

India's Public Financial Management System: Need for Reforms and Way Forward

Kevin James*

Kandarp Patel**

Anoop Singh*** #

Abstract

A robust Public Financial Management (PFM) system contributes to enhanced accountability and transparency in governance, and is associated with efficient and equitable public service delivery, poverty reduction, and economic growth. India's existing PFM framework is scattered across a wide range of provisions and is riddled with inconsistencies. There is a need to bridge the gap between the high-level PFM structure contained in the Constitution, and the operational details found across guidelines, rules, regulations, and manuals at the Union and State levels. In this context, this paper looks at the key areas in which India needs PFM reforms, building on the provisions of a draft PFM law prepared by an expert group and cited by the Fifteenth Finance Commission. These include fiscal responsibility, the Annual Budget, financial management, reporting and accounting, and legislative and executive oversight. We study the existing frameworks in these areas and propose reforms, drawing from international experience and best practices, with the aim of charting a comprehensive way forward for PFM in India.

Keywords: Public Financial Management, Public Service Delivery, Governance, Fiscal Responsibility

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* Kevin James is a Research Associate at the Centre for Social and Economic Progress (CSEP).

** Kandarp Patel is a civil servant and was a Director in the Fifteenth Finance Commission.

*** Anoop Singh is a Distinguished Fellow at the Centre for Social and Economic Progress (CSEP) and was a Member of the Fifteenth Finance Commission. All content reflects the personal views of the authors.

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I Overview

A. The scope and importance of Public Financial Management

Public Financial Management (PFM) has been defined as “the way governments manage public resources (both revenue and expenditure) and the immediate and medium- to long-term impact of such resources on the economy or society” (Andrews et al, 2014). While, initially, PFM was more about financial control and compliance, it has now grown to include the maintenance of a sustainable fiscal position, effectively allocating funds, and efficiently providing public goods.

PFM's “financial management” role has thus transformed into a more comprehensive “finance management” function. Cangiano, Curristine, and Lazare (2013) observed that PFM has now broadened to include “all aspects of managing public resources, including resource mobilisation and debt management, with a progressive extension to the medium to long term implications and risks for public finances of today's policy decisions.” PFM now covers all governmental tiers, and also the public sector, including Public Sector Enterprises (PSEs) and Public-Private Partnerships (PPPs). As described by Cangiano, Curristine, and Lazare (2013), “PFM is now seen as an umbrella definition, covering a set of systems aimed at producing information, processes, and rules that can help support fiscal policymaking, as well as provide instruments for its implementation.”

There is consensus in the literature that the objectives of PFM are achieving aggregate discipline, allocative efficiency, and operational efficiency (Kristensen *et al*, 2019). Along similar lines, the Fifteenth Finance Commission (2020) in its report identified four overarching objectives of PFM, namely aggregate fiscal discipline, strategic budgeting and planning, operational efficiency, and accountability and transparency:

- Under the aggregate fiscal discipline objective, it highlighted the need for adequate and consistent fiscal coverage and reporting, and accurate macroeconomic and fiscal forecasting;
- Under the strategic budgeting and planning objective, it recommended moving towards performance orientation of budgets;
- Under the operational efficiency objective, it recommended strengthening cash management practices; and
- Under accountability and transparency, it noted the importance of timely public information being widely available.

A strong PFM system is a key component of the institutional framework for an effective government, and for public service delivery across the levels of government (Schwartz *et al*, 2020). As such, it is closely associated with reducing poverty and stimulating economic growth (Fifteenth Finance Commission, 2020). Kasoma (2018) notes that “Countries with strong, transparent, accountable PFM systems tend to deliver services more effectively and equitably and regulate markets more efficiently and fairly.” On this basis, he concludes that good PFM is a “necessary condition” for development outcomes. It has been seen as instrumental in achieving broader development objectives such as macroeconomic stability, efficient resource allocation, and service delivery (Welham, Krause, & Hedger, 2013).

Good PFM can thus be a “linchpin that ties together available resources, delivery of services, and achievement of government policy objectives” (Public Expenditure and Financial Accountability [PEFA] Secretariat, 2016). The need to move in this direction has been accentuated by the implications of COVID-19 on public finances and its ‘scissor’ effect on revenues and expenditures.

B. Public Financial Management in India

India’s existing PFM framework encompasses a wide canvas of provisions, including constitutional provisions, legislations, rules and regulations, and other documents. The basic framework for PFM in India is enshrined in the Constitution, which provides for a PFM structure at a high level. This constitutional structure is supplemented by many statutes, subordinate legislations, guidelines, manuals, government orders, and other such instruments, framed at different points in time (Fifteenth Finance Commission, 2020).

Even though multiple reforms have been undertaken over the years, they have largely been piecemeal and driven by the need to incorporate developments in Information and Communications Technology (ICT) (such as the Integrated Financial Management Information System (IFMIS)). So far, reform efforts have not targeted the underlying PFM structure in any significant way.

There is a gap between the broad PFM structure, as contained in the Constitution, and the more operational PFM guidelines, rules, regulations, and manuals.

- The Constitution provides for the relative powers of the executive and legislature on financial matters; the independence of constitutional authorities; independent external audit by the Comptroller & Auditor General of India (C&AG); distribution of powers between the Union and the States; the institutional mechanism of the Finance Commission to divide financial resources between the two levels of government (and to provide for the third tier as well); preparation, presentation, and management of the Annual Budget; and so on.
- On the other hand, operational guidelines are found in other instruments such as the General Financial Rules, 2017 (GFR), Government Accounting Rules, 1990 (GAR), Receipt and Payment (R&P) Rules, 1983, Delegation of Financial Rules, Budget Manual, and Treasury Manuals, at the levels of both the Union and the States.

As recommended by the Fifteenth Finance Commission (2020), there is a need to bridge this gap and encapsulate the essential and core PFM principles in a succinct, consolidated, and organised manner.

Apart from this, since existing PFM provisions have been developed at different points in time and at different levels, there are *inter se* inconsistencies in the underlying provisions and processes. Moreover, many such provisions are outdated. For instance, while the GFR had been amended in 2017 to adopt new changes in ICT, the GAR and R&P Rules still need updating to accommodate the new ICT systems.¹ There is thus a need to rationalise existing rules and regulations, make them internally consistent, and address any gaps and infirmities in them. At the same time, there is a need for overarching, multi-level binding standards that increase consistency and accountability in governance across the tiers of government.

Hence, a number of structural reforms are needed, such as upgrading internal audit, increasing fiduciary duties applicable to all stakeholders, and improving levels of transparency. The crucial role

of legislative oversight needs to be better recognised and enhanced. One way in which this can be achieved is through mandating ex-ante reporting through strategies, plans, and budgets (to establish the government's medium- to long-term intentions), coupled with ex-post reporting through budget execution reports, mid-year and end-year reporting, as well as reporting on the achievement of, and deviation from, fiscal objectives.

Essentially, governments need to be held accountable for their decisions on spending and revenue. While the existing Fiscal Responsibility and Budget Management (FRBM) laws at the Union and State levels do this to an important extent, this regime needs to be built and made consistent across all levels of government.

To address the gaps in transparency and meaningful fiscal analysis, it is essential to have common, comprehensive definitions and formulations of fiscal indicators and standard reporting across levels of government. In practice, the fiscal rules contained in the FRBM Acts have been circumvented by, for instance, using entities outside the government for off-budget borrowings, misclassification of revenue expenditures as capital expenditure, etc. Fiscal deficit or public debt should be defined and calculated in the same way across governments. Presently, however, there is variability in these definitions across State FRBM Acts. This creates room for differences in reported deficit and debt, making them non-comparable, and thereby, difficult to consolidate.

In this context, the Fifteenth Finance Commission (2020) recommended a range of essential PFM reforms for India. It also cited a draft law, prepared by an expert group, that could potentially serve as a comprehensive, overarching legal framework for PFM in India, and usher in these reforms (Alamuru & Vidhi Centre for Legal Policy, 2020).

This paper builds on the provisions of this draft law and takes a close look at the key areas in which India needs PFM reforms. These include fiscal responsibility, the Annual Budget, financial management, reporting and accounting, and legislative and executive oversight (Chapters III, IV, V, VI, & VII of the draft PFM law). We study the existing frameworks in these areas and argue for reform, drawing from a wide range of international PFM experience. On this basis, and elaborating on the provisions of the draft PFM law, we present various recommendations for these reforms. Overall, we aim to chart out a comprehensive way forward for PFM in India.

II Fiscal Responsibility

At the Union as well as State levels, the government's fiscal policy framework needs strengthening in order to ensure that governments make credible and prudent decisions about their spending and revenue, and do so in a transparent manner, over a medium-term horizon.

Governments need to be held accountable against clear fiscal responsibility principles, such as achieving a sustainable budget balance over a reasonable time period, maintaining a prudent level of public debt, managing fiscal risks in a prudent manner, ensuring value for money in the use of resources, and pursuing macroeconomic stability, inclusive growth, environmental sustainability, and intergenerational equity (Section 11(1) of the draft PFM law). These principles should not be time-bound, but should allow governments to manage and tide over the economic cycle or the period over which an adverse situation persists, such as the COVID-19 pandemic.

The draft PFM law cited by the Fifteenth Finance Commission complements the existing regime of FRBM laws at the Union and State levels (Sections 20 & 21 of the draft PFM law). These existing FRBM laws at the Union and State levels, and the rules issued under them, typically include a range of numerical fiscal targets, including fiscal deficits and debt ceilings. The draft PFM law can support both the present numerical-based fiscal rules framework as well as a principles-based one, such as the one in New Zealand.²

To strengthen the existing FRBM regime, governments should be required to prepare and table a Fiscal Strategy before their legislatures, linked to the budgeting exercise (Section 12 read with the Second Schedule of the draft PFM law). The Fiscal Strategy should be accompanied by a suite of allied strategies and plans, including a medium- to long-term outlook in terms of sustainability reporting of existing policies, an investment statement to explain the significant assets and liabilities of the Government, and a Public Investment Programme (PIP) to provide a medium-term list of prioritised programmes and projects (Sections 13, 14, & 15 of the draft PFM law). While the Fiscal Strategy does exist under the existing FRBM regime, albeit in a limited manner, the other documents represent new proposals that do not have any parallels in India currently.

These are not mere reporting requirements. To implement these, governments would need to strengthen underlying capabilities and processes through reforms such as public investment management, financial reporting and accounting, policies on budget allocation, and introducing e-governance applications. This is critical, especially because post-COVID-19, governments should re-evaluate and take medium- to long-term views of their assets and liabilities.

Consistent with international experience, compliance with these strategies and principles should be reviewed by independent institutions, which are created and mandated by law. These reviews should include an analysis of the achievement of and compliance with the fiscal responsibility principles; an analysis of the trends in economic and fiscal forecasts; a review of the accounting and forecasting methods used; and an analysis of the reports and disclosures made for transparency. In the first instance, the government should conduct such a review of its own performance, followed by relevant legislative committees reviewing their respective government's performance, and supplemented by an independent fiscal institution's (such as a fiscal council³) review.

Currently, the C&AG is legally mandated to review the compliance of the Union Government under the Union FRBM Act. This arrangement could continue, for the time being, until an independent fiscal institution is established for this purpose (Section 19 of the draft PFM law). The State FRBM Acts do not require the C&AG to perform this review function. Until independent fiscal institutions are established at the State level as well, it may be desirable to legally mandate such a function to the C&AG in the States as well.⁴

A. Fiscal Strategy

It is critical to lay down a well-defined Fiscal Strategy, so that governments are required to frequently provide information that reveals their intentions. Against this, their performance can be judged. Presently, the Union FRBM Act and most State FRBM Acts do require their respective governments to table a document in the nature of a fiscal strategy in their legislatures.

To take the example of the Union FRBM Act, its "Fiscal Policy Strategy Statement" is expected to include:

- government policies relating to taxation, expenditure, market borrowings, lending and investments, pricing of administered goods and services, securities, and guarantees;
- the government's strategic fiscal priorities;
- key fiscal measures and the rationale for any major deviation in fiscal measures relating to taxation, subsidies, expenditure, administered pricing and borrowings; and
- an evaluation of how current governmental policies are in conformity with fiscal management principles and the objectives set out in the Medium-term Fiscal Policy Statement, as specified in the FRBM Act.

The draft PFM law seeks to strengthen and enhance this critical document, and introduce an element of uniformity in this practice across Union and State levels. The Fiscal Strategy should incorporate the aforesaid fiscal principles in the form of measurable fiscal objectives and monitoring indicators. It should include:

- a report for the recently concluded financial year;
- a medium-term macroeconomic forecast setting out the values of economic variables such as inflation, employment, and interest rates;
- a statement of assumptions and methodologies on which the forecasts are based;
- information on longer-term macroeconomic forecasts;
- medium-term fiscal forecasts setting out the values of fiscal variables such as revenues, aggregate expenditures, budget balance, and sources of budget financing;
- fiscal forecasts for the longer term that have been used in formulating the fiscal policies in the Fiscal Strategy;
- fiscal policy priorities and information for revenues, debt, deficit, expenditure, and assets;
- medium-term expenditure intentions and an explanation of any changes in the proposed ceilings from previous Fiscal Strategies; and
- an explanation of how fiscal policy supports macroeconomic stability, inclusive growth, and intergenerational equity (Section 12 read with the Second Schedule of the draft PFM law).

The Fiscal Strategy can serve as a key accountability document, and can be considered as the front-end of the budget process. It can capture governments' intentions for economic and fiscal performance in terms of budget balance and debt objectives, along with long-term fiscal objectives and short-term goals, with fiscal forecasts for up to the next 10 years. It should also include a fiscal risk statement which details the risks to the forecasts, contingent liabilities, and other material risks including mitigation strategies. This will provide governments with more scope to use fiscal policy to meet emerging economic and fiscal situations, such as the ongoing COVID-19 pandemic. Consistent with this view, while the strategy document must contain a minimum set of fiscal objectives that are numerically measurable, legislatively stipulating such fixed numerical values may not be desirable.

This strategy should be prepared by the time the budgeting exercise commences, as opposed to submissions made at the time the budget is presented. In the future, the Union FRBM Act's four-part Fiscal Policy Statement, comprising the Medium-Term Fiscal Policy Statement, the Fiscal Policy

Strategy Statement described above, the Macro-economic Framework Statement, and the Medium-Term Expenditure Framework Statement, could be subsumed within the comprehensive Fiscal Strategy proposed in the draft PFM law.

It is important to note that in certain circumstances, deviations from the fiscal objectives contained in the Fiscal Strategy might be justified (Section 18 of the draft PFM law). Such circumstances must be clearly specified, and crucially, there should be a mitigation and reporting process that gets triggered in the event of such deviations. For example, such circumstances might cover events that are truly outside the control of governments and severely affect their fiscal positions, such as national security issues, natural calamities, structural reforms in the economy, severe economic shocks, and significant downturns in a productive sector.

The need for this flexibility has been reinforced in the context of the COVID-19 pandemic. This flexibility should be accompanied with a reporting process that requires the deviating government to specify its plan to address the deviation and secure its path back to compliance. The aim should be to allow governments some leeway to act in times of crises, while also requiring them to explain their actions transparently. This should facilitate both flexibility as well as accountability.

B. Long-term Fiscal Sustainability Report

The long-term fiscal sustainability report should attempt to assess the impact and implications of the country's demographics, economy, environment, and other factors, based on various scenarios, on the fiscal metrics. Fiscal sustainability in the long-term looks at whether a government has the ability capacity to finance its future policies and debt obligations without casting an undue burden on future generations. To achieve such sustainability, there needs to be greater economic growth compared to public debt over time. The need for this arises as governments' fiscal strategies and policies are increasingly being challenged on account of foreseeable demographic trends for the future and their impact on the country's public finances in the long-term. This can be seen through indicators such as governmental expenditure as a proportion of Gross Domestic Product (GDP).

The assessment should identify significant actions that need to be taken by various players, and what sectors will put pressure on government expenditure. This report should provide long-term projections of public finances and sustainability of debt, and should include a discussion on fiscal risks. Ultimately, this report should help governments in understanding how to reorient their fiscal policy in a manner that prevents the accumulation of unsustainable government debt in the long-term. This would require governments to prioritise based on relative risk to public finances.

Many countries are now reporting on fiscal sustainability over different time horizons such as Brazil (10 years), Canada (70 years), Ireland (25 years), Switzerland and the United States of America (30 years), Slovakia and the United Kingdom (50 years), Portugal (15 years), and Lithuania (20 years). The frequency of these reports varies from annual to once every two or three years.

A useful example of the benefits of such reporting can be seen through a brief overview of Switzerland's Long Term Sustainability Report from 2016. This report noted that if Switzerland's economy, demographic structure, and net immigration rate do indeed develop in line with forecasted scenarios, then its ratio of general government expenditure to GDP would rise from 32 percent to 36 percent by 2045. It also observed that the foreseeable upward pressure on spending on healthcare and long-term care will make reforms inevitable. To make these burdens manageable, it identified a need

to secure the financing of the country's social security mechanisms in a timely way. On the positive side, it noted that the disposable income of the working-age population was set to rise further thanks to continued economic growth.

Similarly, the 2020 Canadian report concludes that the ageing of the population will move an increasing share of Canadians out of their prime working-age years and into their retirement years, resulting in slower growth in the Canadian economy. Slower economic growth will put a downward pressure on government revenues as growth in the tax base slows. At the same time, population ageing will put upward pressure on other government programmes such as health care, old age security, and pension benefits. Programmes targeted to younger age groups will face reduced pressure as the population ages.

We believe that India should consider introducing long-term sustainability reporting with a time horizon of around 20 years, with such a report needing to be published once every five years.

C. Investment Statement

The Investment Statement should provide details of the state and value of governments' significant assets and liabilities, both current and forecasted, and explanations for these change. These Investment Statements should lay out how public resources have been or will be used. It would hinge on good balance sheet management that includes efficient asset management, sustainable funding, and prudent risk management, accompanied with information that can guide subsequent government decisions and actions.

New Zealand is the pioneer in implementing this futuristic reporting framework, and it produces such a report every four years. New Zealand's 2018 Investment Statement, titled "Investing for Well Being (*He Puna Hao Patiki*)", noted that the task of policymakers is incomplete without having a view on how the application of good balance sheet management principles support living standards. It observed that the government's balance sheet was currently strong, and this provided resilience in the face of adverse events. It stated its long-term aim and vision to further broaden their approach of linking balance sheet management to well-being, using the organising principles of New Zealand's Living Standards Framework.

We believe that India should consider adopting this practice and producing an Investment Statement every two years. However, to meet the Investment Statement's requirement of preparing the government balance sheet, India would need to follow the accrual basis of accounting. Presently, most entities of Union and State governments maintain cash-based system. This issue is addressed in a subsequent section of this paper.

D. Public Investment Programme

The PIP should contain a rolling list of priorities and costed programmes/projects within the medium-term, aligned with the Fiscal Strategy, that aim to achieve the goals of the Government. It should translate the strategies and policies into concrete, prioritised programmes and projects over a 5-6-year horizon, and should be based on an overarching long-term plan or vision statement of the Government.

Under Australia's Financial Management and Accountability Act, 1997, the heads of spending agencies are required to promote "proper use" of public resources, defined as "efficient, effective, and ethical use" that is "not inconsistent with the policies" of the country. New Zealand and the United Kingdom also employ a comparable approach. Once the need for sound public investment management is established, it has to be supplemented by a detailed framework encompassing roles and responsibilities, relevant procedures and methodologies, and assessment criteria (Jay-Hyung, Fallov, & Groom, 2020). For example, Cyprus' Fiscal Responsibility and Budget Systems Law, 2014 details five stages as part of its public investment management process:

1. Pre-selection of projects
2. Project assessment
3. Project selection
4. Project implementation
5. Monitoring of projects and amendments to contracts

The preparation of a PIP would be greatly facilitated through an online ICT application with a database of programmes and projects. This could serve as a tool to link planning, budgeting, and monitoring to move towards performance-based resource allocation and to monitor project implementation and generate reports. For example, the Philippines uses an ICT tool called PIP Online or PIPOL, which contains a database of government programmes and projects.

Beyond serving as a database of projects, the PIP should cover project identification, project screening, and project prioritisation. It should also categorise projects into those that are to be financed by the Government's budget, by development assistance, and by PPPs. It could also serve as a valuable source of data for commitment control, by facilitating some much-needed control over multi-year public investments.

Currently, governments in India do not need to obtain separate legislative approval for multi-year investment projects and commitments. While legislative approval should not be needed for individual projects, governments should be required to table a PIP before their legislatures. This would ensure that the legislature is informed about the projects that the government intends to undertake over the next several years, and enable meaningful legislative oversight over such expenditure as part of the budget approval process. Union Ministries and State Departments should be allowed to enter into multi-year contracts only if the overall contractual amount is within the amount that was disclosed to the legislature through the PIP.

The Union Government and some State Governments are presently working on introducing such a framework for public investment management, and its guidelines are at various stages of development and/or implementation. Also, some State Governments in India have introduced a volume containing a list of programmes and projects (for example, Appendix D in Karnataka). However, these are not prioritised, and are generally presented ex-post after the budget is presented.

E. Financial Memorandum for extra-budgetary proposals

A cardinal principle in financial management requires the spending Ministry or Department not to enter commitments or incur expenditure beyond its remit or above those approved in the Annual

Budget. This emanates from the principles of authority, regularity, propriety, and value for money. However, there is an increasing tendency in India to incur expenditure or introduce a policy or measure that was neither proposed in the Annual Budget, nor accompanied by a detailed explanatory note justifying the proposal and its impact on government finances. This is a cause for concern, especially because many such proposals carry significant multi-year financial implications.

There is a need to create a formal requirement that whenever a Ministry or Department proposes any policy or measure that would require expenditure beyond what was authorised by the legislature in the Annual Budget, it should prepare a financial memorandum that contains projections of financial implications for the government over the short, medium, and long term (Section 16 of the draft PFM law).

- This memorandum should be submitted to the finance minister, who should provide a written opinion regarding the same to the Council of Ministers as to whether to proceed with the proposal.
- If approved, the government should then table a new statement before the legislature regarding the additional expenditure that needs to be incurred on account of the new policy or measure.
- The additional expenditure would then need to be formally approved by the legislature through a new grant and Appropriation Act.

III. The Annual Budget

The broad principles and directions with respect to the Annual Budget are laid down in the Constitution for both the Union (Articles 112-117) and the States (Articles 202-207), while the detailed procedures and processes are provided in the respective Budget Manuals and Financial Rules of the Union and the States.

The Constitution requires the Executive to annually present a statement of the estimated receipts and expenditure of the Government, and this is referred to as the 'annual financial statement'. It seeks to distinguish revenue from other expenditure, and lists expenditure charged on the Consolidated Fund which the Legislature may discuss but not vote upon. The Constitution also provides for supplementary and excess grants, vote on account, and vote on credit to facilitate management of requirement of funds during budget execution.

The Budget Manuals, on the other hand, stipulate the responsibilities of the Finance Ministry or Department and the line departments with regard to the preparation of budget; the timelines, formats for submitting the budget/revised/ supplementary estimates; the principles guiding re-appropriation; and so on.

The annual budgeting exercise is undoubtedly the most important component of PFM, as it is through this exercise that the government seeks to fulfil its promises to the electorate. Important social and economic obligations, as also aspirations of citizens, are met through this annual exercise of raising resources and spending them on various government programs.

Between the very broad guidelines in the Constitution and the minute details in the Budget Manuals, however, the essential principles and necessary good practices are often obscured. As with

PFM generally, there is a need to bridge the existing gap between budgeting guidelines and principles on the one hand, and budgeting practices on the other.

A. The Budget calendar

One of the first issues is about the dates for the presentation and approval of the budget. The PEFA programme's methodology for assessing PFM performance identifies the budget preparation process as a key indicator to assess a country's PFM system. It notes the importance of an orderly budget process that allows budget proposals to be developed in a manner that adequately takes into account all relevant factors (PEFA Secretariat, 2018).

PEFA notes that this increases the likelihood of the budget process being supportive of both, fiscal discipline as well as efficient resource allocation and service delivery. Conversely, it observes that delays in the process and ultimate passing of the budget tend to create uncertainty about approved expenditure and in turn, to delays in government activities. The International Monetary Fund (IMF, 2019), in its fiscal transparency code, also highlights the importance of timeliness of budget documents, such that the legislature and wider public are consistently given sufficient time to scrutinise and approve the annual budget.

These observations are borne out in India's experience. Until 2017, while the Union's Annual Budget was presented on the last day of February, the State Governments would not follow a single fixed date for presentation of the budget. After presentation of the Union budget, Parliament would go into a recess and the departmental standing committees would examine the estimates. Then, Parliament would reconvene sometime in April, and the budget would be finally passed sometime in the second half of May. Parliament would, in the meantime, pass a vote on account that allowed the Government to draw funds from the Consolidated Fund until the budget was approved by the Legislature.

Because of the delayed presentation of the Union Budget, the States would not have a clear idea of their share of devolved funds and grants-in-aid. This led to the States also delaying their budget presentations, sometimes even beyond the start of the new financial year. As a result, governments were unable to start incurring expenditure before the monsoon season, which would effectively put the brakes on public expenditure (especially expenditure on public works).

This was rectified in 2017 when the Union finance minister presented the Union Budget on 1 February, and it is now being approved before the end of the financial year. While this is a positive development, there is a need to formalise this and set a hard deadline for both the Union as well as the States to present their budgets. Ideally, the Union Budget should continue to be presented on the first day of February, and all State Budgets should be presented before the last day of February (Section 22(2) of the draft PFM law).

B. Budget comprehensiveness and guiding principles

Beyond the dates, there is a need to enhance the scrutiny of the schemes that are included in the budget. For this, these schemes should be consistent with the PIP mentioned in the previous section, and they should contain, where practicable, a sunset clause, outcome-based measurable objectives, and a provision for periodic and end-term evaluation (Section 22(6) of the draft PFM law).

Presently, except for the requirement that the revenue expenditure must be distinguished from other expenditure, there is no other legal stipulation regarding what other information should be included in the budget. There is merit in specifying these, to ensure comprehensiveness and uniformity, and also to enable more effective legislative oversight (Section 23 read with the Third Schedule of the draft PFM law).

PEFA (2018) identifies four basic elements of fiscal information that are critical for enabling the legislature to adequately comprehend and scrutinise the government's fiscal position. These are:

- Forecast of the fiscal deficit or surplus;
- Previous year's budget outturn, in the same format as the budget proposal;
- Current fiscal year's budget presented in the same format as the budget proposal; and
- Aggregated budget data for both revenue and expenditure according to the main heads of the classifications used, including data for the current and previous year with a detailed breakdown of revenue and expenditure estimates.

PEFA (2018) also lists certain additional elements, which it considers to be good practice to include as part of budget documentation. These include details regarding deficit financing, macroeconomic assumptions, debt stock, financial assets, fiscal risks, explanation of budget implications of new policy initiatives, medium-term fiscal forecasts, and quantification of tax expenditures.

In India, the Union and State Budgets should depict information relating to budgeted and actual receipts and expenditure for the two preceding financial years, budgeted and revised estimates of receipts and expenditure for the current financial year, budget estimates of receipts and expenditures for the ensuing financial year, and projected estimates of receipts and expenditure for one financial year thereafter.

- The estimates of receipts should show revenue estimates as well as financing estimates, with the latter including information on matters such as external financing in the form of borrowing and grants, domestic issuance of government bonds, issuance of guarantees, divestment of government assets, and approval of new PPP contracts.
- The estimates of expenditure should separately show the expenditure charged on the Consolidated Fund and other expenditure, and distinguish expenditure on revenue account from other expenditure (Section 23 of the draft PFM law). The issue of comprehensive reporting is elaborated upon in a later section of this paper.

Apart from the contents, it is also important to have clear principles that govern the budget (Section 24 of the draft PFM law). Currently, budget principles are dispersed across budget manuals and financial rules, and in some cases, not expressed explicitly at all. We propose that the following budget principles need to be consolidated and consistently followed:

- The Government should ensure that the budget is consistent with the fiscal responsibility principles and the Fiscal Strategy mentioned in the previous section, and any deviation should be explained in the budget itself.

- All public servants that have responsibilities related to preparing or approving the budget submissions should ensure that the submissions support the efficient, effective, and economical use of public resources.
- The budget should be prepared on a cash basis (for the time being, and subject to the eventual transition to accrual-based accounting as discussed in a later section), and all amounts that are expected to be actually received or paid during a financial year should be budgeted in that financial year, including arrears of previous financial years.
- Generally, the budget should present receipts and expenditures on a gross basis (IMF, 2019).
- Generally, receipts should not be assigned to specific types of expenditure.
- All appropriations should be authorised in the Appropriation Act and should be made for one financial year.

C. Performance- and Outcome-orientation

Fundamentally, annual budgeting in India remains an input-based incremental budgeting exercise. There is now an increased focus on linking the budget with performance in terms of outputs and outcomes, but these have largely remained academic exercises. The underlying enabling budget structures and processes have not been modernised towards this approach.

For instance, the departments of the Union Government have been preparing an “Outcome Budget” since 2005, and many States have since started preparing outcome budgets themselves. And yet, the main budget continues to be the same as in the past. The outcome budget is prepared separately and tabled in the legislature along with the main budget. This replaces the performance budget which was hitherto being prepared following the recommendation of the First Administrative Reforms Commission. Against each outlay, the expected outcome is identified, and sometimes indicators to measure the outcome as well as the targets are mentioned. There is no consistency in either the form or content of these documents between the Union and the States.

There are several issues with this practice, with the most significant one being that it is an offline ex-post exercise that does not result in the prioritisation of expenditure based on the desirability of the outcomes. Though termed ‘budget’, it is essentially not a budgeting exercise. If the desired objective of prioritisation of expenditure outlays is to be realised, then the expenditure must be aggregated around a larger or broader objective or a programme.

As noted by the Fifteenth Finance Commission (2020), “there is a misalignment between the annual budget exercise, medium-term planning, and outcome budgets.” Outcomes, output indicators, and targets need to be defined and integrated into the budget documentation process at the Union as well as State levels. The focus of legislative oversight in this regard also needs to shift towards intended outcomes. To facilitate these changes, and to build outcome-based spending more generally, reforms will be needed to the underlying budget structures and processes.

The critical impediment has been the archaic chart of accounts⁵ which is completely at odds with the internationally followed good practices like the COFOG⁶ and the GFS Manual.⁷ India must move towards outcome-oriented budgeting. In consultation with the C&AG, the budget classification and chart of accounts need to be reformed in a manner that facilitates budgeting based on programmes and their expected outcomes. Currently, legislative appropriation is done at the lowest unit of

classification which is object-head level. This makes it difficult to make mid-year corrections and reappropriations leading to inefficient utilisation of the budget. It should be changed to programme-level instead of the current 'object head' level appropriations. (Section 26 of the draft PFM law).

Moreover, programme managers across the different tiers of government⁸ in India presently have very little flexibility in the use of budgetary funds. They lack the freedom to move funds from one head to another within the same program, as re-appropriation of funds is permitted only between one primary unit of appropriation (the lowest level of "object head" in the chart of accounts) and with the permission of the Finance Department/Ministry. Instead, programme managers should be afforded the flexibility and discretion to move funds within the programme based on needs and within pre-defined rules (Section 38 of the draft PFM law).

D. Supplementary grants and rush of expenditure

The Constitution enables the Legislature to approve supplementary grants during the course of the year, to provide funds where there is a requirement for additional funds for an existing scheme, or for new services or new instruments of service (Articles 115 and 205).

Such grants are expected to be few and far in between, so that the sanctity and integrity of the original budget remains intact. However, in the absence of any limits in terms of the frequency and volume of such supplementary estimates, presentation of several supplementary estimates has become quite common. There is thus a need to restrict supplementary estimates, ideally to no more than two in a financial year. Additionally, the finance minister should be required to disclose the impact of such additional expenditure or financing on the performance of the Government against the fiscal objectives contained in the Fiscal Strategy (Section 29 of the draft PFM law).

One major concern in expenditure management has been unproductive expenditure in the last month of the financial year, mainly to avoid budgetary allocations from lapsing. The present system of appropriations lapsing at the end of each financial year encourages undesirable practices such as rush of expenditure at the year-end, involving procurement of unwanted and unnecessary items that may result in lower quality of public expenditure; transfer of funds from the Consolidated Fund to either the Public Account, or parking them outside.

There is a distortion in accounts, as cheques are drawn but not issued to vendors. This also results in an indeterminate cash liability, as no record of such withdrawal is maintained in the books of accounts. These practices are a legacy from the past and need to be phased out. International experience is clear that the annuality of the budget is a crucial principle and should not be distorted. In summary, the accounts should close at year-end, with payments authorised only for commitments made and goods or services delivered before year-end.⁹

E. Facilitating participation

Finally, governments should also endeavour to make the budgetary exercise a more participatory one (Section 22(7) of the draft PFM law). As recommended by the Organisation for Economic Co-operation and Development (OECD, 2015b), governments need to ensure that "budget documents and data are open, transparent, and accessible." Budget reports need to be published fully, promptly, and routinely, in a manner that is widely and easily accessible.

Governments could prepare a simplified summary of the budget, which would be more accessible to the common citizen, and make it available on the government website soon after the presentation of budget (Section 28(c) of the draft PFM law; IMF, 2019). This should help in providing for an “inclusive, participative, and realistic debate on budgetary choices”, and governments should additionally facilitate engagement by legislatures, citizens, civil society organisations, and other stakeholders in realistic debates about priorities, trade-offs, and opportunity costs (OECD, 2015b).

IV Financial Management

A. Debt Management

Achieving and maintaining a prudent level of public debt is a fundamental fiscal responsibility principle.¹⁰ In addition to the Union and State FRBM Acts, the current regulations and practices in debt management in India stem from the Public Debt Act, 1944 (which focuses on government securities and management of public debt by the central bank), and the Government Guarantee Policy of 2010, with operational details contained in the Government Financial Rules, 2017. However, to truly operationalise this principle, there needs to be a comprehensive and consolidated framework for the determination, approval, and risk management of public debt.

In particular, principles need to be established for the issue of government guarantees to PSEs and other parastatals (Sections 64-67 of the draft PFM law). Some of the borrowings by parastatals become contingent liabilities of the government, thereby exerting pressure on the government’s debt sustainability levels. To increase transparency in debt reporting, governments should be required to disclose all the guarantees that they have given. With respect to parastatals, debt includes not only guarantees but specifically also their off-budget borrowings.

While the FRBM Acts (at the Union, and in some States) have amended the definition of debt to include the above understanding, other States still have to incorporate this change. Such borrowings need to be brought explicitly into the overall debt of the government, depending on the relationship of the entity with the government.

To accurately capture the full picture, public debt should be defined as the total outstanding liabilities of the Government on the security of the Consolidated Fund, including external debt, the total outstanding liabilities in the Public Account, and such financial liabilities of any body corporate or other entity owned or controlled by the Government, which the Government is to repay or service from the Annual Budget (as made clear in the Union FRBM Act after its amendment in 2018) (Section 2(ee) of the draft PFM law).

Effective public debt management is financing of government’s spending and payment obligations at the lowest possible cost and with prudent degree of risk. For effective debt management, it might be helpful if governments prepare a Medium-Term Debt Management Strategy (MTDMS) as part of their Annual Budget documentation (Section 56 of the draft PFM law). The MTDMS framework typically comprises a methodology and an analytical tool aimed at facilitating prudent debt management. It can help governments to formulate, adjust, and effectively implement their debt management strategy (World Bank & IMF, 2017).

While the Reserve Bank of India had issued a debt management strategy for 2015-2018, it was not laid before Parliament. No State Government prepares such a document. An MTDMS could be a first step in liability management and can appraise the Government's performance on public debt, reassesses debt sustainability conditions, and continue to guide debt policy over the medium term.

The MTDMS can serve as an annual performance evaluation of government debt management activities, besides having development aspects. These development aspects can include guidelines and specified targets for the composition of the Government's debt portfolio and new debt, to ensure that the risks in the portfolio remain at acceptable levels. It can also include planned measures to support a functioning domestic market for government securities, and policies and guidelines for lending and the issuance of debt guarantees.

The MTDMS should be prepared within the fiscal responsibility principles mentioned previously, and with the Fiscal Strategy. In many countries, the broader coverage provided by the MTDMS was crucial in identifying the true extent and trajectory of vulnerabilities by capturing and highlighting debt management issues linked to PSEs (World Bank & IMF, 2017).

As the economy and operations of a country get increasingly integrated and intertwined with the international economy, risks increase and there are opportunities to reduce the cost of government operations, particularly public debt. The overall objectives of debt portfolio management operations should be to meet the government's financing needs, make payment obligations, ensure lowest possible costs over the medium- to long-term, and maintain prudent level of risks. Modern day practices such as derivatives and hedging can help in achieving these objectives and can be a part of good debt portfolio management practices (Sections 61 & 62 of draft PFM law):

- *Derivatives* - Derivatives are complex financial instruments and include swaps, futures contract, options, foreign currency contracts, and forward agreements. The Union finance minister could be empowered to enter derivatives which are authorised by the Cabinet, in consideration of the risks involved and the public interest. The ultimate objective is to lower the cost of public debt by anticipating interest and/or foreign exchange movements or manage the average maturity of public debt, particularly when exposed to foreign markets.

Derivatives have long been used in the private sector, but are now increasingly being introduced in government operations. However, in the context of public debt, they should be used sensibly, responsively, and transparently. New Zealand and Sweden are examples of sovereign borrowers that frequently use derivatives, and other examples include Ireland, Denmark, and Australia. In Sweden, active debt management is achieved by separating decisions on funding and characteristics of the debt portfolio. Sweden's National Debt Office seeks low-cost funding, irrespective of the currency or maturity, and then transforms the cash flows using derivatives.

- *Hedging* - India's composition of public debt comprises a significant portion of external debt, and hence risk management of this external debt assumes significance. Hedging may be a good option for countries whose debt portfolios have a significant proportion of foreign currencies, given their exchange risk exposures. India too can consider entering into hedging¹¹ transactions or arrangements for avoiding or reducing the effect of currency or

interest rate fluctuations. Such transactions or arrangements should, however, be consistent with the aforesaid MTDMS.

The importance of strictly controlling and monitoring sovereign guarantees was mentioned earlier. Razlog, Irwin, and Morrison (2020) suggest a checklist of ideas to improve management of government guarantees. They note that legislating binding limits on guarantees and centralising the authority to grant guarantees can help in controlling them. In some countries, such as Austria, the legislature has specified that only the finance minister can issue guarantees. It may also be useful to frame guidelines and restrictions for the issuance of guarantees, such as specifying the circumstances in which they may be issued. Once a guarantee is issued, they must also be effectively recorded, reported, and monitored (Razlog, Irwin, & Morrison, 2020).

In India, provisions relating to guarantees are currently provided in the Government Guarantee Policy of 2010, with operational details in the Government Financial Rules, 2017, and in some State-level fiscal responsibility and other legislations. In addition to these, guarantees should comply with the fiscal responsibility principles mentioned earlier, the MTDMS, and be subject to risk-assessment.

The sole authority for issuing guarantees should be vested in the finance minister, and the government should not be liable to pay any liability under a guarantee unless it is a formal guarantee (Sections 64 & 65 of the draft PFM law). In other words, documents such as “letter of comfort” or a communication conveying the intent of the government should not be considered as guarantees under any circumstances.

All debt recording and reporting needs to be formalised, such that all loans taken or guarantees given are required to be disclosed in the Annual Accounts of the government (Section 67 of the draft PFM law). While this is currently being followed both at the Union and State levels, and disclosures are made in the Finance Accounts and in the Annual Budget documentation, there is merit in making this a mandatory requirement.

Additionally, a quarterly report on public debt should be presented to the Cabinet, summarising the debt operations during the reporting quarter. While this is being currently followed at the Union level, there is a need to make this a mandatory requirement at the State level too. The Finance Ministry/Department should be vested with the formal responsibility for debt recording, including recording information on principal, terms of payment, draws, interest and other charges, repayment of principal and payment of interest, alteration of the terms, and outstanding balance. Lastly, parastatals should also be vested with the responsibility of maintaining debt records and submitting periodical reports to their concerned administrative ministry/department.

B. Commitment Control

It is critical to implement commitment control as part of the overall budget control framework (Section 37 of the draft PFM law). In India, excess levels of commitments plague government finances and result either in expenditure payment arrears or resources being thinly spread over large items. Commitment typically is a guarantee given by the government to any entity for raising a loan/debt from the market. In case of loan default by the borrowing entity, it becomes a financial liability to the government, including in the case of PPPs.

Public servants need to be given certain responsibilities that can serve as checks and balances, prior to their taking action that results in committing the government to a financial liability. They should only commit the Government to financial liability if they are expressly authorised to do so; the commitment should not exceed the approved amount and should follow all relevant procedures; and they must maintain a proper record of all commitments, linked to appropriation and expenditure line.

Additionally, multi-year commitments should be consistent with the fiscal responsibility principles reflected in the Fiscal Strategy, be approved by the finance minister, and should be within the expenditure limits set in the approved budget. The Government should specify limits on financial commitments and provide guidelines to link public investments to multi-year commitments.

Moreover, commitments should be included in the fiscal forecasts, financial reporting, and annual accounts of the Government. This transparency is facilitated through accrual accounting, which is presently not followed in India. Multi-year commitments should be included in the Annual Budget at least, so that appropriate expenditure limits may be set. Further, a statement of commitment would be included in the annual accounts of the government, which will help in assessing fiscal risks arising out of commitments (Section 78 of the draft PFM law). This would be facilitated if governments implement an ICT application that includes a dynamic database of commitments.

C. Internal Audit

The internal audit system in government needs to be institutionalised. Internal audit in government at the Union-level is spearheaded by the Controller General of Accounts (CGA). While there are operational guidelines regarding this vital function in chapter 12 of the Civil Accounts Manual of the Union Government, they are not legally binding at the moment.

The current system includes a decentralised internal audit institutional structure that has been implemented under the Chief Controller of Accounts of each Ministry reporting to the Financial Adviser, under the overall responsibility of the relevant Secretary. The CGA has brought out a Generic Internal Audit Manual and some instructions that are followed by the Ministries. On the other hand, internal audit function in the States follow different institutional structures and practices with a few States having their own audit legislations. Some States are pursuing reforms that aim to strengthen their internal audit mechanisms.

Thus, while a system of sorts does exist, there remains ample scope to strengthen it. By and large, the coverage and effectiveness of the internal audit function in the country needs to be enhanced by adopting the contemporary approach to audit based on risk assessment, establishing auditing standards, and defining the scope and ensuring executive compliance to the internal audit function. Internal audit should have a focus on providing assurance to the Secretary of the auditee-department that operations are being carried out economically, efficiently, and in compliance with applicable laws. It should also be able to provide professional and impartial opinion and advise on systems of risk management, control, and governance.

Specifically, annual internal audit reports that include organisational structure, work done, and major findings, should be published along with risk-based internal audit plans. The CGA should develop standards and guidelines for effective internal audit under the direction of the Finance Secretary, and these can be adopted by Finance Secretaries at the State level too. These standards and

guidelines should be published. The scope of internal audit should include an assessment of the risk management, control, and governance process, including:

- whether risks are appropriately identified and managed;
- whether public money and assets are adequately safeguarded and used as intended;
- whether financial and operating information is accurate, complete, reliable, and timely;
- whether ethical standards and values are established and followed;
- whether all applicable laws, policies, and procedures are complied with; and
- whether resources are applied to achieve the strategic objectives of the Government (Section 71 of the draft PFM law).

While the departmental secretaries should have the primary responsibility for ensuring compliance, the finance minister should also set up internal audit committees at various levels of government to provide oversight over compliance (Section 72 of the draft PFM law).

V. Reporting and Accounting

All governments should produce annual financial statements based on internationally-recognised reporting and accounting standards. This is important for accountability, transparency, and decision-making. Article 150 of the Constitution provides that the accounts of the Union and State Governments would be kept in such form as may be prescribed by the President, on the advice of the C&AG.

This function is exercised by the CGA, on behalf of the President, and the CGA thus has to prescribe the form of accounts of the Union and States, and to frame or revise the related rules and manuals in consultation with the C&AG. The procedures for reporting and accounting are primarily contained in the GFR and the GAR. The C&AG (Duties, Powers and Conditions of Service) Act, 1971 also has provisions relating to financial reporting and accounting.

The annual accounts of the Union Government comprise the Appropriation Account and the Finance Accounts. The former is prepared by each Ministry and shared with the CGA for consolidation, and the latter is prepared by the CGA. While at the Union level, the responsibility for accounting of government transactions vests with the CGA, at the State level, accounting is done by the Finance Department through the Treasuries. These accounts are then supplemented and compiled by the State Accountant General (A&E) to produce the monthly accounts and the annual accounts comprising the Finance Accounts and Appropriation Accounts.

Annual financial statements of the governments at the Union and State levels in India are produced primarily based on the cash-based accounting system. The Union Government constituted the Government Accounting Standards Advisory Board (GASAB) in 2002 to act as an advisory body under the C&AG.

GASAB's objective is to formulate standards relating to accounting and financial reporting by the Union and the States. It works on two sets of accounting standards, based on cash and accrual basis of accounting, and standards formulated by it are recommended to the Union Government for notification.¹² These standards, however, are not consistent with international accounting standards

such as the International Public Sector Accounting Standards (IPSAS), which is issued by the International Federation of Accountants.

In India, financial reporting needs to be strengthened in two key areas: one, enhancing the contents of the government's annual financial statements; and two, mandating the setting of government accounting standards in line with international standards.

A. Enhanced reporting

There needs to be a comprehensive and consolidated system of government reporting, including components such as:

- a consolidated quarterly report that covers the government's financial performance, covering all public entities against the Annual Budget and the Appropriation Act;
- a mid-year review report that sets out the progress against the Fiscal Strategy and the Annual Budget;
- annual accounts comprising the finance and appropriation accounts;
- an annual report; and
- simplified summaries of the Annual Budget and reports (Sections 76, 77 read with the Fourth Schedule, 78, 80, & 83 of the draft PFM law).

The mid-year review report should specifically present the progress, achievements, and challenges of the government in budget execution during the first six months of the fiscal year, including important developments and an updated fiscal outlook including items such as revenue outturn and budget balance. This would help in informing all stakeholders, including elected representatives and citizens, of the progress in the use of public resources and implementation of plans. It should contain updated macro-economic forecasts, progress on government priorities, information on reallocations, matters such as divestments, major PPP contracts, and tax arrears and reliefs.

Currently in India, Ministries and Departments at the Union and State levels produce Annual Administrative Reports containing information regarding their mandate, achievements made during the year, their future plans, budgetary achievement, and staffing. These are then tabled in Parliament or the Legislative Assembly, as the case may be. However, in practice, these reports are often delayed.

The practice of preparation and submission of Annual Financial Reports by the governments is internationally recognised, and prevalent in countries such as the United States of America and South Africa. There is a need to mandate and institutionalise this practice, at the levels of individual Ministries and Departments, as well as the Union and State Governments, to capture the whole of government. Moreover, minimum contents for these reports should be specified. It should contain the government's views on major activities during the year, and its commentary on revenue, expenditure, budget balance, borrowings, and so on. To some extent, this is discussed in the budget speech, but the practice and extent of the discussion differs *inter se* between governments.

In addition to these components of reporting, clear timelines are needed for the production of accounts, completion of audit (Section 79 of the draft PFM law), and tabling before the legislature. Presently, these matters are frequently delayed and there is no system of informing the legislature of the reasons for the delays and the action proposed to be taken. Beyond clear timelines, the finance minister should have to explain delays in the legislature, and in the case of delays in auditing the

Annual Accounts, the C&AG should submit an explanatory memorandum to the Legislature (Section 81 of the draft PFM law).

B. Accounting Standards

Several countries have established accounting standards in their financial reporting framework, based on the IPSAS. IPSAS aims to “improve the quality of general purpose financial reporting by public sector entities, leading to better informed assessments of the resource allocation decisions made by governments, thereby increasing transparency and accountability” (Ahmad & Nassereddine, 2020). Adoption of IPSAS is expected to enhance financial accountability in the government and improve the quality of available information, on the basis of which governments can make better informed decisions and improve service delivery. IPSAS is a benchmark for evaluating and improving government accounting (Kasoma, 2018).¹³

For example, in New Zealand, the External Reporting Board or XRB, an independent body set up by the government, is responsible for developing and issuing accounting standards in the country. It has delegated its authority regarding accounting standards to the New Zealand Accounting Standards Board or NZASB, and the standards differ based on the sector in which the reporting organisation operates (for-profit, not-for-profit, or public sector). From 2014 onwards, for public sector entities, New Zealand moved the basis of its accounting standards to IPSAS.

While, as aforesaid, the GASAB currently formulates accounting standards in India, there is a need to change the present approach for implementing standards-based accounting. Rather than drafting new accounting standards, India could consider adopting cash-based IPSAS with minor adjustments for Indian systems. That way, it can spare more time and resources for the implementation of standards.

The standards-setting body should also have powers to notify its standards after adequate stakeholder consultations. Apart from being set and notified by an independent body, the accounting standards should be implemented progressively, including the transition from cash-based to accrual-based accounting. They should also be uniformly applicable to government accounts at the Union as well as State levels, and should be duly notified and made publicly available.

The annual accounts of the government should be prepared in accordance with these notified standards. In case any delay or temporary deviation from the accounting standards are required, their details should be clearly specified in the published standards (Section 73 of the draft PFM law).

VI. Legislative and Executive oversight

A. Legislative oversight of the Executive

Legislatures play a crucial oversight role in PFM. Through increasing transparency and accountability, legislative oversight can, in theory, contribute to better resource allocation and use of scarce public resources. This responsibility is indispensable, ensuring, among other things, that all public money is accounted for, public expenditure is properly incurred, and conditions on the use

and appropriations of public money imposed by the Constitution or the Legislature are duly respected.

The role of the Legislature, therefore, is to supervise the use of public resources and prevent corruption. Legislative oversight, in addition to being an important institutional check and balance on the executive, leads to greater transparency and oversight by civil society as well. This is because documents placed before the Legislature become public documents, available to all.

In India, while there are constitutional provisions regarding legislative oversight of certain broad aspects of PFM, there remains considerable scope to strengthen and enhance this function. Legislative oversight measures exercised in India include debates and review by legislative committees. The legislature should be adequately empowered to approve the Annual Budget and the supplementary estimates, authorise to borrow and invest in public entities, and review audit reports.

For legislative oversight to be effective, there first needs to be an effective system of reporting by the executive, as covered in the preceding section. The existing system in India requires the executive to table specific reports before the legislature, including performance reports and audit reports. The FRBM Acts also contain some requirements in this regard.

As mentioned previously (in the section on fiscal responsibility), there is a need to bolster these requirements, and the government should table a range of ex-ante strategies and plans in the legislature including an investment statement, a financial asset management strategy, a liability/debt management strategy, and a PIP.

The current framework casts responsibility on the government to provide ex-post reports for legislative oversight such as actual spending to budget approvals. As argued in this paper, the ex-post reporting framework should also be strengthened by introducing certain additional responsibilities for the executive, to supplement the FRBM Acts. The discussion in the fiscal responsibility section of this paper regarding the need to report deviations from fiscal objectives to the legislature, and the review role that can be played by the C&AG (for the time being), are also relevant for increasing legislative oversight.

B. Executive oversight of Public Sector Enterprises and other government bodies

Beyond legislative oversight of the executive, executive oversight of PSEs and other government bodies that are owned, controlled, or managed by the government also needs to be bolstered. PSEs and government bodies in India, both at the Union and State levels, are large entities that play an important part in the delivery of goods and services. They play a major role in the economy in many sectors, ranging from infrastructure, energy, and transport, to banking, insurance, and manufacturing.

The activities of these bodies often create fiscal risks for their governments, including contingent liabilities, accentuated by serious gaps in timely and adequate reporting of financial information. Even though the Companies Act, 2013 or the specific statutes under which certain PSEs are established have robust accountability and financial reporting provisions, their implementation, particularly at the sub-national level, leaves much to be desired. In case of other bodies, such as those incorporated under the Societies Registration Act, 1860, the situation is much worse, characterised by incomplete and inadequate financial information.

This ultimately results in poor oversight. Financial reporting by PSEs under the Union Government is quite strong, but there are significant gaps when it comes to State-level bodies, where the consistency, uniformity, and reliability of information needs considerable improvement. This creates gaps in timely reporting of liabilities, improperly-informed policy decisions, and delayed reforms in the sector.

While the Department of Public Enterprises in the Union Ministry of Heavy Industries and Public Enterprises has some oversight role and collects information, such a central body is generally lacking at the State level. In cases where such a body exists (such as a Bureau of Public Enterprises), it tends to be non-operative and/or lacks statutory authority. This points to the importance of extending such arrangements at the State-level as well.

The OECD Guidelines on Corporate Governance of State-Owned Enterprises (SOEs) provide that, “The state should act as an informed and active owner, ensuring that the governance of SOEs is carried out in a transparent and accountable manner, with a high degree of professionalism and effectiveness” (OECD, 2015a). They further elaborate that to perform such a role, the State should set and monitor the implementation of broad mandates and objectives for SOEs, reporting systems that enable regular monitoring, auditing, and assessment of SOE performance, and mechanisms for ensuring quality of information provided by SOEs (OECD, 2015a).

In pursuance of these guidelines, Germany’s Federal Ministry of Finance implemented a standardised monitoring system for State-owned small- and medium-sized enterprises. This monitoring system was designed with the objective of providing government authorities with an analysis and alert tool that could highlight potential financial risks associated with such enterprises (OECD, 2020).

Presently, in India, such bodies come under the purview of their respective administrative Ministries and the Finance Ministry.

- Administrative Ministries need to proactively and effectively monitor the fiscal risks of PSEs under their purview, and to facilitate this, PSEs should be required to report, ex-ante and ex-post, matters such as the preparation of corporate intent and annual plans, and mid-year and end-year reporting on actual performance (Section 90 of the draft PFM law).
- They should be allowed to borrow only in accordance with their approved annual plans, and they should additionally provide periodic debt reports to their respective administrative Ministry for monitoring and oversight (Section 96 of the draft PFM law).
- Their annual plans should include strategic priorities, changes from the previous plan, outputs planned to be achieved, expected government contributions, human resource development, a statement of fiscal risks, and a budget (Section 89 of the draft PFM law).

This should be a mandatory requirement, as presently, while some PSEs and government bodies do prepare annual plans, most do not. More generally, there is a need for a comprehensive framework of control and oversight, covering both financial management as well as fiscal risks (Section 88 of the draft PFM law).

The responsibilities of the Finance Ministry and the administrative Ministry, vis-à-vis PSEs and other government bodies, need to be clearly defined (Sections 85 & 86 of the draft PFM law).

- The finance minister should be responsible for approving loans and guarantees to be provided by the government and major financing and investment proposals, monitoring financial performance and risks, and enforcing the expectations of the government.
- The Minister of the concerned administrative Ministry, on the other hand, should have the power to issue relevant directions to the Board of such bodies,¹⁴ conduct performance reviews (Sections 87 & 91 of the draft PFM law), and fulfil the responsibilities that arise from the shareholding or ownership roles.
- The minister of the administrative Ministry should also be responsible to the legislature for the performance of the bodies under their purview on matters relevant to PFM.

There should also be certain principles and procedures that are applicable at the time of formation of such government bodies. For instance, in order to establish such a body, a due diligence process must be followed that requires the relevant administrative Ministry to consult the Finance Ministry and present a report to the Cabinet on the need, costs, benefits, and fiscal risks over the long term, in case such a body is established (Section 84 of the draft PFM law).

VII. Conclusion and way forward

As argued in this paper, India needs to improve its PFM system in a comprehensive, integrated, and consistent manner, at the earliest. The case for PFM reform has only become stronger in light of the disruptions and strains caused by the COVID-19 pandemic and its continuing effects, which have highlighted and exacerbated existing fault lines in national fiscal architectures around the world. The pandemic has also illustrated the importance of building resilient public finance frameworks that can effectively manage and mitigate future crises.

A strong PFM framework, built on learnings from international experience and best practices as highlighted in this paper, will also help in enhancing accountability and transparency, and ultimately contribute to improving governance. As India emerges from the pandemic, PFM reforms at the Union and State levels are also essential for improving its human capital outcomes (Dahiya *et al.*, 2021).

This paper complements the Fifteenth Finance Commission's (2020) recommendations regarding building India's fiscal architecture for the 21st century, and specifically, the key elements of PFM reforms that it identified. The paper addresses various aspects of India's PFM architecture ranging from fiscal responsibility, budgeting, financial management, reporting and accounting, and oversight, drawing extensively from global best practices.

Based on this study and analysis, and elaborating upon the provisions contained in a draft PFM law prepared by an expert group and cited by the Fifteenth Finance Commission (2020), several recommendations have been suggested for each of these areas (Alamuru & Vidhi Centre for Legal Policy, 2020). This draft legal framework also incorporates the principles-based fiscal responsibility paradigm, as argued in this paper.

Around the world, countries are enacting overarching, comprehensive, and modern legislative frameworks for PFM, along the lines of the draft PFM law discussed in this paper. This approach is emerging as a preferred means for implementing PFM reforms, and examples of countries that have

enacted such laws include large, emerging markets such as Indonesia and South Africa, as well as advanced countries such as Canada, Australia, and the United Kingdom.

For these reforms to be effective, they need to be implemented at the Union as well as State levels, with careful integration and coordination. Future research can look at how some of these PFM reforms may be appropriately extended to the level of India's third tier as well, comprising panchayats and municipalities.

While the need for these reforms is urgent, it would still be advisable, and perhaps practical, to proceed in an incremental and sequenced manner. As recommended by the Fifteenth Finance Commission (2020), the Union Ministry of Finance is best-placed to take the lead in conducting extensive and wide-ranging stakeholder consultations, bringing together State Finance Departments, the C&AG and its subordinate State Accountant Generals, the CGA, the Reserve Bank of India, and research bodies and civil society organisations that work in the area of PFM. These consultations could also be carried out through existing institutional fora such as the Inter-State Council or the NITI Aayog's governing council.

Once the Union and State Governments begin to reform their PFM systems, important learnings from their individual experiences should be widely shared, discussed, and benchmarked. Given the nature and scope of the suggested reforms, a long-term implementation strategy should be developed, and it should be designed and executed in the spirit of deliberation, inclusiveness, consensus, and transparency.

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Notes

¹ The Government of India's Civil Accounts Manual, which supplements the R&P rules, does incorporate process changes that were brought out in pursuance of adopting ICT systems and electronic transactions.

² Under New Zealand's Public Finance Act, 1989, the government's fiscal policy needs to comply with certain specified principles of responsible fiscal management. In contrast to legislated numerical fiscal rules, the New Zealand government has to articulate how its fiscal strategy is consistent with these principles, including by self-setting measurable, numerical fiscal objectives in the strategy document. This approach has been successful, as governments are more likely to achieve principles-based fiscal objectives that they have determined and set for themselves, as opposed to legislatively stipulated numerical rules (Parkyn, 2019). For India to move towards this framework, changes would be needed in its existing FRBM laws and rules.

³ For a discussion on fiscal councils, see Singh, Patel, and James (2021).

⁴ It should be noted that even after an independent fiscal institution is established, the C&AG's role would remain critical, given its constitutional authority and mandate to provide a true and fair view of accounts (among other responsibilities in constitutional and statutory compliance matters).

⁵ There have been attempts in the past to revise the List of Major and Minor Heads (India's chart of accounts applicable to both the Union and State Governments). The Sundaramurti Committee's report made recommendations towards amending the economic segment of the chart of accounts to ensure compliance with the IMF's Government Financial Statistics Manual (CGA, 2016). The CGA was in the process of updating the chart of accounts as proposed by this report, but these changes have not been implemented yet.

⁶ Classification of the Functions of Government, issued by the United Nations (2000) and developed by OECD. It provides a classification of functions of government (Major Heads in the Indian context).

⁷ The Government Financial Statistical Manual, issued by the IMF (2014), provides guidance for economic (Object Head) classification.

⁸ LMMH follows functional 6-tier classification where Programmes/Schemes are depicted at Minor Head level or below. Person authorized to operate these heads could be identified as Programme/Scheme manager.

⁹ Another concern in expenditure management is that unauthorised excess expenditure, such as on salaries and pensions, often remain without regularisation for years. It should be ensured that these are consistently regularised through a demand for excess grant in the new financial year (Section 31 of the draft PFM law).

¹⁰ It is difficult to numerically define the level of prudent debt, since there is no one level of debt that could always and universally be considered prudent. What is prudent is influenced by the prevailing economic conditions, vulnerability to shocks, demographic changes, cost of debt servicing, and other factors. As these are likely to change over time, the prudent debt level will also undergo changes.

¹¹ Hedging is a risk management strategy employed to offset losses in investments by taking an opposite position in a related asset. It is like an insurance against occurrence of unfavorable events.

¹² Since 2002, GASAB has developed six accounting standards on cash basis of accounting (called the Indian Government Accounting Standards or IGAS), of which three have been notified by the Union Government; and five accounting standards on accrual basis of accounting (called the Indian Government Financial Reporting Framework or IGFRS), none of which have been notified by the Union Government as on date.

¹³ There are three ways in which the IPSAS can be implemented:

(i) directly implementing IPSAS without altering any requirements;

(ii) indirectly implementing IPSAS through a national endorsement process that adjusts for any local features; and

(iii) developing national standards using IPSAS as a reference point. IPSAS are available both for cash and accrual basis of accounting.

¹⁴ The scope of the power to issue such directions should be appropriately defined and limited, to ensure a balance between oversight and non-interference.