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India–Himachal Pradesh Public Financial Management Accountability Assessment

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CURRENCY EQUIVALENTS

Currency Unit	=	Indian Rupee (Rs.)
US$1	=	Approx. Rs. 49
1 Crore	=	10 million

FISCAL YEAR

April 1 - March 31

Abbreviations and Acronyms

AA	Appellate Authority
AG	Accountant General
AA & ES	Administrative Approval & Expenditure Sanction
AG (A&E)	Accountant General (Accounts & Entitlement)
AGA	Autonomous Government Agency
BMO	Block Medical Officer
CAAA	Controller of Aid, Accounts and Audit
CMO	Chief Medical Officer
CSSA	Cash Settlement Suspense Account
CAG	Comptroller and Auditor General of India
CFC	Central Finance Commission
CO	Controlling Officer
CSS	Centrally Sponsored Schemes
CST	Central Sales Tax
CVC	Central Vigilance Commission
DA	Divisional Accountant
DDO	Drawing and Disbursing Officer
DPL	Development Policy Lending
DTO	District Tax Offices
ETC	Excise and Tax Administration Commissioner
FD	Finance Department
FRBM Act	Fiscal Responsibility and Budget Management Act
FY	Financial Year
GASAB	Government Accounting Standards Advisory Board
GoI	Government of India
GC	Government Companies
GSDP	Gross State Domestic Product
GoHP	Government of Himachal Pradesh
GSF	Government Financial Statistics
GST	General Sales Tax
HO	Head Office
HoD	Head of Department
HPFR	Himachal Pradesh Financial Rules, 1971
HIPA	Himachal Institute of Public Administration
HPTR	Himachal Pradesh Treasury Rules
HP	Himachal Pradesh
INR	Indian National Rupee
INTOSAI	International Organization of the Supreme Audit Institutions
IPH	Irrigation and Public Health
IWDP	Integrated Watershed Development Project
LoC	Letter of Credit
mn	Million
MTEF	Medium Term Expenditure Framework
MTFP	Medium Term Fiscal Plan
NIC	National Information Center
OA	Origin Authority
PAC	Public Accounts Committee
PEFA	Public Expenditure and Financial Accountability
PE	Public Enterprise
PFM	Public Financial Management
PFMA	Public Financial Management & Accountability
PI	Performance Indicator
PLA	Personal Ledger Account
PRI	Panchayat Raj Institution
PWD	Public Works Department
RA	Revenue Administration
RBI	Reserve Bank of India
RTI Act	Right to Information Act
SMEs	Small and Medium Enterprises
SN	Sub National
SFC	State Finance Commission
SC	Statutory Corporation
TEQIP	Technical Education Quality Improvement Program
TIN	Tax Identification Number
TS	Technical Sanction
ULB	Urban Local Bodies
USD	United States Dollar
VAT	Value Added Tax
VDMS	Verified Data Monthly Statement

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ACKNOWLEDGMENTS

This report was prepared by Tanuj Mathur, Senior Financial Management Specialist (Task Team Leader for this study), Mohan Nagarajan, Senior Economist and Ashish Bhateja, Senior Procurement Specialist, with contributions from Puneet Kapoor, Consultant.

The study was carried out in active collaboration with the Government of Himachal Pradesh (GoHP). We gratefully acknowledge the valuable and extensive contributions of many officials of GoHP and Office of the Comptroller and Auditor General of India (CAG). The Finance Department co-coordinated the study on behalf of GoHP, and we are particularly grateful to the following Finance Department officials: Mr. Arvind Mehta, Dr. Ravinder N. Batta, Mr. Akshay Sood, Mr. Shekhar Gupta, Ms. Nandita Gupta and Mr. Deepak Bhardwaj. Staff from other departments also contributed to the study, including: Mr. Bushari and Mr. Basu Sood (Planning Department); Dr. M. Mahajan and Mr. Rajeev Sharma (Health & Family Welfare Department); Mr. O.P. Sharma (Public Works Department); Mr. Ashok Sharma (Department of Education); Mr. Kewal Sharma (Panchayati Raj Department); Mr. Shamsher Singh (Rural Development Department); Mr. K.S. Verma (Irrigation & Public Health Department); Mr. Sinha (Forestry Department); Mr. V.R. Gupta (Urban Development); and Ms. Suman Saxena, Ms. Geetali Tare, Mr. G.N. Sharma, and Mr. T.C. Dhiman (CAG's office). We thank them and various other officials whom we have not been able to individually name here for their inputs, comments and suggestions throughout the study.

The report has been discussed with the Government of India, but does not necessarily bear their approval for all its contents, especially where the Bank has stated its judgments/ opinions/ policy recommendation.

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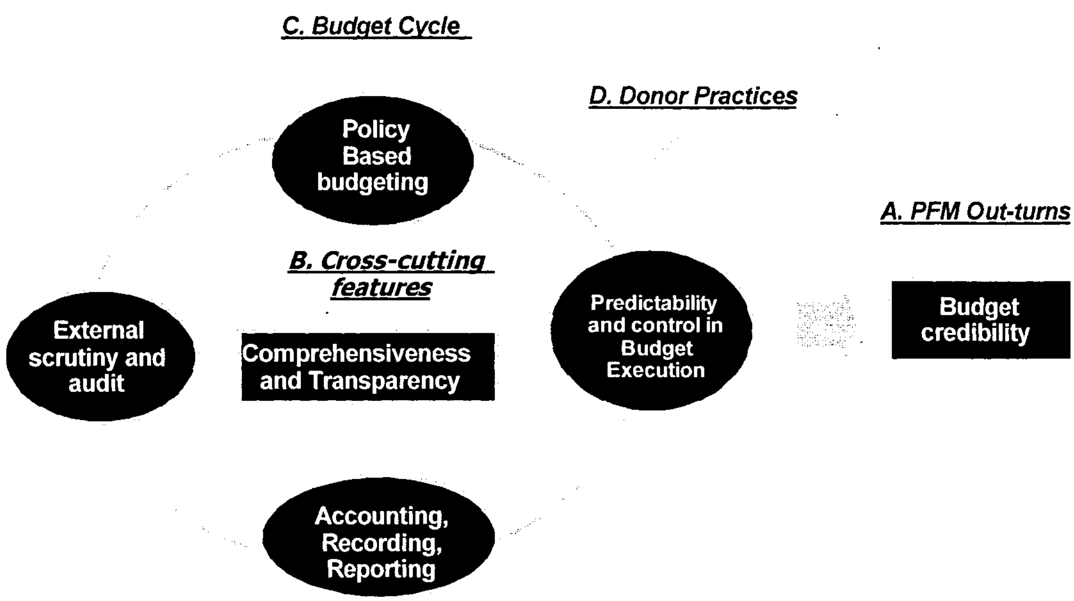
Summary Assessment

The objective of this indicator-led analysis is to provide an integrated assessment of the Public Financial Management (PFM) system of the Government of Himachal Pradesh (GoHP). The analysis draws on the International Monetary Fund Fiscal Transparency Code and other international standards. The analysis proposes to measure and benchmark PFM performance of the State across a wide range of developments over time. The findings are expected to contribute towards strengthening and implementation of the State's PFM reform strategy and in defining priorities and may serve as a baseline against which progress on PFM performance can be measured over time.

STRUCTURE OF THE PERFORMANCE INDICATOR SET



The 31 indicators for the State's PFM system focus on the basic qualities of a PFM system, linking to existing good international practices. Assessments are classified as A (excellent), B (good), C (opportunities for some improvement) and D (in need of improvement in some areas). The indicators cover:

- The results of the PFM system in terms of actual expenditures and revenues by comparing them to the original approved budget, as well as the level of and changes in expenditure arrears.
- Transparency and comprehensiveness of the PFM system.
- The performance of the key systems, processes and institutions in the budget cycle.
- The elements of donor practices which impact the performance of the PFM system.

Apparent positions against the Public Expenditure and Financial Accountability (PEFA) indicators are:

Indicator	Overall Indicator Score	Dimensions rating			
		i	Ii	iii	iv
A. PFM OUT-TURNS; Credibility of the Budget					
PI-1 Aggregate expenditure out-turn compared to original approved budget	**C**	C	-	-	-
PI-2. Composition of expenditure out-turn compared to original approved budget	**B**	B	-	-	-
PI-3. Aggregate revenue out-turn compared to original approved budget	**A**	A	-	-	-
PI-4. Stock and monitoring of expenditure payment arrears	**D+**	Could not score	D	-	-
B. KEY CROSS CUTTING ISSUES: Comprehensiveness and Transparency					
PI-5. Classification of the budget.	**A**	A			
PI-6. Comprehensiveness of information included in budget documentation	**A**	A	-	-	-
PI-7. Extent of unreported government operations	**B+**	B	A	-	-
PI-8. Transparency of inter-governmental fiscal relations	**C**	A	D	D	-
PI-9. Oversight of aggregate fiscal risk from other public sector entities	**D+**	C	D	-	-
PI-10. Public access to key fiscal information	**B**	B	-	-	-
C. BUDGET CYCLE					
C (i) Policy-based Budgeting					
PI-11 Orderliness and participation in the annual budget process	**B**	A	D	A	-
PI-12 Multi-year perspective in fiscal planning, expenditure policy and budgeting	**D**	C	D	D	D
C(ii) Predictability and Control in Budget Execution					
PI-13 Transparency of taxpayer obligations and liabilities	**B**	C	B	B	-
PI-14 Effectiveness of measures for taxpayer registration and tax assessment.	**C**	C	C	C	-
PI-15 Effectiveness in collection of tax payments	**D+**	D	B	B	-
PI-16 Predictability in the availability of funds for commitment of expenditures	**C+**	C	B	C	-
PI-17 Recording and management of cash balances, debt and guarantees	**C+**	C	B	C	-
PI-18 Effectiveness of payroll controls	**C+**	A	A	C	C
PI-19 Competition, value for money and controls in procurement	**D+**	D	C	C	-
PI-20 Effectiveness of internal controls for non-salary expenditure	**C**	C	C	C	-
PI-21 Effectiveness of internal audit	**D+**	D	C	D	-
C(iii) Accounting Recording and Reporting					
PI-22. Timeliness and regularity of accounts	**C+**	A	D	-	-

Indicator	Overall Indicator Score	Dimensions rating			
		i	Ii	iii	iv
reconciliation					
PI-23 Availability of information on resources received by service delivery units	**A**	A	-	-	-
PI-24. Quality and timeliness of in-year budget reports	**D+**	C	D	A	-
PI-25 Quality and timeliness of annual financial statements	**D+**	A	A	D	-
C(iv)External Scrutiny and Audit					
PI-26 Scope, nature and follow-up of external audit	**C+**	A	C	C	-
PI-27 Legislative scrutiny of the annual budget law	**D+**	A	A	D	C
PI-28 Legislative scrutiny of external audit reports	**D+**	D	B	B	-
D. Donor Practices					
D-1 Predictability of direct budget support	**Not scored**	Not scored	-	-	-
D-2 Donor financial information provided for budgeting and reporting on project/program aid	**A**	A	A	-	-
D-3 Proportion of aid that is managed by use of national procedures	**C**	C	-	-	-

Chapter 2 of the Report examines the economic situation in the State. It notes that the State's programs for improving PFM, especially in enabling HP to manage its fiscal space, will help the state in achieving continued growth. It is useful to examine the extent to which the PFM system's performance, shown in Chapter 3 of the Report, supports the overall achievement of the budgetary outcomes of the Government of Himachal Pradesh (GoHP) in three areas, namely aggregate fiscal discipline, strategic allocation of resources and efficient service delivery. This assessment confirms the need for improvements in budget execution and management controls processes as well as the procedures for procurement.

In respect of **aggregate fiscal discipline**, Performance Indicators (PIs) 1 through 3 show that the overall budget out-turn is affected by spending in excess of budget intentions. This may be caused by policy changes during the year or lack of discipline in managing the budget during its execution by line departments. Expenditure control becomes less predictable because of periodic policy pronouncements outside the budget cycle. Revenue targets generally have been exceeded. This could have reduced the impact of over-spending on the deficits. If deficits are to be controlled then expenditure must be monitored regularly. The inability to monitor arrears shown by PI 4 raises additional concerns about the capacity to manage fiscal discipline. It is likely that agencies are building significant commitments that are not monitored. Overall liabilities for the Government are additionally affected by the poor performance in PI 9 where fiscal risks in State Owned Enterprises (SOEs) and other governments are not well monitored. The budget development process, in fact, scores very well in PI 5 to 7 and PI 10 and 11. However, relatively weaker performance in the expenditure controls and scrutiny processes shown in PI 18 to 22 and PI 24 to 28 prevent the checks and balances in the PFM system from working effectively to ensure that the budget is implemented as intended.

An elaborate framework of controls and checks and balances does exist. But weak implementation restricts its working. The GoHP needs to reinforce the responsibility and accountability of the Head of Department (HoD) for improving PFM at all levels in areas where this analysis indicates shortcomings.

In respect of **strategic allocation of resources** most of the PIs show positive indicators. However, weak performance in PI 16, where commitments are not part of the accounting system, and the quality of in-year budget reports in PI 24, reduce the ability to monitor the use of resources as well as identify problems. This may lead to significant changes in the executed budget.

In respect of **efficient service delivery**, the lack of modern open competitive procurement procedures in PI 19, control weaknesses in PI 20, lack of strategic focus on internal audit in PI 21 and the response to external audit scrutiny in PI 26 and PI 28, reduce the extent to which managers can be held accountable for efficient and rule-based management of resources to deliver services. The poor performance in PI 1 is also relevant as budgetary adjustments may fall disproportionately on non-salary recurrent expenditures. This is likely to have significant impact on the efficiency of resources used at the service delivery level. Significantly, for the GoHP expenditure of contractual nature viz. salaries, pensions and interest dominate expenditure. In recent years, these three items comprised nearly 65% of total expenditure. The first two items account for about 44% of total expenditure. If deficits continue, interest will increase at the expense of residual fiscal space.

Following are the dimensions where opportunities exist for improvement in various indicators:

Credibility of the Budget:

PI-1. Aggregate expenditure out-turn compared to original approved budget – Control expenditure to reduce the difference between actual primary expenditure and the originally budgeted primary expenditure.
PI-4. Stock and monitoring of expenditure payment arrears – Increase the availability of data for monitoring expenditure payment arrears preferably using a computerized commitments accounting system.

Comprehensiveness and Transparency:

PI-8. Transparency of inter-governmental fiscal relations – Improve the timeliness of reliable information to lower level governments, and the extent to which consolidated fiscal data on revenue and expenditure is collected and reported.
PI-9. Oversight of aggregate fiscal risk from other public sector entities – Improve the monitoring of the fiscal positions of autonomous government agencies, public enterprises and lower level governments.

Policy-based Budgeting:

PI-12. Multi-year perspective in fiscal planning, expenditure policy and budgeting – Improve debt sustainability analyses, sector strategies and the implementation of medium term expenditure frameworks.

Predictability and Control in Budget Execution:

PI-14. Effectiveness of measures for taxpayer registration and tax assessment – Improve the linkages of tax data bases with other government data bases; increase the penalties for non-compliance, base audit programs on a more sophisticated risk assessment process.
PI-15. Effectiveness in collection of tax payments – Reduce the arrears in tax collections.
PI-17. Recording and management of cash balances, debt and guarantees – Lay down a standard framework prescribing criteria for eligibility, appraisal and approval of guarantees.
PI-18. Effectiveness of payroll controls – Increase degree of control over payroll and personnel records.
PI-19. Competition, value for money and controls in procurement – Improve the degree of competition in procurement and the system for handling complaints
PI-20. Effectiveness of internal controls for non-salary expenditure – Update the internal control guidelines; strengthen application.
PI-21. Effectiveness of internal audit – Improve all aspects of internal audit.

Accounting Recording and Reporting:

PI-22. Timeliness and regularity of accounts reconciliation – Reconcile and clear suspense accounts more regularly.
PI-24. Quality and timeliness of in-year budget reports – Use the accounting system to capture commitments to control expenditure more effectively and issue quarterly reports more promptly with better coverage of non plan expenditure.
PI-25. Quality and timeliness of annual financial statements – Adopt International Public Sector Accounting Standards (IPSAS) for annual financial statements.

External Scrutiny and Audit:

PI-26. Scope, nature and follow-up of external audit – Improve the timeliness of submission of audit reports to the legislature and improve audit responsiveness of departments.
PI-27. Legislative scrutiny of the annual budget law – Allow at least one month for the legislature to review the budget and conform more closely to the Budget Manual for supplementary appropriations to be exceptional.
PI-28. Legislative scrutiny of external audit reports – Improve the timeliness of examination of audit reports by the legislature.

Suggestions for Prioritization and sequencing of Public Financial Management & Accountability (PFMA) reforms

Performance issues exist in all aspects of the PFM system in HP. It would be critical to effectively address these issues in a strategic and sequential manner and not take up all the issues simultaneously. Dimensions scoring C and D should be the areas for attention, as these provide the greatest room for improvement. Within these, priority should be sequenced based on the importance of the weak dimension and which, if left un-addressed, would further undermine the PFM system. GoHP needs to prepare a strategy to move forward along the reform path, keeping in mind the risks associated with non performance of each element of the PFM system as well as the time and attention required to achieve the desired outcomes.

However, the following should be considered for immediate attention:

Overall PFM architecture will be strengthened by a revision of the HP Financial Rules and Budget Manual. These form the basis for exercising internal controls in the State and were issued in 1971. While the Himachal Pradesh Financial Rules, 1971 (HPFR) have been revised from time to time by issue of numerous circulars, the modifications have not been codified. The State Government should give high priority to a revision in line with the General Financial Rules (GFRs) of the Government of India (GoI) and ensure robust implementation of the same.

The control environment in the State Treasuries needs considerable improvement. The Treasuries are undergoing computerization with introduction of additional modules like 'e salary'. Many of the controls around the treasuries are still to be grounded. It is important to ensure that the IT controls, training and connectivity issues are addressed on a priority basis to strengthen the treasury operations.

Procurement aspects need focused attention. The procurement rules need to be reviewed in line with the requirements of a modern system of state contracting. The planned eProcurement initiative presents an opportunity for GoHP to focus on improving effectiveness of procurement as well as to establish the required institutional framework and management capacity.

Internal Audit needs attention to bring about a strategic focus in its approach. Internal Audit should be made functional in all departments and a risk based approach needs to be followed to get the best out of the function. In addition, GoHP needs to ensure that the external and internal audit reports are addressed in a timely manner. Moreover, it should be ensured that the audit process is instrumental in improving the PFM performance of the State.

Way Forward

GoHP's extensive reform programs set out in Chapter 4 pave the way to adopt steps that will secure improvements in PFM. While carefully evaluating the expected benefits of various reform options, GoHP will at the same time need to continue to work on sequencing of the options to ensure that these result in sustainable gains for the state.

1. Introduction

Background and objectives

GoHP signaled its willingness to adopt and continue reforms in key areas to create fiscal space to finance critical investments, promote private sector development, encourage sectors where the State could compete effectively by playing out its natural strengths, improve governance and public service delivery, conserve and protect its environmental heritage, while ensuring improved social outcomes.

To help GoHP in its reform agenda, the World Bank has extended the State, assistance in the form of Development Policy Lending (DPL) to support the Government's medium term program. The Chief Minister's Budget speech (2007/08) mentions approaching the World Bank to *"... ... partner us in accelerating development and sustaining the success already achieved ... ..."* and *" ... ... we need to attempt a parametric shift in our growth plan for this we need greater fiscal space."* The overarching objective of the World Bank lending is to support the implementation of critical structural, fiscal, and administrative reforms needed to achieve sustainable and rapid economic growth and inclusive development over the medium term, while sustaining the environmental heritage of the State.

In preparation for the DPL, a Preliminary Assessment of the Public Financial Management and Accountability arrangements in GoHP was carried out. From this assessment emerged certain findings that pointed to the need for strengthening of the State's PFM system. GoHP had, as part of an agenda for change, agreed to a Public Financial Management and Accountability (PFMA) Assessment with World Bank assistance.

This document contains the report on the PFMA conducted in accordance with the Performance Measurement Framework developed by the PEFA partners[1]. The PEFA indicator set is supplemented by the application of a separate set of indicators on procurement performance that have been established by the World Bank and OECD Development Assistance Committee[2]. The assessment was conducted with active support of GoHP officials in various departments. The Bank extends its appreciation to all officers and staff of GoHP who helped it in producing this assessment report.

This study makes an objective assessment of the PFMA system of the State, lists its strengths and weaknesses and identifies areas in need of strengthening. This will provide a background for articulating a reform strategy and a prioritized implementation action plan by GoHP. Therefore, the assessment will also create a baseline for monitoring the impact of PFM reforms.

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[1] Public Financial Management Performance Measurement Framework, June 2005, PEFA Secretariat, World Bank, Washington DC, USA - PEFA includes World Bank, IMF, European Commission, UK, France, Norway, Switzerland and SPA Strategic Partnership with Africa www.pefa.org

[2] Baseline Indicator System

Process and methodology

The Concept Note for the study was discussed and agreed upon between the World Bank and GoHP. The State Government then nominated a senior official in the Finance Department (FD) as the nodal officer for the study to advise on communication/interactions within the government, planning field visits and facilitating data collection. The study commenced with a workshop in Shimla, in October 2007, attended by officials of FD and select line departments[3] to which this study was extended. The workshop discussed the PEFA objectives and methodologies, salient features of the PFM system in the select departments and key issues being faced. This was followed by a visit to the select departments, apprising officials on data requirements and collecting relevant documents.

A more extensive visit took place in November 2007. During this visit, detailed assessment of the current PFM systems was made, background documents and data were collected, reviewed and discussed and key Government and departmental officials (including Finance and Planning departments) of GoHP were interviewed. Field visits to offices located in two districts (Sirmaur and Kangra) were made to assess ground realities. Work was deferred during December 2007/January 2008 due to elections to the State Legislature. Two more visits were made in end-January and early-February 2008 to collect outstanding information, to fill up the information gaps and discuss the preliminary findings.

A draft report was informally shared with GoHP officials in March 2008 and their feedback incorporated in its revision; the final draft report was sent out to DEA and GoHP in June 2008. Further discussions were held with officials and a Workshop organized by the GoHP in November 2008 in Shimla where key stakeholders were invited to discuss the report findings and way forward. GoHP is already making significant strides in improvement of its PFM systems as documented in Section 4 of this report titled 'Government Reform Process'.

Scope

The PEFA assessment covers all aspects of GoHP's PFMA system. Considering that 90% of the population resides in the rural areas, the Rural Local Self Government (Panchayati Raj Institutions or PRI) was included as part of the assessment for detailed study, and a separate annex has been given in the report. With respect to (a) Public Sector Enterprises including statutory corporations; (b) Urban Local Bodies; and (c) Other agencies like State Societies, the study was restricted to assessing GoHP's system of monitoring and managing risks that arises from budget transfers to these entities. Thus, the PEFA framework was applied mainly at the State Government level.

The table below shows that of the budget expenditures of the bodies mentioned, 97% of the State Budget is expended by the State Government on its activities.

[3] Public Works, Irrigation & Public Health, Rural Development, Panchayati Raj, Forest and Health & Family Welfare departments

(in Rs. Million)

Institutions	No. of entities	Expenditure (2005/06)	% of total public expenditures
State Government	55	70,713	97.0%
Urban Local Bodies	49	274	0.4%
Rural Local Bodies	3330	476	0.7%
Public Sector Enterprises/Statutory Corporations	21	1,406	1.9%
Total		**72,869**	

Note: The above does not include extra-budgetary expenditure. Expenditure of local bodies represents fiscal budgetary transfers. Expenditure of public enterprises/statutory corporations represents budgetary transfers (investment) by way of equity, loan or subsidy during the year 2005/06.

The State Finance and Appropriation Accounts for FY 2006/07 had not been placed before the State Legislature till the time of writing of the report and hence were not in public domain. Therefore, analysis was done with reference to FY 2005/06 and the two immediately preceding years.

2. State Background Information

Description of economic situation

Background

Located in North India, Himachal Pradesh is a small mountainous State bordering Punjab, Haryana, Uttarakhand, and Jammu and Kashmir[4]. With a geographical area of 55,673 sq. kms and population of 6.6 million, HP accounts for 1.6% of the national geographical area and about 0.6% of India's population. HP is a unique State because of the success it has achieved despite severe structural disadvantages of relative remoteness, environmental fragility, and a difficult hill terrain, which raise costs of service delivery, that are typical characteristics of Himalayan states in India. A leading Indian state in terms of human development, HP has some of the best indicators in terms of gender equality and access to services. Moreover, in recent years, HP has achieved economic success in the form of higher growth rates than the rest of the country. The growth has been powered by rapid expansion of the secondary and tertiary sectors, which collectively account for more than 80% of the Gross State Domestic Product (GSDP). HP now has a per capita income of just under US$ 800, which is slightly higher than the national average.

HP has some distinctive characteristics that set it apart from other Indian states. First, it is a relatively *young State* in the Indian Union. The State, currently comprising 12 districts, was granted full statehood in 1971. Second, HP is a *small State* both in terms of area and population. Of the population of about 6.6 million, 90% still reside in rural areas. In terms of area, it ranks seventeenth among India's states and Union territories. Third, it is *geographically different* from most Indian states located in the plains. HP is largely mountainous, but exhibits extraordinary biological diversity. Except for a few pockets bordering Punjab and Haryana, altitudes span from 400 meters to almost 7000 meters above sea level. Of the aggregate geographical area, almost two-third is officially classified as forest. The population density in the State – at around 110 per sq. km – is lower than the national figure of 320 per sq. km., largely due to relatively low and scattered population in the hill and forest areas.

HP is now growing faster than the Indian average. The State experienced slower growth than the rest of the country during the 1970s and 1980s. But over the last decade, HP has achieved higher growth rates in income compared to the average Indian State. Moreover, the economy is showing increasing signs of diversification (Figure 1). The secondary and tertiary sectors have expanded more rapidly than the primary sector, partly in response to national tax exemptions and special incentives that have attracted investment in these sectors. In contrast, the share of the primary sector has dwindled from 32.1% of GSDP in 1993-94 to 21.4% in 2005/06 comparable to the Indian average of about 19.6% (Figure 1). Despite its natural constraints, HP currently has a per capita income, which is more than 8% higher than the national average.

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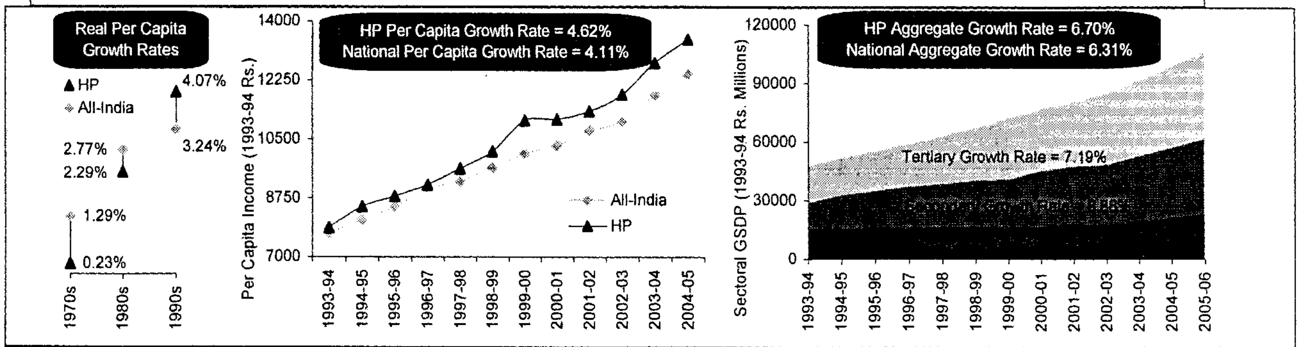
[4] This write-up first appeared in the First Himachal Pradesh Development Policy Loan /Credit Program Document, August 2007.

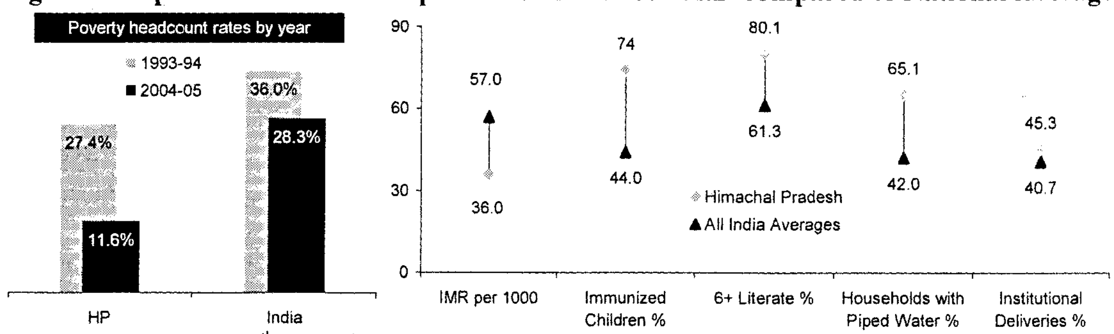
Figure 1: Recent Economic Growth and Diversification



Source: Statistical Abstracts, GoHP.

HP's performance in reducing poverty has been highly satisfactory. In 2004-05, HP had the lowest poverty headcount rate in the country after Punjab, at 11.6%. Poverty has declined much faster in HP since the mid-1990s compared to the rest of the country (Figure 2). HP's per capita real consumer expenditure is almost a third higher than the national average. The State also has superior indicators of human development outcomes and access than the rest of the country on most indicators (Figure 2). Moreover, the State is on track to achieve – or has already achieved – most of its Millennium Development Goals (Table 1). The key issue in the State is no longer about access to social services as in many other states, but about improving their quality. Understandably, however, there are remote areas in the hilly terrain where service delivery costs are higher, owing to insufficient access.

Figure 2: Superior Human Development Performance in HP compared to National Averages



Source: Poverty data from 50th and 61st Round National Sample Survey, from Dev and Ravi (2007). Human development data from Third National Family Health Survey, 2005-06.

Summary Status of Key Millennium Development Goals for HP

MDG Statement	HP's Recent Performance
Between 1990 and 2015, halve the proportion of the poor.	Poverty has declined from 27.4% in 1993-04 to 11.6% in 2004-05.
Achieve universal primary education by 2015.	Enrollment for 6-10 year-olds has risen from 93% to 97% between 1993-94 and 1999-00, and for 11-14 year-olds from 88% to 94%.
Eliminate gender gaps in education by 2005.	For 6-10 year-olds, female and male enrollment rates were 97% in 1999-00. For 11-14 year-olds, female to male enrollment ratio has gone up from .902 in 1993-94 to .938 in 1999-00.
Reduce infant and child mortality rates by two-thirds between 1990 and 2015.	CMR has fallen from 69.1 per 1,000 in 1992-93 to 42.4 per 1,000 in 1998-99. IMR has fallen from 55.8 per 1,000 in 1992-93 to 36 per 1,000 in 2005-06.
Access to reproductive health services for all by 2015.	Births attended by a health professional have gone up from 25.6% in 1992-93 to 50.2% in 2005-06.
Reduce by half the proportion of people without safe drinking water between 1990 and 2015.	Population without access to safe water has fallen from 42.4% in 1992-93 to 22.6% in 1998-99.

Description of budgetary outcomes

HP's budget revenue is highly dependent on Central Government transfers in the form of grants and shared taxes. In 2005-06, there was a 103% increase in Central Government's transfers to the State on account of the Twelfth Finance Commission's award. The introduction of VAT in 2005-06 and revenue from sale of free power from 2004-05 have resulted in a very marginal reduction in the proportion of Central Government transfers from 70% to about 68%.

Fiscal Performance[5] is as follows.

[5] This information is also available on a functional classification under Indicator PI – 2 'Composition of expenditure outturn compared to original approved budget'

% GSDP	1990-91	1999-2000	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07 (R.E)
Revenue	**28.6**	**21.2**	**19.4**	**21.7**	**19.4**	**19.2**	**20.1**	**25.8**	**24.0**
State's Own Revenues	7.5	6.4	5.5	6.4	5.6	6.1	8.0	8.6	8.3
Tax	5.7	4.4	4.7	5.3	4.7	4.8	5.4	5.9	5.2
Non- Tax	1.7	2.0	0.9	1.0	0.9	1.3	2.6	2.7	3.0
Central Taxes and Grants	21.2	14.8	13.9	15.3	13.8	13.1	12.1	17.2	15.7
Shared Taxes	6.7	3.9	2.1	1.9	1.8	2.2	2.3	1.9	2.0
Grants	14.5	10.9	11.8	13.4	11.9	11.0	9.8	15.2	13.6
Non- Interest Expenditures	**34.6**	**25.8**	**25.0**	**23.5**	**24.0**	**23.2**	**20.9**	**22.5**	**22.5**
Salaries (incl GIA for education)	16.7	11.7	11.2	11.4	11.4	10.9	10.0	10.2	9.4
Pensions & Retirement Benefits	1.8	3.4	2.7	2.6	2.6	2.6	2.6	2.8	2.8
Non- Wage O & M	5.8	4.3	4.0	3.0	2.4	3.0	2.7	3.1	3.6
Other Revenue Expenditures	0.3	0.2	0.6	0.6	0.5	1.2	0.9	1.2	0.9
Subsidies and Transfers	3.4	2.3	2.9	2.1	2.6	1.8	1.9	2.0	2.1
Capital Outlay	5.3	3.9	3.5	3.8	4.5	3.8	2.8	3.2	3.7
Net Lending	1.2	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0
HP Primary Surplus (+)/ deficit (-)	-6.0	-4.6	-5.5	-1.8	-4.7	-4.0	-0.7	3.3	1.5
Interest Payments	3.9	5.2	6.3	7.0	7.7	7.5	7.1	6.1	5.7
Go HP Revenue Surplus (+)/Deficit(-)	**-3.3**	**-5.9**	**-8.2**	**-5.0**	**-7.8**	**-7.8**	**-5.0**	**0.4**	**-0.6**
Go HP Fiscal Surplus (+)/Deficit(-)	**-9.9**	**-9.8**	**-11.8**	**-8.8**	**-12.4**	**-11.5**	**-7.9**	**-2.8**	**-4.3**
Consolidated Surplus(+)/Deficit(-)							**-10.7**	**-5.2**	**-11.1**
Debt Stock	**46.0**	**51.9**	**55.7**	**60.4**	**64.3**	**69.0**	**67.6**	**74.1**	**68.8**
Guarantees	**14.3**	**13.3**	**19.5**	**25.0**	**23.4**	**23.2**	**18.7**	**14.0**	
Memo Items									
Power Sector									
Revenue (Excl. Power Subsidy) (1)							5.5	6.4	6.4
Cash Operating Expenditure (excl. Depreciation) (2)							5.0	6.2	6.5
Earning before Int, Deprn, Tax & Appropm (EBIDTA) (3)=(1)-(2)							0.5	0.2	-0.1
Interest (4)							0.5	0.5	0.4
Taxation (5)							0.0	0.0	0.0
Net Loss/Profit (excl. Deprn) before Subsidy (-/+) (6)							0.0	-0.3	-0.5
Capital Outlay (7)							1.8	1.9	6.7
Overall Financing Requirement before Subsidy (+/-)(8)							1.8	2.2	7.1

The surplus has been substantial in the last two years. Two factors significantly affect the budget as a policy instrument. First, much of the expenditure is already committed. Expenditure of a contractual nature on salaries, pensions and interest dominates expenditure. In recent years, these three items comprised nearly 70% of total expenditure. Salaries and pensions account for about 44% of total expenditure. Second, many decisions are made separately from the budget process. Expenditure control is affected outside of the budget cycle by periodic policy pronouncements followed by supplementary budgets to incorporate new spending proposals into the budget. Examples include regularization of temporary staff, new subsidies, and the expansion of the higher education network.

GoHP now has in place a Fiscal Responsibility and Budget Management Act (FRBM Act) and a Medium Term Fiscal Framework that was tabled with the Budget for 2006-07 and revised in 2007. Given the objectives of the FRBM Act, there is a need to modify the budget formulation process and associated documentation to better link policy goals and resource allocation and to embed the medium-term perspective in the budgeting process. The key issues are: sequencing the preparation of a medium-term fiscal program, which defines desired fiscal targets (the fiscal deficit, revenue deficit, and guarantee limits) and establishes broad multi-year parameters for the budget; preparing estimates of expenditure to implement ongoing policy, program, and project commitments; deriving the estimate of the fiscal space over the medium term to accommodate new commitments consistent with the fiscal plan parameters; ensuring that decisions on new policy proposals are considered within the constraints defined by resource availability so defined and integrated into the budget formulation process; and preparing a full annual budget that is consistent with the medium-term fiscal program. Transparency and accountability, and associated information, are keys to improving allocations decisions and resource use.

Description of the legal and institutional framework for PFM

The Chief Minister, assisted by a Council of Ministers, who is directly elected through adult franchise, heads the Government of Himachal Pradesh, provides overall leadership and direction, and formulates the policies of the State. HP has a unicameral Legislative Assembly (the Vidhan Sabha) that functions according to the rules regulating its procedures and conduct of business. The Constitution of India provides for legislative scrutiny of the actions of the Executive.

The governance structure is divided into 55 administrative departments mainly on functional lines, but there are separate departments for tribal welfare and backward area development. Each administrative department is headed by a Principal Secretary/Secretary (Indian Administrative Services) reporting to a Minister (elected representative) and is responsible for policy formulation and oversight over the field formations. Other organizational agencies include the urban/rural local bodies, government companies and statutory corporations, boards, authorities and societies, educational institutions etc.

The PFM structures in HP are embodied in the HP Budget Manual (1971), HP Financial Rules (1972) and HP Treasury Code read with the Public Works Department Manual of Orders, the departmental office procedures and the Fundamental Rules and Supplement Rules and other related employee rules. These rules contain principles covering budgeting, revenue and expenditure, delegation of authority, accounting, procurement, pay, allowances and pensions, stores, works etc. and are supplemented through circulars issued from time to time. A Fiscal Responsibility and Budget Management Act has been legislated that places responsibility on the Government to ensure prudence in fiscal management and fiscal stability. The Act sets out fiscal targets, fiscal management objectives, fiscal policy statements and also stipulates measures for fiscal transparency.

Overall PFM responsibilities vest with the HoDs at the apex level assisted by the Drawing and Disbursing Officers (DDO) at the field level. The FD manages budgeting, cash/treasury management and expenditure control. The Planning Department determines the macro forecasts and departmental outlays and produces the five-year and annual plans of the State. The financial functions in each department are looked after by an officer (of the Subordinate Accounts Services) deputed by FD and in case of civil departments by officers of the Indian Accounts and Audit Service controlled by the Comptroller and Auditor General of India (CAG).

The Constitution's framework for Budgeting and Accounting in GoHP is in three parts – the Consolidated Fund, the Contingency Fund and the Public Account. Consolidated Fund is divided into Revenue and Capital sections, which are further broken down into sectors and sub-sectors. Budgeting and accounting are based on a six-tier structure including functions, programs and expenditure heads.

The HP Budget Manual guides the annual budgeting process and details the process and the timelines. Each department submits its budget separately for Plan and Non-Plan expenditures. The Finance and Planning Departments are the nodal departments for budgeting and planning. The process starts in September with the issue of the budget call letter and ends in March with the approval of the budget by the State Legislature. The Legislature has standing committees for examination of the demand for departmental grants. The budget document *inter alia* comprises of the Finance Minister's speech, the main budget document detailed estimates of receipts and expenditure, explanatory memorandum and recently introduced medium term fiscal plan. During recent years, GoHP's budget has been passed before the commencement of the fiscal year. In-year budget adjustments are through re-appropriation or additionality[6] with the approval of the delegated authority, generally FD. All additionalities are later on approved by the Legislature through a single Supplementary Budget generally in March of the financial year.

On approval of the annual budget by the Legislature, FD releases the demand for grants to the respective line departments that gives them the authority to incur expenditure and utilize the grants. Each department further decentralizes the grants to the DDOs (also the basic accounting units) in the field offices who are authorized to make the actual drawls according to the financial rules. A system of monthly/quarterly reporting of expenditure and outcomes has been implemented.

Actual drawl for two civil departments is through the Letter of Credit system entailing specific authorization by FD (broken up DDO-wise by the HoD); thereafter these departments can write checks up to the authorized limit. Other departments avail of funds by drawing Treasury Bills that are submitted to the district Treasury who, post-verification, issues the checks. The Treasuries, under FD, are the nodal accounting and disbursement centers. The Treasuries in HP are undergoing computerization of their operations that is expected to result in better management of the Treasuries and improve their operational efficiency and internal controls.

The CAG, through the Accountant General (Accounts & Entitlement) located in HP, is vested with the accounting function, compiling information provided by the Treasuries and the civil works departments. The AG issues monthly accounts to GoHP and produces the State's Annual Accounts. These Finance and Appropriation Accounts are tabled before the

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[6] Additional Appropriation can be sought through additionality if the expenditure has exceeded or is likely to exceed the available provision or a new scheme or activity is to be taken up. Re-appropriation is transfer of funds from one unit to another but within the same demand for grant

State Legislature. There is a provision for quarterly reconciliation between the AG and the line departments. Accounting is on cash basis and commitments, contingent liabilities; extra-budgetary operations are presently not accounted for or reported.

Elaborate control and monitoring mechanisms provided in the financial rules spell out *inter alia* the roles and responsibilities, maintenance of records, reconciliation, periodic inspections and meetings, and reporting. GoHP normally does not allow opening of bank accounts. Expenditure, such as salaries, is disbursed in cash. Internal audit exists only in a few departments (e. g. Panchayati Raj, Urban Development, Local Funds) while others have not presently implemented this or the present structure is informal.

The CAG is an independent constitutional authority and, as the external auditor for the State submits reports covering the Civil, Commercial and Revenue accounts. The CAG, through the State Accountant General (Audit) located in HP, conducts financial audits and performance and internal control reviews, covering all departments, government companies and corporations and autonomous bodies and authorities, with substantial government funding. The auditable units are selected on the basis of a risk-based approach. The reports are finalized within six months of the close of the financial year and are tabled in the Legislature. The audit findings are examined by a Public Accounts Committee of the Legislature that issues recommendations and follows up on the action taken by the departments in response to the audit reports/reports of the Committee.

While the bulk of the expenditure flows through the departments, funds are also administered through urban/local bodies that also have the power to raise taxes/duties. These bodies share the revenue of the State and receive substantial resources as grants from the Central and State Governments. The grants are determined on the basis of the recommendations of the Finance Commissions. HP has a three-tier local government (Panchayat) system with their own set of PFM arrangements.

3: Assessment of the PFM systems, processes and institutions

Budget Credibility

PI-1. Aggregate expenditure out-turn compared to original approved budget

Dimensions to be assessed: (i) the difference between actual primary expenditure and the originally budgeted primary expenditure (i.e. excluding debt service charges and externally financed project expenditure)

Details of the budget estimates and actual expenditure figures for aggregate expenditure, excluding debt service payments and donor funded project expenditure are provided in the table below, showing substantial overruns that peaked at over 15% in one year.

Aggregate expenditure – excluding debt service and donor funded

(Rupees in Million)

Particulars	**2003-04**	**2004-05**	**2005-06**
Budgeted	46,583	46,072	47,835
Actual	48,922	48,034	57,313
Difference between budgeted and actual	-5.02%	-4.26%	-19.81%

	2003/04		**2004/05**		**2005/06**	
Primary Fiscal Deficit	Amount	% of Budgeted Expenditure	Amount	% of Budgeted Expenditure	Amount	% of Budgeted Expenditure
Budgeted	626	-13%	3508	7.6%	-10611	-22%
Actual	911	-20%	1693	4%	-8430	-15%
Difference	-285		1815		-2181	

Brief Explanation	**Score (M1)**
(i) In no more than one out of the last three years has actual expenditure deviated from budgeted expenditure by an amount equivalent to more than 15% of the budgeted expenditure.	C
Overall Rating	**C**

PI-2. Composition of expenditure out-turn compared to original approved budget

Dimensions to be assessed: (i) extent to which variance in primary expenditure composition exceeded overall deviation in primary expenditure (as defined in PI-1) during the last three years.

The data on functional classification was sourced from various issues of the Reserve Bank of India's publication "State Finances: A Study of Budgets". As the data shows, the largest functional head is education, followed by pensions,. transport and communication and agriculture. But the variance is highest in the Water and Sanitation head followed by Energy, if we ignore functional heads where variations were caused by on/off events as in some heads of expenditure. An examination of object heads of expenditure under their functional classification will help to understand the quality of expenditure and the causes for their variation.

Rs. million

Functional Classification	2003-04(BE)	2003-04	2004-05(BE)	2004-05	2005-06(BE)	2005-06
Education	10266.8	10056.1	10709	10850	10853	12135
Medical and Public Health	4171	3122.3	3177	3363	3264	3561
Family Welfare	322.4	338.3	326	359	322	372
Water & Sanitation	3147.4	5988.7	3002	4305	2890	5483
Housing	610.1	601.8	639	651	647	668
Urban Development	271.3	230.7	319	339	323	328
Welfare of Scheduled Castes etc.	213.9	153.7	314	268	339	529
Social Security and welfare	953.1	990.4	1054.5	1135.5	1121.5	1151
Relief on account of Natural Calamities	500	503	529	529	1007	2137
Agriculture and allied activities	4240.8	4111.1	3995	3972	3958	4797
Rural Development	908.5	948.5	946	987	1024	1102
Irrigation and Flood Control	1518.2	1527.1	1541	1428	1653	1941
Energy	1544	2463	621	752	959	1235
Industry and Minerals	295.7	314.6	593	615	279	446
Transport and Communications	5923.8	6198.9	5281	6001	5791	6861
General Economic Services	687.7	704.2	1021	941	704	918
Organs of state	472.3	529.3	502	565	518	674
Fiscal Services	704.8	702.8	674	763	749	840
Administrative Services	3438.5	3444.5	3396	3505	3757	4273
Pensions	5800	5327.8	6610	5907	6534	6697
Others	592.7	665.2	822.5	798.5	1142.5	1165
Totalexp	46583	48922	46072	48034	47835	57313
Comp var	46583	48922	46072	48034	47835	57313

Functional Classification	2003-04	2004-05	2005-06	3 year Average
Education	2.1%	1.3%	11.8%	5.1%
Medical and Public Health	25.1%	5.9%	9.1%	13.4%
Family Welfare	4.9%	10.1%	15.5%	10.2%
Water & Sanitation	90.3%	43.4%	89.7%	74.5%
Housing	1.4%	1.9%	3.2%	2.2%
Urban Development	15.0%	6.3%	1.5%	7.6%
Welfare of Scheduled Castes etc.	28.1%	14.6%	56.0%	32.9%
Labour and Labour welfare	1.9%	0.0%	5.5%	2.5%
Social Security and welfare	3.9%	7.7%	2.6%	4.7%
Relief on account of Natural Calamities	0.6%	0.0%	112.2%	37.6%
Agriculture and allied activities	3.1%	0.6%	21.2%	8.3%
Rural Development	4.4%	4.3%	7.6%	5.5%
Irrigation and Flood Control	0.6%	7.3%	17.4%	8.4%
Energy	59.5%	21.1%	28.8%	36.5%
Industry and Minerals	6.4%	3.7%	59.9%	23.3%
General Economic Services	2.4%	7.8%	30.4%	13.5%
Organs of state	12.1%	12.5%	30.1%	18.2%
Fiscal Services	0.3%	13.2%	12.1%	8.5%
Administrative Services	0.2%	3.2%	13.7%	5.7%
Pensions	8.1%	10.6%	2.5%	7.1%
Others	12.2%	2.9%	2.0%	5.7%
Average Variance (excluding debt servicing)	5.0%	4.3%	19.8%	9.7%

Scoring of this indicator is as below

Year	For PI-1 total expenditure deviation	Total expenditure variance	For PI-2 variance in excess of total deviation
2003-04	5.0%	13.5%	8.5%
2004-05	4.3%	8.6%	4.3%
2005-06	19.8%	19.8%	0.0%

Brief Explanation	Score (M1)
(i) Variance in expenditure composition exceeded overall deviation in primary expenditure by 5 percentage points in no more than in one of the last three years.	B
Overall Rating	**B**

PI-3. Aggregate revenue out-turn compared to original approved budget

Dimensions to be assessed: (i) actual domestic revenue collection compared to domestic revenue estimates in the original, approved budget.

The data is taken from State budget documents. The revenue estimates are generally of poor quality because both the State Finance Department and Excise and Taxation Department do not have in-house technical expertise to provide good, systematic estimates and analysis.

The revenue estimates have been overachieved in the years under examination. Revenue projections are not based on a formal revenue estimation model. Budgeted revenue thus tends to be a target rather than a forecast. It is essential for the State to build the capacity to forecast revenue based on relevant factors in order to develop a successful medium term fiscal framework.

Revenue Collection (Rupees in Crore)

Year	2003-04	2004-05	2005-06
Budget estimates	1258.4	1524.1	1709.4
Actual	1276.1	1862.7	2186.7
Revenue as a percentage of budget estimates	101%	122%	128%

Brief Explanation	Score (M1)
(ii) Actual domestic revenue collection was greater than 97% of budgeted domestic revenue estimates in the last three years.	A
Overall Rating	A

PI-4. Stock and monitoring of expenditure payment arrears

Dimensions to be assessed: (i) the stock of expenditure payment arrears (as a percentage of actual total expenditure for the corresponding fiscal year) and any recent change in the stock (ii) availability of data for monitoring the stock of expenditure payment arrears.

Expenditure obligation in respect of payments to employees is recorded and monitored at each office and to lenders for loans by FD and the Accountant General. However, other than payments to employees and lenders there exists no process for recording, reporting and consolidation of expenditure payment arrears. Moreover, the government system of accounting does not allow for distinguishing between payment for current expenditure and arrears as it follows the cash basis of accounting. It is true that there are no salary arrears and that GoHP has not defaulted in its debt obligations. However, other than employees and lenders, no information is available on stock of arrears. As a result, the level of stock in arrears as a percentage of total expenditure cannot be gauged.

Liabilities on account of works and contracts are usually not systematically monitored; however the Government of Maharashtra records, monitors and discloses this information. As part of a recent document titled "Medium Term Fiscal Policy, Fiscal Policy Strategy Statement and Disclosures for Maharashtra 2007-08", the State has disclosed liabilities on account of major works, contracts, unpaid bills and arrears of grants payable to various institutions.

Despite these shortcomings, the HP Budget Manual is impressive for its prescription of detailed guidelines for assessment, reporting and consolidation of liabilities from the field units to the State level. The Manual states that the information on liabilities will facilitate the exercise of exchequer control over progressive expenditure and preparation of correct budget estimates and excess/savings over the budget. However, actual implementation is wanting and compliance of these guidelines is low.

Budget Manual guidelines on payment arrears

- Each drawing and disbursing officer (DDO) to maintain a Liability Register in form BM 13 indicating nature of liability, name of creditor and amount
- Each DDO to submit a monthly Liability Statement in BM 13 (starting from October) to their Controlling Officer (CO) indicating the progressive position of outstanding liabilities
- Each CO to examine the new liabilities incurred and that the expenditure plus the liabilities are within the appropriation
- Each CO to submit the monthly Liability Statement to the HoD and the latter to FD for keeping a watch over the ways and means position

Brief Explanation	Score (M1)
(i) The quantum of stock of arrears is not available.	Could not score
(ii) There is no reliable data for stock of arrears as it is not generated.	D
Overall Rating	**D+**

Transparency and Comprehensiveness

PI-5. Classification of the budget

Dimensions to be assessed: (i) The classification system used for formulation, execution and reporting of the government's budget.

The State Government's overall accounting classification is in line with the uniform countrywide system of classification of accounts, which is consistent with the Classification of the Functions of Government/Government Finance Statistics (COFOG/GFS) structure.

Nevertheless, the Controller General of Accounts (CGA) of India is currently considering a new system of accounts classification for GoI in line with international best practice. The proposed multidimensional account classification system will have distinct segments representing fund, economic categories, functions, programs, and other data attributes. The new system under consideration will be multi-tiered with a simpler chart of accounts than the one existing. It is expected to allow for fund based accounting and facilitate transition to accrual accounting, and assist in preparing reports consistent with GFS.

Brief Explanation	Score (M1)
(i) The uniform countrywide system of classification of accounts consistent with the COFOG/GFS structure.	A

PI-6. Comprehensiveness of information included in Budget documentation

Dimensions to be assessed: (i) Share of the listed information in the budget documentation most recently issued by the Central Government (in order to count in the assessment the full specification of the information benchmark must be met).

The HP Budget Manual details the budget documentation to be presented before the Legislature for scrutiny and approval. Budget documentation comprises of the annual financial statements, detailed estimates of receipts and expenditure (separately for 32 grants), schedules for new expenditure on schemes, speech of the Finance Minister explaining the salient features, budget summary, an Explanatory Memorandum and report on commercial undertakings, supplemented by an Economic Survey. Recently, disclosures under the FRBM Act have also been made part of the budget documentation (this includes the Medium Term Fiscal Statement, Accounting Policies and Statement of Guarantees on long term liabilities).

The 2007/08 budget documentation presented before the Legislature includes seven out of the nine elements of information benchmarks prescribed in the PEFA framework.

Element	Presence
1. **Macro-economic assumptions**, including at least estimates of aggregate growth, inflation and exchange rate	**Yes**
2. **Fiscal deficit**, defined according to GFS or other internationally recognized standard	**Yes**
3. **Deficit financing**, describing anticipated composition	**No**

4. **Debt stock**, including details at least for the beginning of the current year	**Yes**
5. **Financial Assets**, including details at least for the beginning of the current year	**Yes**
6. **Prior year's budget out-turn**, presented in the same format as the budget proposal	**Yes**
7. **Current year's budget** (either the revised budget or the estimated out-turn), presented in the same format as the budget proposal	**Yes**
8. **Summarized budget data for both revenue and expenditure** according to the main heads of the classifications used (ref. PI-5), including data for the current and previous year	**`Yes**
9. **Explanation of budget implications of new policy initiatives,** with estimates of the budgetary impact of all major revenue policy changes and/or some major changes to expenditure programs	**No**

Macro-economic assumptions in respect of growth rates are provided in the disclosures made under the FRBM Act. Fiscal deficit is disclosed in the Finance Minister's speech and the FRBM disclosures are a percentage of Gross State Domestic Product; the absolute amount is not expressly stated and cannot be computed based on the available information. Also, composition of deficit financing is not provided. Opening Debt Stock is given in the Explanatory Memorandum and complete details of Debt Stock and Financial Assets are available in the Finance Accounts presented before the Legislature prior to the Budget presentation. The previous year's budget out-turn, the current year's budget (original and revised) and summarized budget data are detailed in the main budget document i.e. the Annual Financial Statements. References to the nature of the major policy initiatives (mostly welfare proposals) are made in the Finance Minister's speech, but budgetary impact is stated partially. Given the level of information available, the total effect of the policy changes cannot be gauged. Moreover, the Explanatory Memorandum does not elucidate on budgetary implications of new initiatives.

Brief Explanation	Score (M1)
(ii) The recent budget documentation fulfils seven of the nine information benchmarks.	A
Overall Rating	**A**

PI-7. Extent of unreported Government operations

Dimensions to be assessed: (i) level of extra-budgetary expenditure (other than donor funded projects) which is unreported i.e. not included in fiscal reports (ii) income/expenditure information on donor-funded projects which is included in fiscal reports.

Extra-budgetary expenditure (incurred primarily out of funds received from the Government of India under Centrally Sponsored Schemes[7]) is neither covered in budget estimates, nor in in-year budget execution reports, nor the annual financial statements. There is an absence of full reporting of spending of the extra-budgetary funds. This information is also not presented before the Legislature. Consequently, the quantum of extra-budgetary expenditure is not available centrally, though each department that incurs such expenditure maintains this data. Some data on extra-budgetary operations are reported in the Annual Plans or in the individual departmental annual administration reports, but these are incomplete/inadequate. Similarly, certain institutions such as schools, hospitals/clinics and urban local bodies collect fees/user charges that are not deposited in the Treasury. Such receipts are usually banked and utilized on the activities authorized. This income and the related expenditure is neither collated nor reported.

Information relating to extra-budgetary expenditure was specifically collected and compiled for the purpose of this assessment. This worked out to 3.3% of total expenditure for FY 2005/06 on the largest schemes.

Off-budget Expenditure in GoHP		
Department	**Scheme/Project**	**Off budget expenditure for FY 2005/06 (in Rs. mn)**
Rural Development	SGRY	209.8
	DPAP	56.6
	DDP	50.3
	IWDP	167.5
	NREGA	0
Education	SSA	650.2
Health	NRHM	5.5
PWD	PMGSY	1269.6
Total Extra-Budgetary Expenditure		**2409.5**
Total State Expenditure		**72869.1**
% of Extra-Budgetary Expenditure to Total Expenditure		**3.3%**

Source: Annual Administrative Reports 2005/06 and Departments

The proportion of extra-budgetary expenditure appears insignificant vis-à-vis the total expenditure. However, if committed expenditure on salary, pension and debt servicing, that constitutes almost 70% of total expenditure, were excluded, extra-budgetary expenditure would assume a significant proportion, thus emphasizing the need for a strengthened reporting system.

[7] These are developmental schemes designed and monitored by the GoI but implemented by various State Governments. Significant amount of resources under these schemes are provided by GoI, usually outside the regular State budgetary mechanism

Donor-funded project expenditure is insignificant, being less than 1% of total expenditure (FY 2005/06). Nevertheless, all donor-programs are managed through the budgetary system, and are included in the budget, in-year fiscal reports and the annual financial statements under separate budget lines; hence their operations are fully reported (except expenditure in kind).

Brief Explanation	Score (M1)
(i) The level of unreported extra-budgetary expenditure (other than donor funded projects) constitutes 1-5% of total expenditure.	B
(ii) Donor-funded project expenditure is insignificant (below 1% of total expenditure) though all donor-funded projects are budgeted and fully reported.	A
Overall Rating	**B+**

PI-8. Transparency of inter-governmental fiscal relations.

Dimensions to be assessed: (i) Transparent and rules based systems in the horizontal allocation among *lower level* Sub National (SN) governments of unconditional and conditional transfers from *higher level* SN government (both budgeted and actual allocations) (ii) Timeliness of reliable information to *lower level* SN governments on their allocations from *higher level* SN government for the coming year (iii) Extent to which consolidated fiscal data (at least on revenue and expenditure) is collected and reported for general government according to sectoral categories.

In the context of an Indian State, the lower level SN government comprise of Urban Local Bodies (i.e. Municipalities) and Rural Local Bodies (i.e. Panchayats). Inter-governmental fiscal relations are based on the 73rd and 74th Constitutional Amendments and the HP Municipal Acts (for urban local bodies) and Panchayati Raj Act (for rural local bodies). The existing system of inter-government fiscal transfers, as constitutionally provided, comprises of assignment of taxes/duties and grants from three major sources[8] that enables the local bodies to discharge their statutory and delegated functions.

[8] The Urban Development Department at the State level and Ministry of Urban Development at the Central level for ULBs and Panchayati Raj Department at the State level and Ministry of Panchayati Raj at the central level for Panchayats.

System of Intergovernmental Fiscal Transfers in HP

a) *Grant 1:* The State Finance Commission (SFC), constituted every five years[9], makes recommendations on the nature and quantum of grants to be provided out of the Consolidated Fund of the State. The recommendations are based on the gap between estimated expenditure needs of the local bodies and known sources of revenue as well as specific grants. For Urban Local Bodies (ULBs), grants are directed towards meeting expenditure on delegated functions and liquidation of water and electricity arrears, while in the case of Panchayats, these are aimed at meeting committed liabilities (honorarium, salary, office expenses) and expenditure on obligatory functions, including gap filling grants.

b) *Grant 2:* The Central Finance Commission (CFC), also constituted every five years[10], recommends measures to supplement the resources of these bodies through grants for specific purposes from the Consolidated Fund of India. In the case of ULBs, the grants are directed towards improvement in solid waste management, while in the case of Panchayats, these are geared to improvement in water supply and sanitation. Additionally, grants could also be utilized for creation of a database.

c) *Grant 3:* GoI's Ministry of Urban Development (for urban bodies) and the Ministry of Rural Development (for rural bodies) provide funds, with or without contribution of the State Government, under the Centrally Sponsored Schemes, guidelines whereof are decided by the respective Ministry.

Over 90% of allocation of funds by the Central/State Government to ULBs and Panchayati Raj Institutions (PRIs) under (a), (b) and (c) above is made based upon transparent rules and are formula driven. In case of fund allocations under SFC or CFC, GoHP predominantly uses population as the sole criteria. It has not yet institutionalized and developed the necessary base for applying other criteria recommended by these Commissions such as revenue effort, geographical area, among other parameters.

Besides, certain departments also transfer funds for specific purposes to PRIs, including funds under Local Area Development Scheme of elected members of Parliament or Legislative Assembly. Similarly, higher tier of Panchayats also transfer tied funds to lower tiers. Complete data of such fund transfers, however, is not available. It is however understood that there is a significant element of discretion in the allocation of these resources.

Information available with the local bodies on their allocations is limited to the extent of the recommendations, including allocation formula, in the reports of the Finance Commissions. It is another matter how far these are really understood by the local bodies, particularly by municipalities in smaller towns and the Gram Panchayats. The allocations also depend upon the provisions made in the State budget – hence pre-calculation of indicative allocations may also not be reliable. There is no system of conveying the information on proposed

[9] The 2nd SFC covered the period from 2002/03 to 2006/07. Report of the 3rd SFC has been released but was not in the public domain as it had yet to be laid before the State Legislature at the time of writing this report.
[10] The 12th CFC covered the period from 2005 to 2010.

allocations at any point of time – the local bodies get information on actual allocations only. Hence, information of allocations is not known to individual local bodies. The local bodies prepare budgets based on a lump sum increase over the previous year's base. In any case, these budgets are not consolidated, but are considered on an individual basis by the next higher authority. Therefore, information on allocation can only be known to a limited extent after the State budget has been approved by the Legislature and allocations to ULBs and Panchayats finalized. Information about allocation on schemes of the Central Government is also not forthcoming and the local bodies learn of the transfers only at the time of actual allocations. Substantial increase in budget provisions are made through additionalities during the course of the year, particularly in case of Centrally sponsored schemes, which postpones determination of firm allocations to the local bodies.

Timeliness of reliable information on allocations is also influenced by the timeliness of release of the SFC report. The 2nd SFC report, covering the period 2002/03 to 2006/07 was released in October 2002 and placed before the Legislature in August 2003 i.e. after the budgets for 2002/03 had been finalized. Similarly, the 3rd SFC report covering the period from 2007/08 to 2001/12 was released in November 2007 but has not yet been placed before the Legislature for approval.

There is an absence of an adequate mechanism for collection, reporting and consolidation of fiscal data of the ULBs or Panchayats. Local bodies neither generate any periodic fiscal reports nor annual financial statements. The Department of Panchayati Raj comes out with a Report on the Finances of Gram Panchayats (information whereof is collected through special questionnaire), but its release is inordinately delayed (e. g. report for FY 2005/06 was released in late 2007). Though the report is an annual feature, it was not published for FY 2004/05 due to Panchayat elections; and it excludes the other two tiers of Panchayats. The SFC also collects fiscal information, for arriving at the basis for projecting the resources and expenditure needs of the local bodies. The information, again collected through special questionnaire, is collated once in every five years. The level of participation by the Panchayats is also not satisfactory (orderly response was received from only 70% of Gram Panchayats, reaching a low of 18% in one district, with 57% of Block Panchayats responding to the questionnaire of the 2nd SFC). Both the reports are for specific purposes. Annual financial statements of Panchayats are prepared by the Panchayat auditors and audited by them. These form part of their audit reports but are not consolidated and are available on an individual basis.

Consequently, actual revenue and expenditure of the local bodies are not available according to sectoral categories in a routine and timely manner. Both the Commissions have expressed their concern over non-availability of adequate and timely data on the local bodies. The 11th and 12th Finance Commissions have allocated funds for creating a database and maintenance of accounts by these local self-governments. However, little headway seems to have been made in this regard and the funds remain by and large unutilized. The Finance Accounts includes an appendix giving details of grants-in-aid given by GoHP to the local bodies. It is pertinent to note that such details have not been given (Finance Accounts 2005/06), prompting the AG to comment that, "*complete information is not available with the State Government*".

Extracts from the report of the 11th Finance Commission

"Our concern relates to non-availability of data on the finances of the local bodies. There is no mechanism for collection of data on the revenue and expenditure of the various tiers of the rural local bodies at a centralized place where it could be compiled, processed and made available for use. In the absence of any reliable financial/budgetary data, no realistic assessment of the needs of the local bodies for basic civic and developmental functions can be made nor can any information be generated on the flow of funds to the local bodies for the implementation of various schemes for economic development and social justice".

Extracts from the report of 2nd State Finance Commission

"Data sent by PRIs suffered from serious inconsistencies, mainly classificatory in nature, where it was difficult to sift what constituted their own revenue receipts and what constituted object specific grants from the State Government or the GoI. At the implementation level, though resources have been spent on statutory, delegated developmental and maintenance functions, separate information on such functions are not available due to misclassification of accounts and poor reporting system".

Brief Explanation	Score (M2)
(i) The horizontal allocation of almost all transfers (at least 90% by value) from the Government is determined by transparent and rules based systems.	A
(ii) Reliable estimates on transfers are issued after government budgets have been finalized.	D
(iii) There is an absence of an adequate system of collection and the consolidation of local bodies' fiscal information consistent with the government's fiscal reporting.	D
Overall Rating	**C**

PI-9. Oversight of aggregate fiscal risk from other public sector entities.

Dimensions to be assessed: (i) Extent of government monitoring of Autonomous Government Agencies (AGAs) and Public Enterprises (PEs) (ii) Extent of government monitoring of SN (urban and rural local bodies) governments' fiscal position.

In HP, AGAs/PEs take the form of either Government Companies (GC) under the Indian Companies Act, 1956 or Statutory Corporations (SC) constituted under respective statutes. These agencies have their own board of directors, but function under overall oversight of line ministries. There are 18 GCs, of which 14 are working GCs and 3 are working SCs (see Table for a brief profile).

Profile of Government Companies/Statutory Corporations	
Particulars	**Amount** (in Rs. mn)
a. Equity as of March 2006	7,443
b. Loan as of March 2006	37,044
c. Total Investment of GoHP as of March 2006 (equity and loan)	7,739
d. Budgetary outflow during FY 2005/06	1,406
e. Accumulated Losses as of March 2006	9,1739
f. Guarantees given by GoHP	35,533

CAG Audit Report 2005/06 and HP Public Sector Undertakings 2007/08

Fiscal risks in these agencies are from debt service defaults and funding of operational losses. On a global basis, GoHP's equity investment in these agencies stands fully eroded as accumulated losses exceed the equity base of these entities. As GoHP provides guarantees on long-term liabilities of these agencies, extends budgetary support by way of equity, loan or subsidy, these agencies are a significant source of contingent liabilities for GoHP.

Fiscal risk on account of guarantees is periodically monitored by FD and the details are generated at least twice annually – first as part of the budget documentation as statutorily required under the FRBM Act (placed before the Legislature during February-March) and secondly in the Finance Accounts (placed before the Legislature in December). The level of guarantees is also subject to the limit stipulated under the FRBM Act. GoHP's total investment in these enterprises is also disclosed in the Finance Accounts.

All GCs and one SC are subject to annual audit by Chartered Accountants appointed by the CAG, who also conducts a supplementary audit. In respect of the other two SCs, the CAG is the sole external auditor. Finalization of accounts and hence completion of audit is in arrears for almost half of these entities that includes one major corporation. This is an area of concern on which the CAG has adversely commented. Audited financial statements are placed before the Legislature and stand referred to the Committee on Public Undertakings for review and recommendations.

POSITION OF ACCOUNTS FINALIZATION (AS OF SEPTEMBER 2006)		
Particulars	**Government Companies**	**Statutory Corporations**
Total number (excl. under liquidation)	17	3
No. with up-to-date final accounts	8	2
No. with accounts in arrears for 1 year	7	1
No. with accounts in arrears for 2 years	1	--
No. with accounts in arrears over 2 years	1	--

Source: CAG Audit Report Commercial 2005/06

FD produces and presents to the Legislature as part of the budget documentation, a booklet containing a wide variety of financial information including financial statements (audited/unaudited) and operational performance on an enterprise basis, with only a single consolidation of the profit/loss (year-wise and cumulative), equity and employee strength.

Hence, fiscal risk issues are not consolidated and a consolidated overview of fiscal risk is significantly incomplete.

The lower levels of government within the jurisdiction of GoHP are the ULBs or Municipalities and rural local bodies (Panchayats under the three-tier Panchayati Raj system). The ULBs and Village Panchayats raise their own resources by way of tax and non-tax revenues, but their quantum is insufficient to carry out their devolved and delegated functions. The SFCs, constituted under the 73rd/74th Constitutional Amendment, determines at five-year intervals the principles of sharing of taxes between the State and the local bodies and the taxes etc. that may be assigned and the grant-in-aid to be provided from the State's Consolidated Fund. Besides, the CFCs also recommend transfer of grants from the Consolidated Fund of India to these bodies for specific purposes. The Central Ministries of Urban Development and Rural Development also provide grants to these bodies for specific purposes/schemes. These bodies also have the power to raise loans, subject to approval of the competent authority.

Consequently, these bodies are predominantly dependent upon grants-in-aid from the State (and Central) governments and hence theoretically cannot generate any fiscal liabilities for the government as their expenditure should be limited to the funds available. Urban bodies can incur liabilities towards suppliers and there is no system of monitoring the fiscal situation. Urban local bodies created significant arrears of electricity and water charges payments that was not addressed by the government. Therefore, the 2nd SFC had to recommend a one-time provision for liquidation of the arrears (Rs. 171.3 mn). It is understood that other municipal bodies have incurred such expenditure arrears, though a consolidated position is not available.

There is practically no mechanism for GoHP to monitor the fiscal position of the ULBs. Fiscal monitoring is limited to review of utilization of grants (for release of further tranches). Periodic (at least annually) financial position is not collated and presented in financial statements. The municipal acts provide for establishment of a separate and independent audit cell under the Department of Urban Development (administrative department for ULBs in HP) for conduct of annual audit of the ULBs. The audit is in arrears and audit of several years are conducted at a stretch. For instance, during 2002 to 2005, audit of 21 ULBs was conducted. This covered the period ranging from 1994 to 2004. In the current FY 2007/08, audit of 39 ULBs have been conducted for the periods up to March 2007. In any case, the auditors do not attest the financial statements of the ULBs.

Panchayats also stand on a similar footing. There is no periodic reporting of fiscal position by the Panchayats and monitoring is limited to review of grant utilization certificates. They are audited by an Audit Cell within the Department of Panchayati Raj, and on a sample basis by the CAG. Audit coverage of Panchayats by the Department is fairly reasonable though events like elections create a backlog. It is the Panchayat auditors (and not the Panchayat Secretary/Accountant) who prepare basic financial statements of Panchayats and include them in their audit reports. However, these are not consolidated for each level of Panchayats to produce a consolidated report of fiscal position and risk.

The SFC produces a consolidated report of the fiscal position (for revenue and expenditure) and associated risks of urban and rural local bodies every five years. The Department of Panchayati Raj also produces a report on the finances of Village (Gram) Panchayats on an annual basis, though there are delays in issue of the report and the Department had to skip one year due to elections. However, the Government does not produce any consolidated report of overall fiscal risk on a routine basis.

Brief Explanation	Score (M1)
(i) Most major public enterprises submit fiscal reports, including annual audited accounts, at least annually, but a consolidated overview of fiscal risk issues is significantly incomplete.	C
(ii) Monitoring of the fiscal position of urban and local bodies is significantly incomplete. Consolidated overview of fiscal risks is compiled in a report but not on an annual basis.	D
Overall Rating	**D +**

PI-10. Public Access to key fiscal information.

Dimensions to be assessed: (i) Number of the six listed elements of public access to information that is fulfilled (in order to count in the assessment, the full specification of the information benchmark must be met)

In HP public access to key information on fiscal plans and position and performance of the government is mainly through the website of the State Accountant General. Publication of information on the GoHP website or through the press or sale as priced publication is neither defined nor uniform. *Suo moto* disclosures are made under the Right to Information Act, 2005 (RTI Act) but the disclosures do not cover any of the PEFA information benchmarks. Publication of key information adequately and timely falls short of the benchmarks under PEFA guidelines, which identifies six elements.

1. **Annual Budget documentation:** Full text of the budget speech of the Finance Minister and the Economic Survey and certain parts of the Annual Financial Statements, the Budget in Brief and the Explanatory Memorandum are posted on the website of FD. Other documents (see PI-6) are not posted on the website. Publication of the budget documents in electronic mode is, therefore, incomplete and untimely as it is done after approval of the budget by the Legislature rather than when submitted to the Legislature as desired by the PEFA benchmark. These documents may be available to the public in printed form, albeit with considerable difficulty.

2. **In-year budget execution reports:** These are routinely not available to the public by any of the departments, including the Finance and Planning Departments who prepare consolidated reports for the State as a whole. Public access to such reports can be

through the RTI Act only. However, websites of State AG/CAG contain monthly information[11] on revenue and expenditure and budget out-turns for the State.

3. **Year-end financial statements**: These are not made available to the public *suo moto.* To access the financial statements from the GoHP, the public will have to make a specific request or resort to the RTI Act. Again, it is the AG who publishes the financial statements on its website. The latest financial statements for the FY 2005/06 were presented before the Legislature in December 2006 and hosted on the website soon thereafter.

4. **External audit reports**: The full text of the external audit reports issued by the CAG is hosted on CAG's website after the report has been placed before the State Legislature. The reports are also priced publications and can be purchased by the public. For the FY 2006/07, though the report has been issued by the CAG to the State Governor, it has not been tabled in the Legislature and hence, not yet been posted on the website as it is still not in the public domain. For FY 2005/06, the audit reports were placed before the Legislature in April 2007 and hence published thereafter i. e. over six months of completed audit (actual date not known). However, these reports are not available on any of the GoHP's websites.

5. **Contract awards**: GoHP has yet to come out with a policy of periodically publishing award of contracts with value above $ 100,000 or any other relevant threshold. As of now, no department is publishing this information in any degree. Public access is very limited other than through the RTI Act.

6. **Resources available to primary service units:** Budgetary allocation to the primary service units (e. g. local schools[12] or health center) is done annually. However, this information is not disseminated to the public at large and an individual can obtain this information under the RTI Act.

The AG for the State provides an in-year budget execution report, the year-end financial statements and the external audit reports, thereby providing three of the items required by the indicator.
It appears that knowledge of this to the public (as well as the government officials themselves) appears limited. None of the other information is made available to the public by the GoHP in an adequate manner as required by the indicator or is easily accessible from known and publicized sources within a reasonable time.

GoHP has implemented the Central legislation, namely the Right to Information Act, 2005 (RTI Act) in the State since 2006. The RTI Act mandates setting out a practical regime of right to information for citizens to secure access to information under the control of public authorities, in order to promote transparency and accountability in the working of every public authority. Primarily, the Act empowers all citizens to have the right to information

[11] Usually available within 3-4 months of end of the month

[12] These are required to display information relating to funds received/released etc. as per norms of various GoI programs

and all public authorities to *suo moto* publish minimum prescribed information and to appoint Information Officers. The Himachal Pradesh State Information Commission has been constituted under the RTI Act headed by a State Chief Information Commissioner who exercises powers as prescribed in the RTI Act 2005, mainly to receive and enquire into complaints, guide public authorities about the implementation of the Act. Most of GoHP's departments have appointed Information Officers and published the minimum information on their websites, though with varying degree of detailing and timeliness and with information not regularly updated. Normally, a time period of 30 days has been prescribed for providing information requested under the Act.

The Treasury website (http://koshvani.up.nic.in) of the Government of Uttar Pradesh provides detailed (updated daily) information on the finances of the State. It includes information, which is very detailed but can also be rolled-up in a summary form for review and analysis. Examples of information include budget allocated to each Drawing and Disbursal Officer, expenditure till date, district-wise expenditure, receipts of the State etc.

Brief Explanation	**Score (M1)**
(i) The Government makes available to the public only three of the six listed elements of information.	B
Overall Rating	**B**

Policy Based Budgeting

PI-11. Orderliness and participation in the annual budget process

Dimensions to be assessed: (i) Existence of and adherence to a fixed budget calendar (ii) Clarity/comprehensiveness of and political involvement in the guidance on the preparation of budget submissions (budget circular or equivalent) (iii) Timely budget approval by the legislature or similarly mandated body (within the last three years).

Framework for preparation of the budget is as per the Budget Manual, 1972, which also establishes the timelines to be followed in the budget process. The State budget is usually presented during the first week of March. The process begins with a budget call circular issued by FD during September (as against July per Budget Manual), seeking expenditure estimates from departments to be incorporated in the next budget. The expenditure estimates relating to already sanctioned policies and schemes and other non-plan expenditure are required to be submitted between October 10^{th} and 25^{th}. A separate process of consultation by line departments with FD in regard to new schemes is provided for in the Budget Manual. New schemes are required to be submitted for scrutiny by FD in October (as against August per Budget Manual), its administrative approval obtained and subsequently incorporated in the line department's expenditure estimates. The process of consultation with FD takes place during November/December and is concluded in January with the submission of final estimates. In the case of Plan schemes, discussions with the Planning Commission are held before final submission of expenditure estimates to FD.

New spending proposals are submitted by FD for the consideration of the Council of Ministers in the middle of December, approval obtained and incorporated into the State's budget proposal for the next year. The State Budget is usually approved and presented to the Legislature in early March (as against second half of February or in early March per Budget Manual) as per the budget call circular issued in September.

The State Legislature is required to approve the budget as part of an annual Appropriations Act as mandated by the Constitution of India. In case supplementary or additional grants are required during the year, the same also need a similar approval. If the budget is not passed before commencement of a year, a vote-on account is required to enable expenditure in the initial months of the financial year

The process of annual budget preparation should ideally follow the following stages:

- Assessment of overall resource availability and adoption of aggregate expenditure and revenue targets;
- Disaggregation of aggregate targets into department targets;
- Preparation and distribution of budget guidelines, including department ceilings and their distribution to spending departments ('budget call circular');
- Preparation of submissions by spending departments;
- Review of submissions by FD;
- Preparation of draft estimates;
- Legislative approval of draft estimates.

Budgeting in HP, as in other Indian states, follows the latter half of the process beginning with the budget call circular and submissions by line departments. In practice, most budgets are incremental, taking last year's allocation as a base, adding a small percentage for inflation and some real growth on account of new spending proposals. Incremental budgeting reflects a mismatch between policies and resources and excessive focus on funding at the expense of policy in budget deliberations. The Council of Ministers do debate the draft budget before its final approval, but much of the budget is already "committed" by way of contractual programs and the plan, leaving little scope for prioritization. However, political priorities often find their way into the budget through the year, incorporated through additionalities or re-appropriation. In-year additionalities, including new spending proposals, are routed through the supplementary budget that is tabled in the Legislature once a year in February.

Timings of approval of the budget in GoHP are reasonable; the last three budgets i.e. for 2005-06, 2006-07 and 2007-08 have been approved before March 31st. Earlier budgets were passed as per the following timelines: 2004-05 by June 30, 2004 and 2003-04 by July 16, 2003.

Brief Explanation	Score (M2)
(i) A clear annual budget calendar exists, is generally adhered to and allows the departments enough time (at least six weeks from receipt of budget calendar) to meaningfully complete their detailed estimates on time.	A
(ii) The quality of the budget circular is poor as it does not contain qualitative assumptions or reflects ceilings.	D
(iii)The Legislature has, during the last three years, approved the budget before the start of the fiscal year.	A
Overall Rating	**B**

PI-12. Multi-year perspective in fiscal planning, expenditure policy and budgeting

Dimensions to be assessed: (i) Preparation of multi-year fiscal forecasts and functional allocations (ii) Scope and frequency of debt sustainability analysis – Dates for debt sustainability analyses (iii) Existence of sector strategies with multi-year costing of recurrent and investment expenditure (iv) Linkages between investment budgets and forward expenditure estimates.

GoHP has prepared a revised Medium Term Fiscal Plan (MTFP) for the period beginning 2007-08 that articulates the Government's medium term fiscal objectives and strategic priorities consistent with the FRBM Act, and sets clear milestones for five years, beginning 2007-08. The MTFP is consistent with the FRBM and targets elimination of current deficit in 2008-09 and reduction in the ratio of gross fiscal deficit to GSDP from 4.3% in 2006-07 to 2.2% by 2011-12. The share of debt to GSDP is targeted to reduce to 47% by 2011-12. Going forward, GoHP will execute its budget to meet the 2007-08 MTFP targets, and prepare the 2008-09 budget in alignment with the MTFP targets for that year.

While the MTFP establishes the broad contours of the fiscal envelope and provides a distribution of expenditure by economic classification, the budget is prepared by functional heads with detailed allocation for each object head of expenditure that form the basis for economic classification. However, a weakness is that budgeting at the functional level is not supported by medium term expenditure frameworks that support sectoral strategies over the medium term, separating recurrent expenditure from new investments and subsequent recurring expenditure on these new investments. What the Government does prepare is a five year plan that deals with new spending proposals or the plan side of budget which is exclusive of ongoing expenditure, thus robbing the budget of an overall vision based on policies and priorities.

However, to be consistent with its commitment to fiscal transparency and restoration of fiscal indicators to sustainable levels over the medium term under the FRBM, the Government is in the process of initiating reforms in the systems and processes of budget formulation and execution. While the existing budget system is functional, reforms are required to achieve the development vision of the State and to adapt institutional arrangements to support the fiscal strategy. The key challenge is to ensure within a comprehensive resource framework and a medium term perspective guide, the achievement of three objectives of budget management: (i) aggregate fiscal discipline in line with the MTFP; (ii) strategic policy decisions by GoHP within the constraints of the MTFP; and (iii) stimulating the efficient use of public funds. Beginning 2008-09, GoHP proposes to present a Fiscal Policy Paper to the Council of Ministers outlining linkages between government policies and outcomes, following which will emerge a broad agreement over budget contours, and set department ceilings for expenditure in a multi-year framework. GoHP will expand performance budgeting by initiating departmental Medium Term Expenditure Frameworks (MTEF) in a few key departments, such as Education, Health, Public Works, and Irrigation and Public Health

A formal debt sustainability analysis is not conducted, although informally interest expenditure and weighted average cost of debt is monitored and opportunities for reduction in interest expenditure are exploited through debt prepayment and restructuring and swaps. At a policy level, the FRBM Act backed by a Medium Term Fiscal Plan, sets fiscal targets over the medium term that supports the reduction of annual fiscal deficit and eliminates the current deficit. The goal is to reduce annual borrowing and stabilize the debt to GSDP ratio.

Outside of the five-year plan document, the government does not as yet have sectoral processes in place that cost recurrent and investment expenditure in multi-year terms. The Government plans to expand performance budgeting by initiating departmental MTEF in a few key departments, such as Education, Health, Public Works, and Irrigation and Public Health, which should strengthen the link between policy objectives, intermediate outputs and resource inputs.

The Government's five-year plan presents the State's development strategy, investment proposals and new services and policies to be initiated during the plan period. However, new investment proposals themselves do not consider recurring expenditure at the end of the investment horizon or the plan period. At the end of the plan period recurring expenditure on new policies and investments are transferred to the non-plan side of the budget, resulting in under-provisioning for maintenance of assets and diminishing service levels. Forward expenditure estimates for recurring expenditure are, at present, provided for incrementally on an annual basis. These are not linked to maintenance plans or service levels but determined by overall resource envelope, leading to bias towards new investment (plan) that are funded by borrowed or externally funded (Government of India) resources.

Brief Explanation	**Score (M2)**
(i) Forecasts of fiscal aggregates are prepared (only on the basis of main categories of economic classification) for at least two years on a rolling annual basis.	C
(ii) No debt sustainability analysis has been undertaken in the last three years.	D
(iii)Sector strategies may have been prepared for some sectors, but none of them gave substantially complete costing of investments and recurrent expenditure.	D

(iv)Budgeting for investments and recurrent expenditure are separate processes with no recurrent cost estimates being shared.	D
Overall Rating	**D**

PI-13. Transparency of taxpayer obligations and liabilities

Dimensions to be assessed: (i) Clarity and comprehensiveness of tax liabilities (ii) Taxpayer access to information on tax liabilities and administrative procedures (iii) Existence and functioning of a tax appeals mechanism.

Like other Indian states, the most important State taxes for HP are sales tax (changed into State VAT from April 1, 2005), State excise, motor vehicle tax, passengers and goods tax, entertainment tax, and electric duty. Some progress has been made in recent years in simplifying the inherently complex State tax regimes to enhance clarity, interpretability, and certainty of tax liabilities to the taxpayer. Some examples can be highlighted. The registration fee and stamp duty structure has been consolidated and the rates substantially reduced: currently a flat registration fee at 2% of the value of transaction with a cap of Rs. 25,000 has been introduced in combination of a stamp duty with a flat reduced rate of 5%. In addition, with the introduction of the State VAT, the central sales tax (CST) which is levied on origin basis and collected by the exporting State is in the process of being phased out and incorporated into the State VAT. Currently, the rates are 3% on inter-State sales to registered dealers and 10% on sales to unregistered dealers, but is scheduled to be reduced to 2% from April 1, 2008, 1% from April 1, 2009 and 0% from FY 2010.

However, the State tax regime still remains complicated and is combined with cumbersome, largely manual tax administration procedures and multiple rates. For example, the design of the State VAT, the most important State tax, largely follows the recommendations of the Empowered Committee of States Finance Ministers with three main rates of 0%, 4%, and 12.5%, plus 1% for gold, silver, precious and semi-precious stones, and 20% for liquor. The State VAT has a complex structure of low thresholds: Rs. 2 lakh for manufacturers, Rs. 6 lakh for traders, and Rs. 1 lakh for inter-State imports. Such complexity leads to ambiguity and is subject to interpretation and discretion of individual tax administration officers.

The tax policy in HP is predictable in that it is guided by a comprehensive set of laws such as the VAT Act 2005, Punjab Excise Act 1914 (as applicable in HP), Himachal Pradesh Motor Vehicles Taxation Act, 1972 etc. with their accompanying rules. Changes to the rules are undertaken after due consultations and are publicly notified, providing for a transparent process.

Relative to other State governments, the tax administration is fairly consolidated. The Excise and Taxation Department could be the basis for a unified tax administration system in HP. Presently, various tax and revenue collecting agencies report to different Secretaries in the government, making business process reengineering a challenging task. At the current stage, the Excise and Taxation Department administers VAT, State excise, luxury tax, passenger and goods tax and toll tax; the Revenue Department – stamp duty and registration fees; and the State Transport Authority – Motor vehicle tax. There is no comprehensive uniform accountability mechanism. Accountability is based exclusively on collection results. The key Excise and Taxation Department has a territorial rather than functional organization structure and requires more qualified and senior staff.

The key revenue administration agency in HP, the Excise and Taxation Department, has progressed very well in improving its taxpayer service function, making the taxpayers' access to information on tax liabilities and administrative procedures much simpler and more efficient. In particular, it has created a tax website (www.hptax.nic.in) where taxpayers can find tax laws, regulations, and instructions to fulfill their tax obligations. In addition, the taxpayer service function covers the following:

- Publication of new changes in tax provisions and regulations in the mass media including TV, radio, newspapers, official gazette.
- Taxpayers could obtain information related to taxation or get assistance in any circle tax offices. Phone service is also available.
- Distribution of tax forms in all district tax offices (DTO).
- DTOs are responsible for conducting seminars for taxpayers/trade associations, especially when there are changes in tax legislation or tax administration procedures.

Interviews with the business community conducted in October 2007 also reaffirmed the progress made by the tax department. However, the business community also points out that there is limited access to information for SMEs as they are not equipped with sophisticated IT facilities and are normally not invited to seminars, or not typically updated on information by taxpayers/trade associations. This suggests that improvement has to be made to provide better and more accessible service to SMEs.

The tax appeals mechanism in HP is functional. Basically, there are three levels of appeal available. Level 1 is called origin authority (OA) conducted by the assessing authority plus two appellate levels (first and second appellate authority or AA).

- If OA is the district excise and tax administration tax officer, then the first AA is deputy excise and tax administration commissioner (ETC).
- If OA is deputy ETC, the first AA is the commissioner of ETC and the second AA is tribunal or financial commissioner.
- If OA is commissioner, then the AA is financial commissioner.

Taxpayers have 60 days to file their appeal. Before appeal, they are legally responsible to pay 100% of the amount of the tax in dispute. However, some discretion by tax administration remains. In particular, if taxpayers consider themselves unable to pay the legally required 100% of the amount of tax liability in dispute, they can register to the first AA to get his permission for paying only part or none of this amount; and the exact amount to be paid in advance of appeal is at the discretion of the first AA officer.

Brief Explanation	Score (M2)
(i) Legislation and procedures for some major taxes are comprehensive and clear, but the fairness of the system is questioned due to substantial discretionary powers of the government entities involved.	C
(ii) Taxpayers have easy access to comprehensive, user friendly and up-to-date information on tax liabilities and administrative procedures for some of the major taxes, while for other taxes the information is limited.	B
(iii) A tax appeals system of transparent administrative procedures is completely set up and functional, but it is either too early to assess its effectiveness or some issues relating to access, efficiency, fairness or effective follow up on its decisions need to be addressed.	B
Overall Rating`	**B**

PI-14. Effectiveness of measures for taxpayer registration and tax assessment

Dimensions to be assessed: (i) Controls in the taxpayer registration system (ii) Effectiveness of penalties for non-compliance with registration and declaration obligations (iii) Planning and monitoring of tax audit and fraud investigation programs.

The key features of the general registration procedures and control are:

- Procedures for registration of State taxes are completely manual, complex, and ineffective. The complexity is reflected, for example, in the absence of an integrated registration system (e.g. dealers have to formally register for VAT and central sales tax separately, if applicable). The resultant issue of non-unique Tax Identification Number (TIN) is another problem for administration and auditing.
- The time period to complete the registration process takes too long. The whole process for registration takes on an average three weeks. To improve this, the registration process has to be combined with ex-post verification and effective strategy to regularly check the validity of registration, to detect fraud in 'ghost' registration.

The VAT registration procedures are also cumbersome and follow the steps:

- Step 1. Dealers submit their application for registration to the district tax offices or DTO (for VAT, they use VAT form I). The information supplied by dealers in VAT form I includes contact details (address, phone, fax), bank account, type of business. The form is complemented by five different annexes that ask for more detailed personal, financial, and business information of the dealers. To complete the submission process, applicants pay the registration fees directly to the State Bank of India and furnish the stamped certificate (form VAT II challan) and the treasury receipts.

- Step 2. **DTO's verification**. After the DTO receives the application, the inspectors are responsible for the verification. The DTO has established a 13-point check list that inspectors have to follow. The list basically includes the required check of the completeness of the forms, the payment of registration fees, identity proof of the applicant dealers, site plan of the business premises or copy of enlistment (if applicants are contractors). After verification to ensure that there is no suspicion, the inspectors can recommend to the respective excise and taxation officer that the dealers be registered.

- Step 3. **TIN issuance and entry of dealers' information in taxpayer database.** The DTO issues the TIN when the dealers are registered. The DTO completes the recording of the registered dealers in its database. The process is completely manual. Basically the record entry has the following information: TIN number, date of registration, name of dealers, liability start date, return filing period, and TIN for GST. The TIN is not unique for different taxes. (The GoI is in the process of computerization nationwide for the tax administration, and as part of this process it will be responsible for issuing a unique TIN for taxpayers.)

The key feature of the strategy to identify potential taxpayers is:

- The DTO conducts periodic market surveys by sending their inspectors to premises of businesses in their jurisdiction. However, it is not clear how effective this procedure has been to date. There needs to be a study to analyze the effectiveness of the strategy and the uniformity of its implementation across DTOs.

- The fine structure exists and by itself is adequate to give incentives for compliance with registration, declaration, and payment. However, compliance remains poor as the key tax administration procedures, particularly registration, detecting non-registration compliance, and tracking arrears are manual.

<u>Fine for failure to register:</u>
If a dealer fails to register, he has to pay penalty of an amount not exceeding INR 2000. If he continues not to register, the penalty is added by an amount of INR 50 or less per day.

<u>The entire process of detecting late payments is manual; with absolutely no computer/IT aid in the entire process.</u>

- If payment is late the DTO issues the first notice to the taxpayer with the determined date of payment.
- If default occurs, the DTO issues the second notice, including the information on the penalty as applicable.
- Coercive procedures are to be used to deal with non-payment, which include:
- Force taxpayers' banks/holders of financial assets of taxpayers to pay. The State government has the first priority to tap into taxpayers' assets in case of default.
- Attachment of immovable or movable property of taxpayers/auction/collection of taxes including auction fees.
- Imprisonment up to 30 days.
- Late payment subject to a fine of no less than 15% of tax amount with a limit of 150% of the total assessed tax liability. The assessing authority rests with the DTO.

Tax auditing (for example, for VAT) focuses on the three aspects: arithmetical errors in returns; concealment of turnover; and illegal credits. The key audit criteria include turnover, requested VAT refund amount, discrepancies from information in taxpayers' tax return and the key established business accounting ratios (e.g., input/turnovers). Random selection ordered by the Commissioner is part of the overall audit strategy. However, in general, auditing is completely manual, not computer aided. In addition, there exists mistrust of taxpayers by the tax administration; hence, the administration relies much on coercive enforcement. Tax inspectors can come to business premises at any time at their discretion and surprise visits become the norm.

Brief Explanation		Score (M2)
(i)	Taxpayers are registered in database systems for individual taxes, which may not be fully and consistently linked. Linkages to other registration/licensing functions may be weak but are then supplemented by occasional surveys of potential taxpayers.	C
(ii)	Penalties for non-compliance generally exist, but substantial changes to their structure, levels or administration are needed to give them a real impact on compliance.	C
(iii)	There is a continuous program of tax audits and fraud investigations, but audit programs are not based on clear risk assessment criteria.	C
Overall Rating		**C**

PI-15. Effectiveness in collection of tax payments

Dimensions to be assessed: (i) Collection ratio for gross tax arrears, being the percentage of tax arrears at the beginning of a fiscal year, which was collected during that fiscal year (average of the last two fiscal years) (ii) Effectiveness of transfer of tax collections to the Treasury by the revenue administration (iii) Frequency of complete accounts reconciliation between tax assessments, collections, arrears records and receipts by the Treasury.

The Excise and Taxation Department is not able to provide accurate data on tax arrears broken into individual years, citing technical difficulties in compiling such data as the entire process of arrears management is manual. Instead, aggregate data on arrears by major taxes (State sales tax, State excise) indicate that during the period 1972-73 to 2006-07, the total estimated amount of arrears was Rs. 74,106,604 (State excise), and during 1968-69 to 2006-07, the arrears reached Rs. 992,951,731 (State sales tax/VAT). Compared with the amount of arrears outstanding for more than five years for shorter periods for each respective type of taxes, from 1977-78 to 2002-03 (Rs. 41,343,959 for State excise), and for the period 1978-79 to 2002-03 (Rs. 271,403,645 for State sales/VAT), the arrears collection productivity was very poor. The outstanding arrears accounted for almost 56% and more than 27% of excise and sales tax/VAT targets, respectively.

Taxpayers can choose to pay their taxes directly to the treasury if they pay in cash. The revenue agencies can collect taxes and remit it to the treasury only if payment is made by checks. The transfer of tax collections to the treasury is typically within three days after the revenue agencies collect the checks from taxpayers.

The reconciliation of tax payment data and tax assessment between tax office, treasury and the AG office is monthly.

The collection of tax arrears is poor. The problem is acute despite efforts by the Excise and Taxation Department, including the use of coercive measures. This is because the process of detecting late payments is manual without any computer/IT support.

The reconciliation of accounts between tax assessments, collection, arrears records and receipts by the treasury has been implemented smoothly, even though the frequency is rather long (one month). The main reasons are: (1) The reconciliation process cannot be done in real time due to the manual-based process; and (2) The tax agency needs time to obtain the confirmation of fund transfer of check payment from taxpayers' accounts.

Brief Explanation	Score (M1)
(i) The debt collection ratio in the most recent year was below 60% and the total amount of tax arrears is significant (i.e. more than 2% of total annual collections).	D
(ii) Revenue collections are transferred to the Treasury at least weekly.	B
(iii)Complete reconciliation of tax assessments, collections, arrears and transfers to the Treasury takes place at least quarterly within six weeks of end of quarter.	B
Overall Rating	**D+**

Predictability and Control in Budget Execution

PI-16. Predictability in the availability of funds for commitment of expenditures

Dimensions to be assessed: (i) Extent to which cash flows are forecast and monitored (ii) Reliability and horizon of periodic in-year information to Ministries Departments and Agencies (MDAs) on ceilings for expenditure commitment (iii) Frequency and transparency of adjustments to budget allocations, which are decided above the level of management of MDAs.

Though the annual budgets are approved by the legislature at the commencement of the year, a budget release activity by FD to the respective line departments has to take place before the funds can be utilized.

FD prepares a cash flow forecast for the fiscal year on spreadsheets that is updated monthly. For most of the items, the forecast is a month-wise distribution on a time-proportion basis (i.e. spread equally over the year). The FD carries out the forecast, including the updating, internally, as no forecast is obtained from the line departments. Updates for actual receipts/expenditure are made for some items based on the monthly accounts prepared by the AG, the Letter of Credit (LoC) authorization issued for two civil departments, and other high-level information available with FD. The balance expenditure is again spread equally over the remaining months. Outstanding commitments and balances with Treasuries or in bank accounts of other entities are not considered. The cash flow statements are discussed at the level of Secretary Finance, though the variances and reasons between forecast and actual are not minutized.

In recent years, the State Legislature has passed the budget before the commencement of the fiscal year. Hence, budgetary appropriations for making expenditure commitments are available to the line departments at the beginning of the year for substantial part of their capital and recurrent expenditure. Within these budgetary ceilings, the departments can incur/commit expenditure, preferably in the ratio of 20%: 25%: 30%: 25% over the four quarters, though the limit may be relaxed with the approval of FD. The budget is disseminated by the HoD to the DDOs with intimation to the concerned district Treasury.

Within their overall budgetary ceilings, the actual expenditure of two civil works departments is regulated through the LoC authorization system that is issued monthly or quarterly. Information on the Central Government's counterpart share of expenditure is available during the course of the fiscal year and budgetary ceilings are communicated separately by way of "additionality/ies"[13]. In recent years, no restrictions or rationing on budget appropriations have been made on the line departments owing to the comfortable cash position of the State.

The budget released by heads of departments to various offices is entered in the central treasury of the Government of Karnataka and transmitted electronically to all district treasuries. This includes all the accounting details from the Major Head to the object code. Payments are approved only if the budget information relating to each officer (DDO) is available with the local treasury.

In-year budget adjustments are made initially through grant of additional budgets approved by FD based on assessments and requests made by the line departments. The norms for granting additional budgets and the circumstances in which this system cannot be applied, are provided in the HP Budget Manual. Approval of the State Legislature, for all in-year budget adjustments (other than re-appropriation within the same demand), is obtained through the Supplementary Budget. While the number of "additionalities" during a year could be significant, only one Supplementary Budget is moved before the State Legislature, generally in the month of February-March (e.g. first and final Supplementary for 2006/07 was presented before the Legislature on 23/02/2007 and passed on 05/03/2007). The composition of the Supplementary Budget for 2006/07 was 31% for Plan, 51% for Non-Plan and 18% for Centrally Sponsored Schemes. The amount of the Supplementary Budget, as a percentage of the original budget, is showing an increasing trend, though this declined during the last FY 2006/07. (Refer also to the observations in PI – 27).

Size of supplementary budget in Himachal Pradesh

(in Rs. Million)

Fiscal Year	Original Budget	Supplementary Budget	Supplementary as a % of Original
2003/04	76484.1	1946.0	2.5%
2004/05	70956.5	7784.7	11.0%
2005/06	77608.5	14313.9	18.4%
2006/07	86870.4	10475.2	12.0%

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[13] Additionalities are additional appropriation that can be sought if the expenditure has exceeded or is likely to exceed the available provision or a new scheme or activity is to be taken up.

Brief Explanation	Score (M1)
(i) A cash flow forecast is prepared for the fiscal year but is only partially updated (monthly).	C
(ii) Line departments are provided reliable information to plan and commit substantial expenditure at least quarterly in advance.	B
(iii) Significant in-year budget adjustments are frequent, but undertaken in a fairly transparent manner.	C
Overall Rating	C +

PI-17. Recording and management of cash balances, debt and guarantees

Dimensions to be assessed: (i) Quality of debt data recording and reporting (ii) Extent of consolidation of the Government's cash balances (iii) Systems for contracting loans and issuance of guarantees.

FD maintains memorandum records for debt on spreadsheets primarily containing data on principal, repayments and interest. These were updated till FY 2006/07 only (at the time of this assessment). However, the AG maintains detailed records, and reconciliation of debt data between FD and AG is done at least annually. Debt data reporting is done twice annually – at the time of the State's Annual Budget and in the State's Annual Financial Statements. The latter also provides detailed notes on the debts contracted with stock and operations during the year and debt service ratios. The CAG has adversely commented on incorrect exhibition of internal debt. Part of the debt raised by HP Industrial Development Board by floating bonds in the open market was parked under the Deposit head and not transferred to Internal Debt of the State.

Data on guarantees are compiled by the FD at least semi-annually and disclosed in the Annual Budget Documentation and the Annual Finance Accounts. Reversal/cancellation of guarantees that have expired may be delayed and, therefore, the data on guarantees may include expired guarantees.

Receipts and withdrawals are recorded at the 15 Treasuries and 85 sub Treasuries in HP and information thereof flows from the designated banks attached to the Treasuries of the State Bank of India and to the Reserve Bank of India (RBI) on a daily basis. The RBI consolidates the cash position of the State and generates a daily cash position. The system is well established and is on lines similar to other states.

GoHP does not normally permit its departments to open or operate bank accounts. Some agencies such as autonomous bodies (e.g. Societies in the Health and Education Departments) and certain others that receive central funds for program implementation (e.g. District Rural Development Agencies) operate bank accounts. The balances in these accounts are not consolidated in the State's cash balances.

GoHP enacted the FRBM Act, 2005 in 2006 to ensure prudence in fiscal management and fiscal stability. The FRBM Act prescribes that GoHP will progressively reduce its outstanding guarantees on long term debt, until it can cap outstanding risk weighted guarantees at 80% of total revenue receipts in the preceding financial year. However, GoHP assigns equal weightage to all guarantee exposure. A similar limit has not been fixed for debt stock. The CAG has also reported that no law has been passed by the State Legislature under Article 293 of the Constitution laying down the limit within which GoHP may borrow on the security of the Consolidated Fund of the State.
A standard framework prescribing criteria for eligibility, appraisal and approval of debt and guarantees has not been laid down. In actual practice, vetting of all proposals for issue is centralized with FD and approvals with the State Cabinet. A committee for carrying out this function has not been constituted.

Brief Explanation		Score (M2)
(i)	Debt records are complete, updated and reconciled at least semi-annually (and not quarterly). Data is considered of fairly high standard, but minor reconciliation problems occur. Comprehensive management and statistical reports covering debt service, stock and operations are produced at least annually.	C
(ii)	All cash balances are calculated daily and consolidated, except for extra-budgetary funds that remain outside the arrangement.	B
(iii)	Government contracting of loans and issuance of guarantees are always approved by a single responsible government entity, but are not decided on the basis of clear guidelines, criteria or overall ceilings.	C
Overall Rating		**C+**

PI-18. Effectiveness of payroll controls

Dimensions to be assessed: (i) Degree of integration and reconciliation between personnel records and payroll data (ii) Timeliness of changes to personnel records and the payroll (iii) Internal controls of changes to personnel records and the payroll (iv) Existence of payroll audits to identify control weaknesses and/or ghost workers.

The Fundamental Rules and Supplement Rules, the Medical Rules, Conduct Rules etc. (of the Central Government adopted in the State of HP) sets out the procedures, including internal controls, over payroll. Appointment of personnel is limited to the post-wise strength sanctioned by the Government. Personnel costs account for almost 27% of total budgeted expenditure of the State.

The basic personnel record is the Service Book maintained for each employee by the designated DDO. The Service Book (presently maintained manually) is the basic record containing all service related events such as pay, transfers, deputation, citations, suspension, promotion, etc. Till mid-2007, personnel records and payroll were decentralized to the line departments and the DDOs drew the monthly payroll and presented it to the Treasury for verification and release of funds. Now, the Treasuries maintain a personnel database and generate the monthly payroll for all line departments (except Forest Department), though the latter continue to maintain the Service Books. A software application called e–Salary has been installed in each Treasury. Personnel data of all employees have been entered in the e-Salary application through an Employee Master Card prepared and validated by all line departments. Each employee has been allotted a unique number[14]. The line departments manually check the monthly e-Salary and the Treasury crosschecks it with the previous month's payroll and subsequent changes are communicated to, before it is finalized and funds are made available to the DDO. Data input of recently regularized Work Charged Employees in two civil works departments[15] is in progress, but there is no central information available regarding the extent to which computerization has been achieved.

Changes are communicated by the line departments on a monthly basis and incorporated in the e-Salary application by the Treasury. As per extant practice, changes occurring during a particular month are communicated by the DDOs to their respective Treasuries by the 20th of the month to facilitate inclusion in the month's payroll. Presently, line departments inform the monthly changes by way of a simple letter signed by the DDO that may or may not be accompanied by supporting documents. Therefore, reporting of change data is not standardized and may not result in a clear audit trail at the Treasury level. Controls over transferred employees are not clear. Data of a transferred employee has to be re-entered in the district Treasury where the employee is transferred, as inter-Treasury linkage of data has not yet been achieved. Also, a system of direct communication between two Treasuries for confirming discontinuation of transferred employee data has not been introduced. Moreover, major IT application control weaknesses persist in the areas of segregation of duties, assignment of usernames/passwords, access and processing. There are also major organizational control weaknesses such as absence of an operational procedures manual, inadequate back up controls and absence of systems administrators. Shortage of staff at the Treasuries has been reported that may lead to overriding of controls in order to meet the salary deadlines. This is also indicative of inadequate training to staff.

Salary and Pension are paid in cash.

All staff/retirees of the Government of Tamil Nadu receive their payments through the Electronic Clearance System (ECS) directly into their Savings Bank Account. This includes salaries, advances, and medical claims for staff and pension for retirees.

The AG audits payroll, on a test check basis, annually at the time of departmental audit, but this is limited to the units and period covered under audit. Therefore, there may be units that are not audited annually but say once in three years or so. Payroll verification, including

[14] This is called the IPAO number and is generated by a software application; it will remain unique to the employee irrespective of the department/location of posting.

[15] Work Charged Employees have been inducted as regular employees under the charge of Junior Engineers at the sub-divisional offices. Monthly payrolls are prepared by the sub-divisional offices, pre-audited by the Divisional Accountant and approved by the Executive Engineer. The latter draws the salary from the Treasury and transfers the cash to the sub-divisional offices for distribution to the employees.

identification of ghost workers, is carried out in-house and, therefore, there is an absence of independent verification or a systematic periodic plan to conduct this exercise.

Brief Explanation	Score (M1)
(i) Personnel database and payroll are directly linked to ensure data consistency and monthly reconciliation.	A
(ii) Required changes to the personnel records and payroll are updated monthly, generally in time for the month's payroll.	A
(iii) Controls over changes to personnel records and payroll are not adequate to ensure full integrity of data.	C
(iv) Partial payroll audits have been undertaken within the last three years.	C
Overall Rating	**C +**

PI-19. Competition, value for money and controls in procurement

Dimensions to be assessed: (i) Evidence on the use of open competition for award of contracts that exceed the nationally established monetary threshold for small purchases (percentage of the number of contract awards that are above the threshold)
(ii) Extent of justification for use of less competitive procurement methods (iii) Existence and operation of a procurement complaints mechanism

Significant public spending takes place through the public procurement system. A well-functioning procurement system ensures that money is used effectively and efficiently. Open competition in the award of contracts has been shown to provide the best basis for achieving efficiency in acquiring inputs for and value for money in delivery of programs and services by the Government. This indicator focuses on the quality and transparency of the procurement regulatory framework in terms of establishing the use of open and fair competition as the preferred procurement method. It defines the alternatives to open competition that may be appropriate when justified in specific, defined situations.

The public procurement system in HP is in a state of transition. Over the last several years, the emphasis on competition has been complemented by an increased focus on structuring procurement systems so that decision-making authority rests with the department that requires the asset or service that is being procured. The existing State rules emphasize contracting with State-owned enterprises through free and open competition. At the same time, some features of modern public procurement systems have been introduced and the State is exploring ways to improve the performance of its procurement system. In addition, there is no one with responsibility for collecting information on the various procurement operations. The primary challenge in public procurement in the coming years will be managing the transition from a State-dominated purchasing system to a modern system of State contracting. The transition is likely to take several years to implement and will need to be approached in a strategic fashion.

All Government departments follow the Stores Purchase Rules issued by the Department of Industries for purchase of goods and the PWD tender template for works and other contracts. There are no standard rules or documents for procurement of services.

The procurement rules are based on significant preferences for Government owned enterprises, local industrial units and also for small cottage industries or medium sized enterprises in HP. The tenders may be awarded to non-HP Government owned enterprises or cottage industries but subject to a further series of preferences related to the State. Foreign products are actively discouraged. There is lack of data on the procurement that takes places in municipalities and local governments. The State does not have a consolidated database of all contracts issued by all departments. The tenders of GoHP's departments/agencies are being hosted on the website www.himachal.gov.in/tender.htm as per the CVC guidelines in this regard, but all departments are not covered as yet.

The regulatory environment as defined by the PWD template and Stores Purchase Rules mandates that all procurement should be undertaken through open competitive tendering. The Stores Rules, for example, treat open tendering as the default procedure. However, tendering may only be used where the preferential avenues of purchase are not available. When tendering theoretically applies, the exceptions and the conditions for applying the exceptions are reasonably clearly defined, even if they are mostly inadequate. The department may negotiate directly with Government owned enterprises without the requirement of tendering. However, there exists no field or case level verification on the frequency of resorting to non-competitive methods or on the manner in which these cases are justified.

As understood from the departments, there are not many complaints from bidders and as such, disputes raised, if any, are also limited. There is no data available on the number/nature of complaints received. Tender documentation used by the departments also does not indicate any defined process by way of legislation to address complaints during the tendering process. The only reference to a complaint review procedure appears in clause 13 of the Tender Form in respect of rate contracts contained in Annex II. It provides that a complaint may be lodged within 30 days with the Secretary (Industry) or any authority notified by the Government. The Store Rules do not otherwise contain any reference to such a procedure. The rules do not mention any independent complaint redressal mechanism that allows an individual to get his or her complaint heard by an agency that is unconnected to the actual procurement.

Brief Explanation	Score (M2)
(i) Insufficient data exists to assess the method used to award public contracts.	D
(ii) Justification for use of less competitive procurement methods is weak or missing.	C
(iii) A process exists for submitting and addressing procurement complaints, but it is designed poorly and does not operate in a manner that provides for timely resolution of complaints.	C
Overall Rating	**D+**

PI-20. Effectiveness of internal controls for non-salary expenditure

Dimensions to be assessed: (i) Effectiveness of expenditure commitment controls (ii) Comprehensiveness, relevance and understanding of other internal control rules/ procedures (iii) Degree of compliance with rules for processing and recording transactions.

Internal controls with respect to expenditure are defined in the HP Financial Rules, 1971 (HPFR), the HP Budget Manual and the HP Treasury Rules (HPTR), and in the Departmental Financial Rules and Account Code specifically for departments involved in civil works.

The primary control over expenditure is the budget allocation. No expenditure can be incurred unless a budget provision exists. The HoD *exercises general control over the actual expenditure incurred* (HP Budget Manual) and the DDO *is directly responsible for the expenditure incurred ... ... shall keep a close watch over the progress of expenditure ... ... in no case allow the appropriation to exceed without prior approval* (HP Budget Manual). All offices maintain records for budgetary control.

Another point of internal control is the Treasury that ensures that the payment is genuine and within the budgetary limits. For this purpose, all budgetary allocations/LoC allotments are communicated to the respective district Treasury. The HPFR and the HPTR lists checks that are to be applied by the Treasuries prior to releasing the payment. The AG keeps a watch over expenditure incurred against grant on an overall basis and issues warning slips where expenditure is unusually heavy or less.

The HP Budget Manual requires each DDO to record expenditure commitments and submit a monthly liability statement to their CO stating the position of outstanding liabilities (see PI-4). Responsibility has been cast on the COs to carefully examine each statement and ensure that the liabilities have been incurred under proper authority and within appropriations. COs are required to submit the liability statement to their HoD for onwards submission to FD. In actual practice, this system is not followed and a system of reporting commitments has not been established. Hence, commitments are not captured in the accounting or in the in-year reports.

The overall laid down framework of internal controls over expenditure commitment is comprehensive, but it is impractical in a manual system. Budget overruns are common with commitments going beyond the approved budget allocations. Such substantial excesses have not been regularized in a timely manner by obtaining approval of the State Legislature. The CAG has reported (*Audit Report 2006 Vol I*) excesses over grant/appropriations pending regularization to the tune of Rs. 147182 mn over the period 2001/2006. However, such excesses over budgetary provisions are showing a declining trend – from Rs. 45156 mn to Rs. 30951 mn (-31%) to Rs. 8463 mn (- 73%), respectively during FY 2003/04, 2004/05 and 2005/06. *One reason for the large excesses is that the legislature approves the same only after completion of review of that year by the Public Accounts Committee; this leads to delays since the PAC usually has a backlog of a few years.*

Some departments have been allowed to open Personal Ledger Accounts (PLA) post-approval by the FD and AG. PLAs represent funds committed. The practice of opening PLAs is presently not encouraged. Nevertheless, GoHP should re-assess the already existing PLAs as some of these accounts with significant balances are non-operational.

The HPFR provides canons of financial propriety. Besides budget appropriation for civil works, approved work estimates and prior administrative approval and expenditure sanctions, technical sanctions are also mandated. In case of civil works departments, responsibility has been cast on the Divisional Accountant (DA) to conduct a pre-audit of all transactions before payment is approved. Moreover, FD prescribes delegation of authority/spending powers. Internal controls may also take the form of inspections, periodic meetings or monitoring through periodic progress reports but so far these have not been extensive and regular. The Treasuries and the AG do accounting of the departmental expenditure. A system of reconciliation of departmental figures with those in the books of the Treasuries and AG, on a monthly/quarterly basis, is mandated and is in practice.

The manuals are out-of-date and not used. None of the departmental offices visited could produce a copy of the HPFR. These documents have not been referred to for several years and the current version available has outlived its utility due to numerous modifications. The latest version of HPFR available is of the year 1998 and the Budget Manual was released in 1971. There is a need to thoroughly update (effect of numerous circulars should be incorporated), revise and simplify these official documents and modernize them in line with the current work environment (*introduction of alternative service delivery mechanisms, rapid advancement in IT, enhanced expectations of the public towards accountability and transparency* – Report of Task Force reviewing the General Financial Rules of Government of India).

The Government of Rajasthan is actively pursuing a public financial management and procurement capacity building program which focuses on four critical elements viz. budgeting, internal controls, public procurement and oversight. As part of this activity, the State is undertaking revision of its Budget Manual (for making it conducive to electronic budget preparation, allotment and control); General Financial Rules (which have become outdated and in need for modernization and simplification); and Treasury Code (developing a comprehensive self-contained Accounts Code).

Delegations are out-of-date. Delegation of financial powers for departments was issued by FD in the 1990s (e. g Fisheries and Police Departments in 1995, Irrigation & Public Health and Health & Family Welfare Departments in 1999). Further, Schedule of Rates for civil works departments was last updated in 1999, for public health works in 1993 and for electrical works in 1996.

Suspense Account balances are not monitored or cleared in a systematic manner. The Suspense Account is not a final head of account but is to accommodate interim transactions for which further payment or adjustment of value is necessary before the transaction can be finally accounted for. Accordingly, the transactions under this head if not adjusted under the final head of account, are carried forward from year to year. The balance in the account as of March 2006 was Rs. 4,033.6 mn (under minor head 799). Details of Suspense Account are not compiled departmentally and the Appropriation Account is the only source that provides head-wise grant-wise consolidated information, but year-wise break-up is not available. Items in these accounts are pending adjustment since a considerable period of time. Some sub-heads of Suspense Account exhibit adverse balances *inter alia* on account of non-linking of debits/credits and incorrect incorporation of transfer entries. In sample divisions visited, it was observed that Price Stores Ledger is not maintained and hence the stocks are not reconciled. As per rules, Stock Manufacture account should be adjusted annually i. e. the cost of the jobs should be charged off to respective works, which is not being done. CAG has commented that Divisions were also not reporting the correct position in this account as differences were observed between the amount per records and that reported, which also indicates inadequate reconciliation.

IT controls in Treasuries require major strengthening as the Treasuries are operating under an informal and weak IT control environment. In this area, clear, comprehensive control rules/procedures are lacking and the manual systems are impractical under an IT regime.

IT Controls in the Treasuries need strengthening

- No formal operational procedures manual has been developed for the applications implemented in the Treasuries. Consequently, there is no authentic guidance available for reference or to assess the in-built application controls or organizational controls, including access controls. There is also an absence of any disaster recovery plan being put in place. The function of taking back up of data has also not been formally defined. At one DTO, back up of data is taken by a contractual computer operator on the server and CD, the latter being kept with the Stores In-charge within the premises. There is, however, no official recording of this function. *A draft disaster recovery plan has been prepared in consultation with the National Informatics Center and is expected to be released shortly.*

- Technical support such as in the form of a Systems Administrator has not been provided to the Treasuries. Consequently, in case of hardware or software breakdown, the Treasuries have to depend upon unofficial local support or help from the local office of the National Information Center (NIC). In remote areas, this may not be readily available and the technical competence may also not be as per requirements.

- Formal segregation of duties, an essential element in IT applications, is lacking. No formal document or communication on access/authorization levels is available. In actual practice, these are often overridden primarily due to staff shortage and/or work overload. It was actually observed that the same person does data input, authorizes the transaction and generates the output and s/he is aware of the username/password at all these stages.

- There is no formal policy at the Treasuries governing the management of the basic and essential function of allocation of access and password. At one DTO visited, user names and passwords are issued and managed by NIC, the agency that developed the software application indicating assumption of incompatible duties. At another DTO, this responsibility has been entrusted to a computer operator employed on contract.

- The Treasuries could not explain the controls that have been specified at the input, processing and output stages. The staff is not aware of items such as batch controls, field checks or exception reports.

- The computerization of the Treasury functions has not been accompanied by proportionate training of the staff. Discussions indicate that the staff that had no prior exposure to computers was provided a 3-7 days basic training at the Himachal Institute of Public Administration (HIPA) and most of their learning of the applications has been on the job. *GoHP has scheduled another round of training at HIPA for Treasury personnel – the curriculum includes technical aspects to acquaint the staff in identifying the problems in hardware and software.*

Significant adverse observations are made by the CAG/AG with respect to non-compliance of rules for processing and recording transactions.

Key issues in expenditure control

Horticulture Department

- Receipts of significant amount were remitted to the Treasury but were not simultaneously entered in the cashbook nor reconciled.
- Utilization Certificates were furnished though the expenditure was less than certified.
- Drawl was made against "Proforma Bills" and actual payments were made subsequently.
- Stores Account was not prepared and regular physical verification was not done.

Irrigation & Public Health Department

- Works were executed without AA&ES/TS or expenditure incurred beyond the sanction.
- Expenditure was incurred beyond the approved budget or authorized LOC limits.
- In case of deposit works, expenditure was incurred beyond the funds provided.
- Wasteful/un-fruitful expenditure was incurred as the expected benefits did not materialize, indicating inadequate planning.
- Un-reconciled differences were seen in reconciliation with Treasury.
- Public Works Advances remained un-adjusted/un-recovered over a substantial period.
- Suspense Accounts remained un-adjusted.
- Accounting of expenditure was done without actual receipt of material or execution of works.
- Irregular inspection of works; data on inspection was not reported at central level.
- Outdated Schedule of Rates was applied.

	Brief Explanation	Score (M1)
(i)	Expenditure commitment control procedures exist and are partially effective, but may occasionally be violated.	C
(ii)	Internal control rules and procedures consist of a basic set of rules for processing and recording transactions, which are understood by those directly involved in their application.	C
(iii)	Rules are complied with in a significant majority of transactions, but use of simplified/emergency procedures in unjustified situations is an important concern.	C
	Overall Rating	**C**

PI-21. Effectiveness of internal audit

Dimensions to be assessed: (i) Coverage and quality of the internal audit function (ii) Frequency and distribution of reports (iii) Extent of management response to internal audit findings.

There is no formal architecture of internal audit in the State, except in some line departments (i.e. Rural Development, Panchayati Raj and Urban Development Departments), where internal audit cells have been established. The function is fragmented as it is not under a centralized umbrella. Moreover, no policy directives/guidelines/standards have recently been issued. Internal audit is not operational in important line departments such as the civil works departments (Irrigation & Public Health and Public Works Departments). A study of CAG Audit Reports for recent years clearly indicates an absence of an effective internal audit system in the State. Some line departments that established internal audit discontinued it later (e.g. Animal Husbandry, Food, Civil Supplies & Consumer Affairs and Planning Departments). Internal audit staff is assigned non-audit duties (e.g. Agriculture and Horticulture Departments) and/or duties incompatible with their functional profile (e.g. Health & Family Welfare and Tourism Departments where pre-audit is considered as internal audit).

Internal audit, wherever it exists, is transaction based, often covering 100% of the transactions. Systemic audits, including review of internal controls, are rare. Hence, audit recommendations concentrate on a particular transaction, are often generalized and do not address the core problem. Use of audit manuals is limited (perhaps the only exception is the Department of Urban Development which has recently come out with an Audit Manual for audit of urban local bodies). FD provides key staff for audit, but due to shortage of staff, full coverage of the auditable units is not achieved. As a result, audit overflows to subsequent year/s, though the units left out are covered first during the next audit cycle.

Internal Audit in Panchayati Raj Department

- An independent audit of all the three tiers of PRIs is mandated under the HP Panchayati Raj Act, read with the Finance Rules that elaborates the roles and responsibilities, the coverage of the audit and the compliance mechanism.
- The audit function is under a Deputy Controller (Audit) who is assisted by a team of District Audit Officers and Auditors.
- The Department draws out an Annual Plan listing the PRIs to be covered and allocates the units to audit teams.
- A detailed audit checklist is available and a uniform reporting format is in vogue.
- The audit covers all sources and uses of funds and the auditors also draw out the financial statements of the PRIs.
- The district/block officers monitor compliance to the audit findings periodically and its status is also reported in the next audit. The Act mandates publication of the irregularities and status of compliance, but this is still in process.

Shortage of staff in the Department of Urban Development (for audit of ULBs) has been a major cause of audit backlog. During the period April 2002 to March 2005, the audit cell covered 21 ULBs (out of 49) and the period of coverage ranged from 1993 to 2004. Similarly, during the current FY 2007/08, 39 ULBs have been covered under audit for periods ranging from April 2004 till March 2007. The biggest ULB (Shimla Municipal Corporation) has not been audited since 2000. Lack of adequate staff strength has been an impediment in the audit cell. The Examiner Local Fund Audit has the mandate to undertake audit of local funds generated out of local incomes/fees or donations. It has approximately 125 staff including 73 auditors who are required to cover over 600 School Boards, Development Authority, Universities, Colleges, Market Committees, Temple Trusts, among others.

Wherever internal audit is operational, audit reports are issued regularly and generally on time to the audited entity and to the top management. However, these may not be copied to FD or the AG-Audit (although the latter may consider the internal audit reports of the units covered in audit). Since audits are usually done once every year, the frequency of reports is annual. In case of ULBs where audit of several periods is done simultaneously, one report covering all the years is issued.

The degree of action taken by the auditee management to the audit findings needs to be emphasized considering the large number of unsettled audit reports/paras and repetitive observations, which weakens internal audit which is an essential function of an effective internal control system. Perhaps, the time has come for GoHP to segregate the audit function into an independent unit with powers to enforce compliance and recommend penal action for serious unresolved cases, which is lacking under the current regime. A central database of outstanding internal audit reports may be available in absolute numbers but data on ageing and amounts involved is not available/consolidated. The Department of Urban Development publishes an epitome of the audit done and the audit findings (though with some delay) and the Panchayati Raj Department has initiated this process. Internal auditors comment on the previous outstanding audit findings in subsequent reports.

- **Urban Local Bodies**: As on date, over 16000 audit paras are pending compliance (up from 6000 in March 2005) including those pertaining to audits 10 years or more (as far back as the 60s and 70s). For the period from 1966 to 2002, an estimated 1220 audit reports are pending settlement.

  Annual Report 2002-05 Audit Wing, Dept. of Urban Development

- **Horticulture Department** – 16 internal audit reports containing 94 audit paras for the period from 1983/84 to 1995/96, involving recovery of Rs 0.5 mn were lying unsettled as of April/2006.

  CAG Audit Reports

- **Food, Civil Supplies & Consumer Affairs** – Out of 28 internal audit reports relating to audit of food trade issued between 2000/2003, the auditee units furnished replies in 15 cases with considerable delays ranging from 33 to 587 days.

  CAG Audit Reports

- **Gram Panchayats** – As at the end of FY 2003/04, only 45 GPs (1 ½% of total) had 10 or more serious audit paras that increased to 383 GPs (12%) as at the end of FY 2005/06, which is significant.

Report on Finances of GPs

- **Zila Panchayats** – 129 audit paras are outstanding against 10 ZPs.

Panchayati Raj Department

Also, none of the departments have an Audit Committee to exercise independent oversight over the function and enforce compliance to the audit findings. The Rural Development Department has taken penal action against units not effectively attending to the audit findings, but such actions are rare.

Brief Explanation	Score (M1)
(i) There is no effective internal audit function, as it is operational neither in the majority nor in the most important departments; conduct of systemic audits are rare and may not meet professional standards.	D
(ii) Wherever internal audit is operational, reports are generally issued regularly to the audited entity, but may not be submitted to the Finance Department or statutory auditors.	C
(iii) Internal audit recommendations are usually ignored, with few exceptions.	D
Overall Rating	**D +**

Accounting, Recording and Reporting

PI-22. Timeliness and regularity of accounts reconciliation

Dimensions to be assessed: (i) Regularity of bank reconciliations (ii) Regularity of reconciliation and clearance of suspense accounts and advances.

The DDOs are the spending units in each department. Payments are made following the Treasury Bill System, except two departments involved in works (Public Works and Irrigation) that follow the LoC system. Normally, bills are passed by the DDO and are sent to the concerned district Treasury for issue of cheques. Under the LoC system, the DDO is authorised to issue cheques up to the amount authorized. The bank honours the cheque and intimates the Treasury. AG (A&E) prepares the Accounts for the State and presents it to FD. Primary data of departments under the Treasury bill system is provided by the Treasuries, while the departments under the LoC system send the data directly to AG (A&E). The AG (A&E) keys in the data from the original vouchers and details are sent under the system called Voucher Level Computerization.

In Karnataka, financial information is submitted in an electronic form to the AG (A&E) for incorporation in their systems. Treasury generates compiled and classified monthly accounts, which are sent to the AG along with the vouchers; therefore there is no need for keying-in data in the AG office. Tamil Nadu and Andhra Pradesh also render compiled accounts to their respective AG offices.

DDO with AG (A&E): DDO's submit their monthly accounts to their COs, who consolidate the accounts. The Accounts compiled by AG (A&E) are reconciled with the information with the COs on a monthly basis. Though the system of monthly reconciliation is strictly not followed, these are completed before the accounts are finalised. In HP, no reconciliations are pending as of March 2007. In fact, there is no backlog of reconciliations in the last three years. There are 412 COs in the State. As of November 2007, 102 (25%) COs had reconciled their expenditure up to September 2007, 305 (74%) up to August 2007 and the remaining 5 (1%) had reconciled their expenditure up to March 2007. In case of the works departments, following the LoC system, each DDO compiles monthly accounts and submits it to the AG (A&E) directly and follows it up with monthly reconciliation.

DDO with Treasury: As per the financial rules, the DDO should carry out a monthly reconciliation with the Treasury. For instance, in case of the works departments, following the LoC system, the schedule of monthly settlement with Treasuries is prepared in form PWA-51, and submitted to the AG (A&E) along with the monthly compiled accounts. During the field visits it was observed that the monthly reconciliation was being done regularly.

Treasury with the Banks: Each Treasury sends bank-wise transaction details in the form of Verified Data Monthly Statement (VDMS) to AG (A&E). All the banks with which the GoHP is dealing also send details of monthly transaction Treasury-wise to RBI through their Head office. RBI in turn sends bank-wise Treasury details to the office of AG (A&E) every month. This data is reconciled and a monthly report is sent to RBI, Banks, Secretary Finance and the Director Treasury for further action on their part. The reconciliation is normally done within four weeks of the closure of the previous month. Adjustment entries received by the Treasury Office/Banks are passed subsequently. The un-reconciled difference in the closing cash balance according to the GoHP's books and that intimated by RBI as of September 2007 is Rs. 46.67 Lacs and pertains to the period prior to 1992-93.

Suspense Accounts are not a final head of account but are meant to accommodate certain interim transactions for which further payment or adjustment of value is necessary before the transaction could be considered complete and accounted for. Accordingly, transactions under this head if not adjusted are carried forward from year to year. The Suspense head has the following sub-divisions: (i) Stock (ii) Miscellaneous Works Advances (iii) Workshop Suspense (iv) Material Purchase Settlement Account. Details of Suspense Account are given in the Appropriation Accounts of GoHP under each grant, where applicable. This head is operated by five departments namely Irrigation & Public Health, Public Works, Roads, Water Supply & Sanitation and Tribal. A summary of the Suspense Account components, compiled from the Appropriation Account, is tabulated hereunder.

Summary of Suspense Accounts in HP				
				(Rs. in Million)
Suspense Head	**Opening 1/4/2005**	**Debits 2005/06**	**Credits 2005/06**	**Closing 31/03/2006**
Stock	54.6	2122.9	2305.1	(127.6)
Stock Manufacture	676.2	524.0	564.3	635.9
Misc. PW Advances	3201.8	2396.1	2055.8	3542.1
Workshop Suspense	(15.5)	1.1	2.4	(16.8)
Total	**3917.1**	**5044.1**	**4927.6**	**4033.6**

Source: Appropriation Account 2005/06

Details of Suspense Account are not compiled departmentally and the Appropriation Account is the only source that provides head-wise, grant-wise consolidated information. However, the Appropriation Account does not provide year-wise break-up and such information is not available. No concrete steps have been taken to resolve, reconcile and liquidate the old outstanding balances.

Besides these, there are other suspense accounts under the Major Head 8658, which are also meant to accommodate certain interim transactions. Scrutiny of these revealed substantial un-reconciled balances under the head "Cash Settlement Suspense Account". All transactions relating to supplies made/services rendered by a PWD/IPH division to another are booked under the above head. These transactions are required to be settled by the responding divisions within ten days of the receipt of account from the originating division, so that at the close of the year, there is no balance left unadjusted under the head. It was, however, observed that a balance of Rs. 62.8 mn was outstanding as of March 2006 and during that year only Rs. 4.8 mn was adjusted. Though this account has not been in operation since the last three years, no concrete steps have been taken to resolve and reconcile the outstanding balances.

The financial rules along with the notifications issued from time to time lay down the procedure for monitoring of advances given to employees along with the subsidiary records to be maintained. The monitoring of advances is the responsibility of the sanctioning officer and is generally settled within the prescribed time. There is no audit observation of CAG to suggest otherwise.

Brief Explanation	**Score (M2)**
(i) Bank reconciliation between Treasury and the Banks takes place monthly at aggregate and detailed levels, usually within four weeks of end of period.	A
(ii) Reconciliation and clearance of suspense accounts does not take place annually either at the departmental level or at a consolidated level. Reconciliation of advances is generally being done.	D
Overall Rating	C+

PI-23. Availability of information on resources received by service delivery units

Dimensions to be assessed: (i) Collection and processing of information to demonstrate the resources that were actually received (in cash and kind) by the most common front-line service delivery units (focus on primary schools and primary health clinics) in relation to the overall resources made available to the sector(s), irrespective of which level of government is responsible for the operation and funding of those units.

Front-line delivery units in case of health come under Department of Health and Family Welfare and in education, under the Department of Elementary Education and the Department of Higher Education.

Consequent to approval of the annual budget by the Legislature prior to the commencement of the year, a budget release activity by FD to the respective line departments has to take place before the funds can be utilized. These departments operate through the Treasuries and funds are available with the DDO as soon as they are allocated. These units do not have separate bank accounts and no physical transfer of the funds takes place.

Health sector

In the health sector, the Block Medical Officers (BMO) under the Chief Medical Officers (CMOs) are the DDOs of the primary service delivery units of their respective block, comprising of six to eight Primary Health Clinics. The budget is released by the FD to the Directorate of Health, which is further distributed to the CMOs in April, with instructions that the funds should be utilized on a quarterly basis in the ratio of 20:25:30:25. In similar manner, the CMO distributes the budget to the BMOs. Copies of the allocation are sent to the concerned Treasury/Sub Treasury and the Directorate of Health.

Material for primary health services are procured by the Director Health Services after obtaining indents from the CMOs. A committee under the Chairmanship of the Director, Health Services, assesses the indents raised by the CMOs to ensure that the stock position was gauged while preparing the indents. The Directorate monitors the material purchased by each institution through this procedure of checks, though the tracking process is manual.

Financial Reporting in the case of the Department of Health is by way of Monthly Expenditure Statements. All DDOs submit their statements to the CMO's office where these are consolidated. Based on this report, consolidation of the entire Department of Health is carried out. Based on these reports, the Assistant Controller (F&A) of the department reconciles the expenditure with the Treasury as well as the AG on a monthly basis. No difference between the above is reported. The accounting system maintained by the AG (A&E) is also capable of capturing actual expenditures up to the DDO level.

Education sector

In the Department of Higher Education, the headmasters of schools are the DDOs. In case of the Department of Elementary Education, the Block Elementary Education Officers are the DDOs that look after eight to ten schools.

After the budgets are allotted to these departments, funds are further allocated to the DDOs directly by the head office in the month of April/May. The allocation letters are copied to the concerned Treasury/Sub Treasury. The main expenditure of the department is on Salaries and Material and Supplies. Most of the budget for Material and Supplies is retained at the head office and is utilized for making payments for the purchase of text books for free distribution to students. The bills for these purchases are first verified by the district offices and then submitted to the head office for payment. There is a complaint monitoring and regular inspection mechanism to verify whether the books have reached the students for whom they were intended.

In both these departments, there is a formal reporting arrangement for feedback on financial resources utilized at the primary service delivery units. However, no tracking surveys have been conducted by the GoHP to collect such data.

Brief Explanation	Score (M1)
(i) Routine data collection or accounting systems provide reliable information on all types of resources received in cash and in kind by both primary schools and primary health clinics across the country. The information is compiled into reports at least annually.	A
Overall Rating	A

PI 24. Quality and timeliness of in-year budget reports.

Dimensions to be assessed: (i) Scope of reports in terms of coverage and compatibility with budget estimates (ii) Timeliness of the issue of reports (iii) Quality of information.

Every department is expected to maintain a register in the prescribed format for recording expenditure at the spending unit level. A copy of this is required to be sent to the CO every month. A monthly abstract is also prepared for all spending units and submitted to the CO. The abstract allows for comparison between budget and actuals. Reviews in the departments indicate that the above system is being followed. These reports are consolidated to prepare a departmental report for monitoring purposes. At the department level, a consolidated report is prepared every quarter and submitted to the Planning Department for monitoring purposes. The report records budget head-wise budget vs. actual expenditure, which allows direct comparison with the original Budget. The Planning Department consolidates the reports received from the line departments every quarter. The expenditure is recorded and reported at the time of expenditure. No recording and reporting is done at the time of commitment.

The review of the in-year budget reports is done by the concerned Administrative Secretary/Director on a monthly basis. In the Planning Department, the Plan Implementation Division undertakes quarterly reviews. Several committees have been formed for monitoring in-year Budget Reports at the State and at the district level. However, this process is limited to Plan expenditure. The extent of reporting and monitoring of Non Plan expenditure is significantly less detailed.

AG (A&E) maintains and compiles the accounts of the State as an independent office under the jurisdiction of the CAG and provides expenditure data to FD in the form of Monthly Accounts. The monthly accounts are sent by the 25th of the following month. The monthly accounts have major head-wise budget vs. actual expenditure, but do not provide department-wise details for administrative levels i.e. DDO-wise data is not provided. It therefore does not facilitate in-year budgetary corrections, though warning slips/letters are issued by the "Appropriation Section" in the AG (A&E) office to FD and to the respective COs.

Generally, the departments submit their quarterly consolidated plan reports to the Planning department within 8 to 12 weeks from the end of the previous quarter. For example, the departmental reports for the 4th quarter of the FY 2006/07 were received by the Planning department from 15 departments after the 1st week of June 2007.

The quality of these reports generated from the line departments is reasonable. Based on this monthly report, the CO at the head office of the departments reconciles the expenditure with the Treasury as well as the AG. The reconciliation process is reasonable and is done on monthly/quarterly[16] basis. No major reconciliation difference has been reported.

Brief Explanation	**Score (M1)**
(i) Classification of data allows direct comparison with the original budget. Information includes all items of the budget estimates but the expenditure is captured only at the payment stage and not at the commitment stage.	C
(ii) Quarterly reports are prepared but often issued with more than eight weeks delay.	D
(iii) There are no material concerns regarding data accuracy.	A
Overall Rating	**D+**

PI-25. Quality and timeliness of annual financial statements

Dimensions to be assessed: (i) Completeness of the financial statements (ii) Timeliness of submission of the financial statements (iii) Accounting standards used

AG (A&E) prepares the accounts for the State. Annual Accounts of GoHP are prepared on a regular and timely basis and provide considerable information. The structure and framework of year-end financial statements is common across India and is determined by Article 151 of the Indian Constitution. These statements basically consist of two major documents, the

[16] Refer PI 22

Finance Accounts and the Appropriation Accounts; the accounts are certified by the CAG for their correctness.

The framework for Accounting in GoHP is divided into the following three parts:

> *Part I - Consolidated Fund:* Most of the transactions of the State flow through the Consolidated Fund. These include tax and non-tax receipts, capital receipts and proceeds from loans raised by the State Government on the receipt side. On the expenditure side these include revenue expenditure, expenditure on creation of assets and repayment of loans;
>
> *Part II – Contingency Fund:* This fund is established to meet transactions of an unforeseen or urgent nature; and
>
> *Part III - Public Account:* This includes transactions relating to deposits, advances, remittances and suspense. The Public Account also holds the cash reserves of the State Government.

Finance Accounts present the accounts of receipts and outgoings of the Consolidated Fund for the year, under revenue and capital heads as worked out from the balances recorded in the accounts. Corresponding figures for previous years are given. Major variations compared to the previous year are explained, but the explanations are generally brief without always going into the details. The Finance Accounts provide information in form of 19 Statements and various appendices. A few important ones are Capital Outlay, State's Debt Position, Loans and Advances, Guarantees given by the State Government, Cash Balances, Capital Expenditures, Commitments for Incomplete Capital Works, etc. The formats are fairly consistent from year-to-year; in certain cases 'balances till date' are also provided.

Appropriation Accounts provide the comparison of the charged/voted grants with actual expenditure. These analyse each individual grant, minor head-wise, providing details of grants under the revenue and capital head with actual expenditure. The reasons for variations between the budget grant and actuals are provided. The comments also consider the status of supplementary grants. "Accounts at a Glance" are prepared for better understanding of the user.

Since a cash basis of accounting is followed, the financial statements do not present any information on revenue due but not collected, payables and outstanding commitments. In case of Centrally Sponsored Schemes (CSS) only the State's share is reflected in the Financial Statements, since GoI usually directly transfers funds to the implementing entities for these programs. The investments in HP in Public Sector Enterprises (PSEs) are disclosed at face value; the fact that the accumulated losses in the PSEs are greater than the investments is not disclosed.

The statements are submitted for external audit within six months of the year-end. Normally, the financial statements are certified within six months of the year-end, but they are not made available to the public till these are placed on the floor of the house. The following table gives the dates when the financial statements were signed by the CAG and placed before the floor of the house[17] -

Financial Statements for the FY	Dates when signed by CAG of India	Dates when they were placed on the floor of the house
2005-06	29th Sept-06	29th Dec -06
2004-05	19th Sept-05	29th Dec-05

The CAG is responsible for the accounting and auditing function in the States and is responsible for establishment of standards and rules for accounting. However, these rules are not in compliance with international public sector accounting standards for cash-based financial reporting. Further, the accounting policies followed in preparation of the Financial Statements are not disclosed in these financial statements. In 2002, the CAG took the initiative to establish a Government Accounting Standards Advisory Board (GASAB), which has so far issued seven Exposure Drafts.

Brief Explanation	Score (M1)
(i) A consolidated Government statement is prepared annually. They include full information on revenue, expenditure and significant disclosure of information related to financial assets/liabilities.	A
(ii) The statement is submitted for external audit within six months of the end of the fiscal year.	A
(iii) Statements are presented in a consistent format over time but the accounting standards are not disclosed.	D
Overall Rating	**D+**

External Scrutiny and Audit

PI-26. Scope, nature and follow up of external audit

Dimensions to be assessed: (i) Scope/nature of audit performed (incl. adherence to auditing standards) (ii) Timeliness of submission of audit reports to the Legislature (iii) Evidence of follow up on audit recommendations.

The institution of CAG, established under the Indian Constitution, is the Supreme Audit Institution in the country as well as in HP. The President appoints the CAG for a fixed non-renewable term of six years. The CAG submits the reports to the Governor of the State for laying in the Legislature. The powers, roles and responsibilities of the CAG flow from articles 148 to 151 of the Constitution of India and as provided for in a central legislation i. e. Comptroller and Auditor General (Duties, Powers and Conditions of Service) Act, 1971.

[17] Finance and Appropriation Accounts for 2006/07 have been signed by the CAG in September 2007, but not placed before the Legislature till date due to elections. They are expected to be placed during April 2008.

The CAG has wide ranging mandate to audit Government departments, Government companies, statutory corporations, autonomous/local bodies and any entity that is substantially funded by the State Government including externally aided projects and extra-budgetary funds. Recently, it has commenced sample audit of the urban and rural local bodies. The CAG conducts the audit in HP through the office of the Accountant General-Audit (AG-Audit) based at Shimla.

The CAG has promulgated Auditing Standards (General, Field and Reporting Standards) in line with International Organization of the Supreme Audit Institutions (INTOSAI) standards. A Manual of Standing Orders provides guidelines in conducting the various types of government audit. The CAG has its own institutional structure including staffing that undergo continuous capacity building for skills upgrading. A system of internal audit and inspection (including Peer Review) exists in the CAG's organization that reviews the audit office's performance and its adherence to auditing standards.

Performance Ranking of AG Audit Office

A system of performance ranking (with around ten parameters on a scale of 100) to improve the functioning has been developed by the CAG.

For 2006/07, AG-Audit Shimla scored 63.5 on seven parameters. Timely issue of inspection reports, effectiveness of audit committee meetings and efforts in vetting of Action Taken Notes scored full marks. Quality of inspection reports and training of personnel scored less.

Source: Administrative Report AG HP

The CAG certifies and issues a report on the annual financial statements of the State. Additionally, two Audit Reports are issued – one, covering the Government departments, Government companies and statutory corporations (the Civil and Commercial Reports), and the other on the Revenue receipts (Revenue Report). Detailed audit covers the State's finances, Allocative Priority/Budgetary Allocations, Transaction Audit, Regulatory Audit, Propriety Audit, Review of Internal Controls, Performance Reviews and System Audit. Performance and Internal Control reviews are conducted in selected departments every year. Recently greater emphasis is being placed on them. Audit reports issued by the CAG dwell on significant and systemic issues, determined on pre-defined criteria.

Departments recently covered under CAG's Performance and Internal Control Reviews

Year	Departments covered under Performance Reviews	Departments covered under Internal Control Reviews
2005/06	▪ Education ▪ Irrigation & Public Health ▪ Food, Civil Supplies & Consumer Affairs ▪ Forest ▪ Rural Development ▪ Social Justice & Empowerment	▪ Horticulture

2004/05	▪ Planning ▪ Irrigation & Public Health ▪ Revenue ▪ Food, Civil Supplies & Consumer Affairs ▪ Animal Husbandry	▪ Food, Civil Supplies & Consumer Affairs ▪ Education ▪ Panchayati Raj

As actual audit spans all HP departments, all Government entities are covered under audit annually, including revenue, expenditure, assets and liabilities. The auditable units to be covered are determined on the basis of an Annual Audit Plan categorizing the units under annual, bi-annual and tri-annual periodicities on a risk-based approach. Also, audit of local bodies has received increased attention after 73rd and 74th Amendments to the Constitution and the Report of the Eleventh Finance Commission.

There exists a robust constitutional and independent public audit function that provides a range of financial and performance audits according to a set of INTOSAI-based Auditing Standards. The audit reports focus on significant and systemic issues.

The CAG submits the reports to the Governor who causes them to be placed before the Legislature after which the documents become public.

Presentation of Audit Reports before HP State Legislature		
Year	**Presentation of Certified Financial Statements**	**Presentation of Civil & Commercial and Revenue Audit Reports**
2005/06	29th December 2006	3rd April 2007
2004/05	29th December 2005	7th April 2006

Audit reports are placed in (approximately) 12 months after the close of the FY they covered.

During the course of the audit, the auditee-units are provided draft audit observations for on the spot compliance or explanations (called Half Paras). Those observations that are not satisfactorily disposed off are included in the Inspection Report copied to the auditee-unit and the next higher authority. Serious audit observations are conveyed to the Departmental Secretary and HoD. A six-week time frame is provided to submit replies. FD is apprised of the status of pending reports through a half yearly report. Audit observations containing significant and systemic issues proposed for inclusion in the CAG report are forwarded to the departmental Secretaries for reply within eight weeks.

The system thus ensures that reports are finalized through a consultative process. The auditees get an opportunity at every level to respond to audit findings. Nevertheless, replies to the draft audit findings are usually not submitted either by the auditee-unit or at the Secretary level. Hence, serious irregularities are included in the CAG report often without management response. Lack of sufficient response to the audit findings from the Executive, evidenced by the quantum of pending reports/audit paras, is an area of concern. Even initial replies are not submitted or are inordinately delayed and the quality of the replies is also not adequate *(CAG Audit Report Civil 2006)*. As of December 2007, a total of 6216 Inspection

Reports and 16521 audit paras were pending settlement (*AG Audit HP*). Unsettled audit findings include those pertaining to periods ranging from 5 years to 20 years.

Extent of Outstanding Inspection Reports/Audit Paras in sample HP Departments

Department	Number of Inspection Reports pending	Number of outstanding Audit Paras
1. Animal Husbandry	28	68
2. Rural Development	396	993
3. Tourism	19	69
4. Food, Civil Supplies	39	73
5. Sainik Welfare	20	49
6. Health & Family Welfare	287	817
7. Secondary Education	1564	2174
8. Irrigation & Public Health	393	1295
9. Revenue Receipts	3052	7135
10. Horticulture	113	270

Note: All figures as of June 2007 except at sl. 6, 7 and 9 that are as of June 2006 and sl. 10 is as of March 2006

Outstanding in case of Horticulture Department (sl. 10) pertains to 1973/74 to 2005/06 with a financial implication of Rs. 575.7 mn; the corresponding figures as of March 2005 were 131 and 384. Outstanding in case of Food & Civil Supplies (sl. no, 4); increased from 29 and 55 as of March 2005.

In case of the paras in CAG Audit Reports, action taken explanatory notes detailing the corrective measures taken by the Departments are required to be submitted to the Public Accounts Committee (an oversight body of the State Legislature) within three months of tabling the reports in the State Legislature. As of March 2007, Action Taken Reports pertaining to Audit Reports Civil and Revenue were pending in respect of 47 and 32 paras, respectively (*Administrative Report 2006/07, AG HP*).

To expedite the clearance/settlement of outstanding audit paras, GoHP has recently constituted Ad Hoc Committees in each department comprising of the Departmental Secretary, HoD/representative from the auditee-department and representatives from FD and the AG office. A schedule of meetings of the committees is circularized in advance and the matter is followed up at the highest levels of the Government. There is evidence of follow up, but the formal response is delayed and not very thorough. Efforts are on to provide evidence of systematic follow up.

The Government of Karnataka has designated the office of the Controller (Accounts Management) as an ex-officio Secretary to the Government for monitoring responses of departments on inspection reports, draft paras, audit observations, PAC/COPU reviews etc. This is monitored through a web-based system (www.ams.kar.nic.in) and part of the status is available to the public as well. The system has ensured timely attention of departments on audit issues and improved responsiveness. Government of Rajasthan has also taken steps to implement a system on similar lines.

Brief Explanation		Score (M1)
(i)	All Government entities are audited annually covering revenue, expenditure, assets and liabilities. A full range of financial audits and some performance audits are performed; audit reports focus on significant and systemic issues and auditing standards are generally adhered to.	A
(ii)	Audit reports are submitted to the Legislature (almost) within 12 months of the end of the period covered.	C
(iii)	A formal response to audit findings is made, though delayed or not very thorough, but there is some evidence of systematic follow up.	C
Overall Rating		**C +**

PI-27. Legislative scrutiny of the annual budget law

Dimensions to be assessed: (i) Scope of the Legislature's scrutiny (ii) Extent to which the Legislature's procedures are well established and respected (iii) Adequacy of time for the Legislature to provide a response to budget proposals, both the detailed estimates and, where applicable, for proposals on macro-fiscal aggregates earlier in the budget preparation cycle (time allowed in practice for all stages combined) (iv) Rules for in-year amendments to the budget without ex-ante approval by the Legislature.

The Constitution of India provides that in respect of every financial year a budget (the estimated receipts and expenditure statement or the annual financial statements) is to be laid before the State Legislature and, after the grants have been made, the Legislature will pass the Appropriation out of the Consolidated Fund of the State. The amount of expenditure that can be incurred is, thus, strictly controlled by the Legislature (*HP Budget Manual)*. The Legislature has the power to assent or refuse to assent or to reduce any demand for grant. Legislative scrutiny covers fiscal policies, revised estimates for the current year, detailed estimates of revenue and expenditure for the next year, the schedules of new expenditure (new and on going schemes), medium term fiscal plan statement (under Fiscal Responsibility and Budget Management Rules) and status and performance of public sector enterprises. These are supplemented by an Economic Survey for the current year and an Annual Plan for the next year. Supplementary, additional or excess grants, vote-on-account and exceptional grants also require Legislative approval; and hence are within the scope of Legislative scrutiny.

Plan outlays decided between GoHP and the Planning Commission of India or the State Annual Plans are not subjected to Legislative Scrutiny prior to their finalization. Charged expenditure can only be discussed in the House, but cannot be voted upon.

Legislative procedures for consideration and passing of the Budget, including timelines, are enshrined in the "Rules of Procedure and Conduct of the Business of the Legislative

Assembly" and in the Budget Manual. The Finance Minister presents the budget before the Legislature and explains its salient features. This is followed by general discussions on the budget and voting on the demands for grants. The Legislative function of scrutiny of the demand for grants can be delegated to Departmental Standing Committees (presently five) whose functions and business procedures have also been established. The above-mentioned rules stipulate that the reports of the Standing Committees have "persuasive value", shall be treated as considered advice given by them and the demand for grants shall be considered by the Legislature in the light of the reports of these Committees.

Legislative procedure for scrutiny and approval of annual Budget

- Presentation of the budget before the Legislature by the Finance Minister;
- Finance Minister explains the salient features of the budget and government policies;
- General discussions on the budget or on any question of principle or policy;
- Submission of reports by the Departmental Standing Committees; and
- Voting on demands for grants.

The budget proposals are presented to the Legislature in early March and the budget is passed by end March, allowing less than one month for the Legislature to scrutinize and debate on the proposals. The Budget Manual itself provides presentation of the budget in the 2^{nd} half of February or early March. For the 2007/08 budget cycle, the proposals were submitted on 5^{th} March 2007, general discussions were held during 9^{th} to 17^{th} March 2007 (9 days), the Standing Committees submitted their reports on 29^{th} March 2007 (12 days from close of discussions) and voting was concluded on 30^{th} March 2007. In case of any revisions suggested by the Legislature, the Executive may not be able to meaningfully revise the proposals and re-submit the revised budget proposals so that the budget is passed within 31^{st} March.

In HP, the departments seek additional appropriations (where expenditure exceeds the available provision) during the year and the Government presents a Supplementary Demand for Grants for obtaining approval of the Legislature. While there may be several additionalities during the year, only one Supplementary Budget is presented. The Budget Manual provides that all proposals for supplementary appropriations should be submitted to FD by 10^{th} February. Supplementary budget for FY 2006/07 was presented before the Legislature on 23^{rd} February 2007 that was passed on 5^{th} March 2007 i. e. within 12 days.

In-year budget amendments can take the form of additional appropriation[18] or re-appropriation[19]. Rules for authorization of in-year budget adjustments by the Executive and presentation of the amendments for ex-ante approval by the Legislature are detailed in the HP Budget Manual. The Manual articulates (a) the principles including the circumstances and limits for additional appropriations or re-appropriations; (b) the procedures for the preparation and submission of application/proposals; and (c) the sanctioning authorities. The rules allow for the budget to be expanded (through additionalities) or re-allocated (through re-appropriations). The total supplementary appropriations are collated by FD, considered

18 Additional Appropriation can be sought if the expenditure has exceeded or is likely to exceed the available provision or a new scheme or activity is to be taken up.

19 Re-appropriation is transfer of funds from one unit to another but within the same demand for grant

by the State Cabinet and presented before the Legislature for approval. The Finance Minister presents the budget, briefly explaining the demands made. Before the year-end, the departments submit the details of excess and surrenders.

In-year budget amendments as a percentage of original estimates have shown an increase in recent years – 11%, 18% and 12% during the three years ended 2006/07 as compared to 3-7% prior to that. Budget marksmanship vis-à-vis estimation of supplementary appropriations is off the mark as there are instances where -

- **Supplementary demands were obtained significantly higher than requirements.** For example, in 2005/06 against additional requirement of Rs. 1331.9 mn, supplementary grants were obtained for Rs. 4628.5 mn, resulting in a savings of Rs. 3296.6 mn.

- **Supplementary provision proved inadequate to cover the expenditure incurred.** For example, in 2005/06 Supplementary provision obtained for Rs 2067.3 mn proved inadequate, leaving an aggregate uncovered excess expenditure of Rs 5555.8 mn

- Excess expenditures[20] amounting to Rs 147181.9 mn for the years 2001/02 to 2005/06 are yet to be regularized by the State Legislature as required by Article 205 of the Constitution *(CAG Audit Report 2005/06).*

This indicates that estimation of supplementary demand does not strictly follow the principle enunciated in the Budget Manual, which states that, *"Proposals for supplementary appropriations are objectionable in principle and free resort to them indicates on the one hand, bad estimating or imprudent administration and on the other hand impairs the proper management of the State finances... ... The justifications for presentation of supplementary appropriations can accordingly only rest upon circumstances which are exceptional".*

Brief Explanation	**Score (M1)**
(i) The Legislative scrutiny covers fiscal policies, medium term fiscal framework and priorities and details of revenue and expenditure.	A
(ii) The Legislature's procedures for budget review are firmly established and respected. These include internal organizational arrangements such as Standing Committees.	A
(iii) The time allowed for the Legislature's review is significantly less than one month, which clearly is insufficient for a meaningful debate.	D
(iv) Clear rules for in-year budget amendments exist but they may not always be respected and the rules allow for extensive administrative reallocations and expansion of total expenditure.	C
Overall Rating	**D +**

[20] This is expenditure exceeding the provision (original and supplementary) made against it during the financial year

PI-28. Legislative scrutiny of external audit reports

Dimensions to be assessed: (i) Timeliness of examination of audit reports by the Legislature (for reports received within the last three years) (ii) Extent of hearings on key findings undertaken by the Legislature (iii) Issuance of recommended actions by the Legislature and implementation by the Executive.

Legislative scrutiny of external audit reports, including the Appropriation Accounts, is done through a committee of the Vidhan Sabha, the Public Accounts Committee (PAC), comprising of 11 members of the Legislature and headed by a member of the opposition party. The PAC examines and investigates "the extent to which the wishes of the Legislature, as expressed by the demands voted by the Legislative Assembly, are not actually compiled with" (HP Budget Manual). The Assembly can regularize excess expenditure incurred by the Executive only on receiving the recommendations of the PAC. The "Rules of Procedure and Conduct of the Business of the Legislative Assembly" govern the constitution and working of the PAC. The AG-Audit assists the PAC *inter alia* in framing the questionnaire for oral examination, briefing the PAC on the audit findings for which evidence is to be taken and clarifies/elucidates the evidence brought before the PAC.

The reports are discussed on a first-in-first-out basis. Therefore, the latest reports of the CAG are dealt with after a prolonged period from when they are placed before the Legislature. At present, the PAC is examining the audit reports for FY 2004/05.

During 2006/07, CAG reports for FY 2004/05 were tabled in the Legislature and referred to the PAC. Out of 19 and 29 paras/reviews respectively in the Civil and Revenue reports, the PAC selected only 19 (of Civil Report) for discussions during the year, but actually discussed only 17 (including previous years). Cumulatively as of March 2007, 82 audit paras/reviews of Civil Report and 121 of Revenue Report were pending discussions (*AG Audit HP Administrative Report 2006/07).* This shows that examination of audit reports by the Legislature usually takes more than 12 months to complete.

The PAC held six hearings during 2006 and four during 2007. The number of meetings held is not proportional to the number of audit paras pending discussion. Moreover, only a few selected audited departments were covered. During 2006, only six departments were called for hearings (oral examination) while during 2007 only four departments were so summoned. A representative of FD also attends the meetings of the PAC.

The PAC reviews the audit reports through oral examination of departmental officials and/or written submissions and recommends corrective actions. This is followed by issue of Action Taken Note by the Departments that are vetted by the AG. The process may be repeated if the PAC is not satisfied with the action taken. During 2005/06 and 2006/07, respectively 56 and 30 Action Taken Notes were issued for Civil Audit Report and 69 and 35 Action Taken Notes issued for Revenue Audit Reports. Implementation of actions recommended by the Executive is not effective, as is evident from the following data.

- Suo Moto replies not submitted by 20 departments to CAG reports for 2001/02 to 2004/05.
- 16 departments have not submitted responses to 50 Action Taken Reports issued by the PAC including reports laid before the Legislature since 1997.
- 25 departments have not submitted responses to 98 Further Action Taken Reports issued by the PAC including reports laid before the Legislature since 1997.

In the above cases, the PAC has sent final reminders during 2006/07.

PAC Examination in Irrigation and Public Health Department
• Replies submitted by the Department for CAG reports up to FY 2004/05 • Reply pending for CAG report of FY 2005/06 • Oral examination of CAG Audit Reports completed up to FY 2003/04 on 22nd August 2007 • Total Number of Action Taken Notes required is 23 • Number of Action Taken Notes submitted to PAC is 12 • Pending Action Taken Notes is 11 for periods between 1974/75 to 1999/2000

Brief Explanation	**Score (M1)**
(i) Examination of audit reports by the Legislature through the Public Accounts Committee usually takes more than 12 months to complete.	D
(ii) In depth hearings on key findings take place with responsible officers from the audited entities, but may cover only some of the entities.	B
(iii) Actions are recommended to the Executive, some of which are implemented according to available evidence.	B
Overall Rating	**D +**

Donor Practices

D-1. Predictability of direct budget support

Dimensions to be assessed: (i) Annual deviation of actual budget support from the forecast provided by the donor agencies at least six weeks prior to the Government submitting its budget proposals to the Legislature (or equivalent approving body) (ii) In-year timeliness of donor disbursements (compliance with aggregate quarterly estimates)

Till 2007, HP had not received any direct budget support from donor agencies. Recently, the World Bank has sanctioned direct budget support for US $ 200 mn under the HP Development Policy Loan for release in two tranches subject to achievement of prior actions. The first tranche of the support has been released in January 2008. The second tranche is expected to be released in FY 2008/09.

Brief Explanation	Score (M1)
HP has not received any direct budget support in the last completed year and two preceding years.	Not scored

D-2. Financial information provided by donors for budgeting and reporting on project and program aid

Dimensions to be assessed: (i) Completeness and timeliness of budget estimates by donors for project support (ii) Frequency and coverage of reporting by donors on actual donor flows for project support.

Each project is budgeted under a specific line item in GoHP's budget. Since all donor-funded projects in HP are mainstreamed with the State's budget, they follow the budget calendar. Donors undertake periodic supervision missions, implementation support missions and mid-term reviews. Besides, within the overall life-cycle budget estimates, donors agree on annual procurement plans and annual plans, which form the basis for estimating the budgetary provisions required. Outlays are decided with the State Planning Department and provisions made in the State's budget.

Periodic (monthly/quarterly) reimbursement claims are filed for the projects with the CAAA. Once the claims are passed, the GoI's Department of Expenditure, Ministry of Finance informs GoHP on actual donor flows. Also, donors such as the World Bank allow access to disbursement data on their website.

Brief Explanation	Score (M1)
(i) All donors agree on budget estimates for disbursement of project aid at stages consistent with the Government's budget calendar, and breakdown consistent with the Government's budget classification is also available.	A
(ii) Quarterly reports on all donor disbursements are available within one month of end-of-quarter with break-down consistent with the Government budget classification.	A
Overall Rating	**A**

D-3. Proportion of aid that is managed by use of national procedures

Dimensions to be assessed: (i) Overall proportion of aid funds to the Central Government that are managed through national procedures.

Requirement of project funds are budgeted in the State's annual budget under the respective line department's demand. Projects specific to HP also use existing mechanisms i. e. audit being conducted by the CAG and the State mainstream accounting and reporting systems.

However, projects implemented across several states (such as Technical Education Quality Improvement Program or TEQIP) use mechanisms specifically developed for the project. The commonality among the various projects is use of procurement procedures according to the donor guidelines and not through State procurement procedures.

Overall, 73% of aid funds to HP are managed through State procedures (see working sheet below).

Brief Explanation	Score (M1)
(i) 50% or more (but less than 75%) of aid funds to the State Government are managed through State procedures.	C
Overall Rating	C

D-3 Proportion of aid that is managed by use of national procedures
Working Sheet

Name of Project	Total Project expenditure[21] 2005/06 (Rs. in mn)	Whether State procedures used for project management			
		Procurement	**Payment/ Accounting**	**Audit**	**Reporting**
1. Forest Sector Reforms (Forest Dept)	138.9	No	Yes	Yes	Yes
2. IWDP (Hills) II (Forest Dept)	70.2	No	Yes.	Yes	Yes
3. IWDP Mid Himalayan Watershed Dev. (Forest Dept)	69.7	No	Yes	Yes	Yes
4. TEQIP (Education Dept)	24.9	No	Yes	No	Yes
5. Irrigation WASH (IPH Dept)	0.5	No	Yes	Yes	Yes
Percentage following State procedures	304.2	0%	100%	92%	100%
Overall Proportion	73%				

[21] The externally aided projects have an element of contribution from the State Government. Program expenditure, therefore, includes amount financed out of the State's own resources.

4. Government Reform Process

Himachal Pradesh's Reform Program

Sustaining success through important transitions. HP realizes that, to a great extent, the State may be reaching the limits of its traditional model of growth and social development: one that is heavily dependent on public spending financed by borrowing and central assistance. The sustainability of HP's success for the future will depend on addressing three major transitions that the State faces: (i) the *growth strategy* in HP must evolve from one that is still far too heavily dependent on public expenditures and debt – to an increasing focus on growth led by the private sector; (ii) *productive employment opportunities* must be created for HP's young and increasingly educated labor force, so that reliance on the public sector for employment opportunities goes down; and (iii) the State's *environment and natural resources* must be managed well to contribute to effective development in a sustainable manner. Underlying these transitions is the upfront need to sustain recent improvements in the State's macroeconomic performance.

Overall State vision and strategy. The State's overall strategy is articulated in its plan documents. The Approach Paper to HP's Eleventh Five Year Plan (2007-12) presents the overarching objectives of the State as faster and sustainable growth, and inclusive development. HP's articulated medium term development priorities recognize the State's unique challenges and opportunities. The government aims to achieve an annual growth rate of 8.5% during the Eleventh Plan. The State seeks to focus more on capitalizing on its comparative advantage, by increasing the productivity and economic value of its natural assets, and specializing in sectors where it can compete effectively in a globalized economy.

Priority areas in the GoHP program. The priority areas of reform and development for the Government are: (i) creating fiscal space to fund the State's development vision; (ii) exploiting the untapped potential in sub-sectors like hydropower and tourism in an environmentally and economically sustainable manner; and (iii) protecting the State's environmental wealth, and improving the overall institutional approach to environment management. These areas are supported by measures to improve governance and public administration, and to promote private sector development for faster growth and productive employment. For the relatively well developed social sectors, fiscal space will free up room for priority expenditures to promote inclusive development. The major constraint faced by the State is the creation of fiscal space to finance the State's development vision while moving towards a fiscally sustainable position. About 65% of GoHP's expenditure is committed to salaries, pensions, and interest payments, thus squeezing fiscal headroom for investment. GoHP also carries high debt stock of about 74% of GSDP, thereby straining its debt servicing ability. However, GoHP has recently begun to receive substantial non-tax revenue from hydropower royalty, implemented tax reforms (most notably VAT), and it has achieved expenditure compression putting the State on the road to achieving fiscal sustainability. GoHP would now like to consolidate these achievements to find resources to fund its development vision.

Public financial management reform in HP

Improving budget formulation and execution. GoHP's recent PFM reform strategy is directed towards enhancing accountability, improving budget management and control, increasing access to public information and computerization for efficiency in services. Consistent with its commitment to fiscal transparency and restoration of fiscal indicators to sustainable levels over the medium term is the FRBM Act, which has been enacted in 2006, with a view to institutionalize as well as cast a responsibility on the Government to ensure fiscal prudence and fiscal stability. By enacting the FRBM Act, the State gained access to the debt relief and restructuring scheme formulated by the 12th Finance Commission resulting *inter alia* in reduction of interest rate and expenditure. The FRBM Act requires GoHP to progressively reduce its outstanding guarantees on long term debt, until it can cap outstanding risk weighted guarantees at 80% of total revenue receipts in the preceding financial year. GoHP has initiated reforms in the systems and processes of budget formulation and execution. While the existing budget system is functional, reforms are required to achieve the development vision of the State and to adapt institutional arrangements to support the fiscal strategy.

The key challenge is to ensure that a comprehensive resource framework and a medium term perspective guide the three objectives of budget management: (i) aggregate fiscal discipline in line with the Medium Term Fiscal Plan; (ii) strategic policy decisions by GoHP within the constraints of the MTFP; and (iii) stimulating the efficient use of public funds. GoHP has proposed actions to address each of these areas. Beginning 2008/09, GoHP will present a Fiscal Policy Paper to the Council of Ministers to outline linkages between Government policies and outcomes to get broad agreement over budget contours, and to set department ceilings for expenditure in a multi-year framework. Along with the MTEFs being initiated in four key departments and inputs of the Expenditure Review Committee, line departments are expected to make strategic choices among different programs in an endeavor to advance the Government's development objectives. In subsequent years, GoHP intends to improve budget documentation to provide clearer links between policy priorities and goals, budget allocations and performance.

Further, a system of performance based budgeting was introduced in 2006/07 with some departments switching over to this regime. GoHP envisages "*measurable outputs and not expenditure incurred as the true touchstone of efficiency*" (Budget Speech 2007/08). Measures to strengthen internal and external oversight and procurement, as detailed below, will stimulate expenditure efficiency over time.

Value added tax. HP has transited to the Value Added Tax regime from April 2005 and has introduced reforms in other tax structures with greater emphasis on tax compliance and administration, resulting in higher revenues. Similar rationalization of non-tax revenues and user charges has also been planned and initiated.

Use of Information Technology. Computerization of various operations is underway covering VAT administration, Treasuries, departments and urban/rural local bodies. The On Line Treasury Information System and the Personnel Management Information System have been rolled out and these are expected to result in better management of the Treasuries and improve their operational efficiency and internal controls. The State has launched a State Wide Area Network.

Right to information. GoHP has implemented the Central legislation, the Right to Information Act, 2005 (RTI Act) in 2006, thus setting a practical regime of rights for citizens to secure access to information under the control of public authorities, in order to promote transparency and accountability in their working. "*We believe that this Right to Information shall fortify the democratic roots of our polity and help the government to check any form of corruption*" – Budget Speech 2007/08.

Most of GoHP's departments have appointed Information Officers and published the *suo moto* minimum information on their websites, though with varying degree of detailing and timeliness. The Himachal Pradesh State Information Commission has been constituted under the RTI Act, headed by a State Chief Information Commissioner, who exercises powers as prescribed in the RTI Act 2005 to receive and enquire into complaints, and guide public authorities about the implementation of the Act. Normally, a time period of 30 days is prescribed for providing information requested under the Act.

Assessment of public financial management. GoHP simultaneously seeks to modernize and strengthen public financial management and procurement systems to improve the efficiency of public spending. A Preliminary Assessment of the Public Financial Management and Procurement Systems in HP was undertaken by the World Bank as part of preparation of the HP Economic Report[22]. This assessment suggests that the framework for public financial accountability in HP is generally sound, although in need of modernization in several areas, which GoHP must address. Its current strengths include: (i) timely approval of budgets; (ii) exercise of transaction level controls over budgeted expenditures; (iii) regular and timely preparation and reconciliation of monthly and annual accounts; (iv) regular external audit, and timely availability of reports; and (v) legislative oversight over matters reported in audits through follow up by the Public Accounts Committee. GoHP has recently constituted Ad Hoc Audit Committees in each department comprising of the Departmental Secretary, HoD/representative from the auditee-department and representatives from FD and the AG office to expedite the clearance/settlement of outstanding audit paras of the CAG/AG. Also, some progress has been made to cover the backlog in audit of urban local bodies up to the financial year 2006/07.

Strengthening public procurement. Public procurement in HP is governed by Procedures & Rules for the Purchase of Stores, which is an appendix to the Himachal Pradesh Financial Rules. These are maintained by the Controller of Stores under the Industry Department, and relate to procurement of goods. While the Store Purchase Organization is the nodal agency for negotiation of rate contracts, there is an increasing effort to decentralize department-specific purchases to the respective departments. Procurement takes place amidst a large

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[22] Himachal Pradesh: Accelerating Development and Sustaining Success in a Hill State, 2007.

number of controllers and overseers. Improving oversight of procurement involves rationalizing control as well as increasing the ability of the Government and the private sector to monitor performance. The challenge in HP is to integrate procurement into a well-defined PFM system. GoHP proposes to follow such an approach that will focus on integrating procurement with planning, budgeting, accounting and auditing. The reform will work towards instituting a modern procurement law to guide procurement activities in Government and developing an e-procurement strategy implemented to improve procurement outcomes in the State. Procurement assessment of select entities will help identify areas of focus to improve overall procurement effectiveness. This will lead to improved procurement performance over the medium term.

The way forward for GoHP. Despite several achievements, some key areas require strengthening for the State's public financial management system to assist expenditure effectiveness, and support GoHP's medium term fiscal and governance program, as denoted by a preliminary assessment of Public Financial Management and Procurement. The need for reform is particularly evident in the area of budget execution procedures, including weaknesses in internal controls. It is necessary to complete the ongoing computerization of treasury systems, strengthen the internal audit system, and have more effective legislative oversight and timely follow up on audit observations. In response to the preliminary assessment, GoHP has outlined an agenda for further strengthening financial management and procurement and prioritized the following actions from the year 2007/08 onwards: (i) *modernize the Himachal Pradesh Financial Rules*, 1971, in line with the General Financial Rules (GFR), 2005, of GoI, to strengthen internal controls; (ii) reinforce the *responsibility and accountability of* HoDs to ensure more effective utilization of resources and strengthen internal controls; (iii) conduct a PFMA *Assessment* using the PEFA framework; (iv) complete *treasury computerization* and roll out coverage to the sub-district level; (v) constitute a working group to work out an *internal audit function* in terms of scope, coverage, and focus, with a view to moving towards a 'risk based' audit approach as opposed to a transactions based audit approach, and streamline the audit function in ULBs; (vi) *reduce backlog* of Utilization Certificates and audit of ULBs, and (vii) create a database of serious audit observations, to be monitored by a high level State Audit and Accounts committee. GoHP will have to carefully consider sequencing of the reforms, ensure communication of the perceived benefits to all the stakeholders to ensure their buy-in and create the enabling environment for their implementation.

Institutional factors supporting reform planning and implementation

Supportive Government policies, a transparent and accessible administration, a peaceful political environment, and central support have all contributed to the State's development. Classification of HP as a "special category" State has played an important role in the development process. The State has managed well in furthering development through World Bank assistance (First HP Development Policy Loan/Credit, The World Bank). The donor community has been pro-active in extending support to GoHP in its reform agenda. The World Bank has extended assistance to GoHP in the form of Development Policy Lending to support the medium term program of GoHP. The overarching objective of the lending is to support the implementation of critical structural, fiscal, and administrative reforms. The first tranche of the assistance has been released in January 2008.

A new government has taken charge in HP in January 2008 and will be articulating its reform agenda in the March 2008 budget session of the Legislature, which will set the pace for carrying the reforms further. For implementation and sustainability of the on-going and planned reforms, capacity building across all line departments has been initiated and this could be scaled up.

Annex 1: Summary and Explanation of Indicator Scores

Indicator	Rating	Brief Explanation and Cardinal Data used
A. PFM OUT-TURNS: Credibility of the Budget		
PI-1 Aggregate expenditure out-turn compared to original approved budget	C	Actual primary expenditure was about 19.8% below the budgeted expenditure in 2005/06 whereas during 2003/04 and 2004/05 expenditure was 5.0% and 4.3% above the budget. Thus, in only one out of the last three years did actual expenditure deviate from budgeted expenditure by more than 15% of the budgeted expenditure.
PI-2. Composition of expenditure out-turn compared to original approved budget	B	The variance in expenditure composition was 8.5%, 4.3% and 0.0% respectively during 2003/04, 2004/05 and 2005/06. Therefore, the variance in expenditure composition exceeded overall deviation in primary expenditure by more than 5% in one out of the last three years..
PI-3. Aggregate revenue out-turn compared to original approved budget	A	Aggregate revenue outturn was 98%, 113.9% and 118.3%, respectively during 2003/04, 2004/05 and 2005/06. Hence, actual domestic revenue collection exceeded 97% of budgeted domestic revenue estimates in all the last three years.
PI-4. Stock and monitoring of expenditure payment arrears	D+	The quantum of stock of arrears is not available. There is no reliable data on the stock from the last two years, as there is no system for recording and collating of payment arrears (though prescribed).

B. KEY CROSS-CUTTING ISSUES: Comprehensiveness and Transparency		
PI-5. Classification of the budget.	A	Budget classification is based on uniform countrywide system that is consistent with COGOG/GFS structure.
PI-6. Comprehensiveness of information included in budget documentation	A	Budget documentation for 2007/08 meets seven of the nine information benchmarks. It does not include anticipated composition of deficit financing, and budgetary impact of major policy changes is partially covered in the Budget Speech of the Finance Minister.
PI-7. Extent of unreported Government operations	B+	Reporting extra-budgetary expenditure is not comprehensive. Based on data specifically collected and compiled, these are estimated at 3.3% of total expenditure for 2005/06 i. e. they constitute 1-5% of total expenditure. Donor-funded project expenditure is insignificant (below 1% of total expenditure) and is budgeted and fully reported.

PI-8. Transparency of Inter-Governmental Fiscal Relations	C	The horizontal allocation of almost all transfers (at least 90% by value) from the Government to urban/rural local bodies is determined by transparent and rules based systems, though recommendations of the State Finance Commission have yet to be fully applied. Reliable estimates on transfers are issued after Government budgets have been finalized in March or known when actual allocations are made subsequently. Systems for collection and consolidation of local bodies' fiscal information consistent with Government's fiscal reporting are inadequate.
PI-9. Oversight of aggregate fiscal risk from other public sector entities	D+	Most major public enterprises submit fiscal reports, including annual audited accounts, at least annually, though some of these are in arrears. A consolidated overview of fiscal risk issues is significantly incomplete. Monitoring of fiscal position of urban and local bodies is significantly incomplete. Consolidated overview of fiscal risks is compiled (though not on a routine basis) in a report, but not on an annual basis.
PI-10. Public Access to key fiscal information	B	Top-level in-year budget execution reports, year-end financial statements and external audit reports are made available by the Government through the website of the Accountant General of the State. Annual budget documentation made available through the website of the Finance Department is considered incomplete and untimely. There is no information available on contract awards and resources available to primary service units. Information can be obtained through the Right to Information Act, but the process is cumbersome and time-consuming and the information is not directed to the public at large.

C. BUDGET CYCLE		
C (i) Policy-based Budgeting		
PI-11. Orderliness and participation in the annual budget process	B	A clear annual budget calendar exists, is generally adhered to, and allows the departments enough time (at least six weeks from receipt of budget calendar) to meaningfully complete their detailed estimates on time. The budget circular does not contain guidance on qualitative assumptions or reflects budgetary ceilings. The Legislature has, during the last three years, approved the budget in March before the start of the ensuing fiscal year.

PI-12. Multi-year perspective in fiscal planning, expenditure policy and budgeting	D	Forecasts of fiscal aggregates are prepared (only on the basis of main categories of economic classification) for at least two years on a rolling annual basis. No debt sustainability analysis has been undertaken in the last three years. Sector strategies may have been prepared for some sectors though none of them gave substantially complete costing of investments and recurrent expenditure. Budgeting for investments and recurrent expenditure are separate processes with no recurrent cost estimates being shared.
C (ii) Predictability and Control in Budget Execution		
PI-13 Transparency of Taxpayer Obligations and Liabilities	B	Legislation and procedures for some major taxes are comprehensive and clear, but the fairness of the system is questioned due to substantial discretionary powers of the Government entities or functionaries involved. Taxpayers have easy access to comprehensive, user friendly and up-to-date information on tax liabilities and administrative procedures for some of the major taxes, while for other taxes the information is limited. A tax appeals system of transparent administrative procedures is completely set up and functional, but it is either too early to assess its effectiveness or some issues relating to access, efficiency, fairness or effective follow up on its decisions need to be addressed.
PI-14 Effectiveness of measures for taxpayer registration and tax assessment	C	Taxpayers are registered in database systems for individual taxes, which may not be fully and consistently linked. Linkages to other registration/licensing functions may be weak but are then supplemented by occasional surveys of potential taxpayers. Penalties for non-compliance generally exist, but substantial changes to their structure, levels or

		administration are needed to give them a real impact on compliance. There is a continuous program of tax audits and fraud investigations, but audit programs are not based on clear risk assessment criteria.
PI-15 Effectiveness in collection of tax payments	D+	The debt collection ratio in the most recent year was below 60% and the total amount of tax arrears is significant (i.e. more than 2% of total annual collections). Revenue collections are transferred to the Treasury at least weekly. Complete reconciliation of tax assessments, collections, arrears and transfers to Treasury takes place at least quarterly within six weeks of end of quarter.
PI-16 Predictability in the availability of funds for commitment of expenditures	C+	A cash flow forecast is prepared for the fiscal year but is only partially updated on a monthly basis. Line departments are provided reliable information to plan and commit substantial expenditure at least quarterly in advance, other than information on the Central Government's share of centrally sponsored schemes. Significant in-year budget adjustments, decided above the level of departmental management, are made frequently, but undertaken in a fairly transparent manner.
PI-17. Recording and management of cash balances, debt and guarantees	C+	Debt records are complete, updated and reconciled at least semi-annually with the State Accountant General. Data is considered of fairly high standard, but minor reconciliation problems occur. Comprehensive management and statistical reports cover debt service, stock and operations are produced at least annually. All cash balances are calculated daily and consolidated, except extra-budgetary funds that remain outside the arrangement. Government contracting of loans and issuance of guarantees are always approved by a single responsible government entity, but are not decided on the basis of clear guidelines, criteria or overall ceilings.
PI-18 Effectiveness of payroll controls	C+	Personnel database and payroll are directly linked to ensure data consistency and monthly reconciliation. Required changes to the personnel records and payroll are updated monthly, generally in time for the month's payroll. Controls over changes to personnel records and payroll are not adequate to ensure full integrity of data. Partial payroll audits have been undertaken by the AG within the last three years.

PI-19 Competition, value for money and controls in procurement	D+	Insufficient data exists to assess the method used to award public contracts. Justification for use of less competitive procurement methods is weak or missing. A process exists for submitting and addressing procurement complaints, but it is designed poorly and does not operate in a manner that provides for timely resolution of complaints.
PI-20 Effectiveness of internal controls for non-salary expenditure	C	No commitment accounting system is in place; commitment checks are in place but not always followed. There are multiple but old sets of internal controls, which can be readily understood and are generally, but not always followed, but are not cost-effective. IT controls are a particular area of risk.
PI-21. Effectiveness of internal audit	D+	There is no effective internal audit function, as it is not generally operational, including in the most important department. Where internal audit is operational, it rarely undertakes system audits and may not meet professional standards. Reports are generally issued regularly to the audited entity, but may not be submitted to the Finance Department or statutory auditors. Internal audit recommendations are usually ignored, with some exceptions.
C (iii) Accounting, Recording and Reporting		
PI-22. Timeliness and regularity of accounts reconciliation	C+	Bank reconciliation between the Treasury and the Banks take place monthly at aggregate and detailed levels, usually within four weeks of end of period. Reconciliation and clearance of suspense accounts does not take place annually either at the departmental level or at a consolidated level. Reconciliation of advances is generally being done.
PI-23 Availability of information on resources received by service delivery units	A	Routine data collection or accounting systems provide reliable information on all types of resources received in cash and in kind by both primary schools and primary health clinics across the country. The information is compiled into reports at least annually.
PI-24. Quality and timeliness of in-year budget reports	D+	Classification of data allows direct comparison to the original budget. Information includes all items of the budget estimates but the expenditure is captured only at the payment stage and not at the commitment stage as well. Quarterly reports are prepared but often issued with more than eight weeks delay. There are no known material concerns regarding data accuracy

PI-25. Quality and timeliness of annual financial statements	D+	A consolidated Government statement is prepared annually. They includes full information on revenue, expenditure and significant disclosure of information related to financial assets/liabilities. The accounts are submitted for external audit within six months of the end of the fiscal year. Statements are presented in a consistent format over time but the accounting standards are not disclosed.
C (vi) External Audit and Scrutiny		
PI-26. Scope, nature and follow-up of external audit	C+	The CAG audits all government departments annually, covering revenue, expenditure, assets and liabilities. Financial audits and some performance audit are performed; audit reports focus on significant and system issues and auditing standards (based on INTOSAI standards) are generally adhered to. Audit reports are submitted to the Legislature (almost) within 12 months of the end of the period covered. A formal response by the Executive to audit findings is made, though often delayed but there is some evidence of systematic follow up.
PI-27 Legislative scrutiny of the annual budget law	D+	Legislative scrutiny covers fiscal policies, a medium term fiscal framework and shows priorities and details of revenue and expenditure. The Legislature's procedures for budget review are firmly established and respected including internal organizational arrangements such as Standing Committees. The Budget is presented to the Legislature in early-March and passed before the close of the financial year, but providing less than a month for scrutiny and debate. Clear rules for in-year budget amendments exist, but they may not always be respected and the rules allow for extensive administrative reallocations and expansion of total expenditure.
PI-28 Legislative scrutiny of external audit reports	D+	Examination of audit reports by the Legislature is through the Public Accounts Committee that usually takes more than 12 months to complete. In depth hearings on key findings are held with Secretaries and senior officers from the audited entities who depose before the Committee. These hearings, however, cover only limited entities. In case of audit paragraphs not discussed during such hearings, the departments submit action taken reports to the PAC. Actions are recommended to the Executive, some of which are implemented according to available evidence. PAC reports are placed before the Legislature.

D DONOR PRACTICES		
D-1 Predictability of Direct Budget Support	Not scored	There has not been any direct budget support to HP in the last completed year and two preceding years. The World Bank has recently (Sept 2007) sanctioned a Development Policy Lending and the first tranche has been released in January 2008.
D-2 Donor financial information provided for budgeting and reporting on project/program aid	A	All donors agree on budget estimates for disbursement of project aid at stages consistent with the Government's budget calendar; breakdown consistent with the Government's budget classification is also available. Quarterly reports on all donor disbursements are available within one month of end-of-quarter with breakdown consistent with the Government budget classification. Donors such as the World Bank have a web-based information system on disbursements accessible to the recipients.
D-3. Proportion of aid that is managed by use of national procedures	C	As all donor-funded projects are budgeted they follow the State accounting and reporting system. Most of the projects are under the audit system applicable to the State except in case of multi-State projects. The donors, however, follow their own procurement guidelines and not the State's. In 2005/06, 73% of aid funds to the State Government were managed through State procedures.

Note 1: Enhancing Internal Controls In Himachal Pradesh

1. Background

1.1 A Public Financial Management Accountability Assessment is being conducted for GoHP based on the PEFA Performance Measurement Framework methodology. During the PEFA assessment, certain internal control (IC) weaknesses were observed based on detailed examination of controls in certain areas. The reports of the Government auditors also documents IC weaknesses and have been a source of relevant information (examples at Annex 1).

1.2 This note examines some of these issues and develops broad recommendations to enable GoHP to effectively address the weaknesses for risk mitigation and better financial management.

2. Brief Introduction to Internal Controls

2.1 Efficient management of public resources is an essential responsibility of senior Government officials who must ensure that programs operate efficiently and effectively to achieve the desired objectives. The officials should also ensure that the programs are consistent with set goals, are in compliance with laws and regulations and operate with minimal potential for waste, fraud, and mismanagement. The Government has a fundamental responsibility to develop and maintain an effective system of ICs.

Why the Government should establish clear responsibilities for Internal Controls

To reasonably ensure that:

- Obligations and costs are in compliance with applicable law;
- Funds, property, and other assets are safeguarded against waste, loss, unauthorized use or misappropriation; and
- Revenues and expenditures are properly recorded and accounted for to permit the preparation of accounts and reliable financial and statistical reports and to maintain accountability over the assets.

Extracts from Federal Managers' Financial Integrity Act of 1982 USA

2.2 The CAG propounds that an IC system is an integral process by which an organization governs its activities to effectively achieve its objectives. Such a system consists of methods and policies designed to prevent fraud, minimize errors, promote operational efficiency and achieve compliance with established policies. The system also helps to protect resources against loss due to waste, abuse and mismanagement.

2.3 Therefore, IC should be an integral part of the entire accountability cycle of planning, budgeting, management, accounting, and auditing. It should support the effectiveness and the integrity of every step of the process and provide continual feedback to management.

2.4 Internationally, it is accepted that there are five components in an IC system and all five should be in place and operate for the system to be effective.

Internal Control Components	
1. Control Environment	This is the foundation of all components and sets the tone for the Government to influence control consciousness of its officials and includes integrity, ethical values, competence, authority and responsibility.
2. Risk Assessment	Identification and analysis of relevant risks to achieve the objectives, which then forms the basis for developing control activities.
3. Control Activities	Government policies and procedures and means to ensure that they are adhered to including approvals, authorizations, verifications, asset security and segregation of duties.
4. Information and Communication	Relevant information is identified and captured and communicated on time. The flow of information allows for successful subsequent actions.
5. Monitoring	Assessment of control systems' performance over time, management and supervisory activities and Internal Audit.

2.5 Too many controls may result in an inefficient and ineffective Government. Therefore, an appropriate balance between the strength of controls and the associated risks needs to be ensured such that the benefits of controls outweigh the cost of the risks. Both qualitative and quantitative factors need to be considered when analyzing costs against benefits. Identifying IC weaknesses and taking related corrective action are critically important to create and maintain a strong management process that supports the achievement of objectives and promotes a culture of accountability.

3. **Overall Internal Control Environment in GoHP**

3.1 The system of IC in HP is contained in a number of documents, which includes the Budget Manual, Financial Rules, Treasury Code, Office Procedures Manual, Public Works Department (PWD) Manual of Orders, PWD Accounts Code, Fundamental Rules and Supplement Rules (and related employee rules), guidelines of various schemes such as Centrally Sponsored Schemes (CSS) and Externally Aided Projects (EAP) and delegation of financial and administrative powers prescribed by the Finance Department. Collectively, these documents define the roles and responsibilities, institutional arrangements and rules, regulations and control activities in respect of planning, budgeting, approvals and sanctions, control over expenditure, accounting, procurement etc.

3.2 Institutionally, the governance system is organized around line departments that are administratively under an officer of the Indian Administrative Services, with the Finance (including the Treasury) and Planning Departments playing pivotal roles in defining and enforcing controls. The Finance Department has placed Assistant/Joint Controllers (Subordinate Accounts Services cadre) in departments to oversee the finance function and to act as guardians of IC. In civil departments, this function is entrusted to Divisional

Accountants whose cadre is administratively controlled by the State Accountant General (AG).

3.3 Information and communication of relevant information for decision-making is done through in-year budget execution and financial and physical progress reports. Monitoring arrangements include supervision, inspections and to a limited extent, internal audit.

3.4 The most significant ICs provided by GoHP include –

- Regulation of expenditure through budgetary limits and prescribed in-year budget adjustments;
- Technical, administrative and financial approvals before commencement of work;
- Pre-audit by Divisional Accountants in civil departments and by the Treasury in others;
- Prescription of periodical inspections/visits by controlling officers;
- Supervision of work by at least one level;
- Rotation of staff;
- Quarterly reconciliation of departmental accounting figures with those of the Accountant General;
- Restriction on opening of bank accounts/personal ledger accounts i.e. all transactions should be through the Government treasury system.

4. Areas for potential improvement in Internal Controls in HP

4.1 ***Narrow perception of IC vitiates its holistic appreciation:*** IC in HP needs to be expanded beyond inspections, periodic review meetings, surprise visits and scheme evaluation (as and when required) that seems to be the current practice/perception. IC should be appreciated in a holistic framework. It is the responsibility of everyone in the organization to ensure that ICs have been defined and are in place throughout. The essential elements of ICs need to be disseminated to all concerned for better appreciation of the concept. However, it needs to be emphasized that ICs do not guarantee elimination of errors, risks or fraud, but help in managing and mitigating risks.

> Managers (head of departments/controlling officers) should realize that a strong internal control structure is fundamental for control of an organization and its purpose, operations, and resources. Responsibility for providing an adequate and effective internal control structure rests with an organization's management. The head of each governmental organization must ensure that a proper internal control structure is instituted, reviewed, and updated to keep it effective. They are to maintain a level of competence that allows them to understand the importance of developing, implementing, and maintaining effective internal controls.
>
> *Internal Control: Providing a Foundation for Accountability in Government, INTOSAI*

It is felt that the responsibility of ensuring a proper internal control structure should specifically be included in the duties and responsibilities of the heads of departments, controlling officers and disbursing officers. Extensive training to managers on internal controls should be provided. The Office of Management and Budget (OMB), USA has issued a specific circular (A-123) "Management's Responsibility for Internal Control" that defines the roles and responsibilities of managers, and provides guidance on improving the accountability and effectiveness of programs and operations by establishing, assessing, correcting, and reporting on internal control.

4.2 ***Update and simplify IC framework documentation:*** The fundamental framework of ICs in HP is contained in the Budget Manual, Financial Rules, Treasury Code, PW Code etc. that define the underlying methods and processes that all Government officials should rely on to do their jobs. These documents have not been revised for long periods of time; the HPFR as well as the Budget Manual were released in 1971. Moreover, none of the offices visited had copies of the HPFR or the Budget Manual; therefore these are not considered relevant/useful. The forms prescribed in the manuals are either not being used or used in a format different from that prescribed. These need modernization and updating. There is, therefore, a need to thoroughly update, revise and simplify these official documents and modernize them in line with the current work environment. This exercise should take into account the impact of the various circulars issued by the State since the date of issue. Procurement law, contained as an appendix to the Financial Rules also needs modernization. With the rapid pace of computerization taking place in HP, several of the manual controls need to be supplemented with IT controls.

The GoI revised its General Financial Rules in 2005 through a Task Force. The Government of Rajasthan has appointed consultants to modernize its budget manual, financial rules and treasury code. States like Karnataka and Tamil Nadu have adopted modern procurement laws applicable to all procurement through public works for bringing in enhanced transparency in the process, including introducing e-Procurement. GoHP needs to prioritize revision and modernization of its PFM architecture i.e. the Budget Manual, Financial Rules etc.

4.3 ***Reduce payments in Cash*:** Departments in HP follow the practice of making significant payments in cash, including salary and (some) pension disbursements, by drawing cash from the Treasury. In the Forest Department, the proportion of cash payments is relatively higher due to remoteness of locations and small value of works. However, this system provides opportunities for misuse and also exhibits a weak internal control environment. GoHP should move forward to a system of making payments through the banking channels particularly for salary and pension payments and other expenditure beyond a pre-decided threshold limit. Cash payments should be limited to routine expenditure of small value and only in exceptional circumstances. States like Tamil Nadu have already moved towards a system of electronic transfer of salary.

4.4 ***Formal IT Controls need to be established in the Treasuries:*** Significant automation of processes has been initiated in the Treasuries in HP from computerization of accounting to salary and pension. This would increase data processing and availability of information on real-time basis, leading to quicker decision-making. Nevertheless, computerized systems need a strong internal control mechanism, usually more extensive and effective than manual systems.

These would need *General Controls* that include security management programs, access controls, application software development and change, system software controls, segregation of duties and service continuity. What is needed is *Application Controls* (comprising of input, processing and output controls) that apply to processing of data within the application software and help to ensure that transactions are valid, properly authorized, and processed as well as reported completely and accurately.

IT controls in Treasuries in HP require major strengthening as the Treasuries are operating under an informal and weak control environment.

- A formal operational procedures manual has not been developed. Formal documentation or communication defining segregation of duties is lacking.
- The function of taking backup of data has also not been formally defined, is varied across Treasuries and is largely informal. There is an absence of any disaster recovery plan to ensure service continuity.
- Technical support such as in the form of a Systems Administrator has not been provided to the Treasuries.
- The system of allocation/maintenance of user name and password is not being followed rigorously. Passwords are shared and are available with the IT support staff. This needs to be strongly discouraged.
- The computerization has not been accompanied by proportionate training of staff.
- Certain activities do not come under purview of the Treasuries and financial controls are incomplete to that extent; these include the LoC/Forestry Departments and extra-budgetary operations.

GoHP should immediately establish a Task Force on IT Controls that would recommend and suggest an IT control mechanism, help implement the system and also generate the required documentation. This should be followed by extensive training of the Treasury staff.

4.5 ***Establish an effective Internal Audit system:*** HP does not have a formal architecture for internal audit. The system in its current form has not been designed systematically and lacks a strategic focus. Key points for consideration are: (a) coverage of IA is inadequate. It is not operational in high spending line departments like Irrigation or Public Works. Line departments that established internal audit have either discontinued or marginalized it; (b) wherever IA exists, it is transaction based, and systemic audits are rare. Audit recommendations usually concentrate on the particular transaction, and do not address the core problem; (c) follow up on IA findings is extremely poor; eventually IA is not seen as adding any value; (d) there is an absence of centralized directives/guidelines on IA; sometimes IA audit staff is assigned non-audit duties; and (e) audit of urban local bodies was in arrears and only recently audit has been updated till the last year with the local audit department conducting audit of several years at a stretch.

HP needs to establish a more effective IA function by a strategic allocation of resources. A small, centralized, skilled internal audit team should be set up as a first crucial step to conduct systemic reviews in areas of perceived risks. This approach can be assisted by a systemic evaluation of risk in the overall PFM system in the State and garnering all the (currently) dispersed resources to address that risk.

Based on the overall vision, the following details need to be worked out: (a) a senior functionary of the Finance Department needs to head the IA function; based on risk an IA Program for the entire year needs to be chalked out, clearly laying down the risk evaluation, objectives, work plan in light of the resource constraints and the expected results/outputs; (b) the IA function should be overseen by a high level committee with representation not only from finance but also from key departments and the C&AG; (c) explore possibilities of outsourcing options, as this would address the staffing shortfall and bring in expertise; (d) internal auditors should be provided periodical training; (e) coordinating internal audit with external audit conducted by CAG/AG is desirable so that any overlap in audit coverage can be addressed for mutual gain; and (f) adequate guidance must be available for the function in form of manuals, training etc.

4.6 Audit compliance should be everybody's responsibility: Line managements should seriously consider CAG/AG audit reports and internal audit reports in correcting internal control deficiencies identified in these reports. Management has a responsibility to complete action, in a timely manner, on audit recommendations. They must make a decision regarding audit recommendations within a reasonable time period after issuance of the audit report and implement these decisions again within reasonable time.

These principles are not clearly visible in the present internal control environment – the approach towards responding to audit findings is on settling the individual finding instead of effectively addressing systemic issues. Data indicates that a significant number of audit findings (external and internal audit) have not been responded to and audit recommendations, even on internal controls, have not been implemented. As of December 2007, 6216 AG inspection reports and 16521 audit paras remained unresolved. In case of audit of urban local bodies, over 16000 audit paras remain unattended. Even reports of the PAC, the Legislative oversight body, have been left unattended or unsettled. These include 50 Action Taken Reports and 98 Further Action Taken Reports. The essence of timeliness in attending to audit findings is absent. A central database of outstanding audit reports is not available, except in a few cases.

This situation needs to be corrected. Responding to audit observation as well as correcting systemic issues needs to be institutionalized and mechanism to urgently attend to audit findings should be put in place.

4.7 Strengthen the mechanism of Inspections: The financial rules prescribe an elaborate system of inspections by controlling officers. However, these guidelines are not being followed in letter and spirit. Either inspections have not been conducted or conducted irregularly or adequate record of inspections is not maintained. The following are extracts from CAG reports.

- <u>Irrigation & Public Health Department:</u> The standing instructions for inspection of works have been prescribed for major and targeted schemes – monthly by the Executive

Engineer, bi-monthly by the Superintendent Engineers and quarterly by the Chief Engineer. During 2001-2006, as against 780, 390 and 260 inspections required, only 281, 69 and 35 were undertaken; however, inspection notes were not maintained.

- Food, Civil Supplies & Consumer Affairs Department: 4, 6 and 8 monthly inspection (of fair priced shops) norm was prescribed for District Controllers, District Inspectors and Inspectors, respectively. During 2001-2006, there was significant shortfall in targeted inspections.

- Horticulture Department: Neither targets were fixed nor actual inspections of the various offices were undertaken during 2001-2006. The Departmental claim that inspections were undertaken could not be substantiated through documentary evidence.

Source: CAG Audit Report 2006

4.8 Review the mechanism and assess the risk of Suspense Account: Civil works departments account for interim transactions under a Suspense Account and adjust the items when the action is completed. The underlying controls are defined in the Public Works Code. However, the account is used for "parking" transactions and a CAG review indicates possible misappropriation and misuse of the account. As of March 2006, the outstanding balance in Suspense Account was to the tune of Rs. 4034 mn with a large number of transactions lying unadjusted for an inordinate long period of time (pertaining to the 60s and 70s). There are also items whose details are not available and some of the elements of the account exhibit adverse (or minus) balances, indicating incorrect accounting and adjustment. There is no internal consolidated data on the balance, nature or aging of this account and the only source of information is the data provided in the Appropriation account by the AG.

The above indicates a significant control deficiency that needs immediate attention. GoHP needs to address this immediately not by introducing more controls, but by undertaking a risk assessment of the process and identifying the causes underlying the situation. A system of reporting of outstanding in Suspense Account should be re-introduced and the data consolidated at Circle, Zone and State levels for review and monitoring. A Task Force on Settlement of Suspense Account could be constituted to collect data, analyze the outstanding and individual items, identify the old outstanding items, effect reconciliation and suggest appropriate ways and means for concurrent adjustment and clearance of account.

5 Internal Control Standards

The INTOSAI has issued Guidelines on Internal Control Standards "to strengthen financial management and establish more focused accountability in the public sector". India also participated in the development of these standards. The guidelines propound IC standards, which can be adopted by GoHP as good practice. These standards are not new and to some extent are already imbibed in Government operations. They can be viewed as the minimum acceptable standards that organizations follow when instituting internal controls, and provide criteria for auditors when auditing the internal control structure.

General Standards

- Reasonable Assurance: Internal control structures are to provide reasonable assurance that the objectives will be accomplished.
- Supportive Attitude: Managers and employees are to maintain and demonstrate a positive and supportive attitude toward internal controls at all times.
- Integrity and Competence: Managers and employees are to have personal and professional integrity and are to maintain a level of competence that allows them to understand the importance of developing, implementing, and maintaining good internal controls and to accomplish the general objectives of internal controls.
- Control Objectives: Specific control objectives are to be identified or developed for each activity of the organization and are to be appropriate, comprehensive, reasonable, and integrated into the overall organizational objectives.
- Monitoring Controls: Managers are to continually monitor their operations and take prompt, responsive action on all findings of irregular, uneconomical, inefficient, and ineffective operations.

Detailed Standards

- Documentation: The internal control structure and all transactions and significant events are to be clearly documented, and the documentation is to be readily available for examination.
- Prompt and Proper Recording of Transactions and Events: Transactions and significant events are to be promptly recorded and properly classified.
- Authorization and Execution of Transactions and Events: Transactions and significant events are to be authorized and executed only by persons acting within the scope of their authority.
- Separation of Duties: Key duties and responsibilities in authorizing, processing, recording, and reviewing transactions and events should be separated among individuals.
- Supervision: Competent supervision is to be provided to ensure that internal control objectives are achieved.
- Access to and Accountability for Resources and Records: Access to resources and records is to be limited to authorized individuals who are accountable for their custody or use. To ensure accountability, the resources are to be periodically compared with the recorded amounts to determine whether the two agree. The asset's vulnerability should determine the frequency of the comparison.

Annex 1:Evaluation of Internal Control System in GoHP by CAG

Horticulture Department (period 2001 to 2006)	
• Persistent excesses in expenditure had not been regularized.	**CAG's Opinion:** The department had not evolved any mechanism for monitoring/evaluating the internal control system in general and operating controls in particular to gauge its effectiveness and adequacy and take appropriate measures for strengthening the controls where necessary. **Management's Response:** Internal control was being exercised by conducting inspections, holding monthly meetings, carrying out surprise inspection and monitoring and evaluating the scheme by various departmental officers as and when required.
• Receipts realized were remitted directly into the treasuries and were not simultaneously accounted for in the cashbook.	
• Utilization certificates furnished to Government in excess of actual utilization.	
• Irregular release of Grants.	
• Funds drawn against Proforma bills of the suppliers at the year-end and payments were actually made to the concerned firms after periods ranging between 10 and 358 days.	
• No steps taken either to fill up or abolish posts lying vacant for five years or more.	
• Reasons for shortfall in achieving the targets in respect of schemes were not investigated.	
• Stores accounts of 2001-2006 were not prepared.	
• Internal audit had not been conducted.	
• Persistent pendency of compliance to AG Inspection Reports.	

Food, Civil Supplies and Consumer Affairs Department (period 2000 to 2005)	

• Inadequate Budgetary Controls
  • Unrealistic budget estimates
  • Delay in submission of budgetary and monthly expenditure returns
  • Non-maintenance of control records
  • Irregular release of grants
  • Physical verification of cash not done; incorrect issue of cash certificates
  • Receipts realized were remitted directly into the treasuries and were not simultaneously accounted for in the cashbook.
	CAG's Opinion: The department had not evolved specific mechanism for monitoring/evaluating the internal control system to gauge its effectiveness and adequacy.
	
	Management's Response: Periodic review meetings and inspections are conducted. However, this fact was not supported by any documentary evidence.

• Inadequate Operational Controls
  • Office inspections not conducted
  • Shortage of stocks	

• Internal audit not conducted • Persistent pendency of compliance to AG Inspection Reports	

<table>
<tr><th colspan="2">Education Department (period 2000 to 2005)</th></tr>
<tr><td>

- Inadequate Grant Management
  - Release of ad hoc grants
  - Irregular payment of grants
  - Utilization certificates not furnished

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Management's Response:
Response not provided

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Note 2: Alternative Payment Mechanisms And Associated Risks

Introduction

1. The HPFR define *(rule 3.25)* an LoC as an authority to honour cheques. Payments can only be made on checques drawn against it. The LoC scheme is one of the systems for drawl of funds from the Consolidated Fund of the State for making payments (the other is the Treasury Bill system).

2. The LoC system is a mechanism through which the government regulates the level of expenditure in high spending departments. Two high spending civil works departments namely Public Works (PW) and Irrigation & Public Health (IPH) are covered under the scheme. These account for about 10% of the State's total expenditure/outflow. This percentage may be much higher if compared to the State's 'developmental expenditure'. The LoC authorization, therefore, sets the limit up to which these departments can draw from the Treasury during a particular period (month/quarter). Three parties are involved in the system, namely the Finance Department, the Civil Department and the Treasury.

Operation of the LoC System

3. LoC authorization is made by FD based upon a request submitted by the Civil Department's Engineer in Chief (EIC) periodically (monthly or quarterly), along with details of head-wise budget available. This request is a consolidation of the demands raised by the circles/divisions.

4. In FD, the LoC demands are processed after review from the viewpoint of budget availability, amount of previous LoC issued, resource availability etc. The FD can reduce the amount of request or hold back the request in the event it needs to seek clarifications or additional information on any significant matter. Processing time is normally a week, unless FD seeks clarifications or additional information.

5. On receipt of the departmental LoC authorization from FD, the EIC office distributes the LoC to the Chief Engineers (CE) in the zones who in turn make distribution to the Superintendent Engineers (SE) in the circles, and the latter to the Executive Engineers (EE) in the divisions, where the actual expenditure in incurred and paid for. The SE, while releasing the LoC, copies the authorization to the concerned District Treasury.

6. At the District Treasury, the District Treasurer, under authorization of the District Treasury Officer (DTO), issues LoC cheque books to the DDOs. The concerned Government business bank is also informed about this. At the Treasuries, the function of recording LoC has not been computerized (except for accounting of paid LoC checks) and control is in the nature of post-control i.e. recording of information after payment of cheques. There is no requirement for obtaining pre-endorsement of the LoC cheques prior to their release i. e. the EEs can issue the cheques directly to the payee.

Issues and Conclusion

7. Reporting of expenditure information (by the Treasuries) and its monitoring is incomplete to the extent of expenditure by the LoC departments. Therefore, at the State level, overall expenditure is not captured at a single point. The FD is aware of the total LoCs issued but not actual utilization.

8. Internal controls exercised by the Treasury are missing in case of the LoC system. This includes a pre-review of the bills/invoices and validation that adequate budget is available against the expenditure incurred.

9. The GoHP's LoC Scheme envisages periodic assessment of fund requirements; presently allotment of LoC is generally either $1/12^{th}$ of the budget in case of monthly allocation or $1/4^{th}$ in case of quarterly. Therefore, authorization of LoC follows a fixed proportion of the budget. This system of allocation highlights the fact that the LoC system may have lost its relevance and has become a mechanical exercise.

Payment system in the Forestry Department
The system in the Forestry Department is similar to the one described above with the following exceptions which further weaken internal controls:

- No LoC is issued as explained above. DDOs of the department are informed about the budget availability through departmental channels i.e. budget is communicated within the Forestry Department. However, this information is not provided to the Treasury and therefore the pre-control of expenditure v/s budget is missing.
- Accounting function in the department is handled by staff of the Forestry department. This level of independence is lower than that of the LoC departments where the function is exercised by an officer of the CAG
- Compared to the LoC departments, a significantly higher percentage of payment in the Forestry Department is in cash. This is usually attributed to the remoteness of locations and nature of works.

Way Forward

10. States in India (examples are Madhya Pradesh and Karnataka) have started phasing out the LoC system and merging it with the Treasury Bill system.

Madhya Pradesh has decided to abolish the LoC system in all departments starting from the FY 2007/08. The State's Finance Minister, in his budget speech 2007/08 declared that the "change was being effected on the basis of suggestions received during ministerial consultation with administrative officials in order to tone up administration. Now the delay being faced by works departments in getting budgetary allocation through the Government treasury will be done away with".

LoC Phase Out in Karnataka:
The existing LoC system of payments which is used by the Civil Works department, namely Public Works, Water Resources, Minor irrigation, Forest and Rural Development and Panchayati Raj departments suffers from following weaknesses -
1. Over-centralization of releases leading to disjunction between work implementation and payment and attendant problems of bills pendency and delay.
2. Delay in reconciliation of accounts owing to rendering of separate accounts by each works division.
3. Multiple points for data pertaining to payments that hamper better cash management and reporting.
4. Lack of budgetary control, expenditure beyond the financial year and the problem of over appropriation.

Treasury computerization has stabilized and ensures not only budgetary integrity but also facilitates better reporting and accounting. It also helps in decentralization of releases and therefore merging of the existing LoC system in the Treasury system is desirable. Preliminary consultations with user departments have yielded positive results and it is expected to phase out the LoC system in these departments in a short time.

Source: Karnataka Medium Term Fiscal Plan 2006/10

11. The LoC system was relevant during the pre-computerization era i.e. when Treasury Systems were manual and Governments had devised the system to ensure adequate funding for developmental expenditure. GoHP may review the system to assess whether the circumstances that led to introduction of the LoC system in 1981 still exists. The Government may assess whether it would be feasible and desirable to phase out the system in view of the computerization of Treasuries.

Note 3: Public Financial Management in Panchayati Raj Institutions (PRI)

Overview

1. Himachal Pradesh has a three–tier Panchayati Raj system with Zila Parishad (ZP) at the district level, Panchayat Samiti (PS) at the block level and Gram Panchayat (GP) at the village level.

2. **Number**: There are 12 ZPs, 75 PS and 3243 GPs in HP. After delimitation, 206 new GPs were constituted in 2005/06 and presently there are 19,411 Up Gram Sabhas. The State has a total of 24,668 elected PRI representatives.

3. **Term and Elections**: Each Panchayat has a uniform term of five years calculated from the date of its first meeting. Elections to constitute the new Panchayats are required to be completed before the expiry of the term of the existing Panchayats. After the passing of the 73rd Constitutional Amendment, PRIs in HP are in their third year. The first elections were held in December 1995 and the term of the Panchayats expired on 22/01/2001. Second elections were held in December 2000 with the term of the Panchayats up to 22/01/2006. The third elections were held in December 2005 and the present Panchayats were constituted on 23/01/2006 with their term up to January 2011.

The Legal and Institutional framework

4. **Constitutional recognition**: With the promulgation of the 73rd Constitutional Amendment Act, a new era in federal democracy dawned in 1993, conferring Constitutional status to the PRIs. The new set-up envisaged establishment of a democratic decentralized development process through people's participation in decision-making, implementation and delivery. This was sought to be achieved with devolution of powers and responsibilities to Panchayats at appropriate levels. As per Article 243G of the Constitution, 29 subjects listed in the 11th Schedule of the Constitution were identified for devolution to the PRIs.

5. **The Legislation governing the PRIs in HP**: The PRIs in HP are governed by the Himachal Pradesh Panchayati Raj Act, 1994 *(Act 1994)*. The Act is read with two major documents i. e.

- the Himachal Pradesh Panchayati Raj (General) Rules, 1997 *(Rules 1997)*; and
- the Himachal Pradesh Panchayati (Finance, Budget, Accounts, Audit, Works, Taxation and Allowances) Rules, 2002 *(Finance Rules 2002)*.

6. **Institutional Framework of Panchayati Raj in HP**: A three-tier structure has been established in HP as envisaged by the 73rd Constitutional Amendment, with the Zila Parishad at the district, Panchayat Samiti at the development block and Gram Panchayat, at the village. Each level has elected members and representation from other PRIs. Every Panchayat is a statutory body corporate having perpetual succession and a common seal; it can sue and be sued, can acquire, hold or transfer movable or immovable property and can

enter into contracts. The Panchayats are also inter-linked, as there is representation of the higher tier in the lower tier and *vice versa*.

To improve accountability and enhance participatory planning and development, the Gram Sabha (body of citizens with adult franchise), to which the GPs are answerable, has been granted statutory recognition. The Gram Sabhas have the powers to approve plans, programs and budget prepared by the GP, seek clarifications about any activity, scheme or income/expenditure, and issue recommendations on the annual accounts, audit and development programs, which the GPs are bound to consider. Each constituency of the Gram Sabha has an Up Gram Sabha (or Ward Sabha) for better representation and participation.

The GoHP's Department of Panchayati Raj (DoPR) administers the Act 1994 through supervision, exercising financial control, providing guidance, effecting compliance and imparting training; it also conducts the audit of the Panchayats. DoPR also works in conjunction with other departments, particularly the State Rural Development Department (RDD). RDD deals with the Centrally Sponsored Schemes that are administered by the central Ministry of Rural Development (MoRD), and also controls the District Rural Development Agencies (DRDA) that are the principal institutions at the district level overseeing the implementation of the CSS based on guidelines issued by the MoRD.

7. **Devolution**: The State Government has devolved functions pertaining to 15 line departments covering 27 subjects[23] to the GPs. Certain other functions such as issuing of permission/licenses have also been entrusted upon them. They have the power to levy and raise taxes/fees such as land revenue, house tax etc. GPs also receive a part of the liquor cess under assignment of taxes.

Funds and Expenditure profile of GPs in HP

8. In HP, GPs are the only tier of PRIs that have self-generated receipts through levy of taxes/fees, clearly devolved functions and have been vested with implementation responsibility. The funds of the GPs are classified in two accounts.

- Panchayat Fund, Account A: Own resources (tax and non-tax revenue), revenue transfers from the State (liquor cess) and grants under State Finance Commission (SFC) for establishment and office. These aggregated Rs. 136.8 mn during 2005/06 (Rs. 104.2 mn during 2003/04) and constitute about 8% of total funds of GPs.

- Panchayat Fund, Account B: Grants-in-Aids, honorarium to elected representatives/functionaries, grants under 11th Finance Commission, funds for special purposes and loans. These aggregated Rs. 1,602.7 mn during 2005/06 (Rs. 1,118.4 mn during 2003/04).

[23] As against 29 subjects listed in the 11th Schedule of the Constitution of India

Majority of the GPs maintain bank accounts with co-operative banks. On an average, three bank accounts are operated – one being for Account A *(Gram Nidhi)*, and the others for specific schemes. The account is operated under joint signatures of the GP Secretary with the Pradhan, in his absence the Up Pradhan, in his absence an authorized GP member.

9. Sources of Funds: In case of GPs, non-tax revenue receipts include items like rent, interest, proceeds from auctions, fee (from fairs and festivals, *teh bazari*, sanitation, timber distribution), water charges, judicial fees, certification fees, ration card fees, cattle fees, minor forest produce, royalty etc. Tax revenues include house tax, trade/professional tax, stamp duty, commodity tax, property tax and land revenue and share of liquor cess allocated by the State Government. GPs also get purpose specific grants and general-purpose grants. On the other hand, PS and ZPs do not have the power to raise taxes. Their main source of financial resources is funds allocated by the GoHP or development funds under CSS.

10. Application of Funds: The purposes for which the Panchayats can apply funds of Account A are performance of statutory and delegated functions, expenditure on committed liabilities[24], office expenses, audit fees, publicity etc. These aggregated Rs. 896.9 mn during 2005/06 (Rs. 1,066.8 mn during 2003/04).

Funds in Account B can be utilized only for the purpose for which the funds are allocated and expenditure can be incurred in accordance with the requirements and guidelines of the funding agency. These aggregated Rs. 1,330.7 mn during 2005/06 (Rs. 1,110.9 mn during 2003/04).

11. Horizontal allocation of transfers from GoI or GoHP is based on transparent rules and formula driven. The Central Finance Commissions, a Constitutional authority, make recommendations with respect to the measures needed to augment the Consolidated Fund of a State to supplement the resources of the PRIs. The State Finance Commissions[25], also Constitutional entities, constituted every five years, recommends the (a) principles for the distribution of the net proceeds of the taxes, duties and fees between the State and the PRIs and inter-se allocation between the Panchayats, (b) taxes, duties, tolls and fees which may be assigned as, or appropriated by, the PRIs, (c) grants-in-aid to the Panchayats from the Consolidated Fund of the State, and (d) the measures needed to improve the financial position of the Panchayats.

PFMA framework in PRIs in HP

12. The Accountability mechanisms with respect to PRIs are elaborated in the Act 1994, Rules 1997 and predominantly in Finance Rules 2002. The latter is similar to a procedures manual and contains detailed prescriptions pertaining to all key PFMA areas.

Planning and Budgeting

[24] Including honorarium to elected representatives and salary to Panchayat staff
[25] The report of the SFC is laid before the State Legislature

13. The Act 1994 requires every Panchayat to prepare Annual Development Plans, and an Annual Budget of its receipts and payments separately for Account A and B. The principles for preparing the budget, approval thereof, direction of the budget, re-appropriation, budget classification and timelines for the various activities are detailed in the Finance Rules 2002. The budget is prepared by a standing committee of the Panchayat, and thereafter approved by majority vote by the Gram Sabha, in case of GPs and the Panchayat, in case of PS and ZP.

14. In case of GPs, Budget proposals need to be initiated from the Gram Sabha and the legislation makes it mandatory to obtain approval of the Gram Sabha to the plans and budget. As funds under CSS are a major source, planning and budgeting procedures under CSS are a key guiding factor. Plan/budget for CSS[26] are also prepared separately and submitted to the DRDAs.

15. The Budget includes estimate of own sources and aggregate funds likely to be provided by the Central or State Governments under various development schemes for which a lump sum provision is made, as the quantum of untied funds available with the GPs is meager and information on likely allocation of tied funds is unavailable. In actual practice, therefore, planning is "top down" and more often an extrapolation of the previous year's budget increased by a certain percentage. The size of the Budget of GPs in HP ranges from under a lac to over five lac rupees.

16. The Constitution provides for the institution of a District Planning Committee (DPC) in each district to consolidate the plans prepared by the PRIs, but since DPCs are operational in only five to six districts, this is still not working well.

Extracts from Approach Paper to the 11th Five Year Plan, GoHP
The District Planning Committees are being constituted in all districts of Himachal Pradesh. Much of the planning investment will be finalized in consultation with these committees. Plan resources shall also be placed at the disposal of the Panchayats/Local Bodies, as per the recommendations of the 12th Finance Commission and the 3rd State Finance Commission.

17. Annual Budgets are generally prepared by the GPs but may not be on prescribed format or prepared separately for Account A and B and all activities in the Development Plan may not be valued. The GPs are unaware of the allocations for the ensuing year based on which they can prepare a realistic plan and budget. The Budget process generally commences in December-January and is prepared by the Pradhan, Up Pradhan and the Secretary. Proposals of Up Gram Sabha/Ward Members may be occasionally considered in planning. The prioritization of the activities may or may not be done. A copy of the budget is generally sent to the prescribed authority and is prepared on a yearly basis and is not broken down periodically, say quarterly.

[26] The Centre's share of CSS is not reflected in GoHP's budget; the latter includes only the State's share in CSS

Key Issues

- *PRIs do not receive reliable information on allocations from the Government in advance. Prior intimation of funds likely to be allocated should, therefore, be provided to the PRIs to facilitate realistic development of their budgets.*

- *Budgets prepared by the PRIs should be considered at an appropriate level and feedback provided to them so that they get the feeling of inclusiveness and that their budgets are relevant. DoPR may develop a mechanism for collation and consolidation of budgets for each tier of PRI.*

Budget Execution

18. Budget execution is limited to implementation of schemes against tied funds provided by MoRD or GoHP. The provisions regarding execution of public works are elaborated in a separate chapter titled "Panchayati Raj Public Works Rules" in the Finance Rules 2002. The overall responsibility for execution of development works is entrusted upon the Works Committee (including supervision and performance monitoring and obtaining accounts) in case of the GP, the Chairman, in case of the PS and the Chief Executive Officer and the officers of the concerned department/s, in case of the ZP. Formal meetings of the GP Works Committee are occasional.

19. In case of GPs, works can be executed through either a Participatory Committee (1st preference, including representative from village-level agencies), or village-level registered bodies, or departmentally or through contractors (for works over Rs. 5 lacs and open tender). Preparation of estimates, technical sanctions, maintenance of measurement books, issue of completion reports and monitoring/quality control are done through the Engineering Wing of the Rural Development Department. The Technical Authorities (*Takniki Sahayaks*, Junior and Assistant Engineers) have been entrusted the responsibilities of inspection of works.

20. The quantum and timing of resources made available to GPs are considered inadequate, resulting in delayed project implementation or dropping of projects altogether. GPs are unaware of the availability – quantum and source – of the funds to be received by them. The situation is further escalated as the funds from various sources are released in installments (often 4-6) over the year and the timing of the release of the next installment is uncertain. Timely and adequate compliance of prior conditions by GPs is also a factor governing release of subsequent installments. Release of the Central share at the year-end is a matter of concern.

Key Issues

- *Timely intimation of quantum of funds and release and streamlining of actual funds transfers is essential. This will ensure that the GP gets sufficient time to prioritize and prepare for the works to be taken up and accordingly inform the Gram Sabha.*

Procurement

21. The Finance Rules 2002 require every Panchayat to constitute a Procurement Sub-Committee for the purpose of purchase and procurement of stores. The members include the chairperson and nominated Panchayat members. Items normally procured include cement, wire, bricks, plantation, sand, stone and concrete. Three procurement procedures are mandated.

Prescribed Procurement Procedures

- Direct Procurement either through the Controller of Printing and Stationery or from approved rate contractors on the list of Controller of Stores, GoHP or where the value of stores is less than Rs. 1,000
- Three Quotations procedure where the value of stores is more than Rs. 1,000 but less than Rs. 50,000
- Tendering where the value of stores is more than Rs. 50,000 with advertisement in minimum two newspapers having wide circulation in the area.

22. Generally, the Pradhan makes purchases with the Secretary or Ward Member (including market survey and preparation of comparative chart). Procurement through the Procurement Sub-committee is limited. Quotation system is the most common procurement procedure due to the low value of each procurement. Custody of goods is with the Pradhan and Ward Member and the goods are stored at the construction site till consumed.

Accounting

23. Article 243J of the Constitution mandates the States to make provisions for maintenance of accounts by the PRIs that, in case of HP, are detailed in the Act 1994 and the Finance Rules 2002. Accounting is done at all the three tiers of PRIs and is on cash basis. Books and records, including their formats, a 5-digit coding system and a Store Accounting system has been prescribed. The responsibility of maintenance and custody of books and records of the GP has been vested upon the Panchayat Secretary who functions under the overall supervision of the Pradhan/Up Pradhan.

24. Key books/records are generally maintained. These are prepared by the Secretary (who also has their custody) and occasionally counter signed by the Pradhan. The GPs have not adopted the 5–digit coding system and may not maintain accounting records separately for Accounts A and B.

25. HP is moving towards double entry accrual system of accounting in PRIs for which a Steering Committee has been constituted. GoHP is also considering implementation of the new CAG accounting system prescribed for PRIs.

Key Issues

- *Extensive training of Panchayat functionaries should precede any significant change in the accounting system. Introduction of the double entry accrual accounting system needs to be well thought out.*

Internal and External Reporting

26. Reporting is primarily through the Annual Receipts and Payments Account and Utilization Certificates (UC) for funds received from DoPR for committed expenditure, funds under Central Finance Committee and other grants-in-aid. UCs for committed expenditure are sent by the GPs to the DPOs along with Actual Pay Certificates. These are then consolidated at the district level and thereafter forwarded to the DoPR where these are presented before the Accountant General for audit. There is a mandatory requirement that the Gram Sabha would authorize issue of UCs only after being satisfied about these.

27. A laudable initiative of the DoPR is the publication of an annual report titled, "*A Report on the Finances of Gram Panchayats in Himachal Pradesh*". The first report was published for the FY 2002/03, followed by second report for FY 2003/04. The report for 2004/05 could not be published, but was followed by the report for FY 2005/06. The reports dwell upon demographic profile, funds and expenditure profile, status of meetings of the Gram Sabha and status of serious audit paras and outstanding advances. Also, DoPR has commenced providing 12th Finance Commission's funds for creation of a database at the level of Panchayats that includes installation of computers.

28. There is a system of preparation of Annual Receipts and Payment Accounts and the Audit Reports also contain a similar statement. However, there is no system in vogue for consolidation of these accounts at the State level. Thus, there is no mechanism for collection of fiscal data of PRIs on a routine basis and consolidation into periodic reports for assessing the fiscal risks and position of the PRIs.

> Data sent by PRIs suffered from serious inconsistencies, mainly classificatory in nature, where it was difficult to sift what constituted their own revenue receipts and what constituted object specific grants from the State Government or the GoI. At the implementation level, though resources have been spent on statutory, delegated developmental and maintenance functions; separate information on such functions are not available due to misclassification of accounts and poor reporting system.
>
> *Source: Report of 2nd SFC*

Key Issues

- *Annual financial statements should be produced by all PRIs regularly and timely as per the statutory requirement. DoPR should institute a mechanism to consolidate the accounts for each tier for monitoring, planning and statistical purposes and assessing the fiscal position of the PRIs.*

- *A mechanism for consolidation of fiscal data should be formalized and strengthened. The Report on Finances is one of its kind in India. It should become a mandatory* *document and be published in a timely manner. Gradually, more aspects of the GPs could be captured, and ZP and PS could also be included. Collection of data for the report should commence immediately on close of the financial year and the report published within six months thereof.*

Audit

29. The Act 1994 provides for formation of a separate and independent audit agency under the control of the Director of Panchayati Raj. The overall responsibility of the function is entrusted to a Deputy Controller (Audit) at the State level, assisted by District Audit Officers (DAOs) at the State and district levels. The DAO is assisted by Panchayat Auditors. The benchmark for the number of Panchayat Auditors has been fixed at one for every 35 GPs. During 2006/07, there were 86 Panchayat Auditors against the sanctioned strength of 88 (Source: Annual Administration Reports, DoPR 2006/07).

30. The Finance Rules 2002 mandates that all receipts and expenditure of every Panchayat shall be audited before the close of the succeeding financial year. During the audit, accounts for the complete financial year will be taken up. An Audit Checklist and a uniform format of the Audit Report that have been developed are already in use. An Annual Audit Plan is prepared by the Audit Cell and approved by the Director. The law prescribes the time limit for submission of audit reports.

31. The Pradhan and Secretary, in case of the GP and Chairman and Secretary, in case of the PS and ZP have been entrusted with the responsibility of responding to the audit report and placing it before the Panchayat for approval, thereafter forwarding the compliance to the authorities.

32. Not all the PRIs are audited every year. One audit visit may cover more than one financial year. The percentage of GP audits covered during the last four years ended 2006/07 is 83%, 75%, 55% and 89%. The Comptroller and Auditor General of India has also commenced sample audit of PRIs.

33. Audit conducted by DoPR is transaction based, often covering 100% of the transactions. Systems audit is not conducted. Financial statements of the Panchayats are prepared by the auditors and included in the audit report. Yet, these are not certified.

34. Compliance to the audit report is an area of concern. Compliance is in arrears in a majority of GPs. The compliance is also not placed before the GP or the Gram Sabha. The Panchayats are not giving due consideration in preparing compliance to previous audit reports or resolving audit objections. The Act 1994 empowers the DoPR to stop release of funds in case the PRIs do not comply with the audit reports within a period of six months. However, no instance where this power was exercised has been reported. A central repository of outstanding audit reports is presently not available.

The official reasons for this situation is shortage of auditors, i. e. sanctioned posts have not been filled up.

Key Issues

- *The matter regarding less than full coverage of GPs under audit, as mandated by law, needs to be addressed by re-assessing the sanctioned strength of auditors vis-à-vis the increased number and volume of activities of GPs. The possibility of co-sourcing the function could be explored for which a mandate is already available in the Act.*

- *DoPR should focus on systemic issues instead of conducting full-scale transactional audit. Systems audits will bring out major weaknesses across PRIs that could be taken up for policy review and change, if necessary. Capacity of the auditors to undertake such audits needs to be built up.*

- *Compliance to audit findings and clearance of arrears needs special attention. Adequate provisions are available in the Act 1994 that should be invoked and applied in serious cases to act as a deterrent. DoPR should also expedite the release of epitome of audit findings. This should be widely disseminated and also placed before the Legislature. An inventory of outstanding audit reports/paras should be maintained and updated.*

Internal and External Controls

35. The Act 1994 read with the General Finance Rules prescribe a basic set of internal and external controls on the use of Panchayat resources and on governance.

36. GoHP has the mandate to exercise control over the affairs of the Panchayats or its functionaries. It has the powers inter alia to inspect books, suspend execution of orders, order execution of works, dissolve Panchayats and suspend or remove office bearers based on circumstances as provided in the Act/Rules. The Act empowers the Gram Sabha and the elected members of the PS/ZP to remove the Pradhan/Up Pradhan or the Chairman/Vice Chairman.

37. The minutes and books of the Panchayats or any of its committees are open to public inspection and copies can be taken on payment of prescribed fees. The Act 1994 lists out the incidents that disqualify a person from being an office bearer of the Panchayats. Primarily, these include conviction under other laws, encroachment of Government property, conviction for electoral offences, guilty of corrupt practices, making false declaration under the Act 1994, not paying taxes or rent due to the Panchayat etc.

38. Internal controls actually implemented at the GP level include signing of cashbook by the Pradhan, physical verification of cash, fixed assets and stores, reconciliation of bank accounts and preparation of an annual list of inventories. Payments are generally made in cash, only occasionally through cheques. A proper record incorporating details of the assets vested and those created and inventory of such assets are not available. Where these have been maintained, they are in arrears.

39. The Act mandates inspection of GPs by Panchayat Inspectors and of the Panchayat Samitis by the District Panchayat Officers. A detailed checklist for inspection has been prescribed in the Finance Rules 2002. The number of Panchayat Inspectors is decreasing year-on-year – 72, 66 and 61, respectively in 2004/05, 2005/06 and 2006/07, which effects full coverage of the PRIs. During 2006/07, 2193 GPs (67%) were covered. Coverage during the previous year 2005/06 was 42% due to Panchayat elections (Annual Administration Report, 2006/07 DoPR).

Key Issues

- *DoPR should appropriately address the staffing issue to ensure that all GPs are covered under inspection at least once a year, with a follow up in serious cases based on a risk based approach. This will enable DoPR to meet the requirement of the Act that mandates inspections at least once a year.*

- *Maintenance of records for assets and compilation of inventory should be taken up as a special exercise and should become part of the annual reporting, non-availability of which has been adversely commented upon by the 2nd SFC.*

Public Participation

40. The meetings of the Gram Sabha are the most important mechanism through which people can exert influence and also carry out their oversight functions and participatory planning, thereby discharging their responsibility. At the level of GP, there is no greater accountability than that to the Gram Sabha, the collective body of the citizens. The legislation has empowered the Gram Sabha and has made adequate provisions in this regard, but the ground reality is not satisfactory.

41. It is mandatory that four general meetings of the Gram Sabha and two of the Up Gram Sabha are convened every year. Although meetings of the Gram Sabha are convened, these are generally adjourned due to want of quorum. In these cases, fresh meetings may not be held. In case of Up Gram Sabhas meetings are either not held or have been infrequent.

- During 2002/03, in 76% of the GPs at least one meeting of the Gram Sabha was postponed due to lack of quorum and in about a quarter of the GPs, four or more meetings were so postponed. The corresponding figures during 2003/04 were 76% and 25% and for 2005/06 were 68% and 24%, respectively *(Report of Finances of GPs, DoPR).*

42. The above situation brings out certain grave issues. Meetings held without quorum have their own repercussions. However, due to lack of participation of the electorate the important functions of oversight and participatory planning are absent. People do not identify themselves with the Gram Sabha or consider that the GPs are accountable to them. Greater empowerment of the PRIs, particularly through devolution of financial powers, has to be another thrust area to ensure people's participation in the development process

(*Source: Himachal Pradesh Development Report*). Revitalizing people's participation is perhaps the most challenging task before GoHP.

43. Public perception on the working of the GP in general and the Gram Pradhan in particular is not very encouraging. It is felt that the Pradhan acts as an agent of the State, dependent on fund transfers under the schemes and does not act as a team with other GP members. It is also reported that actual expenditure is less than that reflected in the books (DoPR Report).

Key Issues

- *Participation of the Gram Sabha in the meetings has to be improved. In this case, both the GP members and the electorate would need to take a step forward and the GoHP should act as a catalyst.*

Social Audit

44. Several mechanisms for Social Audit are incorporated in the Act 1994. Budget and Annual Accounts are placed before the Gram Sabha, but audit reports and compliance thereto are generally not placed. Budget, income and expenditure of ongoing works and list of beneficiaries are not displayed on the notice board. The Gram Sabha members are not aware of the funds available with the GP, the schemes being implemented or whether funds have been utilized in the manner resolved in the meetings of the Gram Sabha. Income and Expenditure of ongoing works (statutory requirement) is generally not placed before the Gram Sabha.

> "Social Audit is an important complement to formal audit and for sound and healthy development of Panchayati Raj, it is essential to establish a symbiotic relationship between social and formal audit" (extract from the resolution passed at the 6th Round Table Conference of Panchayati Raj Ministers, Guwahati, Nov 2004).

45. Recently, through Amendment 2005, GoHP has made it mandatory for the GPs to obtain approval of the Gram Sabha on the budget and development plans and for issue of UCs. However, the mechanism and the strategy to build up the capacity of the community in effective discharge of these vital functions has not been developed.

46. The system of Social Audit in HP needs a booster. This situation gains significance in view of the fact that the Up Gram Sabha is inactive and attendance at the Gram Sabha meetings is thin.

Key Issues

- *Social Audit needs to be revitalized as it an essential element in governance at the local level. It is mandated that departmental officers have to compulsorily attend the Gram Sabha meetings and they can play a role in providing handholding support to steer the function. A statewide awareness campaign may be planned to popularize Social Audit and to make the community realize its importance.*

Participation of Panchayat Members

47. Proactive participation of the Panchayat members can be ensured through regular and meaningful holding of meetings, and their involvement in the Standing Committees prescribed in the legislation.

48. The law envisages administration of the Panchayats through the instrumentality of Standing Committees. The purpose of these Committees is to assist the PRIs in the discharge of their functions. The Committees can delegate functions or powers as legislated or as required and ensure participation of not only Ward Members but also other stakeholders. The Act 1994 prescribes constitution of Committees at all tiers of Panchayats. For example, GPs are required to constitute two committees namely the Budget Committee to formulate the annual budget and the Works Committee to execute development works.

49. Meetings of the Panchayats are generally convened as prescribed. But, the Standing Committees of the GP are non-functional in as much as the targeted activities are not routed through them and they do not meet regularly.

Key Issues

- *DoPR should ensure that the statutory standing committees are functional at the PRIs and that regular meetings are held; this will greatly benefit the overall governance.*

Staffing

50. Secretary of the Panchayats: The key functionary in the Panchayats is the Secretary. In case of the GPs, the Secretary is an official of the Rural Development Department. The overall duty of the Secretary is to assist the GP in the discharge of functions. As per Government policy, there should be one Secretary for every two GPs. However, actually there are 1025 Secretaries (sanctioned posts are 1465) for 3243 GPs, a ratio of 1:3. New appointments for the post of Secretaries are not being made and this has been considered as a "dying cadre" and the vacancies are being filled up by appointment of the Panchayat Sahayaks. The appointment of the Panchayat Sahayaks is through a Selection Committee comprising of the Block Development Officer, Pradhan and Secretary as members. The minimum qualification required is High School (class X) and they are imparted a three-month training, followed by an examination.

51. The Panchayat Sahayak is attached to a Panchayat Secretary and works under his guidance. Earlier, the Sahayaks were part-time functionaries, but recently GoHP has amended its policy and made the Sahayaks full-time.

Key Issues

- *Initiate rigorous training of the Panchayat Sahayaks to strengthen their capacity and to ensure that they are better able to serve the rural local body.*

Capacity Building

52. Training is imparted at the two training institutes under the DoPR and also at the Himachal Institute of Public Administration. During the year 2006-07, 6473 Pradhans and Up Pradhans (99.79%) out of 6486, 459 Panchayat Samiti Members (27.38%) out of 1676 and 204 Zila Parishad Members (81.27%) out of 251, were provided training.

53. It has been pointed out that trainings held by the institutes are classroom-based lectures with limited participation of trainees. Also, it has not been tested how much the trainees have grasped or what their weak areas are. Trainings are given one time and only to first timers. There are no schemes for ongoing training. Ward members are not provided training and hence to this extent the training program is not inclusive. Moreover, there is a shortage of full time skilled resource persons; sometimes Government functionaries are called to impart trainings. Though some NGOs are active in training GP members, yet their reach is local and is often constrained by financial resources. Capacity building measures targeted towards the community have not been initiated. In any future scheme, this aspect needs to be considered.

Key Issues

- *Training programs organized at the district level needs to be continued and further rolled out at block level. All GPs in the block and at least majority of the GP members (in addition to Pradhans and Up Pradhans) should be covered as part of these trainings. NGOs may be engaged to supplement the local resource persons, but with a uniform training guide and material.*

- *Training of GP ward members should also be taken up to enhance their awareness and proactive involvement in the working of the Panchayat.*

GPs institutional structure for levy and collection of taxes

54. GPs have been empowered to levy taxes and other duties such as house tax, land revenue, fees for fairs/markets etc. There are instances where the GPs have not levied the statutory taxes which they can and are required to do so under the Act. The rates and procedure also vary from place to place, and taxes and other levies are in arrears. There is reluctance of local rural bodies to impose taxes, thus leaving limited resources in the hands of the GPs. For example, during 2005/06, 40% GPs did not levy/collect land revenue. (*DoPR Report*). The geographical spread makes it also difficult for collection of taxes.

55. It is argued that to avoid Social Audit, Panchayats deliberately reduce dependency on internal resources and try to mobilize funds from outside. Larger amounts contributed by the community attract Social Audit and genuine peoples' participation. SFC opined that in the pre-73rd Constitutional Amendment regime, transfers to PRIs were dominated by grants, which promoted a "dependency syndrome". Post 73rd there is a need to build a strong local rural financial base.

Key Issues

- *2nd SFC has suggested that resource transfers recommended by it should not be released unless the GPs collect the statutory taxes, but this proposal has not yet been implemented. GoHP should gradually move to a regime that links release of grants to incremental revenue efforts.*

- *GPs should be provided an institutional mechanism for levy and subsequent collection of taxes and fees. A special training program in this area could lead to better tax administration.*

Conclusion

56. Accountability arrangements in Panchayats in HP are elaborate and well structured. Panchayats in HP have exposure of handling public funds, have experience in implementing projects/schemes and carry out functions such as meetings, budgeting, planning, accounting, procurement, preparing estimates, supervision, reporting, etc. Actual implementation of the Accounting and Accountability instruments, though, could be further strengthened.

57. Panchayats have a strong presence in rural areas and are recognized by the rural citizenry and the Government as constitutional institutions of self-governance. In HP, their importance gains significance as 90% of the population resides in the rural areas. As more powers, responsibilities and functions are devolved on the Panchayats, demand for accountability and transparency would increase. The role of the community cannot be overemphasized – they should be more knowledgeable in the activities meant for their benefit.

Note 4: Modernizing The Public Procurement System

Summary

This document reports on an assessment of the Himachal Pradesh Public Procurement System based on the framework developed by the OECD-DAC (Organization for Economic Co-operation and Development-Development Assistance Committee). The assessment is part of a broader PFMA Assessment for Himachal Pradesh that is being undertaken by the GoHP with the support of the World Bank.

The discussions with key stakeholders in GoHP indicate that the public procurement system in is in a state of transition. The methods used for procurement also vary, depending on the basis of conditionality prevailing in each funding, i.e. whether the funds belong to budget allocations, centrally sponsored grants or donor projects. In this situation, it is probably not appropriate to consider performance of the "procurement system", since multiple procurement systems operate in the State. There is no one department assuming overall responsibility of either the rules or management of procurement. Efforts are on to build such responsibility in each key procuring department. Given this framework, no attempt has been made to assign scores to indicators, as this will not give a clear picture.

This report provides an initial overview of the current features of the HP procurement system. This draft does not draw specific conclusions about the strengths and weaknesses of the procurement system, but tries to establish an overall framework for assessing the State's system. Therefore, it can serve as an input for development of a strategy to improve procurement outcomes in the State. However, we have not proposed a set of actions to improve procurement as we believe that a sensible procurement reform strategy can only be developed by GoHP as part of a broader strategy to improve the management of public financial resources and the effectiveness of spending.

Introduction

The public procurement system in HP is in a state of transition. Most modern procurement systems reflect an overall concept that the State gets best value from its contractual relations by fair and open competition for contract opportunities. Over the last several years, the emphasis on competition has been complemented by an increased focus on structuring procurement systems so that decision making authority rests with the party that requires the asset or service that is being procured. The current procurement system in HP does not correspond to this model. A large proportion of contracting is done by a central contracting agency. State rules emphasize contracting with State-owned enterprises over free and open competition. At the same time, some features of modern public procurement systems have been introduced. The State is exploring ways to improve the performance of its procurement system.

The primary challenge in public procurement in the coming years will be managing the transition from a State-dominated purchasing system to a modern system of State contracting. The transition is likely to take several years to implement and will need to be approached in a strategic fashion.

Public Procurement System

Public procurement – the purchasing of goods, works, and services by the Government from the private sector – is a key mechanism for Governments to spend public money. In most Governments, the volume of spending that takes place via public procurement is rivaled only by the amount of money that goes to salaries and debt payments. The volume of public spending and the impact of development spending in particular is strongly influenced by the efficiency with which the Government contracts with the private sector and the value it gets from its contractual relations. The functioning of the public procurement system in Himachal Pradesh is especially important given the exponential growth that has occurred in capital spending in the last two years and ambitious plans to ramp up this spending in the future.

Procurement systems encompass the laws and other legal norms that define and regulate the contracting process, the mechanisms used to manage and monitor the application of these rules and the systems' performance, the actual interactions between executing agencies and private sector bidders and contractors, and the accounting and oversight of the entire process. Procurement systems are deeply embedded in the entire process of managing and spending of public money. The performance of a public procurement system is as dependent on good budget processes and effective auditing as it is on well-defined procurement regulation and experienced procurement staff.

Well-performing procurement systems are founded upon four strong pillars:

- A simple regulatory structure defined by a single procurement law drafted in accordance with principles of good practice, supported by easily available implementing regulations, standard bidding documents, manuals, among other things;
- A body entrusted with responsibility and authority to oversee the management of procurement, including devising procurement policies, monitoring the application of procurement rules, supporting the development of trained procurement professionals, and assembling and analyzing procurement information to determine how procurement outcomes could be improved;
- Spending agencies that have the ability to execute procurement transactions in an efficient and effective manner working with a competitive private sector that has the ability to meet the State's needs; and
- Mechanisms for accounting and oversight of procurement operations that ensure that regulations are followed properly and that the State gets good value for the money it spends on contracts.

The hallmark of a well-designed procurement system is that it executes most transactions through competitive processes and that it has an active and independent mechanism for receiving and resolving procurement complaints in a fair and timely fashion.

Methodology for Assessing the Public Procurement System

The developing countries and bilateral and multilateral donors having a concern for increasing the effectiveness, efficiency and transparency of procurement systems, under the auspices of the joint World Bank and OECD-DAC Procurement Round Table initiative, worked together to develop a set of tools and standards that provide guidance to improve public procurement processes, management, and outcomes. Among these tools is the Baseline Indicator System (BIS) – an instrument designed to enable countries and donors to gain a comprehensive overview of the elements of a procurement system, and benchmark those elements against the features of well-performing systems. The BIS tool is structured around the four key pillars of procurement systems (laws and regulations, management and oversight, the capacity of executing agencies, and the internal and external monitoring of procurement operations). It comprises of 12 indicators, each of which has a number of sub-indicators.

Table 14 : Baseline Indicators

Indicator Number	Indicator Description
1	Existence of well-designed procurement regulations
2	Existence of comprehensive and available implementing regulations and standard bidding documents
3	Integration of procurement into the overall public financial management system
4	Existence within Government of one or more bodies with responsibility for setting and monitoring overall procurement policies
5	Capacity of the public procurement unit
6	Efficiency of the State's procurement operations
7	Functioning of the procurement market
8	Existence of rules to guide contract administration and resolve contract disputes
9	Effective control and audit of procurement
10	Efficiency of appeals mechanisms
11	Access to information
12	Existence of ethics and anti-corruption measures

The BIS presupposes that there exists a single procurement system that can be assessed and evaluated. This situation does not exist in HP since public procurement is undertaken by different agencies using different rules. The system features aspects of centralized purchasing, strong preferences for particular suppliers (State-owned firms), as well as certain aspects of decentralized, market-driven procurement. In such a context, the value gained by arriving at a particular "score" for an indicator is highly suspect, since the score can only be obtained by a rough approximation and averaging of the scores of each of the different sub-procurement systems that can be found in the State.

The assessment methodology that has been used in this report is to model the analysis on the overall framework that is contained in the OECD-DAC indicators. Individual indicators have not been applied or scored. The assessment provided in this document should therefore be seen as part of the transition process that is taking place in public procurement in HP, with the expectation that a more precise baseline will be possible after the State has acted to define a coherent public procurement system.

State context

Procurement in GoHP is governed by Himachal Pradesh Financial Rules, 1971. These are based on the GFRs of the Government of India, 1963 version. These rules are formulated by the Finance department. While the GoI's GFRs have been revised in 2005, the GoHP Financial Rules have not been updated.

The State is moving from a centralized procurement regime to decentralizing the procurement function to the respective departments. For example, while the Store Purchase Organization is the nodal agency for negotiation of rate contracts, there is an increasing effort to decentralize department specific purchase to the respective departments. When procurement is decentralized, multiple rules and departmental regulations/instructions develop over time.

Simplification of laws and regulations is often best accomplished through the adoption of a modern procurement law that applies to all kinds of procurement undertaken, using public funds related to goods, works and services. States like Tamil Nadu and Karnataka have adopted modern procurement laws.

The procurement rules in GoHP by themselves are relatively old, generally incomplete and inconsistent in places. Creating provisions like provision for preference for State suppliers were introduced with an aim to promote the local industries. It needs to be reviewed whether such preferences actually result in the desired effect or end up limiting competitiveness for public procurement. The documents for goods and works have been published in book format and are thus available, although there is currently no information available as to the extent of public access to these publications. None of these documents are available on the Government website www.himachal.gov.in or the department links given therein.

Procurement presently takes place amidst a large number of controllers and overseers. Improving oversight of procurement involves rationalizing control as well as increasing the ability of the Government and the private sector to monitor performance.

Some departments are using IT initiatives to improve their existing commercial practices. The Irrigation Department has launched various initiatives including improved contracting, better inventory and asset management, supplier registration and building of a database. However, these initiatives will help achieve significantly improved outcomes if they are integrated across departments and get benefits from experiences in other states/countries with experience in similar initiatives.

Under the National e-Governance Plan, GoHP is planning to launch a State-wide e-Procurement initiative. The IT department is providing the required technology leadership. In addition to using technology for bringing in standard procurement practices, e-Procurement can help improve procurement outcomes, improve competition and help the Government to effect cost savings.

Procurement of Goods

The Stores Rules are relatively brief. Although they deal with many aspects of the procurement process, they are generally incomplete and rather unclear. These are drafted in terms of the Government officers who have authority to make procurement decisions. They state that they apply to the Stores Department and all Heads of Department and other officers. The rules would, therefore, be applicable to all procurement for which authority has been delegated. There is, however, no mention of the procurement authority of Government owned enterprises, notably those in the utilities sectors. Nevertheless, the rules are set up considering a heavily centralized purchasing system which is mandatory for all Government entities in respect of the products enumerated in Annex I of these rules. The purchase of these items will be carried out by the Store Purchase Organization ('SPO') on the basis of rate contracts entered into by the SPO on behalf of the Government and on the basis of the consolidated needs of the various entities. Only the items listed in Annex V of the rules may be purchased by the various departments themselves. This will be done by duly constituted Departmental Standing Purchase Committees (constituted with the concurrence of the Finance Department) which will apply the same rules and procedures as the SPO. Any item not covered by either Annex I or V will also fall within the procurement authority of the SPO.

Discussions with key departments have highlighted GoHP's efforts to decentralize procurement to the concerned line departments. While there have been no focused efforts to build the capacity of the line departments for effectively conducting procurement, the nominee of the SPO is generally on the tender committee. Different Government agencies register suppliers independently.

There are, however, a number of provisions, which seem to allow the Store Rules to be ignored whenever that is in the 'public interest'. What constitutes 'public interest' is, however, not defined.

Procurement of Works

Unlike in case of goods, a set of rules regarding procurement of works was not available, and a tender template being used by the Public Works Department was made available. It was mentioned that the rules of the Punjab Government are being used for procurement of works, but these are quite old and have not been updated. Instead, the tender template is updated for use.

Procurement of Services

While guidance is available on purchase and works contracts, it cannot be said that the methodology is universally applicable for services procurement. Whether the written guidance is state-of-the-art in terms of thresholds, tendering tools, documentation etc. is also debatable. Considerable "modernization" of the processes, procedures and methodologies of selection is required to make it comparable with international best practices.

Provisions for e-Procurement

The IT department has taken few initiatives for effective deployment of technology in the procurement process. The tenders of the departments/agencies of GoHP are being hosted on the website www.himachal.gov.in/tender.htm as per the CVC guidelines in this regard. The departments that are participating in this initiative are Irrigation & Public Health, Public Works Department (for PMSGY), Baddi-Barotiwala Nalagarh Development Authority, HRTC, Excise & Taxation, Education Department (for SSA) and Information Technology (for major tenders).

In addition, Information and Public Relations Department is also hosting on its website information on date range and names of newspapers in which tender notices have been issued by various departments.

HRTC (Himachal Roads Transport Corporation) has started implementing e-Tendering for which the services of M/S ITI Industries Ltd have been taken on a per tender hiring basis. Irrigation & Public Health Department is also developing application software incorporating some of the features of e-procurement as part of its overall IT initiative.

The development of "islands of systems" tends to be expensive and due to the lack of inter-operability among the many modules, the Government does not get the full benefit of implementing e-procurement. GoHP has proposed to bring out a common policy and implementation framework for e-procurement in the State and develop a common application with sufficient adaptability, so that it can be used across all procuring agencies.

HP has been selected as one of the pilot states for implementation of e-procurement under the National e-Governance Plan. This initiative is being developed under the IT Department. The planned initiative will cover supplier registration, indent and inventory management, e-Tendering, e-Contract Management, e-Payments, Auctions, Rate Contracts, Accounting and MIS.

However, e-procurement will not address the core issues around public procurement in the State by itself. Rather, e-procurement could be a very effective tool to improve procurement in the State if it is part of an overall procurement reforms program. Computerizing a set of improperly defined practices in a less efficient functioning system for interacting with the private sector will not generate strong benefits.

Effective e-procurements are characterized by a business approach, with IT providing leadership on technology dimension, finance on procurement processes and change management.

Institutional Framework and Management Capacity

Due to the increasing decentralized procurement, there is no single entity with an overall responsibility to monitor public procurement performance or provide procurement information. The legacy institutions are responsible for providing clarifications in case the rules are not clear. There is no systemic way of reporting on procurement to the Government or developing and supporting implementation of initiatives for improvements of the public procurement system. Implementation tools and documents to support training and capacity development of implementing staff are also lacking.

Procurement as a function is not a separate specialization. As such there is no separate skill profiling for procurement functions. On an ad hoc basis and through departmental entry level mastery training programs, the staff that handles procurement are considered as having the requisite knowledge.

Procurement Operations

Capacity building of staff responsible for procurement needs to be strengthened through relevant training programs for new and existing staff in Government procurement. These programs are essential to maintain the supply of qualified procurement staff to the public and private sectors.

Department wise some information is available on tenders on web sites. But this is not uniform across all departments. Detailed information on tenders opened and closed, details of awards made, agencies awarded, award price, percentile variation to the original estimate, among other data is lacking.

Right to Information Act, applicable for all public procurement activities can also be used by the public for securing any information on procurement actions undertaken by any Government department.

List of principal persons met

Finance Department
1. Mr. Arvind Mehta, Principal Secretary Finance.
2. Dr. Ravinder N. Batta, Additional Secretary Finance
3. Mr. Akshay Sood, Special Secretary Finance
4. Mr Shekhar Gupta, Special Secretary Budget
5. Ms Nandita Gupta, Special Secretary Budget
6. Mr. Deepak Bhardwaj, Joint Director Treasuries
Planning Department
7. Mr. Bushari, Director
8. Mr. Basu Sood, Deputy Director, Plan Implementation Division
Accountant General, Himachal Pradesh
9. Mr. G. N. Sharma, Deputy Director
10. Mr T C Dhiman, Deputy Accountant General
Health and Family Welfare Department
11. Dr M Mahajan – Director of Health Services
12. Mr. Rajeev Sharma – Additional Director
13. Mr. B R Shinha – Dy. Controller (F&A)
14. Mr. Rajiv Sood, Consultant Finance – NHRM
Public Works Department
15. Engineer In Chief
16. Mr. Sharma, Joint Controller of Finance
17. Mr. OP Sharma – Executive Engineer Projects
18. Mr. M L Chouan, Financial Controller – PMGSY
19. Mrs. Asha Saraik, Superintendent, Planning Branch
Department of Education
20. Mr. Ashok Sharma, Additional Director, Secondary Education
21. Mr. Negi, Deputy Director, Shimla Dist., Secondary Education
22. Mr. Prasher, Section Officer, Secondary Education
23. Mrs. Nirmal Bhandari, Superintendent, Planning Branch, Secondary Education
24. Mr. B K Sondhi, Asst. Director – Planning, Primary Education
Panchayati Raj Department
25. Mr. Kewal Sharma, Deputy Director
Rural Development Department
26. Mr. Shamsher Singh, Joint Director
Irrigation & Public Health Department
27. Mr. K S Verma, Asst. Controller (F&A), Irrigation and Public Health
Forestry Department
28. Mr Sinha, Controller Finance
Urban Development Department
29. Mr V R Gupta, Deputy Controller Audit

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• Budget in Brief
• Demand for Grants
• Appendices to Schedules of New Expenditure (Plan)
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