mechanism of state societies, which are legal entities created under the Societies Registration Act 1860 which is an all India Act. A few States such as Karnataka, Andhra Pradesh, Tamil Nadu and West Bengal have enacted their own Acts, on lines of the Central Act, to register societies being constituted under their respective jurisdiction. The Society Registration Act 1860 and the related state acts have minimal financial management obligations; however each society is registered under its own bye-laws, which have certain financial management framework. Normally these include preparation of financial statements, audits and approval of the audited accounts in General Body Meeting. The societies also need to comply with certain financial management obligations to obtain tax exemptions.

- **Accounting Standards**: As mentioned above the accounting and financial reporting in GOI and the states is based on rules; however the CAG has constituted the Government Accounting Standards Board. (GASAB) with the intention to move from a rule based to standards based financial reporting. GASAB has released a few Exposure drafts and is in the process of finalising its first accounting Standard. The Institute of Chartered Accountants of India (ICAI) is the other body which sets accounting standards for the private sector. A number of Accounting Standards have been issued which are

[8] Ministry of Finance (2004): Formulation, Appraisal and Approval of Plan Schemes and Project – Guidelines and compendium of Important circulars, Dept of Expenditure, GOI

mandatory. It has also issued a Technical Guide on Accounting and Auditing for Not-for-Profit Organizations. There is however an ambiguity on the applicability of the accounting standards to not-for-profit organizations and more specifically the state and district societies implementing CSS[9]. See annex IV for the full text of the clarification provided by the Institute.

- **Audit Framework and standards**: Under section 13 of the Duties and Powers of the CAG Act, Section 13, it is the duty of the CAG to audit the expenditure from the Consolidated Fund of India and of each State and of each Union territory having a Legislative Assembly. In addition under Section 14 (1) of the DPC Act the CAG shall audit any body or authority which is substantially[10] financed by grants or loans from the Consolidated Fund of India or of any State or Union territory having a Legislative Assembly. The CAG carries out audit as per standards which are in line with the standards by the International Organization of the Supreme Audit Institutions (INTOSAI). Chartered Accountants are required to adhere to the Auditing and Assurance Standards (AAS) issued by the ICAI.

2. **Legislation relating to the *Panchayati Raj Institutions* (PRIs): the Rural Local Bodies:** In many CSS especially those relating to rural development and poverty alleviation, the actual implementation responsibility rests with the PRI's. The three tiers of PRIs got their legal status after the states enacted their respective *Panchayati Raj Acts* [and related Rules] in conformity with the 73rd Constitutional Amendment in 1992. These Acts provide for institutional mechanisms such as the holding of *Gram Sabhas*, setting up of State and Central Finance Commissions, District Planning Committees and the jurisdiction over 29 subjects specified in the Constitution. States also set up *Panchayati Raj* Departments as the administrative department for PRIs in the State. The legal and institutional framework has thus far made PRIs function as extensions of the State and not as independent self-governing bodies in the true sense. In 2004, a new Ministry of *Panchayati Raj* (MoPR) has been set up as the nodal agency to exclusively deal with policy matters relating to PRIs. A parallel study has been carried out by the Bank on the Public Financial Management and Accountability in PRIs[11]. The key conclusions of the synthesis study are documented in section XI of this report.

The implications arising from the multiplicity institutional framework for CSS is discussed in the relevant sections of this report.

[9] Para 3.29 on page 31 of the technical guide on Accounting and auditing for not-for-profit organization clarifies that the Accounting Standards issued by the ICAI do not apply to a not-for-profit entity if no part of the activity of such entity is commercial, industrial or business in nature.

[10] Substantially is defined as grant or loan not less than Rs 2.5 million or not less than 75% of the total expenditure of the body or authority.

[11] World Bank study on Public Financial Management and Accountability in PRIs

III. DESIGN OF SCHEMES & IMPLEMENTATION ARRANGEMENTS

1. The design of CSS has significant bearing on the financial management arrangements of the scheme.

Appraisal Framework of a CSS Scheme

2. The Department of Expenditure, Ministry of Finance (MoF) has prepared **guidelines for formulation and appraisal**[12] of Govt. schemes and projects including a Generic Structure of Detailed Project Report (DPR). The guidelines are quite detailed and lay a lot of emphasis on how to arrive at project cost, internal rate of return (IRR), sensitivity analysis on IRR, financing arrangements, etc

The guidelines, per se, do not require the financial management arrangements, which are more relevant in the context of CSS, as opposed to financing, to be addressed during the formulation and in the appraisal note to the Expenditure Finance Committee (EFC) and the Cabinet for approval. While in Bank funded projects the financial managements risks are assessed, the lack of an 'in built' mechanism to address the financial management issues during formulation and approval process, means that inadequate attention is paid to these issues.

> **Box 1**
> **Need for Fiduciary Risk Assessment**
> **A recent example from National Food for Work Program- NFFWP**
>
> The recently launched NFFWP has a condition which requires the submission of non-diversion and non-embezzlement certificate for subsequent release of funds. This probably reflects the inherent fiduciary risk in the program, but is not necessarily a risk mitigating measure. Incorporation of a fiduciary risk assessment as part of the MOF Guidelines for formulation and appraisal will provide a framework for explicitly identifying risks during formulation of CSS programs and building appropriate mitigating measures such as enhancing transparency at local level.

3. Appraisal procedures lay down detailed framework[13] on who all need to be consulted on detailed DPR, which includes the review of the scheme by the Financial Advisors (FA) within each ministry. The expectation is that the financial management issues would have been reviewed by the FAs. Discussions with the FAs in the ministries indicate that that their focus during review, prior to concurrence of the proposal, is more on the broader aspects, mainly the financial envelope, plan provisions, etc and not necessarily on the adequacy of the financial management arrangements such as existence of standard accounting policies, financial reporting standards, adequacy of finance staff and audit assurance mechanisms. In CSS it is the management structure, implementation, financial management and procurement arrangements that have an important bearing on the effective implementation of the CSS.

Large Number of Centrally Sponsored Schemes

4. Currently there are more than 200 CSS out which about a dozen accounts for over 2/3rd of the budget outlay. Refer annexure I and II for a list of schemes. There are a large

[12] Guidelines for Formulation, Appraisal and Approval of Government funded plan schemes / projects dt. 7-5-2003, issued by Plan Finance II Division, Ministry of Finance

[13] Time Frame for appraisal and approval of projects / schemes – Annexure II to the above Formulation, Appraisal Guidelines

number of schemes with small budget outlays. Small schemes have the following limitations:

- The amount allocated to each state is negligible which combined with uniform and rigid cost norms for implementation prevents the states from taking adequate ownership and commit resources and manpower for implementation of such schemes.[14]
- tend to get crowded out and may receive inadequate attention of the state and district administrators as compared to larger schemes.
- It is not cost effective to justify independent implementing and financial management arrangements and these have to depend on the implementing entities of other programs or projects. For e.g the Food & Drugs Capacity Building project depends on State AIDS Control Society for funds flow and financial management arrangements.
- Benefits of synergies and consequently cost savings in activities such as Information education and Communications (IEC) across similar schemes may not be achieved.

6. Certain ministries have redesigned the projects in an effort to reduce the number of schemes and reduce fragmentation/ duplication. The SSA and RCH-II[15] programs are two examples where the ministries have adopted a programmatic approach and various schemes have been clubbed together with greater flexibility to states. The Planning Commission is currently engaged in a review of the schemes with a view to rationalize the number of CSS. The Ministry of Health & Family Welfare (MOHFW) is also proposing to merge all the existing societies at the state and district level into one integrated implementing unit to derive the benefit of synergies from various programs under the National Rural Health Mission (NHRM).

Box 2:
12th Finance Committee comments on CSS
(*extract from para 4.70 of the report*)

CSS are characterized by large numbers, duplication and lack of monitoring. The CSS have been the subject of study by many committees. The general consensus has been towards reducing their number, but the follow up action has been weak. A state should be given its entitlement and allowed to select its own mix of CSS floated by different ministries, within the limit of the total grant. The CSS would then start competing among themselves and pressure would come on the ministries to design schemes that are in demand.

Lack of Flexibility in Design

7. Most schemes, when formulated identify cost norms for various activities based on which the program cost is arrived at. These norms cover many areas including cost of each activity, number of additional persons/employees which a scheme can engage and the cost for each of the identified positions, the program management costs, etc. These subsequent to the EFC approval, are also drafted into the guidelines or administrative orders issued to the state level implementing units. While the purpose of the norms is presumably to facilitate preparation of overall project cost, these become inflexible and the programs

[14] In most of the Bank supported disease control projects it has been observed that the state level officer in charge of the project normally holds the position as additional charge.
[15] In RCH-II the number of schemes has been reduced to less than 20 from a level of 54 under RCH –I. The budget of the department has also been reorganised to reflect this in the year 2005-06.

are constrained to work with the same norms during the entire period of implementation. This often makes the program very rigid and reduces the level of ownership and consequently accountability of the states. It also tends to create a principal and agent relationship rather than one of partnership, between GOI and the states.

8. More importantly there is a need to move away from the central norm based programs to a state and eventually district plan based programs, which will address the specific needs and issues in the states and district rather than a 'one size fits all' program driven by the GOI. GOI thinking on such norm-based schemes already appears to have changed with many newer programs such as the *Sarva Siksha Abhiyan* (SSA) and the National Aids Control Program -II (NACP-II) moving to a State Annual Work Plan (AWP) based financing. This is in contrast to the Reproductive and Child Health (RCH), Phase I project which commenced in 1997, wherein norms were laid down for each activity and funds were released by GOI for each activity separately with limited flexibility to use idle funds of one activity for another. This resulted in staff at the field level also concentrating on their specific activities with no real ownership of the project as a whole at the state level.

9. However within RCH phase I project a concept of financial envelope was evolved wherein selected states were allowed a flexible grant[16]. The state of Tamil Nadu used this flexibility to decide program strategy and financial norms for 4 different activities under RCH project. Implementation of a '24 hour delivery care services in PHCs' under such strategy achieved impressive results. Such successful examples indicate the importance of allowing flexibility to accommodate local needs and initiatives. Such type of decentralized planning enhances the ownership of the project, as the team can identify better with its own plan and is likely to take that extra initiative to make the plan successful.

Box 3
Impact of flexibility
Tamil Nadu experience in RCH

Deliveries at PHCs covered under the scheme went upto 15.53 per PHC per month as compared to 4.22 deliveries per PHC per month for those not covered under the scheme (2003-04)

Box 4:
RCH-II - Building on the Experience
Increased Flexibility to states

The RCH program, phase II has built on this approach and has also moved to an annual work plan based financing for the entire program. The role of the ministry is one of working out the resource envelope for each State, review, appraisal & approval of the annual work plans of the states and regular monitoring of the performance against the plan by the states. The project has sought to move away from a 'norm based' approach with the ministry only identifying a negative list of activities. The ministry is entering into a Memorandum of Understanding (MoU) with the states agreeing on state specific output / outcome indicators. The GOI is also providing program and financial management capacity building support in selected states to assist them in this new approach.

10. For this approach to take shape and for states to accept the new way of doing business, many of the states and more so the districts will need hand holding and capacity building support, to help in formulation of the plans and the ministries will need to reorient

[16] In Tamilnadu this consisted of Rs 27 million (FY 2000-01), Rs 18.7 million (FY 2003-04) and Rs 10.2 million as first installment (FY 2004-05).

their approach to one of monitoring and evaluation rather than one of fund release. This will also necessitate training and development of program management skills for effective implementation of the plans. In the RCH-II program, recognizing this constraint, technical and management support has been provided by the GOI to the states with lower capacity to (a) help them with the preparation of the state plans and (b) provide support during the implementation. The review and support from GOI during implementation is also geared towards the states with lower capacity.

11. The task force set up for review of the General Financial Rules, 1963 (GFRs) has also made recommendations on similar lines and have proposed a new rule[17] which suggests the principles to be kept in view while designing CSS. Some of the salient features of the proposed rule are:

- each CSS to be treated as a project with time bound targets for monitoring, mid term evaluation and detailed impact studies.
- designed with in-built flexibility for states to make changes,
- to have monitoring and effective control,
- to establish mechanisms to ensure that the funds earlier released have been effectively utilized and the data reported is correct,
- to focus on attainment of the objectives and not just expenditure,
- mechanism to be included in the scheme to avoid release of large part of funds towards the end of the year
- mechanism to be built into the project for concurrent reviews and applying mid-course corrections.

12. Considering that there are no specific provisions in the existing GFRs, this is a laudable step and will help in design framework and positively impact the financial management and accountability framework on CSS. However while the proposed rule addresses the design and formulation issues GFRs fall short of addressing the critical down stream financial management issues such as standards for accounting, financial reporting and audit assurance mechanism. These are discussed later in the section VIII to XI.

13. **Program Management Costs**: Given the scale of implementation of CSS and the focus on outcomes, there is a need to provide for a minimum program management or support costs in each program. Currently in most schemes these are provided by way of specific posts with fixed salary structure approved by the EFC. This restricts the ability of the program managers both at the GOI level and the state level to engage program support staff including finance staff with the requisite skill sets in line with the needs of the program. Some projects, such as RCH-II and Tuberculosis, which have support from agencies such as the World Health Organization (WHO) and European Union (EU) have

Box 5:
Program Support Cost: Approach in SSA program
The SSA program is a good example in flexibility and adequacy of funds for program support costs where the States have been allowed to spend up to six percent of the approved Annual Work Plan as program management costs.

[17] Rule 215(2) General principles for award of Grants in aid for Centrally Sponsored Projects

the flexibility to engage consultants, both at the central and state level through the funding mechanisms of these agencies. However projects such as the Women and Child Development (WCD) have suffered on this count, as the initial proposal of the project approved by EFC did not envisage the need for financial and procurement positions in the CPMU and the subsequent need for such skills during program implementation could not be addressed due to lack of EFC approval. The DRDAs administration guidelines provide for a fixed amount for each DRDA as program administration cost.

14. The increasing process of devolvement of identified functions, functionaries and funds to the PRIs in line with the 73rd Constitution Amendment in many states will also have a significant impact on the overall financial management and accountability framework of CSS which should be considered and addressed during the design stage.

Externally Aided Projects – Multiple Agencies financing the same sector program

15. In many projects, especially in the health sector, there are multiple development partners financing a part of the same program. These take the form of financing certain identified activities across the country or financing the activities in specific states. For e.g in the NACP-II there are six development partners financing specific activities of the program. Similarly in family welfare sector, in Uttar Pradesh, there are three large development partners supporting separate CSS projects. This necessitates the CPMU, states and districts having to maintain different sets of accounting records, separate bank accounts, staff dedicated to and identified with one development partner, different reporting and audit requirements[18].

16. **Way forward**: Adherence to key design principles plays a critical role in determining ownership, accountability and performance of any program. Going forward GOI should consider taking the following actions:

a) complete the process of review by Planning Commission for merger and closure of small and unviable schemes

b) ensure that the design principles recommended in the proposed GFR for CSS are adhered to during formulation of new schemes i.e CSS are based on state and eventually district based plans with the role of the GOI being policy formulation, resource allocation, review and appraisal of state annual work plans with agreements on output/ outcomes, setting up robust mechanisms for monitoring financial and physical progress of schemes in the states and periodic impact evaluations. Such an approach should allow appropriate flexibility, within overall budget ceilings, to the ministries, project directors in the GOI, states and districts to make changes in the plan/ costs to address actual implementation experience and constraints. To facilitate this approach to take shape, GOI could set up a facility funding mechanism for providing technical and capacity building support to states and districts and assist the ministries to reorient their approach to one of financial and physical monitoring and evaluation

[18] In Uttar Pradesh, the USAID project has independent implementation arrangements with separate state and district societies and independent reporting structures

rather than one of fund release. This would enable states to take greater ownership and accountability, for the outputs/ outcomes.

c) Incorporate, in the MoF guidelines for formulation and appraisal of projects a requirement that the financial management and accountability arrangements are assessed and documented / reflected in the internal appraisal note of the GOI. This will provide a framework for these issues to be addressed during the design stage.

d) review the implementing arrangements, especially at the state and district level with a view to merge smaller implementing entities i.e societies in the same sector into one integrated society. This will facilitate development of robust management structure and effective financial management arrangements within which different schemes can implement their programs. Such a merger should however have a change management strategy to reflect and appropriately address the needs of various programs.

e) With the merger of small schemes into larger programs, CSS are very amenable to a programmatic approach and pooling of finances by the various development partners to support one integrated program. GOI should consider taking a policy decision that all development partners should finance a GOI led program. Strengthening of the financial management framework will facilitate this to a large extent and reduce the burden of developing and maintaining parallel systems.

IV. IMPLEMENTATION ARRANGEMENTS

1. Just as the design, the implementation arrangements also have an important bearing on the financial management arrangements for any CSS. It impacts planning and budgeting process, funds flow, reporting, staffing, accounting policies & procedures, internal control and audit assurance mechanisms. The implementation arrangements in CSS vary from relatively simple vertical structures like Tuberculosis Control project to complex arrangements like RCH, Sarva Shiksha Abhiyan (SSA) programs where funds flow to a significantly large number of implementing agencies including various CBOs. In most of the rural development programs a significant involvement of the PRIs either directly in managing the program or in beneficiary selection and community mobilization.

2. **Implementation arrangements at the GOI Level:** At the GOI level, CSS are normally coordinated through a CPMU within the ministry and is generally headed by a project director. Unlike states which have created societies, all CSS are managed within the line ministries in GOI.[19] While the project directors are responsible for the implementation, all fund releases from GOI have to be approved by the FA in the Integrated Finance Division (IFD) within each ministry. The program managers at the CPMU have little or no financial delegation. The lack of financial delegation to the project directors creates bottlenecks in the day to day management of the program, especially for small activities such as training, consultation workshops etc.

3. **Implementation mechanisms at the State & District Level:** Implementation responsibilities in CSS largely rest with the States[20]. There are two models: Treasury model and Society model, for implementation or the funds flow arrangements, which in turn have a bearing on the financial management arrangements.

4. **Treasury Model:** In this model, the funds are routed through the respective state treasury. The funds to the implementing units at the state and district units are made available through the budget of the respective state. There is no separate legal entity and CSS project is implemented by the respective department, though most CSS have separate Project Management Units (PMUs) headed by a project director or co-ordinator at the state level.

5. **Society Model**: Under this model, a society (a special purpose vehicle) at the state level and/ or district level is formed. The society is registered either under the Societies Registration Act 1860 or the relevant state societies act. Under the society model the funds flow directly to the state or district society by- passing the Consolidated Fund of the state. This practice was started by the Ministry of Rural Development, when District Rural Development Agencies (DRDAs) were created in consultation with state Governments. Other ministries have since applied this approach to many of the schemes administered by them. The members of the society are normally the senior state government

[19] For implementing the NACP-II program a separate entity National Aids Control Organisation (NACO) has been created, but it is not a legal entity and does not enjoy financial powers.

[20] In most CSS in the health sector major procurement of drugs and equipment is managed by GOI and distributed as commodity grant to the states. The procurement is handled through central level procurement agents.

officials, in their ex-officio capacity. Many projects in the health sector initially followed the DRDA model of district societies with funds being transferred directly to the districts, but as the span of control was too wide and unmanageable, GOI requested the states to create a state society which now has control and oversight over the district societies.

6. **Reasons for creation of Society:**The reasons that led to the adoption of such a model was:

- to insulate the program from the fiscal stress that are faced by many states and often resulting in 'restrictions' being imposed on release of funds
- the attended risk of funds meant for programs being used for purposes other than those intended eg payment of salaries[21].
- delay in the approval of the release of funds from the state treasuries and in providing sanctions for expenditures.

7. Concerns on such off-budget transfers and consequent weakening of the financial management control framework have been raised by the state governments. The finance departments in the states do not track the amounts transferred by the GOI directly to the societies and nor are these reflected in the state budget or accounts of the state. In January 2003 the MoF, GOI issued instructions that all funds to states would flow through the state treasuries which in turn was to make funds available to the implementing units within 3 weeks. This was however reversed after six months in June 2003.

8. The society model has become more prevalent among various CSS and the trend is continuing. Many projects have moved from the treasury model to the society model in subsequent phases of implementation eg the NACP, while many states moved to the society model during the implementation itself e.g. RCH phase I project. The table below gives the mode of implementation in some of the large CSS.

Table IV

Implementation mode in some of the large CSS Schemes

Program	Implementation Mode
Sampoorna Gramil Rojgar Yojana (SGRY) *	District Rural Development Agency (District Societies)
Rural Housing : mainly *Indira Awas Yojna* (IAY)	
National Food for Work Prigram (NWFFP)	
Swarnajayanti Gram Swarozgar Yojana (SGSY)	
Prime Minister's Grameen Sadak Yojana (PMGSY)	State Societies
Sarva Shiksha Abhiyan (SSA) incl. DPEP	State & District Societies
Integrated Child Development Scheme including the Bank funded Women & Child Development Project(WCD)	Treasury **
Reproductive and Child Health(RCH)	State and District Societies ***
National AIDS Control Programme (NACO)	State AIDS Control Society
Various Disease Control Programs such as National Tuberculosis Control Programme, Vector Borne Disease Control program etc	Independent State and District Societies

** this project is implemented through the 3 tiers of PRI's*
*** Under the WCD Project Uttar Pradesh has opted for a Society model*
*** Tamil Nadu and Karnataka follow the treasury model*

[21] The CAG in its various state audit reports for financial years 2000-01 to 2002 -03 has indicated diversion of CSS funds by states for other uses.

9. While direct transfers ensures that funds reach the state level implementing[22] units faster and saving on efforts to obtain releases from the state treasury, efficiency in implementation and utilization of funds by an organisation depends upon a number of factors such as the existence of an adequate organisation and management structures, appropriate financial delegation to approve AWPs and activities, adequate manpower with appropriate skill levels and clear guidelines especially on procurement process to be followed. In the RCH phase I project the society was more in the nature of a funds flow mechanism rather than an implementing entity which reflected in the slow pace of implementation. What is equally, if not more important, is to recognise the needs of the program and enable the societies with adequate management capacities[23] and well laid down administrative and financial framework and establishing a line of control for the state level implementing entity over the district level implementing entity. This is illustrated by the following table which compares the implementation period of the RCH and the WCD projects:

Box 6
Instance of inadequate management structure at state level
In Rajasthan Reproductive and Child Health project (RCH-I) was under the charge of a Commissioner, who also held other charges. Financial management responsibilities of the entire state project unit were being managed by one financial consultant. Similarly in the Sikar District only one person, the RCH officer was managing entire project. Financial responsibilities were managed by a Statistical Assistant

Table No: V
Comparison of implementation period of two bank funded projects

S.No	Project	Funds Flow through	Credit Amount (USD Mill)	Planned Implementation period	Actual implementation period **
1	Women & Child Development *	State Treasury	240	5 yrs	6 ½ yrs ***
2	Reproductive & Child Health- I	State Society	240	5 yrs	7 yrs

* Project scope expanded to include additional states and funds also allocated to other projects. Credit amount is net of reallocation to other projects
** both the projects have also been faced with issues such as over estimation of costs and other implementation delays
**.* considering the proposed extension till March 31, 2006.

10. Way forward: program management capacity at all levels is critical for the successful implementation of the project. The creation of society as a ‘funds flow’ mechanism may be a necessary, but not a sufficient, condition for effective utilisation of funds and for program implementation. Going forward GOI should, during the appraisal of the new CSS programs ensure that :

[22] District level in case of DRDAs
[23] The GOI has launched a new program NFFWP targeting 150 backward districts of the country. The budget outlay for the program in 2005-06 is Rs 54,000 million and is to be implemented by the DRDAs. The program guidelines do not address the need for augmenting the program management capacity of the DRDA to handle a new project.

- implementation arrangements are assessed at all levels for adequacy of the management capacity, and that the administrative and financial framework, including financial delegation are appropriate and commensurate with the size of the program to ensure effective implementation. This should also be reviewed periodically during implementation. New programs implemented through existing implementation structures or increased allocation to an on-going program should provide for enhancement of management and implementation capacity.

- Society mechanism should create an enabling environment and is not adopted merely as a funds flow mechanism.

- project directors in the ministries are given some level of structured financial delegation and built into the design of the scheme.

V. BUDGETS & ANNUAL WORK PLANS

1. **Budget Estimates**: Annual budget exercise in GOI for CSS programs is not a bottom up approach. Estimates of the resource requirements are prepared, without taking inputs from the States or recognizing their absorptive capacity. Projects like NACP-II have also not benefited from additional funds committed by various development partners due to overall budget ceilings, which has meant that the share of each development partner within the overall annual budget for the program has reduced and the implementation period of the project has been extended. The states are also not informed of the indicative budget allocation for the year. This is particularly relevant in case of projects which have adopted the treasury model, as similar budget provisions are required to be made in the State budget and approved by the state legislature before funds can be released. The lack of adequate budget provision at the State level can affect the funds flow to the implementing agencies. Alternatively excess provisions in the state budget could result in under utilization of budgets and inviting audit references in the audit report of the CAG. The following tables from two projects illustrate this:

Table VI (a)

Mismatch in Fund Transfer from GOI and budget provision in the state Women and Child Development Project - Rajasthan

Rs. million

Financial Year	Fund Transfer by GOI	Budget Provision in the State	
		Budget Estimate	Revised Estimate
1999-2000	90	49	3
2000-2001	150	666	342
2001-2002	350	580	625
2002-2003	335	403	527
2003-2004	320	383	328
2004-2005	401	250	314

Table VI (b)

RCH- Compensation for sterilization for one state**

Rs. million

Financial Year	Fund Transfer by GOI	Budget Provision in the State	
		Budget Estimate	State Release
2001-2002	93	26	9
2002-2003	126	30	7
2003-2004	175	36	11
2004-2005 @	41	36	nil

@ upto August 2004

Source:* data provided by Rajasthan project, ** AF Fergusson Treasury report on RCH*

2. **Annual Work Plans**: Certain projects such as the AIDS Control Program, SSA and more recently the RCH-Phase II programs have moved to a concept of state based plans, wherein the states are required to submit AWPs. Similar AWP are also being prepared by the states and district in the Tuberculosis project. The districts identify the level of performance that they would like to achieve and identify activities that are to be performed and the budgets required for the same against which funds are made available. The concept of mid year review of progress against AWP by GOI is however yet to develop. Also the time frame for preparation and submission of AWP by States is such that

it does not form an input to annual budget process at the GOI level. Given that these are recent initiatives, it would take time to build capacities and advance the time frame for submission of such AWP. Also in the absence of communication of the indicative resource envelope from GOI to states the AWP at times tend to be a wish 'list.'[24] However as social sector projects have a lower absorptive capacity and have tended to under utilize their approved allocation this has not been a serious constraint. In the projects involving PRIs also budgeting is done at local level without any reference to the overall resource envelope resulting in variation between budget, sanctioned expenditure and fund release.

3. **Conclusions and way forward:** the change from top down to bottom up approach to budgeting in certain projects is in line with the state based planning as discussed in section III of this report. However shift to decentralized planning based on state AWP and its appraisal and approval by GOI will bring some degree of certainty in the likely resource transfer from GOI. Going forward GOI should:

- communicate to the states and state societies the likely annual allocation for the previous year based on provisional budgets estimates. This would enable the state plan and prioritize activities which are dovetailed to the quantum of funds likely to be received from GOI. Such an approach will also prevent the annual work plan from being a wish list. The allocations should be reviewed at mid year based on actual progress by the states against the plan and decisions on re-allocation across states could be made.
- Such an approach should be further devolved to the districts and eventually the PRI in line with their increasing capacity to plan and manage projects.

[24] AWP of Andhra Pradesh in the NACP-II project have been highly ambitious and faced cuts during the appraisal by GOI.

VI. FUNDS FLOW & FUNDS MANAGEMENT

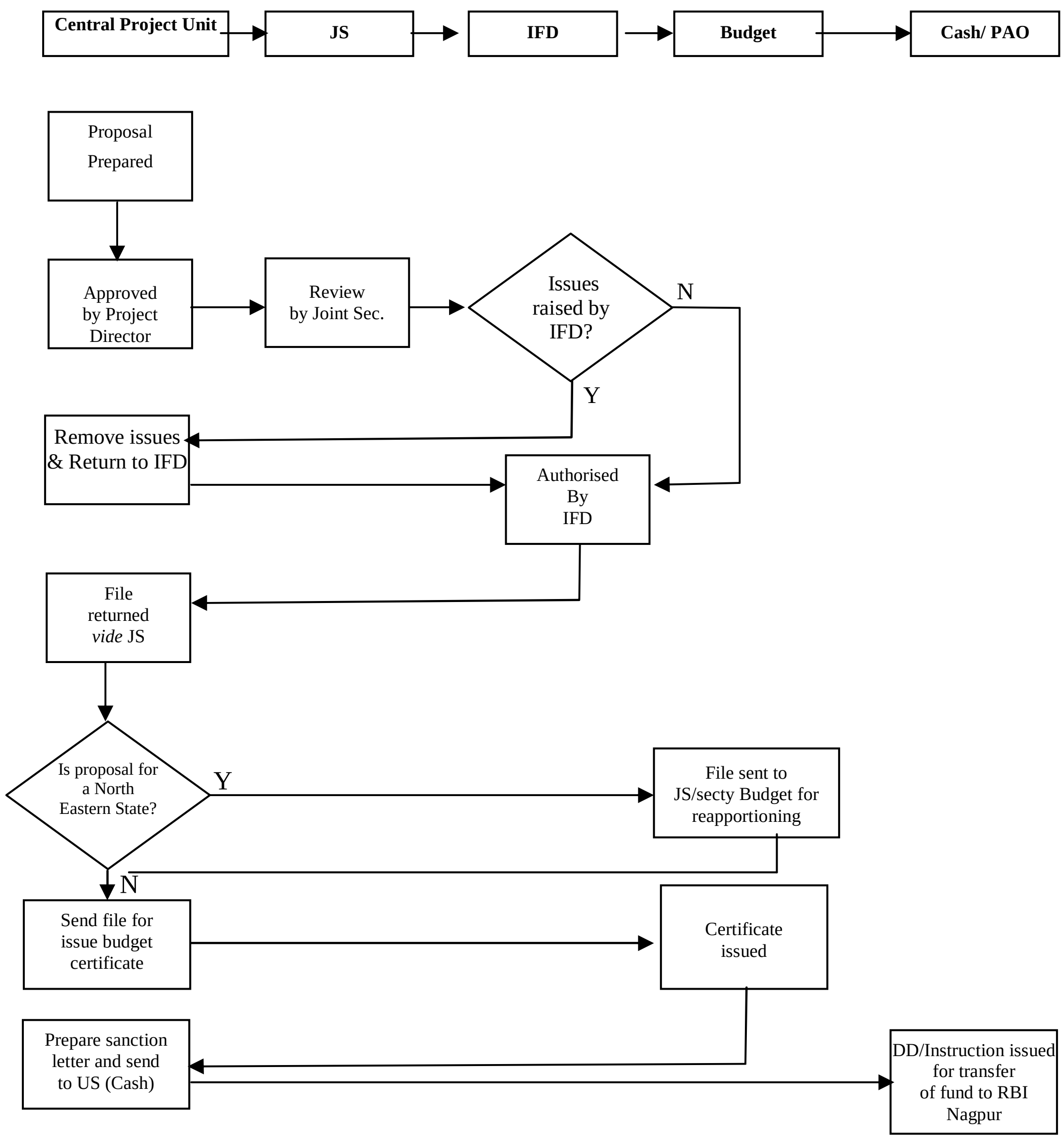
1. Given the multiple layers through which the funds flow in CSS and the consequent delays before it is available to the implementing units, ensuring timely availability of funds has been one of the primary focus of GOI. The funds flow is affected by

- the approval process for the transfer; and,
- the physical mode of transfer.

Transfer of funds by GOI to States

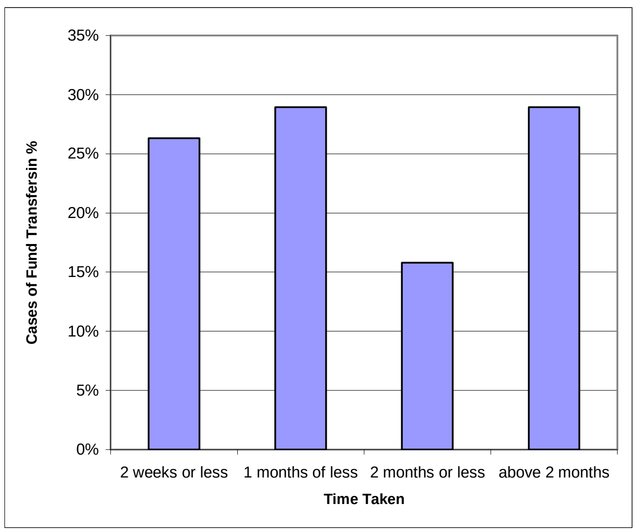
2. ***Approval for transfer & release of funds at GOI level*****:** The approval process for transfer of funds from the GOI to the States is time consuming especially when files are referred back by IFD to the CPMU. The typical process followed is depicted below:

Chart 1: Flow chart for approval Process for funds release



3. Normally funds are transferred in two installments to the States. The first transfer is normally effected in May/ June of each financial year and the second, based on the actual utilization of fund is planned for November/ December. In the normal course the approval and the release process takes 20 days to a month The release of the first installment normally is not affected by the need for utilization certificate confirming the utilization of the earlier installments, while prior to the release of the 2nd installment a utilization certificate[25] (in case of transfers to autonomous societies) and Statements of expenditure (in case of transfers to State treasuries)[26] is required. In some cases details on physical progress has also been sought by IFD. However numerous instances have been observed where approvals have taken longer than a month. In the WCD project, following chart illustrates that approval of sanctions for funds release at the GOI level has taken more than 2 months in 30 % of the cases for sample states. Certain clearances have even taken 4-6 months.

Chart 2:
Percentage-wise time taken in processing fund releases over 1999-2004 at GOI, WCD Project for 3 sample states



4. Based on the discussions with various project management units, the perception is that the IFD is not consistent with the information that they seek or require prior to approval. However as IFD perform a critical task, i.e. checking if funds are being utilized in an adequate manner and not lying unused, this perception is perhaps unjustified. The guidelines for various programs in the MORD clearly lay down the process and documents required for release of the first and second installment and a recent NWFFP links fund

[25] Rule 151(1) of the GFR, 1963 requires that utilization certificate should be submitted within one year of the close of the financial year by the institution concerned. The Task Force for review of the GFRs 1963 has recommended that the period be reduced to 9 months.

[26] There is no specific provision in the GFRs which require State Governments to submit a utilization certificate to the GOI, but in case of externally aided projects, where reimbursement has to be claimed, SOE are insisted upon from the States. Audit certificates are expected to be submitted by the states. (see section on external audit for backlog in furnishing of audit certificates)

release to financial and physical progress. Similarly, in the RCH phase II, the fund release function within the program unit has been vested with the FMG, which has developed a checklist on issues that need to be available in the sanction file, prior to submission to the IFD. This mechanism has helped in reducing the delay in approval of sanctions by the IFD.

Box 7:
Guidelines from NFFWP- Conditions for release of 2nd installment
(para 4.4, chapter IV)

- 60% of the total available funds should have been utilized.
- Opening balance of the district and all implementing agencies should not exceed 15% of the funds available during the previous year.
- Submission of audit reports, action taken reports on the comments made in the audit report of the previous year and a certificate from the auditor that advances have not been treated as expenditure.
- Submission of utilization certificate.
- Submission of non-diversion and non-embezzlement certificate.
- Submission of all pending progress/monitoring reports.
- Submission of a statement about number of inspections conducted by officers at Block, sub-divisional, district and state level.

5. **Mode of transfer:** While all fund transfers to the State Treasury are effected through Reserve bank of India Nagpur[27], funds to the State Societies are sent through 'Demand Draft'[28] which also contributes to the delay in transfer of funds.

Transfer of funds from States to District Blocks

6. **Approval process**: Once funds are transferred to states, these need to be transferred to the district / blocks.[29]Since CSS are implemented by the states the approval processes in the state plays an important role in funds flowing to the lower level implementing units. It has been found that these processes vary from state to state. One of the reasons for lower pace of utilization of funds is the rather cumbersome system of providing approvals. In the states/ project visited, it was observed that almost every proposal mooted by a project management required approval not only by the secretary of the concerned department, but often also by the concerned Minister. This is one of the main reasons for delay in the implementation of projects. While GOI has no control over this aspect under the treasury model, it is marginally better under the society model where some level of financial delegation have been provided to the project directors in some states. Under the WCD project in Tamil Nadu an Empowered Committee was set up which consists of a number of secretaries of different depts. Such a step, instead of reducing delays in the approval process has resulted in further delays, which is demonstrated by the following instances:

[27] A recent study submitted by the National Institute of Administrative Research to the Planning Commission on Funds Flow monitoring has indicated that there are many instances of delays in RBI effecting credits to state consolidated fund..
[28] Funds to the DRDA's except North East States and Jammu and Kashmir is transmitted through telegraphic transfers.
[29] Exceptions being the DRDA's which receive funds directly from the GOI and there is no State level entity and the State Aids Control Societies which in most States do not have District Societies.

- To streamline and expedite expenditure utilization in Udisha project, GOI asked the state to form a Designated Committee for approval purposes. It took the government of Tamil Nadu more than a year just for formation of the committee, thus defeating the very purpose of the exercise.

- A proposal of Rs 44,200 for organising a Pavillion at Trade Fair was initiated on Sept 4, 2002 and was approved on October 7, 2002, but the Government Order (GO) however was issued only on October 30, 2003. As a result the project was able to participate in the exhibition, not in the year in which it was proposed, but in that of the following year.

- A Rs 1.4 million proposal for initiating a monitoring study was initiated on may 30, 2001 for which the GO was approved in May 2002. The reason for the delay was attributed to certain queries raised by one of the committee members on the cost aspects.

7. In Bihar all proposals of more than Rs 25 lakhs need to be approved by the Cabinet, is another example of how excessive centralisation of authorisation process can stall all activities. The long and circuitous route, involving file to travel to Chief Minister at least 3 times before any activity can be approved[30]. Such delays in approval at the state Govt. level, ultimately delay the project implementation. In Andaman & Nicobar, for example, Finance dept. had to give around 1900 concurrence during 2003-04 on various proposals.[31] If Finance Dept. of a small Union Territory (UT) has to provide more than 1900 approvals, one can consider number of approvals that the larger states may be required to provide.

8. The society model, on the other hand, allows more flexibility as the funds are available in the bank account of the state society and can be transferred to the district by the state societies. However delays are experienced due to lack of delegation to the project directors and the need for approval by the chairman of the society i.e. the secretary of the concerned department, in most cases which at times can take up to a month[32]

9. **Mode of Transfer**: Under the treasury model the normal practice of allocations to block is decided upon by the state unit and intimated to both the district/block unit as well as the state treasury, which allocates funds accordingly. The project units at the blocks accordingly obtain fund release from the treasury based on submission of bills and subject to budgetary discipline inherent in the treasury

Box 8:
Exemption from expenditure control restrictions on CSS

Tamil Nadu has recently issued a GO which exempts certain schemes, including CSS from the operation of quarterly expenditure control restrictions.[33]

[30] Based on a report published in Indian Express on 16-3-05 by Vargheese K George. Similar conclusions have been given in a study by Dr NC Saxena on Central Financial Transfers to Bihar.

[31] Circular dt. 24-8-2004 issued by Chief Secretary, A&N Administration

[32] In the Malaria Control Project in Orissa, all approvals for fund transfer have to be given by the Secretary (Health) and the project director had no financial delegation, which often delays the transfer form the integrated state society to project bank account by one month.

[33] GO 167 dated March 31, 2004 exempts CSS, projects shared between GOI and GoTN, externally aided projects (EAPs) and schemes funded through loan assistance from financial institutions from the operation of quarterly control of appropriations.

system. Fund releases could also be subject to delays in States facing a tight fiscal position and running overdraft with the Reserve Bank of India (RBI).

10. Under the society model the delay is primarily attributable to the physical mode of transfer, i.e by demand draft and delays in clearance of cheques. The delay in fund transfer is more acute in the case of rural development schemes where funds flow to the three tiers of PRIs and the use of localized rural banks and delays in inter- bank clearance.

11. A recent study conducted by the Planning Commission on monitoring of funds flow in CSS has also concluded that (a) there are significant delays in transfer of funds to and from state treasuries to the implementing units and the delay has a close co-relation to the fiscal stress and quality of accounting in the states; (b) At central level, schemes with an ability to enforce greater adherence to conditions of prior expenditure by the states before making subsequent releases, clearly showed smaller time lags in releases at the intermediate level. See annexure V detailed conclusions of the study.

Issue of Idle Funds

12. One of the downside of the Society model, where funds are normally transferred twice a year is the issue of idle funds. A funds flow analysis for the year 2003-04 of the TB project, a small project relatively, indicates that the level of idle funds across various states and district societies could be approx Rs 250 million. This works out to approx 40% of the total utilization of Rs 626 million by the states during the year. Similar situation is likely in schemes with significantly larger outlays. The audit reports of the CAG have also regularly highlighted the issue of large funds lying idle in bank accounts or as deposits in PL accounts[34]. Given the nature of the CSS and the large number of implementing units (at a minimum of 600 districts) while some minimum level of cash float is necessary to maintain smooth operations, the large amount of idle funds is perhaps the main cause for concern and possibly attraction for state governments which face a tight fiscal position and run overdraft positions to insist that funds be routed through the consolidated fund of the state. Under the RCH phase I project the Government of Rajasthan temporarily utilized the idle funds aggregating to Rs 240 million lying in the state society in the year 2000-01 by transferring the surplus from the RCH society into the Public Account of the State[35].

Use of E- Banking Facilities

13. Most of the CSS have not been able to develop an effective MIS which would enable the CPMU and the FA to know on a periodic basis the actual level of physical funds and the advances/ deposits at various state and district Societies. The Ministry of Rural Development (MORD) has developed an on line data entry system for updating the financial status based on which the funds available with each DRDA could be tracked, but this is undermined to some extent by the backlogs in data entry by many districts[36]. Some other recent initiatives in this direction are the RCH, phase II program where an e-banking

[34] Para 3.5.2 and para 3.5.4 – CAG report 3 of 2003
[35] RCH –I project audit report for the state of Rajasthan the year 2000-01.
[36] The website of the MORD indicates that 187 districts have not updated the data in the system.

solution is being piloted which could address the issue of funds flow, as well as availability on-line, of the status of fund utilization at each level. Similarly the *Prime Minister's Grameen Sadak Yojana* (PMGSY) project has also developed an on-line accounting and monitoring system with the assistance of Center for Development of Telematics (C-DAC). There have also been some simple but effective initiatives to reduce delays in fund transfer at the state and PRI level. For e.g. in Bihar under the ICDS program all the scheme accounts in a district with a single bank, which facilitates cheque clearance and in Karnataka funds are remitted electronically to all GPs.

14. **Way forward:** There is a need to address constraints in approval process, both at the state and central level and adopt the opportunities provided by improvement in banking, IT and communication to further streamline the funds flow process. Going forwards GOI should:

- Review the sanction and fund release process within the ministries in order to reduce the time taken for fund release. Line ministries should have clear guidelines for funds release for all CSS projects. This would bring about transparency and objectiveness in the review and approval process and would also reduce the time taken for approval. States could also be encouraged to adopt similar guidelines for CSS projects where funds flow though the treasury.

- Require states to incorporate appropriate financial delegation for state and district level project directors managing CSS as part of the design.

- Develop a road map for use of e-banking facility, which is increasingly becoming available for transfer of funds to states and districts and eventually to the PRIs. Also with the improvements information technology and lowering of communication costs effective Management Information Systems (MIS) must be developed through which funds can be tracked.

- With the combination of improvement in the approval process, less number of schemes, appropriately skilled finance personnel at all the levels, use of IT based systems, a plan to move to a quarterly funds from GOI could be envisaged in the medium term. This will address the incidence of idle funds. Given the opportunity cost of such idle funds, the pay back on investment in IT systems could be even less than one year.

VII. ACCOUNTING FRAMEWORK

Accounting Framework

1. Government accounting system in India is rule based[37]. Basic principles of Government accounts are enunciated in the Government Accounting Rules. The Accounts Code, the Financial Code and the Treasury Codes all form part of Government accounting structure.

Basis of Accounting

2. **All fund releases by GOI for CSS, both to the State Treasuries and to the state societies are recognised as "Grant in Aid' in the accounts of GOI and is reported to the Parliament as expenditure**. The down stream financial management aspects such as utilization, financial reporting and audit assurance essentially comes under the realm of financial monitoring.

3. The risk of un-utilized budgets lapsing at the end of the financial year creates the pressure to '**spend**' the budget at GOI level. This often results in the ministries pushing funds out, particularly in the last quarter of the year, despite instructions from the ministry of finance to restrict fund transfers in the last quarter to not more than 1/3rd of the budget allocation. Similar pressure is also faced in the states where the CSS funds flow through the treasury. CAG reports regularly identify this practice, both in the GOI and the audit reports of the states. The following table as reported in one of the CAG reports highlights this practice of transferring funds not only in the last quarter but sometimes even during the last month.

Table No VII

Instances of large fund release in the last quarter of the Financial Year

Year	Total funds disbursed during the year *(Rs in million)*	Disbursed during the last qtr.	Disbursed during March
1997-98	900	23 %	13 %
1998-99	59	100 %	100 %
1999-00	700	100 %	100 %
2000-01	609	100 %	100 %
2001-02	92	24 %	24 %

Source: CAG's Audit report 3 of 2003 for National Scheme of Liberation and Rehabilitation of Scavengers

4. An analysis of the of the fund transfers for the 3 sample states over 5 years in the WCD project indicated that on an average 47 % of transfers have taken place in during the last quarter, with 53% of that taking place in the month of March.

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[37] With a view to move from a rule based to a Standards based accounting and financial reporting the CAG has constituted the GASAB, which is developing accounting standards for the government sector.

Accounting Practices & Policies at State Level

5. The accounting practice and policies is determined on the basis of whether the project at the state level is departmentally implemented or by state or district societies.

6. **Treasury model:** Accounting in the state government is on the basis of the existing treasury system and the accounts are compiled by the state Accountant General (Accounts & Entitlement). AG (A & E) The state financial rules and procedures are applicable to the CSS project also and GOI has no control over the varying administrative processes and the effectiveness of the internal control in individual states. A uniform account code structure is followed across the country, both in the GOI and the states. This ensures that the broad budget heads used by states implementing CSS are common across the country and normally for externally aided projects (EAP) a separate budget line is used. However the limitations of the treasury model however are:

- As states also follow a cash basis of accounting, releases from the state treasury are accounted as expenditure.

- CSS projects, including EAP are normally budgeted and consequently accounted under a single line item[38] in the accounts with the exception being a distinction between revenue and capital. It is, therefore, not possible to obtain financial reports activity wise from the regular accounting system of the treasury and AG (A & E) which could facilitate monitoring on a periodic basis.

- The departmental accounts are often not reconciled (sometimes not reconciled for years on) with the accounting records of the AG (A & E), leading to concerns on the correctness of the reported expenditures.

- No financial statements are prepared by the states and consequently no opinion on the financial statements is provided by the CAG.[39]

- In the states of UP it was observed that the finance department does not track fund receipts for CSS and it is left to the department implementing the project.

Some states have initiated efforts to improve the financial management and internal control aspects by linking fund release to settlement of advances, reconciliation and submission of Utilization certificates.

[38] An Expert Group has recently published a report on present Govt. structure of account codes and its suitability to display the nature and objective of Govt. expenditure. The Group has recommended adoption of a computerised multi-dimensional classification code. Major benefits of proposed scheme are expected to be improved data extraction, in the form required and would allow transfers to functions and programs. It will also facilitate transition to accrual accounting.

[39] CAG provides an audit certificate confirming the eligibility of the expenditures incurred

Box 9:
Example of Linking fund release to adherence to financial discipline
The Andhra Pradesh Government has issued a GO (GO 507) which is an important step in setting the framework for financial accountability. The GO targets key accounting controls which affect the timeliness and reliability of the accounts, being: replies to audit observations, settlement of abstract contingency bills, submission of expenditure statements and utilization certificates and links release of further funds or payments of bills to compliance with enforcement via the treasury departments

7. **Society model**: The accounting framework, which governs the accounting policies, format of financial statement and disclosure requirement for projects implemented through the society model is weak. These appear to have evolved more by practice and experience. The accounting framework of the state and district societies is impacted by the following:

- **The Societies Registration Act, 1860 or equivalent state act that they are formed under**: These acts[40] only require that accounts be prepared by the society and be audited by a chartered accountant; there is no reference to the accounting standards that are to be used.

- **The GFRs 1963 of the GOI**: The GFRs on Grants in aid and loans indicate that Utilization Certificates (UC) and audited accounts are to be furnished by the autonomous agencies receiving the grant from the GOI, within one year of the close of the financial year. The recommendations of the task force for review of the GFRs have incorporated a clause under the rule 209 (6) (xiii) which states that the standard formats for presentation of financial statements formulated by the MoF shall apply to all for Central Autonomous Organizations. This however does not cover the state and district societies, as these are state bodies and the GFR of the GOI does not apply to them.

- **The Accounting Standards Issued by the ICAI**: The ICAI' Technical Guide on Accounting and Auditing in Not-for-Profit Organisations which clarifies the applicability of accounting and audit assurance standards to such entities. The ICAI has issued clarifications that the Accounting Standards issued by the ICAI ***do not apply to not-for-profit entities, if no part of the activity is commercial, industrial or business in nature[41].*** (see annex 3 for the extract) There is an ambiguity on the applicability of the Accounting Standards to the state and district societies.

8. In practice most of the state and district societies are following a cash accounting system[42]. In most cases it has been observed that the financial statements are prepared and audited by the Chartered Accountants not only undermining the audit but significant variations have been noticed in the accounting policies adopted, in the format of financial statements and the disclosures. During transaction audit by CAG and MoRD, the DRDA

[40] The Societies registration Act, 1860 does not spell out any requirements but subsequent acts enacted by the states require a receipt and payment and balance sheet to be prepared.
[41] The ICAI has however recommended that even if no activity of commercial, industrial or business nature is carried out, the Accounting Standards be used such entities.
[42] The DRDA accounting manual requires accounts to be maintained on an accrual basis

accounts were found lacking in depth and scope.[43] Please see annexure VI for inconsistencies in application of accounting policies from various audited financial statements received in Bank funded projects. Many projects have prepared accounting manuals, which seeks to address this issue, but there is a clearly a need for uniform accounting policies distinguishing between expenditure and advance, standard format for financial reporting and disclosures. For e.g. the CAG audit report no 3 of 2003 on the SGSY scheme indicates that out of the expenditure of Rs 9884 million test checked there is a over reporting of expenditure to the extent of Rs 2440 million (approx 25%).These relate to outstanding advances, deposits in personal ledger accounts, term deposits in banks etc being reported as expenditure. A clear set of accounting policy and disclosure requirement could help in addressing this issue either in the accounting process itself or during the course of audit.

9. Ministry of Finance appointed a Committee of Experts in May 1999 which finalised a Uniform Format of accounts for Central Autonomous Bodies and suggested the use of accrual accounting. The format is a vast improvement on non-standard accounts being prepared by most such organisations. However the format is more in line with financial reporting for a commercial entity. There is no requirement for functional reporting or disclosure by activities, which is more relevant in the social sector. Also there is a lack of awareness within the ministries implementing CSS schemes of this format and none of the ministries have adopted the Uniform Format of Accounts as finalised by the Expert Committee.

10. A review of some international accounting standards and practices for the not-for-profit entities indicates the following:

- In the United Kingdom the Accounting Standards Board (ASB) has issued a Statement of Recommended Practices (SORP) for 'Accounting and Reporting by Charities' in 2005. It is an exhaustive document and provides guidance on the format of the financial statements, policies on recognition of resources expended, additional disclosures requirement and the contents of the annual report which focuses on achievement and performance. In addition the ASB has issued a discussion paper on Statement of Principles for Financial Reporting for 'Public Benefit Entities'.

- In the United States of America, the Financial Accounting Standard Board (FASB) has issued FASB- 117 which provides for the format of financial statements for Not-for-Profit Organisations which also provides for financial reporting by functions i.e activities.

11. While strictly the international practices are not directly applicable to this unique model of state and district societies, the need for standard financial reporting is something that needs urgent attention. This is illustrated by the extract from the financial regulations clause 7.10 (i) of the *Maharastra Prathmic Shikshan Parishad* (implementing

[43] World Bank synthesis report on Public Financial Management and Accountability in PRIs- para 4 in external auditing section.

the SSA program) which reads " the Parishad shall maintain an annual statement of accounts including the Balance Sheet in such form as the Central Government prescribes". The state societies thus look to the GOI to specify the financial reporting and disclosure requirements.

12. **Conclusions and Way Forward:** the institutional framework for accounting and financial reporting is unclear, with no clear mandate either in the GFR or the Societies Registration Act. This has led to application of varying accounting policies by each project. The use of the society model has also meant that the state budgets an financial statements do not reflect the 'off budget' transfer. With states also following a policy of accounting releases as expenditure, expenditures get reported to the GOI even if no activity has happened on the ground. There is clearly a need for developing uniform formats of financial reporting and disclosure for both the societies and state departments.Going forward GOI needs to:

- in the near term build on the initial initiatives of the expert committee and develop, in consultation with the CGA and ICAI, a framework for standard financial reporting, with uniform and consistent accounting policies and disclosure requirements for the state and district societies. This should reflect the specific needs of the social sector where the traditional account classification may be less useful and relevant. These would also be relevant in the broader context of many societies receiving funding exclusively from the states. These would also need to be elucidated in the GFRs of both the GOI and of the states.

- in the medium to longer term should consider amending the Societies Registration Act, 1860 to incorporate provisions regarding: maintenance of accounts and disclosure requirements, compliance with Indian Accounting Standards, filing of accounts, appointment of auditors and constitutions of audit committee.

- Require projects implemented through state treasury to prepare financial statements (statement of sources and uses of funds) and the accounting policies used to prepare the financial statements.

- Consider creating a non lapsable fund or '*kosh'* for major CSS which could reduce the pressure to release funds especially close to year end and spend the budget.

- GASAB to consider and address the issue of off budget financing and commodity grants from GOI while developing accounting standards, which would provide for appropriate disclosures both in the budget and in the annual financial statements of the states.

VIII. INTERNAL CONTROL & AUDIT, REPORTING & MONITORING

Internal Control

1. While the funds flowing through the state treasuries are subject to the normal budgetary and internal control framework and rules of the state, the internal control framework in societies is driven by the program guidelines & administrative guidelines, scheme formulations and the accounting manual of each of the project prepared by the CPMU. In some of the societies[44], in which states are also required to contribute a share, the financial regulations of the society have been approved by the finance dept of the state. This creates a sense of ownership and responsibility of the state. The actual compliance with such internal controls is however is weak as indicated in selected management letters of the auditors. For a list of such instances refer to annex VII.

Internal/Management Audit

2. The need for a regular review and monitoring of the program can not be overstated. Such a review can include financial and physical progress, accuracy of the reports being submitted, adequacy and effectiveness of the internal controls in the implementing units, identifying operational bottlenecks & constraints in flow of funds or implementation, vacancies in staff, shortages or delays in delivery of books or drugs etc. This can be achieved through a mechanism of management or internal audit. However the internal audit system which can periodically review the adherence to such internal controls and procedures is either not in existence or the internal auditor is from within the society or agency compromising on its independence. The SSA program has state level internal auditors, while in the MORD, the CCA carries out audit reviews which covers approx 40 to 50 districts in a year Some new initiatives for management audit and states review based on financial management indicators are given below.

Box 10:
RCH-II: Use of Financial Management Indicators as a basis for review of states and districts

A set of financial management indicators, classified into staffing and empowerment related and financial performance related[45], been developed by the MOHFW in the RCH, phase II program. This along with output and outcome indicators will be used to determining the frequency of state reviews by GOI, additional performance allocation to states and in identifying additional capacity support for states/ districts.

Box 11
SSA – Independent Agency for Management Audit

The SSA program has appointed an independent agency, the Institute of Public Auditors of India (IPAI) to carry out a management review, which is a combination of management audit and PER of selected states and districts. This review focuses on the physical and financial progress, quality and accuracy of the data submitted by the field to the district units, physical verification of the assets, identifying operational delays etc

[44] *Maharastra Prathmic Shikshan Parishad* (implementing the SSA program)
[45] This looks at the quality and adequacy of finance staff, adequacy of financial delegation, the plan verses actual expenditure, quality and timeliness of financial reports, financial statements & audit reports, audit observations and settlement of audit observations etc.

3. Under the treasury model the states also have their own internal audit departments but the focus is more on checking compliance with the procedures. In the WCD project in Rajasthan, it was observed that the project involves its internal auditors to undertake reconciliation with the AG (Accounts) and in UP, the internal audit normally follows up on resolving audit objections that the audit made during the annual audits. A recent review by the CAG of the performance of the internal audit function across states has concluded that there are significant delays in internal audit, shortage of staff in the internal audit departments and lack of compliance or response to internal audit observations.[46]

Monitoring Reports – Financial and Physical

4. In most of the programs the financial reports or statements of expenditure (SOE) are submitted on a quarterly basis. The timeliness of submission of financial reports is linked to the quantum of funds released. For instance in the WCD project the states receiving larger financial assistance (called project states) are reasonably regular in submission of the SOE's, while there is a backlog in submission of SOE's by the states receiving funds for training component under which relatively less quantum of funds are transferred[47]. Similarly under RCH-I where funds were released activity wise, there were delays in submission of UC and SOE's. In 2001 the Dept. of Family Welfare (DOFW) had to engage a firm of chartered accountants to visit the states to collect UC/SOE from the states. Also given the lack of clear accounting policies which distinguish expenditures and advances/ deposits and the cash basis of accounting followed under the treasury model expenditures tend to be overstated, For e.g in the WCD project releases from the departments to DRDAs/ Zila Parishads for construction of *Anganwadi Centers* (Day care centers) are recorded as expenditure at the time of release of funds and reported to the GOI as expenditure. However the system of monitoring the receipt of utilization certificate for such transfers is not very effective[48]. Similar observations abound in the audit reports of the CAG on various programs of the rural development (see Table I). To some extent the issue of excess reporting is driven by the fact that subsequent fund release by GOI in rural development programs are linked minimum level of spending. District units have to spend at least 60 percent of the available funds to obtain the second instalment, thereby putting pressure on them to transfer funds to lower level implementing units and report it as expenditure[49]. Some recent initiatives which require the auditors to verify a reconciliation statement between the expenditures as per the quarterly financial reports/ SOE and the expenditure as per the audited financial statements has been useful in the NACP-II project to identify any excess or short reporting.

[46] various state audit reports of the CAG for the year ended March 31, 2003

[47] As per the quarterly progress report (Sept 30, 2004) of the WCD project eight states had not submitted SOE for the quarter ended June 30, 2004 and 16 states for the quarter ended Sept 30, 2004..

[48] Various Audit reports of project States of the WCD project by the CAG which indicate that UCs are pending.

[49] A recent Bank study Public Financial management in Bihar indicates that in order to demonstrate utilization of at-least 60 %, funds are transferred from DRDA to bank accounts held by junior engineers or Gram Panchayat secretaries and others. This gives a misleading picture of actual achievement and also results in loss of control and increases the risk of misuse of funds, since there is no systematic process for monitoring and controlling the creation and use of such accounts.

5. The projects covered in the field visits are also submitting data on key physical outputs achieved, based on information received from the field level workers or implementing units who maintain registers to record such information. This does not come along with the financial reports and co-relation between financial and physical progress is often not possible. While financial information contained in the report is normally subjected to some degree of check by way of audits, the physical aspect of information is normally not subjected to any regular checks. In this regard, it was observed that TB project has provided guidance notes to its state units on undertaking regular monitoring of quarterly reports and some evidence for undertaking district-wise monitoring of quarterly reports was generally seen. WHO consultants, based in the states, in the TB project provide good support in this regard.

6. In the year 2000 GOI constituted a working group for suggesting measures to strengthen monitoring and evaluation systems for the social sector development schemes. See annexure VIII for a summary of recommendation. The MORD has, about a year ago appointed district and national level monitors to periodically review the progress of various rural development programs. The reports are submitted to the MORD. Synopsis of these reports along with evaluation reports and impact assessment studies are also complied and published by the monitoring and evaluation department of the MORD. We understand that the scope includes financial and physical monitoring. The MORD in the PMGSY project has instituted a good mechanism to monitor the quality of the works carried out.

Box No 12:
PMGSY: Quality Assurance Mechanism[50]

Under the PMGSY a 3-tier quality monitoring arrangement has been set up wherein National Quality Monitors (NQM) have been appointed to monitor the quality of works. The guidelines provide for minimum qualifications for appointment of monitors, clear terms of reference and actions to be taken on the reports of the NQM at the district, state and national level. ***More importantly the guidelines provide that writing a letter to the contractor or a subordinate does not constitute action taken and should not be treated as action taken***. The on line accounting and physical progress tracking system enables comparison of financial and physical progress. This information is also available on the website of the project.

Information Technology

7. The experience with developing computerized financial management systems (CFMS) in Bank funded CSS projects, which would have enabled monitoring of funds position as well as generation of financial reports for monitoring purposes, has been mixed, with more failures than successes. The CFMS developed for the NACP-II has been implemented with reasonable success. The reasons for successful implementation were a strong level of ownership within the project, adequate and appropriate finance staffing structure both in the CPMU and in the States and periodic training and upgrading of the software to address the new needs of the project. Similar initiatives for developing a CFMS in the Leprosy Control project and the WCD projects, which started in the year 1999 did not succeed as these were seen as initiatives to meet Bank's reporting requirement and there was a lack of ownership of the initiative. However where the initiatives have come from the

[50] Pmgsy.nic.in

line ministries themselves, such as MORD (PMGSY and the DRDA) the success rate has been better.

Utilization Certificate

8. The GFRs 1963 only require the state societies to submit a utilization certificate (UC) under rule 151 (1). The current requirement of the UC which is only a confirmation on the quantum of funds utilized and that it has been spent in intended purpose only serves the purpose of a control or a fiduciary document rather than a document which could enable monitoring of the financial and physical progress of the project.

> **Box 13:**
> **UC reconciled to audited financial statements: TB Project**
> In the TB project a consolidated UC reconciled with the expenditure as per the consolidated audited financial statements for the state is sent.

9. The task team for the review of GFR 1963 has recommended that in case of Central autonomous bodies, the UC clearly distinguish between the physical funds available and the advances or deposits pending with suppliers, construction agencies, staff etc, which do not constitute expenditure at that stage[51].

Conclusion and Way Forward:

10. Through the framework for internal control by way of state financial rules and accounting manuals is adequate, the compliance with such procedures internal control procedures especially in projects implemented through state and district societies is not robust. There accounting policy followed by the state and the pressure to spend money to obtain future releases leads to over-reporting of expenditures. The internal audit function, both in departmentally implemented projects and by state societies is either weak or non existent. GOI should build on various initiatives of individual ministries to improve monitoring and oversight and:

- consider de-linking the subsequent release of funds to achievement of certain minimum expenditure levels. With a shift to state and eventually district based plans fund releases should be based on the projected requirement of funds and review of the progress against the approved work plan. This will reduce the pressure to over report expenditures.

- require the ministries, states and district units to set in place mechanisms to monitor progress of the progress in line with the recommendations of the steering committee on monitoring and evaluation of social sector projects with transparent mechanism for taking actions on the reports on lines similar to the arrangements in the PMGSY project.

- require line ministries to develop a system of management audit or a risk based audit mechanism as an integral part of the design of the scheme.

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[51] Proposed rule no 212 (1) note 2 on utilization certificate

- encourage the use of low cost off the shelf accounting package, which can also be web-enabled should be considered by GOI for use in the societies. Most of such packages permit maintenance of accounts of multiple programs and consolidation. The use of such accounting packages would not only enable uniform and consistent reporting, but also facilitate monitoring of cash balances.

- consider making the proposed rule in GFR for preparation of UC for central autonomous bodies also applicable for CSS- both treasury and society to address the issue of excess reporting i.e. clearly distinguish between physical funds available and advances or deposits with suppliers, construction agencies, staff etc which do not constitute expenditure at that stage.

IX: EXTERNAL AUDIT & LEGISLATIVE OVERSIGHT

1. The independence of the auditor from the executive and the Legislature and the auditors powers are well established in the Constitution, well recognized and adequate. Under the CAG's Duties and Powers of the CAG Act, Section 13, it is the duty of the CAG to audit the expenditure from the Consolidated Fund of India and of each State and of each Union territory having a Legislative Assembly. CAG carries out certification audit of expenditures for CSS projects and also performance audit of selected CSS on an annual basis

2. **Treasury model - Audit Certification**: under the Treasury model all CSS, including externally aided are audited by the CAG. This audit is in the form of an audit certificate to confirm the eligibility of the expenditures incurred by the projects. The report of the CAG[52] indicates a high level of backlog in the issue of such certificates.

Table No: VIII
Backlog in submission of audit certificate by states for CSS

S.No	Schemes	No. of schemes for which audit certificates were			
		Due to be issued	Actually issued	Outstanding as on March 31, 2003	Percentage Outstanding
1	Central Plan Schemes	1339	860	479	36
2	Centrally Sponsored Schemes	4654	2257	2397	52
	Total	**5993**	**3117**	**2876**	**48**

3. The reasons for the delay in audit of accounts of the CSS are attributed to the delay in submission of the Statements of Expenditure by the project implementing units. This is also probably due to a lack of follow up by the GOI for the audit reports. As the projects do not prepare any set of financial statements, the audit opinion also takes the form of a certification of the eligibility of the expenditures incurred under the CSS rather than an opinion on the financial statements.

4. In bank funded projects, where reimbursements are made on the basis of actual expenditures incurred and not fund release, has resulted in the CAG disallowing expenditures for which proof of utilization is not available[53]. Such disallowances are considered for recertification only during the subsequent year's audit. The fact that states continue to receive funds from the GOI, despite issues identified in the audit reports of the CAG means there is little incentive for the states to take action on the observations in the CAG audit reports.

5. **Society model:** A society being a legal entity needs to prepare financial statements. The GFRs, 1963 require that these are submitted within one year from the close

[52] Chapter 3 of Activity Report of Indian Audit and Accounts Dept for the year 2002-03
[53] The WCD project has faced the problem of large disallowance which has been partly recovered by the Bank.

of the financial year of the society[54]. As per section 14 (1) of the DPC Act the CAG shall audit any body or authority which is substantially financed by grants or loans from the Consolidated Fund of India or of any State or Union territory having a Legislative Assembly. However most societies are audited by chartered accountants appointed by the governing body of the state or district society. The chartered accountants are required to adhere to the Audit Assurance Standards issued by the ICAI and provide an audit opinion on the financial statements.

6. **Quality and independence of private auditors**: While an opinion on the financial statements is provided by the chartered accountants the quality of the financial statements suffers on the following counts:

- lack of independence of the auditors as they are appointed by the entities themselves.[55] Also most auditors prepare the financial statements due to lack of capacity of the staff, thereby undermining their role as auditors.
- given the large number of firms of chartered accountants adherence to the Audit Assurance Standards issued by the ICAI is not always certain, though the ICAI has started initiatives on peer review mechanisms[56].
- there is no assertion or confirmation required that the funds have been used for intended purposes[57].

7. The follow up mechanism within the ministries in the GOI on the qualifications, observations and internal control weaknesses, if any, identified in the audit report of the state and district societies is also weak. The MoRD guidelines for recent schemes have incorporated a requirement of submission of action taken report on audit observations.

8. In the United States the Office of the Management and Budget issued a circular[58] which require auditors of not-for-profit entities which receive federal grants to make certain specific assertions in addition to providing an opinion on the financial statements which include a report on the internal control related to the financial statements and major programs, a report on the compliance with the laws, regulations and provisions of the grant etc. Similarly certain additional assurances are required to be provided by the auditors of private sector companies in India under the Statement on Companies (Auditors) Report Order, 2003 u/s 227 (4A) of the Companies Act, 1956. Auditors of public sector banks in India are also required to provide a Long Form audit report (LFAR).

[54] The task force for review of the GFRs has recommended reduction of the period to nine months. Most projects require audit reports to be submitted within 6 to 9 months.
[55] In the RCH project the GOI obtains a list from the CAG and circulates it to the state societies. This brings in some element of independence.
[56] In recent bank funded projects one level of filter has been introduced which requires that only chartered accountants empanelled with the CAG be appointed as auditors and appointing one auditor per state has shown improvement in the quality and consistency of the financial statements.
[57] In bank funded projects an additional opinion on the eligibility of the expenditures incurred and claimed in the SOE is provided by the auditors.
[58] Circular A-133 of the office of the Management & Budget , Govt. of USA.

Legislative Oversight

9. **Performance audit:** In addition to the regular audit certification the CAG carries out performance audits of CSS. It is understood that about three schemes are identified for performance audit each year. These highlight different aspects of the scheme, including design defects, programme performance, both financial and physical, fund outlays, release and utilisation, efficiency and effectiveness of the use of funds, institutional mechanisms and adequacy of monitoring arrangements, etc. The performance audit report of the CAG is also incorporated in the audit report of the states even if no contribution is required to be made by the states.[59]In the absence of any other formal reporting on the performance of the CSS to the parliament or legislature this is often the only independent information available to the parliament and the Public Accounts Committee on the performance of the CSS.

External reporting and Transparency

10. Each ministry is required to prepare an annual report covering all its activities, including all CSS undertaken by the concerned ministry, during a financial year. This is a qualitative in nature and is required to be submitted to the parliament along with the demand for grants.

11. Each ministry also submits along with the demand for grants a Performance Budget to be placed in the Parliament. The Performance Budget report is a collective summary of activities proposed to be implemented by the ministry. A review of the performance budget of a few departments shows that it mainly contains the budget details by various schemes and write-up about the scheme activities. It does not contain any physical targets or outputs expected to be achieved during the financial year. The performance budget also contains details of the expenditure i.e. funds released by GOI to the states towards CSS. Given the inherent time-lag in CSS, between transfer of funds to states and the actual expenditure, this timeline does not permit the actual results (financial and physical outputs) to be reported against the planned targets. Thus there is no systematic and annual feedback mechanism on actual performance of the CSS to the parliament in GOI, the legislatures in the states. The absence of such a mechanism reduces the incentive to set up efficient systems and standards for reporting.

Box 14:
From expenditures to Outcomes:
Comments of the 12th Finance Commission on Performance Budgets
(para 4.61)

A critical part of budgetary reforms must include information on the relationship between expenditures and the corresponding performance in producing real results as in determining the size of the budget and its allocation among different heads. Although in the past there have been attempts at introducing performance budgets, such endeavours have receded in importance. There is a need to bring back performance budgeting as an integral part of preparation and evaluation of budgets, both for the centre and states.

[59] The PMGSY which is a 100% financed by the GOI and uses the society model has audit findings included in the state as well as the report of GOI (year 2003-04)

12. The state and district societies are also not required by the Societies Registration Act to publish their accounts. In practice a few projects are publishing the annual report together with the audited financial statements – for e.g the state society in Gujarat implementing the SSA program and the state society in Uttar Pradesh implementing the WCD project publish an annual report together with the audited financial statements.

13. **Way Forward:** the framework for external financial audit, performance reporting and transparency in CSS needs considerable strengthening. While the quantum of funds in CSS has grown the audit assurance mechanism has not been received adequate attention. GOI should:

- In view of risk of diversion of funds of CSS by states as highlighted in the CAG audit reports, GOI should address of backlog in submission of audit certificates from the states and set up mechanisms for monitoring timely submission audit certificates from the states.

- Given that large amount of public funds are routed through the society route, approx Rs 300,000 million per annum (based on budget estimates of financial year 2005-06), the process of selection and appointment of chartered accountants as external auditors for state and district societies requires strengthening to bring in an element of independence. Alternatives could be a process similar to the appointment of the audit of Public Sector Units (PSUs), where the auditors are appointed by the CAG or a selection of auditors by a panel, as created for the appointment of auditors of Pubic Sector banks.

- develop a standard ‘Terms of Reference’ in consultation with the CAG for chartered accountants auditing societies to cover a list of additional issues such as internal control, control over assets, inventory, reconciliation of reported expenditure with actual expenditures, physical verification of a sample of projects/ beneficiaries and on which specific assurances may be sought.

- consider de-linking the performance report for CSS from the performance budget to reflect the inherent lag between the fund release and the actual expenditure. The performance report could be submitted to the parliament after a period of six-nine months after the close of the financial year when information on actual outputs and fund utilization achieved as compared to the planned targets is available. Similar report could be submitted to the state legislature on the performance of the CSS relating to the state. The performance report should also include the action taken on observations of the CAG performance audit reports. This would not only provide a mechanism to report to the parliament but also to the media and other stakeholders and will provide support to a shift in focus from fund release to actual financial and physical outputs and also provide an impetus to improve the quality of monitoring. In addition additional disclosures can be made in the annual accounts of the GOI on the status of financial performance of the CSS.

- Require the state and district societies should also be require prepare an annual report reflecting the performance for the year together with audited financial statements within a specified limit frame after the close of the financial year. Such reports should be made public and could be hosted on the web sites.

- The MoRD should consider putting findings and the action taken on reports of the district and national Level monitors also on the website. Other ministries to be encouraged to follow the transparent mechanism set up to monitor quality in the PMGSY project.

X. IMPACT OF THE INVOLVEMENT OF PRIs IN CSS

1. The MoRD has the largest budget among all the line ministries in the GOI for CSS. It finances various programs in the area of poverty alleviation, rural employment, housing and roads. A large number of these programs are implemented by the three tiers of PRIs. Currently PRI are not playing a significant role in most CSS which the Bank is currently supporting in the health and education sectors. However with the decentralization agenda of the GOI in conformity with the 73rd Constitutional amendment, the likely trend is one of increasing involvement of PRIs in all the sectors. Karnataka has taken the initiative to devolve functions, functionaries and funds to the PRIs and other states like MP, Rajasthan and UP have also made significant progress in achieving devolution of powers. This will increasingly need to be reflected in the design of the CSS and the public financial management and accountability framework in PRIs will also critically impact the overall financial accountability framework for CSS. The CAG in its report has consistently reported the issue of diversion and over-reporting of expenditures in projects of the rural development. (See table II) This study draws on the conclusions of a parallel synthesis study on Public Financial Management and Accountability in PRI's:[60]

2. The synthesis study on PFMA in PRI indicates that the accounting and accountability framework in PRI is still evolving and there are several weaknesses; the need to strengthen the framework for accountability, especially mechanisms to ensure adherence to basic financial controls, putting more trained accountants on the ground to match the increased levels of financial responsibility. There are however a series of ongoing initiatives at the Centre and State levels that have the potential for altering the accountability landscape in PRIs. Furthermore, there are several success stories. All stakeholders, especially other states, need to take note of these initiatives and consider emulating them. The conclusions on specific aspects of financial management are:

3. **Planning and Budgeting:** While the state Acts and Rules contain elaborate provisions for the preparation and approval of PRI budgets, there is a lack of information about the progress of projects at the village level. As the flow of funds is unpredictable from the higher tiers, budgeting in all three Panchayat tiers becomes a top-down rather than bottom-up and demand driven. In addition, since budgeting is done in an unrealistic manner, there is no serious attempt to forecast revenues and expenditures. Budgets are pro forma, they are prepared only to comply with statutory requirements; they are not used as a tool for financial control or long-term planning.

4. **Fund Flows:** The flow of funds to the three tier Panchayats mainly consist of Plan assistance from the Central and State governments. However, the timing and amount of these funds varies considerably from one state to another and is generally unpredictable. What further complicates the situation is that these funds come through many different paths and banking arrangements and clearance of cheques takes a long time. Also CSS funds typically move from MoRD to DRDA accounts, then to the three respective tiers of PRIs. In Rajasthan, the ZP receives these funds directly and then it moves sequentially to the Panchayat Samiti and then to the Gram Panchayat.

[60] World bank report on Public Financial Management and Accountability in PRI's

5. **Internal Control and Internal Audit:** In general, the Panchayati Raj Act and Rules of States provide for a tight set of internal controls on the use of PRI resources. However, these controls have not curbed the thousands of reported frauds and embezzlements at the PRI level. The various State Financial Accountability Assessments of the Bank (SFAAs) have documented that internal audit is either non-existent or inadequate at the PRI level.

6. **Accounting:** The accounting practices adopted by the Panchayats, each of which is an accounting unit, do not reflect the financial resources entrusted to them. Their registers and books of accounts have not been upgraded to enable them to account for the increased and diversified flow of resources in the present decentralized system. There are no accounting standards or uniform accounting codes for Panchayats. Variation exists even within the same State. Furthermore, the accounts are often late and unreliable. However, the lack of reliability is changing as a result of a recommendation put forth by the Eleventh Finance Commission, namely it entrusted the Technical Guidance and Supervision (TGS) of PRI accounts to the CAG. To fulfil the TGS mandate, the CAG has prescribed accounting formats for PRIs, as well as auditing standards, guidelines for certification audit. Eighteen states are in an advanced stage of implementing these formats; several others are modifying the formats in keeping with local requirements. PRIs are also constrained by lack of capacity particularly GPs. In Uttaranchal one secretary is allotted five to six GPs and it is the responsibility of this person to maintain the account books.

7. **External Reporting and Transparency:** Organized financial reporting is scant in any of the three PRI tiers. Each PRI tier submits financial and physical performance reports to the next higher tier. The frequency of reporting, the level of detail and quality of information contained in them varied significantly across the states and also within the same state. To improve accountability, the Central and State Governments have issued many directives that focus on enhancing transparency in the use of funds. One outcome has been to create a ‘fourth tier’ of institutions/ Community-Based Organizations (CBO) below the GP. The goal is to ensure more participation by people closest to project execution and to expect greater accountability from them. Giving the electorate access to information and introducing social audits at the *Gram Sabha* level help to ensure transparency. Good practices worth mentioning are:

- Right to Information Act (pioneered in Rajasthan; now introduced in seven other States)
- The posting of GP accounts for public display (Karnataka, UP and Kerala amongst others)
- Televising Gram Sabha proceedings (Karnataka)
- Vaarta Boards at ward headquarters display daily information regarding the names of workers, material costs, etc (Kerala)
- Citizen’s charter specifying responsibilities of each PRI tier (Andaman & Nicobar Islands)
- Jan Sunvai or public hearing (Rajasthan)

8. **External Audit:** The statutory auditor of Panchayats in all three tiers is either the Local Fund Audit (LFA) or the CAG. Chartered accountants are engaged by the District Rural Development Agency (DRDA) audit CSS funds. Although there are many audits, they tend to be late. Moreover, audit procedures are lacking or deficient. For example, PRI auditors are not required to verify assets nor does the audit encompass the existence, completeness, valuation, presentation and disclosure of the financial statements. In addition, there is no mandate for PRIs to publishing their annual performance reports or their certified financial statements. However, the TGS of the EFC has made recommendations to improve the accountability of PRIs; the CAG has prescribed an audit methodology and procedures for LFA.

9. The monitoring and evaluation reports of the MoRD[61] also indicate a low level of awareness in the community regarding schemes, eligibility criteria, eligible benefits, details of works and the types of works that could be undertaken under the schemes. The reports of the District Level Monitors (DLM) also indicate instances of wrong selection of beneficiaries especially in the rural housing scheme.

10. **Conclusions and the way forward:** More than a decade after the 73rd Constitutional Amendment, PRIs are still evolving. There is a need to strengthen the framework for accountability at PRI level, especially mechanisms to ensure adherence to basic financial controls, putting more trained accountants on the ground to match the increased levels of financial responsibility, enhancing awareness, transparency and public involvement. From a CSS perspective the conclusion that can be drawn is that the state of affairs adversely affects the level of fiduciary assurance in projects where funds flow to PRIs. There are a large number of schemes which require the PRI's to maintain separate bank accounts at the GP level and submit separate audited utilization certificates (UC). In a sense, these UCs are issued and audited in isolation of entity accounts; are often submitted on a provisional basis, particularly at year-end, to comply with requirements for drawing the second instalment under the CSS even though expenditures may not have been incurred.

11. To strengthen accountability, the Central and State Governments have issued many directives to enhance transparency in the use of funds. Two fundamental tools which will help to improve this situation are giving the electorate a right to information and introducing social audits at the Gram Sabha level. There are various initiatives to improve the financial management capacity and scope, coverage and independence of external auditors.

12. Going forward, it is important build on various successful initiatives in states like Rajasthan, Karnataka etc to increase the awareness of rural populations regarding the usage of public funds and the importance of and procedures for social audits and their right to information and transparency.

[61] Report on Monitoring and Evaluation of Rural Development Programs, MoRD, GOI , 2004

XI. FINANCIAL MANAGEMENT CAPACITY

1. The role of financial management in the ministries, in the context of CSS, has been largely confined to one of fund release and follow up for utilization certificate (UC) and audit reports and not on the broader aspects of financial management such as planning and budgeting, internal control, monitoring of state program units, training, financial reporting and audit assurance. This is primarily due to the perception of the role of financial management i.e. one of a control and accounting function rather than one that can support and facilitate effective program implementation. This is best amplified by the wording in the GFR – rule 151 (2) which reads '………the ministries will **'watch'** for receipt of utilization certificates'. Similarly the state or district societies the role of finance staff is limited to accounting not on the broader aspects of financial management and certainly not one of oversight and monitoring of lower level implementing units.

2. The responsibility for the financial management within the line ministries implementing CSS also appears to be fragmented between the CPMU, the IFD and the CCA within each ministry. To illustrate the CPMU is responsible for financial monitoring of the program, the IFD has responsibility for according sanctions for fund release and the CCA for accounting and internal audit. In addition the sensitivities with center- state relationship, often preclude the core financial management issues from being adequately addressed, both during formulation and implementation of CSS. These have a bearing on staffing the finance function with people of the requisite skill set at all levels, GOI, states and districts. The 12th Finance Commission has also commented on the lack of professionalized accounting personnel and the need to upgrade the skills of accounting personnel particularly at the lower and middle levels of the accounting hierarchy and has recommended the setting up of a National Institute of Public Financial Accountants[62].

3. **GOI Level**: In most of the Bank funded projects the finance function within the CPMU is looked after by consultants, with a few exceptions like the AIDS Control project where the GOI decided to create a position of Director (Finance) during the inception of the phase II project. In the WCD project (USD 240 million), the finance functions in the CPMU is being managed by only one officer with support from two clerical level staff. This has restricted their ability to effectively monitor the financial management performance of the project in the states. In RCH-I, for a large part the project was handled by one finance consultant. The IFD and the CCA also appear to be constrained by staff capacity to have an effective oversight over various CSS programs

4. **State Level:** There is a lack of capacity, both in terms of number of staff and the skill sets[63] in the states and districts. The existence of many small programs also does not justify deputation of staff from the state government or for engaging a full time finance staff on contractual basis. In DRDAs out of the 1486 number of sanctioned positions of finance staff in approx 250 district 657 positions are vacant are vacant[64]. In the projects

[62] Para 14.18 of the 12th Finance Commission Report

[63] Often the finance staff in the district implementing units are not familiar with double entry accounting and basics of internal control and the financial statements are prepared by the auditors.

[64] Information from approx 250 districts as available in the website of MORD (rural.nic.in)

reviewed during the field visits generally finance staffing was found to be inadequate e.g. in the Tuberculosis (exception of Tamil Nadu) and RCH projects, financial management aspects at the state level and more so at the district level were being 'managed' by persons who have had little skill sets and experience in managing the finance function. At one district in the Tuberculosis project the accounts were being maintained by a technician. Similarly in RCH phase I project district level staff was also found to be inadequate, and often persons undertaking finance related responsibilities had to take help of personnel from other projects. The WCD project on the other hand, which at the state level is integrated with general Integrated Child Development Program (ICDS) program was found to be relatively better staffed in the states. Similarly the NACP-II project has put together a good staffing structure for the finance function at the state level and is one of the reasons for the successful implementation of the computerized financial management system. One of the constraints has been the low cost norms approved for 'accountants' by the EFC.

5. The bank study on PFMA in PRI has concluded that the lack of capacity (adequacy and skills) as one of the critical constraints which needs urgent attention (see section XI)

Box 15:
Recognition of Role of Financial Management in program support
RCH-II Approach

This mindset however is showing some signs of change. In the RCH, Phase II program the MOHFW, recognizing that program and financial management are critical to program implementation is augmenting such capacities in the state and districts and empowering them with qualified finance staff. A Financial Management Group (FMG) headed by a Director (Finance) with support from qualified finance consultants has been created within the MOHFW with overall responsibility for all the financial management aspects of the program. This frees the technical professional to concentrate on technical review and support. Regular training of financial management staff is also an integral part of the RCH-II program

6. **Way forward**: the lack of financial management capacity affects the control environment and impacts the implementation of the programs. Going forward GOI should:

- recognize the need for skilled finance staff to support the effective implementation of CSS. It should review the experience of certain CSS, where a position of Director (Finance) with appropriate support team has been created within the ministries, to provide financial management support and consider building this into all programs in the design stage itself.
- The GOI could consider agreeing with the states and prescribing certain desired skill sets (e.g. minimum qualifications, IT literate etc) and the job description for the key finance functions in the state and districts. This could definitely be feasible if the number of CSS and implementing units are merged.
- Capacity building and training of the finance staff at all levels should be an integral part of the program and more particularly at the PRI level where increasingly larger resources are expected to flow. In the near term the GOI could consider engaging various national institutions such as the Institute of Pubic Auditors, National Institute of Financial Management etc to develop training modules and impart for finance staff.

ANNEXURE I

Compiled list of CSS as of Financial Year 2004-05

Sl. No.	Name of the Scheme	FY 2004-05 Budget Estimates (Rs in crores)
	DEPARTMENT OF AGRICULTURE AND CO-OPERATION	
1	Technology Mission on Cotton/Intensive Cotton prog	50.00
2	Technology Mission on Horticulture for NE Regions	200.00
3	*Agriculture Census*	13.83
4	Macro Management	1034.94
5	Integrated Scheme of Oil Seeds, Pulses, Maize, Oil Palm	152.75
6	*Comprehensive scheme for collection of Agricultural Statistics/improvement of agricultural Statistics/*	24.76
7	On-Farm Water Management(New)	50.00
		1526.28
	DEPARTMENT OF ANIMAL HUSBANDRY AND DAIRY	
8	National project on Cattle and Buffalo Breeding	55.00
9	*Assistance to State Poultry/ Duck Farms (includes)*	8.67
10	*Livestock Health*	102.50
11	Integrated Dairy Development Project	41.50
12	*Development of Inland Fisheries & Aquaculture*	27.00
13	National Welfare of Fishermen	24.50
14	*Development of marine Fisheries, Infrastructure*	46.00
15	Conservation of Threatened Livestock Breed	6.00
16	Strengthening Infra. For quality & Clean Milk	38.42
17	Fisheries Training & Extension including HRD	2.50
18	*Integrated Sample Survey*	7.50
19	Livestock Census	68.39
20	Strengthening of Data Base & Infrastructure	15.00
21	Feed and Fodder(old)	15.50
22	*Assistance to States for Establishment & Improvement of abattoirs carcass by Products Utilization Center*	0.00
		458.48
	MINISTRY OF COMMERCE	
15	*Assistance to States for IDE*	425.00
		425.00
	DEPARTMENT OF DRINKING WATER SUPPLY	
23	*Accelerated Rural Water Supply Programme*	3148.00
24	*Central Rural Sanitation Programme*	400.00
		3548.00
	DEPARTMENT OF ELEMENTARY EDUCATION AND LITERACY	
25	National Programme of Nutritional Support to Primary Education(MDM)	1675.00
26	Sarva Shiksha Abhiyan(including DPEP)	3725.23
27	Kasturba Gandhi Swatantra Vidyalaya	100.00
28	*Literacy Campaigns and Operation Restoration*	26.00
29	*PL & CE (Conti. Education for new literates)*	157.24
30	*Support to NGOs in Adult Education (including National Population Education Project)*	26.25

31	*Restructing & Reorganization of Teacher Education*	207.00
		5916.72
	MINISTRY OF ENVIRONMENT AND FORESTS	
32	Common Effuent Treatment Plant	4.00
33	Environment Management in Heritage,Pilgrimage and Tourist Centres including Taj Protection Mission	1.00
34	Biosphere Reserves	8.00
35	National River Conservation Plan (NRCP)	254.20
36	NRCP (EAP)	62.00
37	National Lake Conservation Plan	45.00
38	Project Tiger	30.00
39	Eco-development around Protected Areas (EAP)	7.25
40	Project Elephant	13.00
41	*Conservation and management of Mangroves, Coral Reefs and Wet Lands*	11.00
42	Development of NP & Sanctuaries	43.00
43	*National Afforestion Programme (NAP)*	230.00
44	*Integrated Forest Protection Scheme (IFP)*	100.00
		808.45
	DEPARTMENT OF ISM & H(now AYUSH)	
45	*Development of Institutions*	26.20
46	*Hospitals and Dipensaries*	20.02
47	*Drugs Quality Control*	7.03
		53.25
	DEPARTMENT OF HEALTH	
48	National Leprosy Eradication Programme	55.00
49	National Tuberculosis Control Programme	140.00
50	National AIDS Control programme including Blood Safety Measures and National S.T.D. Control Programme	476.00
51	National programme for Control of Blindness	88.00
52	UNDP Pilot Initiatives for Community Health	0.00
53	Integrated Vector Borne Disease Control Prog	296.00
54	National Cancer Control programme	60.00
55	*National Iodine Deficiency Disorders Control programme*	8.00
56	National Mental Health programme	33.00
57	Hospital Waste Management	5.00
58	Assistance to states for Capacity building (drug quality)	20.00
59	*Assistance to states for Capacity building for drug & PFA*	23.50
60	*Drug De-addiction Programme including assistance to States*	7.00
61	Disease Surveillance Programme	50.00
		1261.50
	DEPARTMENT OF INDUSTRIAL POLICY & PROMOTION	
62	Growth Centre Scheme	25.00
63	*Central capital Investment Scheme-NER to be transferred to DONER*	0.01
64	*Central Interest Subsidy Scheme-NER to be transferred to DONER*	0.01
65	Comprehensive Insurance Scheme	0.01
66	Package for Special category States J & K	70.00
67	Transport Subsidy Scheme	36.00
68	Capital Investment Subsidy Scheme (old)	0.25

		131.28
	MINISTRY OF LABOUR	
69	Rehabilitation of Bonded Labour	3.00
70	Estt. Of new ITIs in Northern Eastern States & Sikkim & J & K (100% assistance)	18.10
71	Testing and Certification of skills of Workers in the informal sector	0.40
		21.50
	DEPTT. OF LAND RESOURCES	
72	Integrated Wasteland Development Programme (IWDP)	448.00
73	Drought Prone area Programme (DPAP)	300.00
74	Desert Development Programme (DDP)	215.00
75	*Modernization of Revenue and Land Admn.*	70.00
		1033.00
	MINISTRY OF LAW AND JUSTICE	
76	Development of infrastructure Facilities for the Judiciary	135.00
		135.00
	MINISTRY OF NON CONVENTIONAL ENERGY SOURCES	
77	Small Hydro Power	30.00
78	SPV Demonstration	33.00
79	National project on Bio-gas Development (NPBD)	41.00
80	Integrated Rural Energy Programme (IREP)	22.00
		126.00
	MINISTRY OF ROAD TRANSPORT & HIGHWAYS	
81	Roads/Bridges of Inter-State and Economic Importance	96.00
82	Model Driver Training School	6.50
		102.50
	MINISTRY OF RURAL DEVELOPMENT	
83	Rural Housing/IAY	2500.00
84	SGSY	1000.00
85	*DRDA Admn.*	230.00
86	SGRY	5100.00
87	Training	24.40
88	PMGSY	2468.00
89	Food for work	2020.00
		13342.40
	DEPARTMENT OF WOMEN AND CHILD DEVELOPMENT	
90	Integrated Child Deveplopment Services	1837.44
91	World Bank Assisted ICDS Projects	270.00
92	*Integrated Women's Empowerment Programme (Swayamsiddha)*	20.00
93	Training of ICDS functionaries	60.00
94	Balika Samridhi Yojana	0.03
95	*Rural Women's Development and Empowerment Project (Swashakti)*	25.00
		2212.47
	MINISTRY OF TRIBAL AFFAIRS	
96	Scheme of PMS, Book banks and Upgradation of Merit of ST Students	65.49
97	Research and Mass Education, Tribal Festivals and Others	7.50
98	*Ashram School in TSP areas*	14.00
99	Scheme of Hostels for ST girls and boys	24.00
		110.99
	DEPARTMENT OF SECONDARY & HIGHER EDUCATION	

100	Integrated education for Disabled Childern (IEDC)	39.00
101	National Merit Scholarship Scheme	3.00
102	Area Intensive Modernization of Madarasas program	29.00
103	Vocational Education & Training	50.00
104	Access and Equity	30.00
105	Information and Communication in Schools (ICT in Schools)	97.00
106	Quality Improvement in Schools	20.00
107	*Development of Sanskrit Edn.*	18.00
108	*Appointment of Language Teachers*	16.00
109	Education in Human Values	3.00
110	National Scholarship Programme	4.00
		309.00
	MINISTRY OF SHIPPING	
111	Inland water Transportation Scheme implemented by States	20.00
		20.00
	MINISTRY OF SOCIAL JUSTICE AND EMPOWERMENT	
112	Scheduled caste Development Corporation (SCDCs)	50.00
113	Implementation of PCR Act, 1955 & the SC/ST (POA) Act, 1989	35.00
114	Post matric Scholarships and Book banks for SC students	319.55
115	Merit based scholarships for OBC and minority students	42.75
116	Scheme for prevention and Control of Juvenile Social Mal-adjustment	21.00
117	*Pre-Matric Scholarships for Children those engaged in unclean occupation*	16.00
118	*Hostels for SC & OBC boys and girls*	64.30
119	*Coaching and Allied scheme for SCs/OBCs & other weaker sections*	8.00
120	Employement of the handicap	2.00
121	*Up-gradation of Merit of SC Students*	25.00
		583.60
	DEPARTMENT OF TOURISM	
122	Product / Infrastrucrure and Destination Development	140.00
123	*Computerization and Information Technology*	17.00
124	Integrated Development of Tourism Circuits	85.00
125	Revival of Tourism in J & K (J & K Package)	9.00
126	*Assistance for Large Revenue Generating Projects*	18.00
127	*Market Research including 20 years perspective plan*	3.00
		272.00
	DEPARTMENT OF URBAN EMPLOYEMENT & POVERTY ALLEVIATION	
128	SJSRY	103.00
129	*Valmiki Ambedkar Awas Yojna (VAMBAY)*	280.58
130	Integrated Low cost Sanitation Programme (ILCS)	30.00
131	*Night Shelter*	4.00
132	National Scheme of Liberation & Rehabilitation of Scavengers & their Dependants (NLSRS)	20.00
133	Solid Waste Management and Drainage in 10 Selected IAF Airfield	40.00
		477.58
	DEPARTMENT OF URBAN DEVELOPMENT	
134	*Accelerated Urban Water Supply Programme for Small towns with Population less than 20000*	150.00
135	Mega City	220.00

136	Integrated Development of Small & Medium Towns (IDSMT)	200.00
		570.00
	MINISTRY OF WATER RESOURCES	
137	Command Area Development & Water Management Programme	180.00
138	*Rationalization of Minor Irrigation Statistics*	7.00
139	Critical Anti- erosion works in Ganga Basin States and maintenance of flood protection embankments in Kosi & Gandak	43.00
140	Critical anti-erosion works in coastal and other than Ganga basin States	6.00
141	*Improvement of Drainage in Critical Areas of the Country*	8.00
142	*Flood proofing Programme in North Bihar*	1.00
		245.00
	YOUTH AFFAIRS AND SPORTS	
143	National Service Scheme	28.00
144	*Scheme Relating to Infrastructure*	48.05
		76.05
	MINISTRY OF TEXTILES	
145	Handloom Export Scheme	4.50
146	*Deen Dayal Hathkargha Protsahan Yojana*	43.10
147	Cotton Technology Mission (Mini Mission iii & iv)	40.00
148	Apparel Park for Export	30.00
149	*Textile Centres Infrastructure Development Scheme*	30.00
150	*Weavers Welfare Scheme*	6.00
151	*Workshed-cum-Housing Scheme*	20.00
152	Catalytic Development Programme (Sericulture)	44.07
		217.67
	MINISTRY OF AGRO & RURAL INDUSTRIES	
153	Cooperativization	1.00
		1.00
	DEPARTMENT OF FAMILY WELFARE	
154	*Sub centres*	1792.71
155	*Urban FW Services*	123.04
156	*Direction & Administration*	226.80
157	Area Projects (IPP Projects)	53.51
158	Basic Training for ANM/LHVs	72.00
159	Free distribution of contraceptives(I) Conventional contraceptives 35.00 (I) Oral Contraceptive 18.5 (ii) IUP 24.2	77.70
160	*Sterilization*	233.57
161	Immunization	220.00
162	Pulse Polio	1011.70
163	*Maternal Health*	244.20
164	*Training*	32.00
165	*Other Projects under RCH*	0.00
166	Maternity Benefit Scheme	112.00
167	*Information, Education and Communication*	111.59
168	*Empowered Action Group*	185.00
169	Family Welfare Link Health Insurance Plan	9.10
170	*Contractual Services /Consultancies*	58.21
171	*Adolescent Health*	5.00
172	MTP services (Manual Vac. Aspirator for safe)	0.00
173	*Child Health*	0.50

174	USAID Assisted Area Project	60.00
175	EC Assisted SIP Project	300.00
176	*Maintenance & Strengthening of HFWTCs*	15.70
177	*Basic Training for MPWs Workers (Male)*	9.40
178	*Strengthening of Basic Training Schools*	2.80
179	*Role of men in planned Perenthood*	3.20
180	Routine Immunization Strengthening	3.00
181	*Other RCH Interventions and services*	76.00
182	*Logistics Improvement*	2.00
183	RTI/STI prevention and management	3.25
184	*Urban Slums Projects*	25.00
185	*Maintenance of vehicle already available*	55.00
186	*District Projects*	0.00
187	*Community Incentive Scheme*	1.00
188	*Supply of Mopeds*	0.00
189	*F.W. Training and Res. Centre, Bombay*	1.53
190	*NIHFW, New Delhi*	4.75
191	*IIPS, Mumbai*	1.60
192	*Assistance to IMA*	0.25
193	*Population Research Centres*	7.33
194	*CRDI, Lucknow*	2.30
195	*ICMR and IRR*	30.00
196	National Population Stabilization Fund	0.00
197	*Social marketing of contraceptives*	252.50
198	Testing Facilities	0.45
199	*NGOs and SCOVA*	44.00
200	*Travel of Experts/Conferences /Meetings etc.*	1.00
201	International Cooperation	1.70
202	*Social Marketing Area Projects*	10.00
203	*Jan Shikshan Sansthan*	28.00
204	*Policy Advocacy/Seminars/Melas*	3.00
205	*Other Research Projects*	0.00
		5513.39
	DEPARTMENT OF CULTURE	
207	Setting up of Multi-purpose cultural complexes for children	9.00
		9.00
	GRAND TOTAL OF CSS	**39507.11**

ANNEXURE II

Major CSS with projected budget estimates for the year 2005-06

(Rs. in millions)

Scheme	Revised budget Allocation	Revised Budget Allocation	Budget Estimates [note]
	2003-2004	2004-2005	2005-2006
Sampoorna Gramin Rojgar Yojana (**SGRY)**	96400	45900	36000
Nacional Food for Work Program **(NWWFP)**	-	18180	54000
Prime Minister's Grameen Sadak Yojana (**PMGSY)**	20900	22190	38100
Rural Housing : mainly *Indira Awas Yojna* (**IAY)**	17100	26070	25000
Swarnajayanti Gram Swarozgar Yojana (**SGSY)**	7200	9000	8620
Sarva Shiksha Abhiyan (**SSA) incl. DPEP**	35323	53536	77560
Mid-Day Meal	13750	15075	30110
Accelerated Rural Water & Supply Programme	23260	26100	36450
Integrated Child Development Scheme **(ICDS)**	18015	19344	33150
Reproductive and Child Health **(RCH)**	4424	4859	13810
National AIDS Control Programme **(NACP)**	2050	4220	4770
Macro Management	5490	10370	7820
Immunisation program & eradication of Polio	7632	10175	13050
TOTAL	***251543***	***265018***	***378439***

Note: The above outlays are based on Budget Estimates as provided in Budget document for FY 2005-06, presented to the parliament.

ANNEXURE III

Clarification on applicability of the Accounting Standards of ICAI to Not-for-Profit entities

The ‘Preface to the Statements of Accounting Standards’, issued by Institute of Chartered Accountants of India, states the following:

“3.3 The Institute will issue the Accounting Standards for use in the presentation of the general purpose financial statements issued to the public by such commercial, industrial or business enterprises as may be specified by the Institute from time to time and subject to the attest function of its members….”

3.28 The Institute has issued the following Clarification[65] regarding the exact purport of the above paragraph of the *Preface.*

“The reference to commercial, industrial or business enterprises in the aforesaid paragraph is in the context of the nature of activities carried on by the enterprise rather than with reference to its objects. It is quite possible that an enterprise has charitable objects but it carries on, either wholly or in part in part, activities of a commercial, industrial or business nature in furtherance of its objects. The Board believes that Accounting Standards apply in respect of commercial, industrial or business activities of any enterprise, irrespective of whether it is profit oriented or is established for charitable or religious purposes. Accounting Standards will not, however, apply to those activities which are not of commercial, industrial or business nature (e.g., an activity of collecting donations and giving them to flood affected people).

It is also clarified that exclusion of an entity from the applicability of the Accounting Standards would be permissible only if no part of the activity of such entity was commercial, industrial or business in nature. For the removal of doubts, it is clarified that even if a very small proportion of the activities of an entity was considered to be commercial, industrial or business in nature, then it could claim exemption from the application of Accounting Standards. The Accounting Standards would apply to all its activities including those which were not commercial, industrial or business in nature.

3.29 From the abovementioned Clarification, it is apparent that the Accounting Standards issued by the Institute do no apply to an NPO *if no part of the activity of such entity is commercial, industrial or business in nature.* The Standards would apply even if a very small proportion of activities is considered to be commercial, industrial or business in nature. It may be mentioned that since the Accounting standards contain wholesome principles of accounting, these principles provide the most appropriate guidance even in case of those organisations to which Accounting Standards do not apply. It is, therefore, recommended that all NPOs, irrespective of the fact that no part of the activities is commercial, industrial or business in nature, should follow accounting standards issued by the Institute**.**

[65] Published in *‘The Chartered Accountant’* September 1995 (page 79)

ANNEXURE IV

CONCLUSIONS OF A STUDY ON FUNDS FLOW BY THE PLANNING COMMISSION

Major conclusions arrived at in a study commissioned by the Planning Commission on 'Flow of Funds and Monitoring Arrangements under selected Centrally Sponsored and Earmarked State Plan schemes':

- Transfer from GOI to state treasuries: Generally it is accepted that under Treasury model, fund transfer mechanism is much faster between GOI and State, there is a need to evolve better release procedures, if both greater accuracy and timely credit are to be ensured. The study noted that in its sample of transfers over a 3-year period, 69% releases took more than 15 days to be credited to state Govt. accounts. Though similar transfers which involved Ministry of Finance, such delay was only around 1%. Regarding the accuracy, the study noted that almost 18% releases could not be traced to the state Govt. accounts at the RBI.

- Though overall conclusions for society model on time lag were not reached, mainly because of data limitations, however scheme-wise details provide evidence to suggest large delays in the funds reaching the last stage i.e the PRI institutions. Funds to district level under DRDA are much faster compared to other modes.

- States with better account keeping systems appear to show lesser time lags. This is also correlated to level of fiscal stress being experienced by states. At central level, schemes with an ability to enforce greater adherence to conditions of prior expenditure by the states before making subsequent releases, clearly showed smaller time lags in releases at the intermediate level.

- The conclusions on time lags in funds flow draw attention to the importance of need to adhere to appropriate design principles if better implementation is to be secured. In themselves, time lags in expenditure can, to an extent, be curtailed if the operational guidelines, monitoring systems and penal provisions are well structured. But spend pressure at the central level needs to be tackled if adherence to even better design of these spheres has to have meaning. A core issue of the principal agent problems and consequent lack of ownership at state level will however, still continue to be bedevilling such transfer schemes. This can be mitigated only by reducing the number of such schemes and restricting them to matters involving significant spill overs.

- Overall, in sum, the conclusion of this study is that it is not the type of release mechanism that is critical to lesser time lags and (if time lag is an appropriate proxy for this) of better performance. It is adherence to key design principles that matters far more and it is this area that really needs attention.

ANNEXURE V

INSTANCES OF VARIATION IN ACCOUNTING POLCIES ADOPTED BY STATE AND DISTRICT SOCIETIES*

- Grant in aid received from GOI by the states treated as 'Revenue Grant' in some projects, while in other it is treated as a Capital Grant'
- Civil works and equipments supplied to implementing units eg schools or health centers shown as assets in the financial statements of the society or charged to expenditure
- Deposit with Public Works Dept for civil works charged to expenditure or treated as an advance till receipt of a utilization certificate.
- Advances to NGOs treated as advances or charged to expenditure
- Depreciation charged by some projects and not by others
- Commodities received in kind accounted for in the books of account or ignored
- Basis of accounting is either Accrual basis or Cash basis.

***** *from various audit reports of bank financed projects.*

ANNEXURE VI

INTERNAL CONTROL WEAKNESSES**

- Bank reconciliations are not prepared or prepared once a year.
- Lack of segregation of duties
- No monitoring of advances to NGOs
- Fund transfers from GOI to states, states to districts and between districts are not reconciled.
- Only a cash book maintained and staff not familiar with double entry accounts
- Lack of serial control over vouchers
- Lack of fixed assets & physical verification is assets is carried out
- Advances settled with insufficient supporting documents
- Physical Cash verification not carried out on a regular basis

*** as per findings in the study by AF Fergusson on strengthening of accounting, financial management and management information systems for the GOI RCH and Sector Investment Program.*

ANNEXURE VII

Extract From the Report of Working Group[66] on Strengthening Monitoring and Evaluation system for the social sector development schemes in the country

SYNOPSIS OF RECOMMENDATIONS

a) Mechanisms which could facilitate monitoring

At all India level

- Amalgamate, scrap CSS as necessary. There should be very few schemes in the social sector so that M&E can be dome focally and thoroughly.
- To have a central institute to coordinate between different monitoring agencies. The agency will hold review meetings with central nodal ministries and the state govt. to evaluate performance of various programs. The decisions taken in the review meetings should be binding on the central ministries and the state Govt. for improving the performance.
- Budget fixing should be based on performance of the scheme. Present practice of fixing budget based on last financial year's expenditure should be given up. Flexibility to award additional funds for better performance of the states/UT should be considered.
- Tentative targets for next financial years be fixed before the commencement of the year in line with financial allocations. These should be finalized and intimated to each state latest by 31st May. Presently targets are fixed by Planning Commission without considering funds available.
- Implementation unit cost be developed for similar schemes across the states and this should be compared across states.

At State level

- Each state to constitute a committee headed by Chief Minister / Chief Secretary to monitor follow-up actions on the monitoring and evaluation reports.
- State Plan divisions and sectoral divisions of the Planning Commission should monitor and evaluate performance for the preceding year, of the states and administrative ministries respectively, before recommending release of funds.
- Financial monitoring to prevent diversion of development funds to non-developmental activities be made part of review when releasing funds to the states.
- State Govts. should have program review committee at states, districts and block levels.

At District Level

[66] A working group was constituted in October 2000 on strengthening monitoring and evaluation systems for social sector development schemes. It consisted of members from the Planning Commission, ministries/ departments with focus on social sector, planning secretaries from seven states, MoF, CAG, academicians from reputed institutes and universities The Terms of reference was to .

- review existing machinery and systems of M&E in central ministries / CSS / projects and State Plan schemes
- suggests measures for strengthening M&E organisations in the country
- suggests institutional framework for linking M&E results with planning, policy making and public spending
- to suggest areas of use for IT
- suggest measures to involve research institutions, universities ,PRIs, NGOs to improve quality of M&E in the country

- District Collector, heads of the monitoring units should have a minimum of 3 year stay in their positions.

At Grass-root levels

- States should involve panchayats / Nagar Palikas in planning, designing and monitoring of all programs at the grassroots level. This is in consonance as envisaged under 73rd & 74th amendments.

<u>b) Transparency</u>

- Monitoring will become more effective by enhancing transparency at the grass-root level by publicizing lists of beneficiaries and works completed and preparing social maps.

c) <u>Staffing, Training, IT</u>

- Use multi-disciplinary teams. Diversion of staff sanctioned for monitoring should be stopped.
- The performance evaluation of grass-root functionaries should be based more on outcomes rather than target outputs or allocated financials.
- Report recognizes spirit of experimentation in trying to improve performance and states that if genuine errors are punished, improvements will also cease.
- It lays importance on choosing relevant indicators to judge performance at input level, output level and at impact level, but with minimum numbers of indicators.
- Recognizing the importance of Training and IT in M&E, it suggests setting up of a national training institute in 10th Plan. Recommends use of palmtops for monitoring units in the field to cut down on time in collection of data.
- Recognizes need for networking of all villages and blocks of all social schemes for improving monitoring and recommends development of an internet based system for on-line monitoring.

d) <u>Other measures</u>

- Need to have effective monitoring of assets created through several social sector schemes.
- Monitoring units to be held accountable for reports and data submitted by them on performance of schemes.
- Necessary changes are made to ensure that information required for monitoring flows to units responsible for such functions.
- Wider involvement of stakeholders, NGOs, academic institutions in designing and monitoring should be encouraged. It recommends that huge expertise and academic manpower available with such institutes be utilized for monitoring and research.

ANNEXURE VIII

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	Guidelines for District TB Control Societies
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	Guidelines of the National Food for Work Program, SGSY, SGRY and IAY schemes
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	FASB 117 on Financial Statements of Not-for-Profit Organizations (US)
	Circular No. A-133 on Audits of States, Local governments, and Non-Profit Organizations issued by Office of Management and Budget, The Excutive Office of the President of USA
	Exposure Draft 2 on Accounting and Classification of Grants-in-Aid issued by GASAB
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	Roles and Functions of Controller General of Accounts
	Reviewed various documents to gain understanding of roles of Department of Expenditure, Plan Finance Divisions I & II, PMU Division
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	Financial Systems & Decentralization –presentation by Dr Chris Potter, European Commission Technical Assistance
	Sector Wide Approaches – a presentation by NN Sinha, Dy. Secretary, Donor Coordination
	RCH Program – a presentation by Dr G Ramanna, Public health Specialist, World Bank
	Issues on Pooling of Finances – a presentation by T Martineau, Sr. Health Advisor, DFID
	Innovations at Work – a handout State Innovations in Family Planning Services Project Agency, UP (SIFPSA)
	Various correspondence and office circulars issued by different projects on different aspects of implementation
4	**Legal Documents**
	Societies Registration Act 1860
	Tamilnadu Societies Registration Act 1975
	Swamy's General Financial Rules
	Memorandum of Assoociation of Tamilnadu State Tuberculosis Society, Chennai
	Memorandum of Assoociation of Uttar Pradesh State Tuberculosis Society, Lucknow
	Memorandum of Association of District Health Society, Sikar, Rajasthan
	Various circulars / office memorandum of GOI and state Govts.
5	**World Bank Documents**
	PAD: Hydrology Project Phase II, July'04
	Project Agreement between IDA & certain states: Women and Child Development Project, July'99
	Interim Fund DCA: Women and Child Development Project, July'99
	PAD: Women and Child Development Project, Interim Trust Fund Credit for USD 300 million May'98
	PAD: Second National HIV/AIDS Control Project, May'99
	Interim Fund DCA: Reproductive and Child Health Project, July'97
	PAD: Reproductive and Child Health Project, April'97
	DCA: Tuberculosis Control Project, March'97
	PAD: Tuberculosis Control Project ?
	Karnataka Public Financial Management and Accountability Study
	Orissa State Public Financial Accountability Assessment
	Audit reports of individual projects

Websites:

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