Report of the
High Level Expert Committee on

Efficient Management of Public Expenditure

Government of India
Planning Commission
New Delhi

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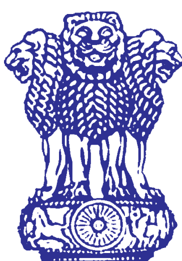

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PREFACE

The 11th Plan document raised several conceptual issues arising out of the present structure of plan financing. The classification of expenditure has an important bearing on the overall expenditure management. The distinction of expenditure into Plan and Non-Plan categories has significant implications for efficient management of public expenditure. The revenue and capital categorization also requires a fresh look in the post-FRBM scenario in view of the need for substantial resource transfers to States and local bodies. The transfer of Central resources to States through various types of schemes and multiple modes of transfer have posed problems in obtaining a comprehensive overview of transfers to States as well as in effective monitoring of expenditure. There are also issues concerning accountability of funds directly transferred to implementing agencies in States. The Eleventh Plan document also referred to innovative methods of financing of projects such as public private partnerships and new administrative mechanisms of implementation and the need, in this context, to clarify the scope of the public sector plan. In response to these issues, Planning Commission set up a High Level Expert Committee to suggest measures for the efficient management of public expenditures. The composition and terms of reference of the Committee are given as Annexure to the Report. I have had the pleasure of chairing this Expert Committee and now in submitting the report of this Committee.

Major recommendations of the Committee are as follows:

The Plan and Non-Plan Distinction

The classification of expenditure into Plan and Non Plan, although not rooted in the Constitution, has evolved with planning process. Over a period of time, several issues have cropped up from the distinction between plan and non-plan, making it dysfunctional and an obstacle in outcome-based budgeting. Therefore, this distinction should go for both Union and State Budgets. On removal of Plan/Non-Plan distinction in the Budget, there should be a fundamental shift in the approach of public expenditure management- from a segmented view of Plan and Non-Plan to holistic view of expenditure; from a one year horizon to a multi-year horizon; and from input based budgeting to the budgeting linked to outputs and outcomes. This shift to holistic view of expenditure would require, interalia changes in organizational structure, mandates and processes.

In the envisaged system, the MOF will prepare proposed allocations for ministries with broad scheme-wise allocations and committed items and send it to Planning Commission for their feedback and scrutiny. The Planning Commission will scrutinise these allocations based on the overall development priorities, outcome targets and sectoral requirements. On the receipt of the comments of Planning Commission, the budget allocations will be further reviewed and incorporated in the budget by the MOF.

Comprehensive framework of Transfers to States

A new multidimensional budget and accounting classification being worked out, may include independent dimensions in respect of Functions, Programmes and Schemes, Economic Object, Recipients of funds, Geography and Beneficiary. The proposed classification and coding system must provide uniform codes for Central programmes, sub-programmes and schemes which are implemented in States so that comprehensive view across the country is facilitated. The Committee recommends that the Central Plan Scheme Monitoring System (CPSMS) should be extended to interface with State treasuries and AG offices as well as Core Banking Solution (CBS) of banks to enable tracking of expenditure down to the last level of implementation.

Accountability Concerns arising from Direct Mode of Transfer

The Committee recommends the treasury mode of transfer of central plan funds. The switchover to complete treasury mode of transfer of funds may be made straightforward possibly beginning all new schemes from the 12th Five Year Plan. For existing schemes, a short transition period is required to allow for necessary adjustment. However, till complete switchover to treasury mode is done, accounting, and submission of Utilisation Certificates under society mode should be rationalized and auditing strengthened through several measures in the manner described in Chapter 4.

Revenue Capital Classification

The Committee is in favour of continuing the Revenue-Capital classification. Capital expenditure should relate to creation of assets and be determined by ownership criterion. While all transfers should be treated as revenue expenditure in accounts, an “adjusted revenue deficit” (adjusting the revenue deficit to the extent of grants for creating assets) may be considered only for FRBM compliance.

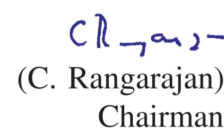
Scope of the Public Sector Plan

The Budgetary component of the Plan of the Centre or a State will have one-to-one relation with the Government Budget of the Centre or of a State respectively. The Central or State Plan should continue to include investment outlays (funded by IEBRs) of CPSEs and SPSEs respectively. All States/UTs must include information about investment outlays of SPSEs (funded out of IEBRs) in their budgets as a separate annexure. The resources of the rural and urban local bodies should

also be included as part of the State/UT Plans. As regards Public Private Partnership (PPP) projects, since both annuity payments and VGF are provided from the budgetary support, these will form part of Plan of the Centre or the State. It is important to have regular information on the investment crystallized through PPPs. Therefore, there should be supplement to the Central/ State Budgets providing Project-wise, Ministry-wise and Sector-wise information on PPPs.

I would like to thank all members of the Committee for their active participation and contribution. Professor Abhijit Sen, Member, Planning Commission, Smt. Sudha Pillai, Member Secretary, Planning Commission Smt. Sushama Nath, Secretary (Expenditure), Dr. Subir Gokarn, Deputy Governor, RBI and Dr. Kaushik Basu, Chief Economic Adviser, DEA, MoF. provided deep insight into the issues. Dr. Rekha Gupta, Deputy Comptroller & Auditor General and Shri C.R. Sundaramurti helped prepare position papers on the allocated subjects to bring clarity on the outstanding issues and options to go forward. Dr. Nitin Desai, Professor D.K. Srivastava, Dr. M.G. Rao and Professor Ravindra Dholakia provided analytical and critical comments from their years of experience and research. Shri C.M. Bachhawat, Shri N.K. Shanmugan, Shri G.P. Singhal and Shri H. S. Das enriched the discussions with their practical experience of the issues at the State level and suggested several pragmatic solutions. I would particularly like to acknowledge the outstanding contributions of Shri Tuhin K. Pandey, who as Member Secretary of the Committee provided analytical, logistical and drafting support to the Committee.

I would like to acknowledge important contributions of Shri R. Sridharan, Dr. K.P. Krishnan, and Shri Ritvik Pandey who generously shared their experience and ideas on the subject. I would also like to thank Shri Shaktikanta Das for his valuable comments. Finally, I would like to place on record my appreciation for the support and assistance rendered by Shri H.K. Hajong and other members of the secretariat team, namely Shri Subhajit Roy and Ms. Shraddha Kothari in FR Division of Planning Commission.



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Acronyms

ACA	Additional Central Assistance
AG	Accountant General
AIBP	Accelerated Irrigation Benefits Programme
BCR	Balance from Current Revenue
BE	Budget Estimates
CA	Chartered Accountant
CA	Central Assistance
CAG	Comptroller and Auditor General
CAGR	Compounded Annual Growth Rate
CBS	Core Banking Solution
CEA	Chief Economic Adviser
CGA	Controller General of Accounts
CM	Clearance Memo
COFOG	Classification of Functions of Government (United Nations)
CPSE	Central Public Sector Enterprise
CPSMS	Central Plan Scheme Monitoring System
CSS	Centrally Sponsored Scheme
DFPR	Delegation of Financial Power Rules
DLFA	Director, Local Fund Audit
DoE	Department of Expenditure
DRDA	District Rural Development Agency
DSS	Decision Support System
EAC	Economic Advisory Council
EBR	Extra Budgetary Resources
Exp.	Expenditure
FC	Finance Commission
FR	Financial Resources
FRBM	Fiscal Responsibility and Budget Management
FY	Financial Year
FYP	Five Year Plan
GAAB	Government Accounting Advisory Board
GAR	Government Accounting Rules
GBS	Gross Budgetary Support
GFR	General Financial Rules
GFSM	Government Financial Statistics Manual
GOI	Government of India
HLEC	High Level Expert Committee (On Efficient Managament of Public Expenditure)
HRD	Human Resource Development
IA	Implementing Agencies
IEBR	Internal and Extra Budgetary Resources
IFAC	International Federation of Accountants
IGAS	Indian Government Accounting Standard
IIFCL	India Infrastructure Finance Company Limited
IIM-A	Indian Institute of Management -Ahmedabad
IMF	International Monetary Fund
IPSAS	International Public Sector Accounting Standards
IR	Internal Resources
J&K	Jammu and Kashmir
JNNURM	Jawaharlal Nehru National Urban Renewal Mission
MCR	Miscellaneous Capital Receipts
MGNREGA	Mahatma Gandhi National Rural Employment Guarantee Act
MIS	Management Information System
MoF	Ministry of Finance

MoPR	Ministry of Panchayati Raj
MSE	Madras School of Economics
MTEP	Medium Term Expenditure Plan
MTFP	Medium Term Financial Plan
NCA	Normal Central Assistance
NDC	National Development Council
NeGP	National e-Governance Plan
NER	North Eastern Region
NGO	Non Government Organisation
NHAI	National Highway Authority of India
NIC	National Informatics Centre
NIPFP	National Institute of Public Finance and Policy
OBC	Other Backward Classes
OECD	Organisation for Economic Co-operation and Development
PAO	Pay and Account Office
PAPFMS	Plan Accounting and Public Finance Management System Scheme
PC	Planning Commission
PMGSY	Pradhan Mantri Gram Sadak Yojana
PPP	Public Private Partnership
PRI	Panchayati Raj Institution
PSE	Public Sector Enterprise
PSU	Public Sector Undertaking
PWD	Public Works Department
RBI	Reserve Bank of India
RD	Revenue Deficit
RE	Revised Estimates
SARC	Second Administrative Reforms Commission
SC	Scheduled Castes
SCF	State Consolidated Fund
SG	State Government
SPSE	State Public Sector Enterprise
SPV	Special Purpose Vehicle
SSA	Sarva Shiksha Abhiyan
ST	Scheduled Tribes
TA	Travelling Allowance
TG&S	Technical Guidance and Supervision
TOR	Terms of Reference
U.K.	United Kingdom
UC	Utilization Certificates
ULB	Urban Local Bodies
UT	Union Territories
VGF	Viability Gap Funding
VLC	Voucher Level Computerization
WP	Working Paper
ZP	Zila Parishad

EXECUTIVE SUMMARY

I. INTRODUCTION

In the context of improving public expenditure management, there is a new recognition on the role of institutional arrangements in influencing budget outcomes in the areas of aggregate fiscal discipline, strategic allocation of resources and operational efficiency. The essential requirements for public expenditure management include performance-focus, link between policy making, planning and budgeting, well-functioning accounting and financial management systems and appropriate links between budgeting and other systems of the Government.

In India too, there is an emphasis on improving outcomes of public expenditure in Central and State Governments through the instrument of outcome budgets. However, there have been several limitations that impede widespread practical use of the outcome-based budgeting. These include segmentation of expenditure between Plan and Non-Plan, absence of a hard budget constraint, lack of incentives to Ministries to reallocate resources, non-availability of information on costing of services, problems in budget and accounting classification, inadequate information systems on transfers of resources to States and absence of robust financial management information systems. The Eleventh Plan document has raised many of these issues while discussing financing of the Plan. The High Level Expert Committee has been asked to examine some specific issues and make recommendations.

II. THE PLAN AND NON-PLAN DISTINCTION

The classification of expenditure into Plan and Non-Plan, although not rooted in the Constitution, has evolved with planning process. In the initial years of planning, the emphasis was to direct capital investment in sectors according to priorities of each Plan. The bulk of Plan expenditure was capital expenditure and the aim was to increase the productive capacity of the economy. However, the composition of the plan expenditure in both Centre and States has changed over time as the bulk of the plan expenditure is now revenue expenditure. Over a period of time, several issues have cropped up from the distinction between Plan and Non-Plan.

Current scheme of expenditure classification

The expenditure of the Government is classified into functional heads. The functional classification signifies broadly the function of Government for which the expenditure has been incurred and the activity on which the expenditure has been incurred. The functional classification being followed as of now, is a six tier structure with a hierarchy of major, sub-major, minor, sub-head, detailed heads and object head. The first tier of the functional classification, called the major head denotes the functions of the Government that are discharged through the expenditure.The second tier of functional classification provides the description of sub functions. The third tier,

denoted by the minor head, indicates the objective of the Government being achieved through that particular expenditure. Below the minor head are the two tiers of sub heads (fourth tier) and detailed heads (fifth tier). The Sub head indicates specific schemes or activities of the Government under which the expenditure has been incurred and the detailed head indicates various components of the schemes or sub schemes. The sixth tier of object head provides details about the object of expenditure. Thus, this forms a two dimensional classification where the expenditure is classified into object heads for each functional head. The division provided by Plan/Non-Plan classification is laid over the functional and object classification. This division cuts across the entire classification hierarchy into two columns.

Plan and Budget

The division originates from the budgeting exercise where the Non-Plan expenditure is estimated first. Since the Non-Plan expenditure is of a committed nature, it is mostly budgeted based on historic parameters. After estimation of the Non-Plan expenditure, the resources (both tax and non-tax) are estimated. The amount of resources left after meeting the Non-Plan expenditure is called the Balance from Current Revenue (BCR) and is a part of the non-debt resources that is available for plan expenditure. The second part of non-debt resources is the Miscellaneous Capital Receipts (MCR) taken on net basis. These non-debt resources added to the amount of net borrowing planned to be incurred would give the total amount of resources available for plan expenditure. This amount is called the Gross Budgetary Support (GBS) for Plan. The Gross Budgetary Support is then allocated into sectors, down to development heads and finally to plan schemes. These allocations are then formatted into budgetary classification. The Plan and Non-Plan budget put together comprise the expenditure budget of the Government. The natural corollary of this budgetary practice is that while the Non-Plan envelope is based broadly on the requirement of the departments depending on the expenditure items that are more or less committed, the plan envelope is broadly based on the availability of resources.

Expenditure Classified as Plan

Plan expenditure in the Government, generally, signifies expenditure taken up under development schemes during a particular Five Year Plan. However, some of these schemes can be continued from a previous plan or some may be 'spill-overs'. At the initial stages of the exercise of preparation of a Five Year Plan, Planning Commission issues detailed instructions directing what should be classified as 'Plan Expenditure'. The plan schemes are mostly expected to be limited to a Five Year Plan period. But they may have implications that may extend beyond the plan period.

Major Issues relating to Plan/ Non-Plan Distinction

Due to the complex nature of Government, the policy regarding what should get classified as plan expenditure and what should get classified as Non-Plan expenditure has been losing clarity. Besides, a notion has widely gained ground among the policy makers and officials across all levels that plan expenditure is good and Non-Plan is bad. This bias in favour of Plan expenditure and against Non-Plan expenditure has led to a situation in which essential Non-Plan expenditure like maintenance of assets is neglected. This has also led to a motivation for showing higher plan expenditure and higher plan sizes both at Central and State levels. Further, several factors such as shift of plan focus from capital to revenue expenditure and the process of transferring expenditure of old schemes to Non-Plan at the end of each Five Year Plan mean that correspondence cannot be drawn between plan and development expenditure.

The Plan/Non-Plan bifurcation of expenditure has contributed to a fragmented view of resource allocation to various programmes/ schemes. With fragmented view, it is difficult not only to ascertain cost of delivering a service but also to link outlays to outcomes. Outcomes and outputs of programmes depend on total expenditure, Plan and Non-Plan put together and not merely on Plan expenditure which constitutes about 30% of the total expenditure only. To conclude, Plan and Non-Plan distinction in the budget is neither able to provide a satisfactory classification of developmental and non-developmental dimensions of Government expenditure nor an appropriate budgetary framework. It has, therefore, become dysfunctional.

The Committee, therefore, recommends that Plan and Non-Plan distinction in the budget should be removed. At the Central Government level, Planning Commission may be responsible, for the sake of convenience and domain knowledge, for guiding the overall development priorities of the Government, setting of outcome targets and review of performance of Ministries/Departments. Ministry of Finance may be responsible for guiding the fiscal policy, preparation of budget and financial decisions. Planning Commission may be responsible for consolidation of the Five Year Plan covering all Services based on the inputs from the Ministry of Finance. The annual budgeting process may need to be revised to facilitate output and outcome-based budgeting within a multi-year framework.

This issue has been extensively dealt with in Chapter 2, which evaluates the present scheme of things using the lens of efficient public expenditure management and elucidates the basis for recommendations. The main recommendations on this issue have been outlined later in this part under the heading Summary of Recommendations.

III. COMPREHENSIVE FRAMEWORK OF TRANSFERS TO STATES

The resources flow from Centre to States by way of assignments and transfers. The States' share in central taxes (tax devolution) is an assignment. The transfers from the Centre to States include Non-Plan and Plan transfers. The Non-Plan transfers comprise Finance Commission grants and other Non-Plan grants. The important plan grants that are transferred from Centre to the States are of four types: (1) State Plan Schemes that include Normal Central Assistance (NCA) and other Scheme based Central Assistance (CA)- which are also known as ACA Schemes; (2) Centrally Sponsored Schemes (CSS) for which funds are routed through consolidated fund of States and (3) Centrally Sponsored Schemes (CSS) for which funds are transferred directly to State/District Level Autonomous Bodies/Implementing Agencies and (4) A small portion of FC grants treated as Plan grants.

The Non-Plan transfers such as Finance Commission grants and other Non-Plan grants are transferred to the States through treasury route. As regards plan schemes, resources are transferred through treasury route or direct transfer/society route. A clear framework is needed for a comprehensive view of the total transfers to States and accounting and reporting issues linked to these transfers. This issue is also intimately connected to the budget and accounting classification.

Problems in the current system

A major problem faced today is in generating scheme wise information from the accounting classification due to absence of a one-to-one correspondence with schemes and heads of accounts. The present six-tier budget and accounting classification has several problems.

Functions are repeated under the Revenue, Capital, and Loans sections. A significant proportion of Union Government expenditure takes place in the form of transfers to States. These transactions are recorded under the Major Heads 3601 and 3602. The sub-classification under these heads has not kept pace with the changing pattern of plan assistance. Also, there is no provision to show State-wise breakdown of such transfers. Further, separate heads for transfers to States (which should be an object head) and for resources meant for north-eastern areas (geographical attribute) within functional classification results in not being truly functional. The minor head is a very critical level and needs an extensive review. There has to be some level of budgeting and accounting that relates to broad objectives of the Government for a given function to which eventually outcomes can be linked. This would also enable reporting on cost incurred by Government under various items of expenditure for a particular objective and to achieve a desired outcome. A related issue is non-reporting / non-availability of information in the State Finance Accounts of significant amount of resources being devolved on States through direct Central Assistance outside the State Consolidated Funds. The problem gets compounded due to lack of uniform coding for plan schemes across the States. Another issue that leads to weakening of the accounting classification is the structure of Finance Accounts. As of now, the Finance Accounts show the expenditure details up to the minor head level across all sectors.

Central Plan Scheme Monitoring System (CPSMS)

The Central Plan Scheme Monitoring System (CPSMS) is being currently setup by the Controller General of Accounts in collaboration with the Planning Commission to serve as a comprehensive management information and decision support system for monitoring of the plan schemes of the Government. CPSMS has the challenging task of integrating tens of thousands of implementing agencies through a common system so that fund movement is tracked at each successive stage starting with the initial release from the Centre till the money actually reaches the ultimate beneficiaries. CPSMS portal is operational now. Over 1000 Plan schemes of the Government of India have been mapped on this system and more than 75,000 sanctions for release of funds have been captured. Nearly 20,000 programme implementing agencies have been registered with the system. Ministry-wise, Scheme-wise, State-wise, District-wise, NGO-wise, Individual-wise data of releases from GOI is now centrally available on CPSMS on a real-time basis.

A unique feature of CPSMS is its close interfacing with the Core Banking Solution (CBS) of the individual banks to obtain information on movement of funds from one level to another and from one agency to another on a real-time basis. This feature will help in efficient and effective cash management. Several major banks in the country have agreed to join the CPSMS interface and it is expected that all banks would be part of this network. CPSMS also seeks to have interface with State treasuries and State AGs to obtain real time expenditure information for schemes for which funds are transferred from the Central Ministries to the consolidated fund of the States. On full implementation, the system would provide a platform on which the management at each level would be able to monitor fund utilization under various developmental schemes operated through treasury route or society route. CPSMS is expected to provide customized information of fund deployment and utilization vertically under each scheme to programme managers and horizontally across schemes in one geographic area for senior management and political functionaries. Inputs

provided by the system would be vital for programme management and policy planning. The information on fund utilization is also planned to be placed in the public domain for greater public awareness, public participation in the policy making and execution and toward enhanced transparency in Government operations.

Change in Classification of Budget and Accounts

The Union Ministry of Finance has constituted a Committee headed by Controller General of Accounts recently for revision of the List of Major and Minor Heads of Accounts of the Union and the States. Issues related to accounting of plan schemes and the need for developing a mechanism to provide a comprehensive view of the transfers to States are under active consideration of this Committee, which will address structural deficiencies of the current system and develop a new design which will be computer friendly and which will enable flexible multi-dimensional views of expenditure data and a comprehensive view of the transfers to States.

The issue of comprehensive framework of transfers to States has been extensively dealt with in Chapter 3. The main recommendations of the Committee on this terms of reference are listed below under the heading Summary of Recommendations.

IV. ACCOUNTABILITY CONCERNS ARISING FROM DIRECT MODE OF TRANSFER

Modes of transfer of resources to States

The Government of India releases funds under CSS through two methods: treasury mode and society mode. In the treasury mode, after the sanction of funds by the concerned administrative ministry/finance ministry of the Union Government, the RBI is intimated to transfer the funds to the State Government. The expenditure is routed through the treasury and is captured by the AG office through the vouchers received for the same. With the IT systems in treasuries and AG offices in several States, funds can be tracked till the State Government spends through State Departments or transfers the fund to the Implementing Agencies (IAs) (mostly local bodies). The funds are audited by CAG. In the society mode, funds are sanctioned by the concerned administrative ministries and released by them. The funds are credited directly to the bank accounts of the concerned Implementing Agencies (IAs) of States. These funds are subsequently released further by these first level recipients to their constituents at the District, block (taluk) or village level. The expenditure of funds is monitored by the concerned central administrative ministry/ department by keeping a watch over the Utilization Certificates provided by the agencies. The audit of such bodies is conducted by chartered accountants.

The quantum of direct transfers (society mode) of plan funds by the Government of India has rapidly increased in the last few years and amounted to about ₹1.22 lakh crore in 2010-11, which was about 31% of the total plan expenditure of the GoI.

Issues and Concerns

There are several advantages of the treasury mode of fund transfer- it is robust, expenditures incurred are voucher-based, validated by AG and audited by the CAG. There is a well-defined system of tracking, cash management and bank reconciliation which provides information on cash flows at any point of time. However, this mode also has a few deficiencies. The transfer to States by Centre and to implementing agencies (in case they are not within treasury network) by States is

immediately booked as final expenditure irrespective of actual utilization. The tracking of central releases is also difficult in view of several factors such as one lump transfer head for all Schemes, different nomenclature and budget heads in States and different systems of delegation by States.

In the society mode, there are more drawbacks than in the treasury mode. The transfer to States is booked as final expenditure under the functional major heads of accounts belonging to respective departments. In this case, unlike the treasury mode, the trail of fund release and utilization ends here. The central ministries are concerned about avoiding lapse of budget which acts as an incentive for them to spend (release moneys) not connected with utilization by IAs. There is no uniform formal accounting framework for these IAs. There is no assurance whether the amount has actually been spent by the IAs on the schemes or not. There is no centralized data on expenditure available in any financial statement. Until the CPSMS project, there was no centralized information on releases by various ministries of the GOI. Since the funds are not spent fully by the IAs in the same financial year, there remains substantial amount of unspent funds in their bank accounts. The unspent balances with the IAs constitute the float outside and the carrying cost of the float is substantial. There is no formal/regular system of getting monthly expenditure figures. Audit of the IAs is carried out by CAs, appointed locally by the State level Society or the District level IA. In case of PRIs/ULBs, the responsibility is usually on Director, Local Fund who is a functionary of the State Government. CAG's audit jurisdiction is not comprehensive over all sub-grantees, i.e. down the line implementing agencies which receive funds from first level IAs at State level.

Shortcomings in the implementation of CSS

The CAG has studied the implementation of many CSS and observed a common pattern of shortcomings in their execution. As early as 1999, the CAG's Union Audit Report pointed out various constraints in CSS. The Ministries execute programmes without quantitative and qualitative evaluation of delivery. The funds are released mechanically without reference to capacity of State Governments or effective utilization of funds released earlier. The ministries were unable to ensure correctness of the data and facts reported by the State Governments. The internal audit function in both the departments implementing the projects as well as the societies was inadequate or non-existent. The emphasis by State Governments was more on releases of assistance by the central ministries rather than ensuring the quality of expenditure and attainment of the objectives. The Ministries and State Governments were not seriously inclined to check misuse- expenditure booked in accounts assumed precedence over the bonafide and propriety of the expenditure. Expenditure figures given by down the line IAs do not tally with the figures reported by the District level agencies. On the whole, expenditure information is unreliable.

The issue of accountability concerns arising from the mode of transfer has been discussed in detail in Chapter 4. The main recommendations of the Committee on this terms of reference are listed below under the heading Summary of Recommendations.

V. THE REVENUE CAPITAL CLASSIFICATION

The Revenue-Capital classification has been incorporated since the inception of the budget. However, this classification has also given rise to some issues. First, the classification has

implications for the post-FRBM scenario. The revenue expenditure component of the Gross Budgetary Support (GBS) to Plan cannot exceed the Balance from Current Revenue (BCR) if the revenue deficit is to be eliminated (as per the FRBM Act). Second, the Constitution distinguishes only between 'expenditure on revenue account' and 'other expenditure'. But in practice, 'expenditure on revenue account' has been taken to mean revenue expenditure. Third, the revenue capital classification may be dysfunctional from an economic management perspective. Over the years essential maintenance expenditure has become a casualty of the revenue–capital distinction.

Rationale for Revenue Capital separation

The separation of current and capital portions of budgets is supported on several considerations. Separation provides greater control over public debt and its utilization. It facilitates implementation of the 'Golden Rule' followed by many countries which requires that current account is balanced over an economic cycle and Governments borrow only to invest and not to pay for current spending. Debt financing of capital expenditures is justified to ensure intergenerational equity. The separation facilitates strategic allocation of borrowed funds for capital expenditure. It, thus, provides a framework for the best use of borrowed resources. It enables better determination of responsibility within Government. Capital expenditures need greater care in selection and execution of capital projects. Separate disclosure facilitates economic analysis of the budget and spending, besides generating information on capital formation.

Critics, however, put forth several arguments against the separation. The criteria for economic returns should be applied to all expenditures and not just to capital expenditures. From the stabilization point of view, it is the size of the overall deficit and the pattern of its financing that is far more important. Capital budgets may contribute to a shift in emphasis toward 'brick-and mortar' projects. This may systematically bias allocation of resources towards capital expenditures without adequate provisioning for essential maintenance and operating costs. Investment proposals, however, need to consider both capital and operating costs together for a holistic view of the costs involved and the benefits. Budget policy and planning requires a unified consideration of all budgetary proposals. Borrowing spending can be more expansionary than taxation spending. Further, information on capital formation can be presented in supplementary tables to the main budget rather than resorting to separation of revenue and capital.

On balance, it can be said that the need for separation of revenue and capital budgets should be seen not merely as a rationalization of borrowing but in the wider context of the formulation of fiscal policy, in terms of overall expenditures and the appropriate mix of taxation and borrowing.

International Perspective

Empirical evidence suggests that the international practices vary considerably with regard to budgeting for capital expenditures. Some countries have moved to accrual accounting and budgeting and they make distinction between operational and investment budgets. Others make a distinction between current and capital expenditure in accounts but not in budgets. There are others which have adopted modified accrual accounting without depreciation. In many countries, capital budgets are maintained through special accounts. Some have multi-year investment budgets. Most countries that distinguish between current and capital expenditures also show transfer payments of capital nature distinctly.

In general, the shift to program budgets in developed countries in the 1960s and 70s led to some dilution of the need for separate capital budgets, as unified presentation of capital expenditures alongside related current expenditures and outputs became the norm in these countries. However, the need for distinguishing capital and current budgets seems to have been strengthened in the last decades or so with the introduction of accrual based accounting and budgeting techniques, particularly in the OECD countries.

While there is no unanimity of opinions on this issue and no uniformity in the country practices, there seems to be general agreement that planning and budget formulation needs to take an integrated holistic view of capital and current expenditure proposals and that a clear distinction between capital and current expenditures facilitates the budget execution and analysis.

The literature on public expenditure management, therefore, recommends a unified presentation of budget with a clear distinction between capital and current expenditures.

The Indian Perspective

In India, the classification of budget and accounts into current and capital portions is governed by various Constitutional and rule provisions on the subject. The Fiscal Responsibility and Budget Management Act, 2003 also indicates two components of expenditure in the Government – (a) the revenue expenditure and (b) those which result into increase in assets of the Government. The FRBM aims to ensure inter-generational equity in fiscal management and long-term macro-economic stability by achieving sufficient revenue surplus. It also seems to conform to the classical view about use of borrowed funds and implicitly aims at balancing the current and capital sides of the budget in its application to the Union Government as a distinct budgeting and accounting entity. The Constitutional requirement is elaborately reflected in the financial rules (GFR 46, 79 and 90) and in Government Accounting Rules (Rule 30).

Principles of Classification

The other important and related issue is measurement of capital expenditure and there seems to be greater uniformity among the expert bodies in this area. According to the definition of asset as per IPSA, the fundamental characteristics which assets possess under any accounting basis would be:

(i) The existence of service potential or future economic benefits;

(ii) The service potential or the future economic benefits must arise from past transactions or events (i.e. future assets cannot be recognized); and

(iii) The service potential or future economic benefits must be controlled by the entity.

The Government Financial Statistics Manual (GFSM), 2001 of IMF recommends inclusion of only those assets that satisfy ownership as well as economic value criteria. It also provides for separate disclosure of capital and current grants, but both current and capital grants are classified in the GFSM as expense.

The draft Indian Government Accounting Standard (IGAS) on Accounting and Classification of Grants-in-Aid prepared by the Government Accounting Advisory Board (GAAB) in the C&AG's office maintains that "Grants-in-Aid are part of the operating expenditure of the grantor and thus classified and accounted for as revenue expenditure in the Financial Statements irrespective of its ultimate application by the grantee.

The UK presents a typical case where capital grants are included in the capital budget but shown as recurrent expenses in the accounts.

The above discussion suggests that apart from durability and productivity considerations ownership of and control over assets is the key factor in deciding whether the expenditure incurred on its acquisition can qualify to be classified as capital expenditure.

Previous attempts to reconsideration

The issue of classification of grants based on end-use has been examined in detail by Ashok Lahiri Group in 2004. The Group, in its report submitted in July 2004 concluded that the current norms for distinguishing revenue and capital expenditures are based on sound accounting principles and are in line with the international practice. However, it suggested that for the sake of disclosure such transfers that are meant for capital expenditure by the transferee may be classified as "Capital Grants" under the Revenue Section in the books of the transferor. This suggestion of the Group has been recently implemented by the Government. A new Object Head "Grants for creation of capital assets" has now been opened and the existing Object Head "Grants-in-Aid" has been renamed as "Grants-in-Aid-General". This would distinguish and explicitly disclose grants meant for capital creation from the rest in the budget and accounts.

Issues

It is generally agreed that strategic allocation requires an integrated and holistic view of expenditure proposals and a balance between revenue and capital allocations is critical for optimally achieving public spending outcomes. The separation of capital and current may not lead to undue bias if a proper perspective is maintained. On the other hand, this separation has distinct utility in budget presentation/ analysis and budget execution.

With regard to measurement of capital expenditure and classification of grants based on their end use, there seems to be universal recognition of grants as current expenditure at least in the financial statements. The classification of transfer payments according to their end use in the accounts of the transferor could lead to their double counting in the national income accounts as such transfers are also shown as capital in the books of the transferee. However, there is a merit in distinguishing grants into those which are purely for revenue expenditure and those which are meant for creation of capital assets by State/local bodies/ IAs of States. Considering the need to transfer resources to State and sub-State level for capital investments, it may be justified to consider adjusted revenue deficit instead of revenue deficit as a policy target under FRBM, the adjustment being to the extent of grants made to State or sub-state level for creating capital assets.

The issues relating to revenue–capital distinction have been discussed in detail in Chapter 5. The main recommendations of the Committee on this terms of reference are listed below under the heading Summary of Recommendations.

VI. THE SCOPE OF THE PUBLIC SECTOR PLAN

The process of having a plan of the Government began with the launching of the First Five Year Plan. The Annual Plans are the operational phase of the Five Year Plans. Over the years, both the scope of public sector plan and the administrative machinery involved have undergone changes.

Annual Plan of the Centre

As per the practice, Annual Plan is the plan component of the budget as well as Internal

and Extra Budgetary Resources (IEBR) of PSEs which is prepared by Planning Commission in consultation with Central Ministries concerned. The BCR, MCR and the fiscal deficit put together determine the size of Gross Budgetary Support (GBS) for plan. Out of total GBS, a portion is provided to States as central assistance for State Plan. The Public Sector Enterprises (PSEs) also mobilize some resources in the form of Internal Resources (IR) and Extra Budgetary Resources (EBR), commonly known as IEBR. The GBS (net of assistance to State Plan) and the IEBR constitute the plan resources of the Centre.

Annual Plan of the States

Annual Plan of States is plan outlay in the State Budget and includes IEBR of State PSEs and resources of local bodies. The budgetary resources for the plan include State's Own Resources (including BCR and MCR), net budgetary borrowings and central assistance to State Plan. The resources transferred from Central Plan are not treated part of the State Plan to avoid double counting.

Issues relating to Public Sector Plan

The main issues rearding the scope of public sector plan of the Centre and States relate to:

- Budgetary Plan of the Centre and States
- Plan of the public sector enterprises of the Centre and States
- Plan of rural and urban local bodies
- Plan of the Implementing Agencies/ SPVs
- Public Private Partnerships(PPP)

Budgetary Plan of the Centre and States

The budgetary plan of the Centre and States is the main component of the Five Year or Annual Plans. As this Committee has recommended that the distinction between Plan and Non-Plan in the budget may be done away with, the budgetary component of the FYP will be the sum total of the projected aggregate expenditure for five years of Centre and State Governments. The annual budgetary component of the Plan of the Centre or a State will have a one-to one relationship with the Government budget of the Centre or of a State respectively. The Plan classification/ heads of development and budget classification/ heads of expenditure should become the same. Consequently, there will be no longer any necessity of any other plan-budget link document.

Plan of the Public Sector Enterprises of the Centre and States

The Centre has consistently followed the practice of including the investment plans of a large number of Central Public Sector Enterprises (CPSEs) as Central Plan outlay in the annual budgets. It appears quite reasonable that all the CPSEs may not get included in the Central Plan outlay in the annual budget of a particular year, as only the CPSEs having investment plans in that year need to be included. CPSEs incurring losses or not generating resources (IEBR) will not contribute to plan resources or plan outlays.

At the State Level, the practice of including the State Public Sector Enterprise (SPSE) plans in the Annual Plans of the States has not been followed uniformly by different States. While some States include the SPSE plans in their Annual Plans, quite a few States are keeping them outside their Annual Plans.

Plan investments and resources (IEBR) of the CPSEs have always been important components of the Central Plan. Moreover, in several economic and even some social services, public sector investments are made and services delivered through CPSEs and SPSEs. More importantly, the size of the plan of the public sector should be neutral as regards medium and mode of delivery of functions/services.

Even for States, there is a need for a uniform adoption of the concept of planning investment outlays of State PSEs funded, inter-alia, from IEBR.

Plan of the Local Bodies

As prescribed by the guidelines of Planning Commission, some States specifically indicate the plan resources of the local bodies separately in the State Annual Plan as well as the annual budget. But generally, all development resources allocated from the State Budget to local bodies are subsumed in the Annual Budgets of the States. As a consequence, it is difficult to ascertain the expenditure and developmental programmes of the local bodies from the Annual Budgets of the States.

Local bodies are legal entities recognized by the Constitution and they need to have financial delegation and autonomy to function independently. They need to have their separate annual budgets and plans. However, there is a strong merit in the view that local bodies are but different organs of the State/UT Governments and the State/UT Annual Plans should reflect the resources and expenditures of all the organs, including local bodies, in a comprehensive manner.

Rural and urban local bodies have own internal resources, resources mobilized through borrowings and transfers from State and/or central Government. Transfers may be of various kinds- for administrative expenses, for general development or for specific programmes of the State/Central Government. The 13th Finance Commission has made recommendations for providing budget supplements containing details of transfers and maintenance of accounts of local bodies. Further, proposed multi-dimensional budgeting will facilitate programme-wise information on transfers to urban and rural local bodies from the central and State Governments.

Plan of the Implementing Agencies/ SPVs

The Implementing Agencies/SPVs are generally societies of the State/UT Governments created to avail direct fund transfer from Central Government used to augment public assets that belong to State or local Government. These generally do not have any independent resources of their own and resources transferred to them are included in State or Central Plan. The recommendations on mode of transfer of funds may mean that many SPVs created only to enable direct transfer of funds may not be necessary.

Public Private Partnerships (PPP)

PPP is a mode of providing public infrastructure and services by Government in partnership with private sector. It is a long term arrangement between Government and private sector entity for provision of public utilities and services. The investments being made or management provided by private sector entity, there is risk sharing as well as performance linked payments to be paid by Government to private entity. PPP concessions can either be sustained by user charges to be collected by the concessionaire or through annuity payments to be made by the Government. In case Annuity payments are made they are typically borne by the Government out of the annual budgetary allocations spread over time and are essentially in the nature of deferred budgetary payments. The Government of India also supports PPP projects through schemes like Viability Gap Funding (VGF) and improving access to finance (both refinance and direct lending) through IIFCL.

The 13th Finance Commission (FC) has recommended that explicit contingent liabilities, which may be in the form of stipulated annuity payments over a multi-year horizon, should be spelt out.

An inter-Ministerial Task Force chaired by Shri B.K.Chaturvedi, Member, Planning Commission has made several recommendations with respect to annuity payments. First, there should be ceilings to be applied on individual projects or collectively to all projects on commitments for annuity payments. Second, all expenditure on annuity payments for the first ten years may be booked as plan expenditure and, thereafter, shifted to the Non-Plan side. Third, the standards and specifications to be adopted for annuity projects should be similar to those followed for similar conventional contracts. Fourth, a statement of annuity commitments may be depicted transparently in the budget documents. Finally, annuity payments are akin to debt service or charged expenditure and Ministry of Finance should review the annuity commitments from time to time and lay down further ceilings as may be necessary in the interest of prudent fiscal management.

The issues relating to scope of public sector plan have been discussed in detail in Chapter 6. The main recommendations of the Committee on this terms of reference are listed below under the heading Summary of Recommendations.

VII. SUMMARY OF MAIN RECOMMENDATIONS

Plan and Non-Plan Distinction

(i) The Committee recommends that Plan and Non-Plan distinction in the budget should be removed. The present functional classification in budget and accounts should also be made a truly functional classification by removing several anomalies. This will facilitate linking expenditure to outcomes and better public expenditure management (Para 2.20).

(ii) The process of preparing Five Year Plans may be continued (Para 2.21).

(iii) The annual budgetary component of the Plan of the Centre or a State will have a one-to one relationship with the Government budget of the Centre or of a State respectively. The Plan classification/ heads of development and budget classification/ heads of expenditure should become the same. Consequently, there will be no longer any necessity of any other plan-budget link document(Para 2.22).

(iv) On removal of Plan and Non-Plan distinction in the Budget, there should be a fundamental shift in the approach of public expenditure management- from a segmented view of Plan and Non-Plan to holistic view of expenditure; from a one year horizon to a multi-year horizon and from input based budgeting to the budgeting linked to outputs and outcomes. This shift in public expenditure management is necessary among all Stakeholders involved with planning, implementation, appraisal and review of Government and broader public sector expenditure(Para 2.23).

(v) The shift to holistic view of expenditure would require changes in organizational structure, mandates and processes as well as appropriate interventions in human resource development, information technology, intra and inter-Governmental communication and incentive structure of public expenditure system (Para 2.24).

(vi) The Committee, in keeping with the terms of reference, has outlined broad redefinition of roles of Ministry of Finance, Planning Commission, administrative Ministries and State Governments in the formulation and implementation of the Plan. Planning Commission may be responsible for consolidation of the Five Year Plan covering all Services based on the inputs from the Ministry of Finance. The Ministry of Finance may be responsible for preparation of annual budget based on the inputs from Planning Commission (Para 2.25 to 2.33).

(vii) The annual budgeting process may need to be revised in the manner described (Para 2.34).

Comprehensive framework of Transfers to States

(viii) Various obstacles posed by current budget and accounts classification in presenting a comprehensive view of Central resources transferred to States can be addressed through the new multidimensional budget and accounting classification being worked out by a Committee (headed by CGA). The new framework may include independent dimensions in respect of Functions, Programmes and Schemes, Economic Object, Recipients of funds, Geography and beneficiary. It should take into consideration proposals put forward by an IMF Mission in 2007 on the request of the Ministry of Finance and should also be in conformity with UN's Classification of Functions of Government (COFOG) and compatible with Government Statistics and Finance Manual (GSFM, 2001). It should facilitate easy slicing and dicing of information. The Committee also recognizes that successful development and implementation of the new classification will require adequate consultation with multiple stakeholders, changes in existing software of Central and State Governments and widespread training to staff (Para 3.26).

(ix) The proposed classification and coding system must provide uniform codes for Central programmes, sub-programmes and schemes which are implemented in States so that comprehensive view across the country is facilitated (Para 3.27).

(x) The Committee recommends that the CPSMS should be extended to enable tracking of utilization of funds for all Central Schemes in all States for which resources are either transferred through treasury route or society route. This may require interface of Central IT systems such as CPSMS with State treasuries and AG offices as well as Core Banking Solution (CBS) of banks. When implemented, it would be possible to have utilization certificates to be linked with and supported by transaction-level information to ensure tracking of funds up to the final beneficiary (Para 3.28).

(xi) The proposed changes in budget classification and accounting being worked out and the new IT interfaces being planned between Central, State and Banks to keep track of resource flows have the potential to provide a comprehensive view of the extent

of Central resources transferred to States and their agencies and their utilization across different Schemes. The same system can also provide similar information for schemes of State Governments. The citizens can also be empowered with information on flow of resources and utilization through a portal. This will effectively promote transparency and accountability (Para 3.29).

Accountability Concerns arising from Direct Mode of Transfer

(xii) The Committee recommends the treasury mode of transfer of central plan funds. The budget classification and accounting changes and effective linkages of CPSMS with State treasury systems should be able to provide an effective Management Information System (MIS) on releases/advances and expenditure on plan schemes (Para 4.29).

(xiii) A suitable accounting methodology, to bring out the distinction between "final expenditure" and "transfers" and to enable a view of final expenditure through the books of accounts needs to be worked out by the CGA and office of CAG(Para 4.28).

(xiv) The switch over to complete treasury mode of transfer of funds may be made straightforward possibly beginning all new schemes from the 12th Five Year Plan. For existing schemes, a short transition period is required to allow for necessary adjustment. However, till complete switchover to treasury mode is done, accounting and submission of Utilisation Certificates under Society mode should be rationalized in the manner described in the Chapter 4 (Para 4.29 and Para 4.37).

(xv) In the transition period till complete switchover to treasury mode, auditing should be strengthened through several measures. Selection of auditors for the societies may follow a process similar to that in case of PSUs where the auditors are appointed by the CAG. Guidelines may be formulated in consultation with the CAG for the auditors to cover a list of additional issues such as internal control, control over assets, inventory, reconciliation of expenditure and physical verification. Provision should be made for preparation of annual reports of the agencies reflecting the performance for the year together with audited financial statements within a specified time frame after the close of financial year. As funds are often released further to down the line implementing agencies by the first recipient (grantee), CAG's audit jurisdiction over the sub-grantees in such cases can be made mandatory and placed beyond doubt by making suitable changes in GFRs/sanctions (Para 4.42).

Revenue Capital Classification

(xvi) The Committee is in favour of continuing the Revenue-Capital classification. Capital expenditure should relate to creation of assets and be determined by ownership criterion. While all transfers should be treated as revenue expenditure in accounts, the Committee also considered the need and merits of classifying revenue expenditure by end use only for the purpose of FRBM compliance(Para 5.37).

(xvii) There is a merit in classifying grants in more categories depending upon end use instead of clubbing all grants into one object head. One of the categories may be Grant for Creating Assets. This category may broadly meet the requirements specified for capital grants in GFS Manual, 2001 as discussed in the foregoing paragraph (6.21). There is a need to ensure a fairly rigid compliance to the requirements to prevent mis-classification. The recipient of the capital grants must be required to maintain assets records/registers, which should be made available in public domain(Para 5.38).

(xviii) As it is the FRBM Act that lends the Revenue Deficit concept some rigidity, amendments to the Act may be considered to provide scope for adjustment. An "adjusted revenue deficit" may, therefore, be possible for FRBM compliance. i.e. adjusting the revenue deficit to the extent of grants for creating assets and applying aggregate controls to this parameter. In essence, Government may disclose two measures of revenue deficit - the conventional measure and one adjusted measure, and the aggregate control may shift from the conventional measure to the adjusted measure (Para 5.39).

Scope of the Public Sector Plan

(xix) The budgetary plan of the Centre and States is the main component of the Five Year. As this Committee has recommended that the distinction between Plan and Non-Plan in the budget may be done away with, the budgetary component of the FYP will be the sum total of the projected aggregate budget expenditure for five years of Centre and State Governments. The annual budgetary component of the Plan of the Centre or a State will have a one-to-one relationship with the Government budget of the Centre or of a State respectively. The Plan classification/ heads of development and budget classification/ heads of expenditure should become the same. Consequently, there will be no longer any necessity of any other Plan-budget link document (Para 6.12).

(xx) The Central or State Plan should continue to include investment outlays (funded by IEBRs) of CPSEs and SPSEs respectively. All States/UTs must include information about investment outlays of SPSEs (funded out of IEBRs) in their budgets as a separate annexure. With this obligation, it will be possible to get a true sense of SPSE component of State Plan of each State making horizontal, vertical and temporal comparison more meaningful (Para 6.18 and 6.19).

(xxi) It may be feasible to have consolidated information on the resources (transfers and IEBR) and expenditure of rural and urban local bodies on an annual basis. This information may be provided through special supplements to the budgets of State/UT Governments. The total expenditure of these bodies, net of transfers from Central and State/UT Governments, may be added to the State/UT Plan as a separate component (Para 6.28).

(xxii) As regards Implementing Agencies/ SPVs/Societies during the transition

period when resources are still being transferred to them by way of direct transfer, their budget and accounts should be shown as separate supplements to the budget. However, the resources transferred to them by the Central and State Governments have already been accounted for in the budgetary component of the Central or State Plan or both, so there may not be any need to add their expenditure to the Central/State Plan (Para 6.31).

(xxiii) As regards Public Private Partnership (PPP) projects, the Committee supports recommendations of the Task Force on the ceiling on annuity payments on fiscal prudence, standard and specifications and disclosure of annuity commitments. However, some of the recommendations of the Task Force on Plan/Non-Plan treatment may not be relevant if the recommendation of this Committee on abolition of Plan and Non-Plan distinction in budget (Chapter 2) is accepted. The annuity commitments may form a part of committed expenditure of the budget of the function/service (and corresponding Ministry/Department) under which the PPP is undertaken. Similarly, viability gap funding or any other form of support for PPP projects may form the expenditure budget of relevant function/service to which the PPP belongs. Annuity payment is a unitary charge (for both capital asset and maintenance). However, in some cases it may be possible for it to be split into capital and maintenance components based on details of the project cost. Therefore, separate object heads for annuity (capital) and annuity (current) may be created and outgo on these accounts may be treated as capital or revenue expenditure respectively. If, the components between capital and maintenance are not separable, the whole annuity may be treated as capital expenditure. As regards Viability Gap Funding (VGF), it is a grant provided to private concessionaire of the PPP project. It can be a separate object head and treated in the same manner as the grant for creation of capital assets. Further, as both annuity payments and VGF are to be provided from the budgetary support, these are automatically included in the budget/Plan of the Centre (Para 6.50).

(xxiv) It is important to have regular information on the investment crystallized through PPPs. Therefore, there should be supplement to the Central/ State budgets providing project-wise, Ministry-wise and Sector-wise information on PPPs (Para 6.51).

CHAPTER 1

INTRODUCTION

1.1 Improving public expenditure management has remained an important objective of budget reforms around the world. In recent years, there has been much emphasis on the role of institutional arrangements in influencing budget outcomes at three levels: (i) aggregate fiscal discipline; (ii) allocation of resources in accordance with strategic priorities and (iii) efficient and effective use of resources by the implementing agencies. An improvement in public expenditure management, it is believed, requires (i) a greater focus on performance; (ii) adequate link between policy making, planning and budgeting; (iii) well-functioning accounting and financial management systems and (iv) appropriate links between budgeting and other systems of the Government (World Bank's Public Expenditure Management Handbook, 1998).

1.2 The outcome budgets of Central and State Governments in recent years are aimed at improving outcomes of public expenditure as against earlier emphasis on inputs. The link between expenditure (input) with outcomes will be facilitated if there is complete view of expenditure on programmes. Traditionally, the budgeting system in India is conventional input based. There is segmentation of expenditure between Plan and Non-Plan. The hard budget constraint is not applicable in several cases. At the same time, administrative Ministries lack incentives to reallocate resources across programmes. A piece meal approach to sanctioning of funds and schemes is also not an uncommon practice leading to loss of considerable time and delays in the realization of objectives. Multi-year expenditure information is not available making it difficult to link planning and budgeting. There is not much information on costing of services and programmes at different service levels and standards. There are several issues in the current budget and accounting classification. The design and effectiveness of Financial Management Information System (FMIS) needs to be improved. Complete fiscal and accounting information pertaining to various plan schemes being implemented in the States/Union territories is not readily available. Apart from the absence of unique and uniform budget lines for each programme/scheme which stands in the way of generating scheme-wise information, there are also other accounting and reporting issues intimately linked with budget and accounting classification.

1.3 The Eleventh Plan document has raised many of these issues while discussing financing of the Plan. The classification of expenditure into Plan and Non-Plan has an important bearing on overall expenditure management. The revenue capital distinction has acquired new significance in the post-FRBM scenario. The transfer of resources from Centre to States on Plan schemes is revenue expenditure for the Centre which is contrained by the need to maintain revenue balance. Due to massive expansion of Centrally Sponsored Schemes, transfer of resources is increasingly made directly to the implementing agencies of the State. This mode of transfer has

raised issues relating to accounting, reporting and accountability of funds. The current structure of budget and accounting classification has several limitations in presenting a comprehensive view of transfers and proper monitoring of public expenditure. The administrative mechanisms for plan implementation have undergone many changes with the setting up of PRIs and SPVs/ implementing agencies. In several areas of infrastructure building and services, public investment is being supplemented by Public Private Partnerships(PPP). These developments need a relook of the scope of Public Sector Plan.

1.4 In view of these issues and concerns, High Level Expert Committee has been constituted with the following Terms of Reference (TOR):

(i) To clearly define the scope of the Public Sector Plan and the expenditures incurred there-under keeping in view the changes in the administrative machinery for implementation of the Plan, and the new mechanisms that have evolved such as special purpose vehicles and public-private partnerships.

(ii) To suggest an action plan for the abolition of the classification of expenditure into Plan and Non-Plan, which include the detailing of the changes in the mandates of the various organizational units in the Government that deal with allocation of public resources and the management of public expenditure.

(iii) To suggest a proper framework for taking a comprehensive view of the total transfer of resources from the Centre to the States, ensuring its accounting and reporting in a uniform manner.

(iv) To examine the accountability concerns arising out of the direct transfer of the funds to the States/ district-level bodies under Centrally Sponsored Schemes and to suggest an appropriate mechanism to guard against dilution of accountability.

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

1.5 The TORs represent key issues being faced in the management of public expenditure in India today. These issues are not mutually exclusive but inter-related. Each of these issues is discussed in detail in the chapters that follow.

1.6 Chapter 2 discusses the Plan Non-Plan distinction. In Chapter 3, the issues of comprehensive overview of transfers to States as well as of accounting classification are examined. Chapter 4 deals with modes of transfer of resources to States and accountability issues. The revenue-capital classification issue is deliberated in Chapter 5. Finally, the Scope of the Public Sector Plan is discussed in Chapter 6.

1.7 Each chapter begins with the description of the present situation and analysis of problem areas. This is followed by Committee's recommendations based on the analysis, best international practices available and deliberations.

CHAPTER 2

THE PLAN NON-PLAN DISTINCTION

BACKGROUND

2.1 Budget classification of expenditure is one of the fundamental building blocks of a sound budget management system. The way it is classified and presented has a direct impact on the transparency and coherence of the budget. The classification of expenditure is important for policy formulation as well as performance analysis. While enabling an efficient allocation of resources among sectors, it can also ensure compliance of budgetary allocation.

2.2 The present expenditure classification system is partly constitutional and partly evolved to serve certain desired objectives of the Government. The classification of expenditure into Plan and Non-Plan by both Centre and States has been one of the central characteristics of the structure of fiscal management. Although not rooted in the Constitution, this distinction is a result of the overall fiscal and governance framework that has evolved since the beginning of the planning process in 1950s. In the initial years of planning, the emphasis was to direct capital investment in sectors according to priorities of each Plan. The bulk of plan expenditure was capital expenditure and the aim was to increase the productive capacity of the economy. However, the composition of the plan expenditure in both Centre and States has changed over time as the bulk of the plan expenditure in now revenue expenditure. Over a period of time, several issues have cropped up from the distinction between Plan and Non-Plan.

CLASSIFICATION OF GOVERNMENT EXPENDITURE

2.3 The expenditure of the Government is classified into functional heads that have evolved with the changes in the role of the Government. The functional classification signifies broadly the function of Government for which the expenditure has been incurred and the activity on which the expenditure has been incurred. The detailed classification is given at **Annexure II.** The Table below depicts the expenditure classification by broad functions. The functional classification being followed as of now is a six tier structure with a hierarchy of major, sub-major, minor, sub-head and detailed heads. Below the fifth tier of functional heads is the sixth tier of object heads that provide details about the object of expenditure. Thus, this forms a two dimensional classification where the expenditure is classified into object heads for each functional head.

2.4 The first tier of the functional classification, called the major head denotes the functions of the Government that are discharged through the expenditure. For example, there are major heads for judiciary, police, education, health, rural development, power, transport etc. The second tier of functional classification provides the description of sub functions within the function

2.1. Classification of Expenditure by Functions

Current expenditure classification by broad functions
A. GENERAL SERVICES
(a) Organs of State (b) Fiscal Services (c) Interest Payment and Servicing of Debt (d) Administrative Services (e) Pensions and Miscellaneous General Services (f) Defence Services
B. SOCIAL SERVICES
(a) Education, Sports, Arts and Culture (b) Health and Family Welfare (c) Water Supply, Sanitation, Housing and Urban Development (d) Information and Broadcasting (e) Welfare of Scheduled Castes, Scheduled Tribes and Other Backward Classes (f) Labour and Employment (g) Social Security and Nutrition (h) Others
C. ECONOMIC SERVICES
(a) Agriculture and Allied Activities (b) Rural Development (c) Special Areas Programmes (d) Irrigation and Flood Control (e) Energy (f) Industry and Minerals (g) Transport (h) Communications (i) Science, Technology and Environment (j) General Economic Services
D. GRANTS-IN-AID AND CONTRIBUTIONS

indicated by the major head of account. The third tier denoted by the minor head indicates the objective of the Government being achieved through the particular expenditure. Till the minor head of account, the classification is rigid, provided by the Government of India, in consultation with the Comptroller and Auditor General of India (CAG) and is uniform across Centre and States.

2.5 Another important feature of the heads till the level of minor heads are that the Finance Accounts of the Centre as well as the States report Government expenditure upto the level of minor head.

2.6 Below the minor head are the two tiers of sub heads and detailed heads. The Sub head indicates specific schemes or activities of the Government under which the expenditure has

been incurred and the detailed head indicates various components of the schemes or sub-schemes. This classification currently, in force, has emanated from the original structure recommended by the Mukherjee Committee[1] in 1974.

2.7 The sixth tier, the object head is an important component of the classification structure which provides the details about items of expenditure e.g. salaries, allowances, travel expenses, office expenses, minor and major works, maintenance, machinery and equipment etc. This tier is very significant as it provides the cost of inputs classified under various items. It is also important because, consequent to the recommendations of Ramchandran Committee[2], the object heads are uniform across all functional heads. Thus, expenditure aggregated on the basis of object heads, across functional heads can provide cost of inputs for a particular function/sub-function. Currently, the budgets as well as the accounts follow the same classification subsequent to the recommendations of Ramchandran Committee.

PLAN/NON-PLAN BIFURCATION

2.8 Laid over the functional and object classification briefly outlined above is the division provided by Plan/Non-Plan classification. This division cuts across the entire classification hierarchy into two columns. Although this practice began in 1959-60, it was formally recommended by the Mukherjee Committee in its first report submitted in 1971[3].

PLAN AND BUDGET

2.9 The division originates from the budgeting exercise where the Non-Plan expenditure is estimated first. Since the Non-Plan expenditure is of a committed nature, it is mostly budgeted based on historic parameters. For example, salary expenditure is based on the salary expenditure of previous year, the real change due to estimated change in number of employees and due to increase in real wage level (increment) and the inflation adjustment (dearness allowance). The interest payments are estimated on the basis of the existing debt profile and the estimated borrowing for the year. The pension payments are estimated on the basis of the previous year's pension payment, the change in number of pensioners and adjustment for changes in price levels.

2.10 After estimation of the Non-Plan expenditure, the resources (both tax and non-tax) are estimated. The amount of resources left after meeting the Non-Plan expenditure is called the Balance from Current Revenue (BCR) and is a part of the non-debt resources that is available for plan expenditure. The second part of non-debt resources is the Miscellaneous Capital Receipts (MCR) taken on net basis. These non-debt resources added to the amount of net borrowing planned to be incurred would give the total amount of resources available for plan expenditure. This amount is called the Gross Budgetary Support (GBS) for Plan.

2.11 The Gross Budgetary Support is then allocated into sectors, down to development heads and finally to plan schemes. For this purpose, Planning Commission follows a five tier classification structure that broadly follows the same structure as that of the budget/ accounts but not exactly the same. These allocations are then reclassified into the budgetary classification.

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[1] Headed by Shri A.K. Mukherjee, Deputy Comptroller and Auditor General of India

[2] Headed by Shri V. Ramachandran, Deputy Controller General of Accounts.

[3] This recommendation of the Committee was part of its recommendations on restructuring of detailed demands for grants.

2.12 The Plan and Non-Plan budget put together comprise the expenditure budget of the Government. The natural corollary of this budgetary practice is that while the Non-Plan envelope is based broadly on the requirement of the departments depending on the expenditure items that are more or less committed, the plan envelope is broadly based on the availability of resources.

EXPENDITURE CLASSIFIED AS PLAN

2.13 Plan expenditure in the Government, generally, signifies expenditure taken up under development schemes during a particular Five Year Plan. However, some of these schemes can be continued from a previous plan or some may be 'spill-overs'. At the initial stages of the exercise of preparation of a Five Year Plan, Planning Commission issues detailed instructions directing what should be classified as 'Plan Expenditure'.

2.14 The plan schemes are mostly expected to be limited to a Five Year Plan period. But they may have implications that may extend beyond the plan period. For example, maintenance of assets created out of plan expenditure, salary of establishment created for a plan scheme. These expenditure liabilities of the Government, arising out of plan expenditure are called committed liabilities which get shifted to the Non-Plan budget of the department. Various instructions have been issued regarding shifting of expenditure from Plan to Non-Plan budget and it is no longer a simple policy due to complex and diverse nature of plan schemes. These instructions go along with the instructions regarding what items of plan budget can continue within plan budget.

MAJOR ISSUES RELATING TO PLAN/NON-PLAN DISTINCTION

2.15 Due to the complex nature of Government, the policy regarding what should get classified as plan expenditure and what should get classified as Non-Plan expenditure has been losing clarity. There are no clear cut criteria that can, without exception, demarcate an expenditure item as Plan or Non-Plan. There are items such as salary, expenditure on establishment and maintenance which are included under plan. There are also expenditure items such as scholarships, expenditure on Anganwadis and nutrition for children which are included under Non-Plan.There is a general impression that subsidies should be a part of Non-Plan side of the budget. But there are several subsidies, direct and indirect, which are included in the plan. For example, the diesel and food subsidies are provided by the Centre under Non-Plan, but power and other input subsidies to farmers are provided by most States under plan.

2.16 A notion has widely gained ground among the policy makers and officials across all levels that Plan expenditure is good and Non-Plan is bad. Not so productive plan expenditure is often understood in the system as productive and even productive Non-Plan expenditure is labelled otherwise. This bias in favour of Plan expenditure and against Non-Plan expenditure has led to a situation in which essential Non-Plan expenditure like maintenance of assets has been neglected. This has also led to a motivation for showing higher plan expenditure and higher plan sizes both at Central and State levels. There has been a tendency to classify more and more items under plan budget to show a higher plan size. Different approval processes apply for expenditure proposals for Plan and Non-Plan expenditure. The asymmetric treatment of some items like creation of posts under Plan and

Non-Plan expenditure windows appears to discourage a coherent view on expenditure control. The gaming behaviour encouraged by distinction between Plan and Non-Plan results in an expenditure item unacceptable under the Non-Plan side finding resources under the Plan side of the budget through a change in nomenclature. The distinction between Plan and Non-Plan has, therefore, got blurred further.

2.17 One of the objectives of Plan and Non-Plan distinction is to provide a link between the development objectives and plan allocations. Ideally, the Gross Budgetary Support for Plan ought to indicate the proportion of resources which is not committed in the form of Non-Plan and which can be allocated as per the development objectives of the Government. But this objective is now achieved only partially due to the changing nature of plan expenditure. In the initial years of Planning, Plan expenditure was predominantly meant for capital projects. Therefore, plan resources could be allocated to other projects on completion of on-going capital projects. In recent times, however, the focus of plan expenditure has shifted from capital projects to on-going revenue expenditure schemes. As it is not easy to exit from revenue expenditure based schemes, allocation of plan resources has become less flexible. Consequently, a major proportion of the plan budget has become committed in the sense of being predominantly determined on the basis of the past commitments. Further, the shift of expenditure of old schemes to Non-Plan at the end of each Five Year Plan also means that correspondence cannot be drawn between plan and development expenditure.

2.18 Outcomes and outputs of programmes depend on total expenditure, Plan and Non-Plan put together and not merely on plan expenditure which constitutes about 30% of the total expenditure only. There is a recent emphasis on linking budgets to outputs and outcomes to improve efficiency and effectiveness of public expenditure. This makes a strong case for adopting a total expenditure approach.

2.19 To conclude, Plan and Non-Plan distinction in the budget is neither able to provide a satisfactory classification of developmental and non-developmental dimensions of Government expenditure nor an appropriate budgetary framework. It has, therefore, become dysfunctional.

RECOMMENDATIONS

Plan/Non-Plan Distinction in the budget to go

2.20 The Committee recommends that Plan and Non-Plan distinction in the budget should be removed. The present functional classification in budget and accounts should also be made a truly functional classification by removing several anomalies (detailed recommendations follow while discussing TOR 3). This will facilitate linking expenditure to outcomes and better public expenditure management.

Plan and Budget

2.21 The process of preparing Five Year Plans (FYP) may be continued. The FYP may be useful to indicate the total quantum of resources and inter-sectoral allocation proposed under the Plan. The Plan of the Centre may have components such as the Budget of the Central Government and other components relating to PSEs, SPVs and PPPs. The Plan of the States may have all the above mentioned components along with a component relating to Local bodies. The budgetary component of the FYP will be the sum total of the five years of budgetary expenditure of Centre and State

Governments. The detailed recommendations on the scope of Public Sector Plan are provided in a separate Chapter.

2.22 With the removal of Plan and Non-Plan distinction in the budget, the plan classification/ heads of development and budget classification/ heads of expenditure will become the same. Consequently, there will be no longer any necessity of any other plan-budget link document.

Changes in Mandates and Processes

2.23 On removal of Plan and Non-Plan distinction in the Budget, there should be a fundamental shift in the approach of public expenditure management-from a segmented view of Plan and Non-Plan to holistic view of expenditure; from a one year horizon to a multi-year horizon; and from input based budgeting to the budgeting linked to outputs and outcomes. This shift in public expenditure management is necessary among all Stakeholders involved with planning, implementation, appraisal and review of Government and broader public sector expenditure. To illustrate, let us take the example of a sub-set of Social Services, namely, services in respect of Education, Sports, Art and Culture. Planning Commission is currently concerned with only plan schemes for both Centre and States. A large part of the Central and States' Budgets on these services is on the Non-Plan side, particularly relating to salaries and maintenance of assets. The total expenditure (2010-11, BE) of all States on Education, Sports, Art and Culture Services amounted to ₹1.90 lakh crore of which about ₹1.50 lakh crore was on the Non-Plan side and only ₹0.40 lakh crore was on the Plan side (*RBI, State Finances: A Study of Budgets of 2010-11*). The removal of the distinction between Plan and Non-Plan would mean that the entire expenditure will need to be taken into consideration for planning instead of only about 21% of total expenditure of States currently classified as plan expenditure.

2.24 This shift to holistic view of expenditure would require changes in organizational structure, mandates and processes as well as appropriate interventions in human resource development, information technology, intra and inter-Governmental communication and incentive structure of public expenditure system.

2.25 The Committee, in keeping with the terms of reference, has outlined broad redefinition of roles of Ministry of Finance (MoF), Planning Commission (PC), administrative Ministries and State Governments. Planning Commission may be responsible for consolidation of the Plan covering all services based on the inputs from the Ministry of Finance. Similarly, Ministry of Finance may be responsible for preparation of annual budget based on the inputs from Planning Commission. The redefinition of mandates/roles of main organizations and broad processes involved in the formulation of FYP and its implementation are described below.

Role of Ministry of Finance

2.26 The main role of the Ministry of Finance in the formulation of the FYP may be as follows:

- Provide information on the total budget receipts, expenditure and their components function-wise, programme-wise, economic object wise and Ministry-wise for the previous years including the base year. Also provide information on IEBRs of CPSEs in consultation with Central Ministries.

- Prepare projections of budgetary expenditure component for the Sectors and Ministries covered under the broad classification of General Services, which includes **Organs of State, fiscal services, interest payment and servicing of debt, administrative services, pensions and miscellaneous general services and defence services and other committed items**. The grants to be provided to the State or other sub-national Governments under these functional heads should also be included in these projections.

- Set up assumptions/rules for Central Ministries to enable them to project expenditure, mainly of committed nature, on several items presently covered under Non-Plan expenditure.

- On approval of the size and inter-sectoral allocation of resources for the FYP, prepare needful mapping documents for budgetary and other components function-wise, programme-wise and Ministry-wise.

2.27 The role of the Ministry of Finance will have an important role in implementation of the Plan. The main responsibilities may be as follows:

- The budgetary resources need to be estimated and indicated to Ministries on a three-year rolling basis. For the budget year, ceiling in the form of hard budget constraint should be communicated to the Ministries well in advance to enable the Ministries to prepare their detailed budget proposals. The MoF may also try to achieve aggregate fiscal discipline through this process.

- The MoF may take responsibility, after due consultation with Planning Commission, to communicate budget ceilings, seek budget proposals from Ministries and approve those proposals.

- The inter-sectoral allocations of resources for functions/programmes/ Ministries as approved in the overall plan framework may need to be broadly adhered to while working out budget ceilings.

- The MoF may continue to set rules relating to pay and allowances, creation of posts, procurement procedures, travel and other entitlements, accounting, financial control and internal and external audit. These rules may apply across the Ministries/Departments with requisite delegation.

Role of Planning Commission

2.28 Planning Commission has played a key role in formulation, appraisal, review and evaluation of the Five Year Plans. It may continue to play such a role. However, budgetary resources of the plan hitherto included only a proportion of total budgetary resources. A large part of the budgetary resources, called Non-Plan expenditure, has been kept out of plan resources. Therefore, a major proportion of outlay of Sectors/ Ministries/States covered by General Services and a substantial proportion of outlay of Sectors/Ministries covered by Social Services and Economic Services are neither discussed nor included in the FYP documents. If Plan and budget have a one-to-one relation after the removal of Plan and Non-Plan distinction, there may be a need to discuss the resources and outlays for the plan of the Sectors/Services/

Ministries left out hitherto from the FYP documents. However, it may be specifically stated that the FYP will exclude discussion on specific Sectors/Services such as defence services.

2.29 As regards estimating the overall resources for the FYP, Planning Commission will need to undertake the following tasks:

- Prepare projections of budgetary resources of Centre and States based on the projections of tax, non-tax and other receipts within an acceptable fiscal deficit target in consultation with Ministry of Finance, Central Ministries and States. This primarily helps prepare projected total budgetary resources for five years of the plan.
- Prepare projections of IEBRs of PSEs, and Local bodies, in consultation with Ministry of Finance, Central Ministries and States.

2.30 Planning Commission may have following roles in projecting allocation of resources across different Sectors/Services during the FYP:

- Set up assumptions/rules in consultation with MoF for Central Ministries to enable them to project total resources required for different Sectors/Services/Ministries on expenditure of committed and non-committed nature at different service levels over the period of the FYP.
- Define rules/guidelines for transfer of resources to States.
- Prepare projections of resources to be allocated to different Sectors/Services/Ministries and to States over the FYP period consistent with approved priorities of the FYP.
- Prepare projections of budgetary expenditure component of the plan for the programmes in Sectors/Ministries covered under the present functional categories of (**Social Services and Economic Services. These services include education, sports and culture; health and family welfare; water supply, sanitation, housing and urban development; information and broadcasting; welfare of SCs/STs/OBCs; labour and employment; social security and nutrition; agriculture and allied activities; rural development; special areas programmes; irrigation and flood control; energy; industry and minerals; transport; communications; science, technology and environment; and other social and general economic services**). The grants to be provided to the State or other sub-national Governments under these functional heads should also be included in these projections.
- On approval of the size and inter-sectoral allocation of resources for the FYP, assist MoF in preparing needful mapping documents for budgetary and other components function-wise, programme-wise and Ministry-wise.

2.31 The Planning Commission may have the following responsibilities in the implementation of the Plan:

- Planning Commission may scrutinize the budget allocations proposed by the MoF during the annual budgeting exercise. Within the resources

allocated to each Ministry/ Department, there may be annual and rolling estimates of the resources committed on the ongoing services, schemes and programmes and the likely resources for taking up new programmes. Planning Commission should also undertake outcome/output linked review of programmes of the Ministries/Departments.

- The inter-sectoral allocations of resources for functions/programmes/ Ministries as approved in the overall plan framework may need to be broadly adhered to while working out budget ceilings for different Sectors/ Ministries.

- **As regards State Plans, Planning Commission, in consultation with Central Ministries, needs to indicate to States well in advance the likely resources to be made available to States for different programmes to enable States to prepare their respective budgets. With the removal of Plan and Non-Plan distinction, there may not be any need for approval of State Plans as per the current practice. States may provide information about the budget/plan function-wise to Planning Commission/MoF to enable consolidated information to be prepared and available in public domain. Planning Commission may hold strategy/review meetings with States in an appropriate format.**

- Planning Commission may conduct evaluation of programmes either itself or through other institutions/ mechanisms.

Role of Administrative Ministries

2.32 The main responsibilities of the Administrative Ministries in the formulation of the FYP may be as follows:

- Assist Planning Commission in preparing strategic plans for the respective Sectors/Services/Ministries in accordance with priorities approved by Planning Commission.

- Project resource requirements overall and for different programmes under different scenarios based on costing of programmes consistent with the resources indicated by Planning Commission.

2.33 The Administrative Ministries will be primarily responsible for implementation of the Plan. Main areas of their responsibility may be as follows:

- The administrative Ministries/ Departments may be provided greater flexibility within the hard budget constraint indicated to them by the Ministry of Finance on a three-year rolling basis. This may incentivize the Ministries to identify slack or idle resources and use the same for better purpose. The Ministries may try to achieve the objective of operational efficiency through better design and implementation of the programmes. Greater flexibility in this regard needs to be used for moving resources to better programmes and uses and to achieve more optimal mix of inputs so that better outputs and outcomes are obtained.

- The administrative Ministries/ Departments may prepare budget proposals of their programmes on a three year rolling basis taking into consideration committed and non-committed resources within the budget ceiling.

- The administrative Ministries may be required by the Ministry of Finance/ Planning Commission to provide information on the costing of services vis-à-vis benchmarks and targets. Over a period of time, several operational performance parameters may be developed and mile stones specified for each Ministry/ Department.

- The administrative Ministries should respond to review mechanisms of plan/budget/programmes set up by MoF and Planning Commission within their respective domain of Sectors/Services/Ministries.

Annual Budgeting Process

2.34 The revised budgeting process in the Central Government may be as follows:

- The FYP will provide the overall framework for sectoral allocation for Sectors/Services/Ministries over the FYP period. The multi-year expenditure framework will be continually updated in the light of resources availability, sectoral priorities and performance. MoF will prepare the Medium Term Expenditure Plan (MTEP) on a three year rolling basis broadly based on the FYP as part of the statements to be laid under FRBM Act, that will provide the breakup of the expenditure projected in the Medium Term Fiscal Plan (MTFP) presented as per the FRBM Act.

- In June/July of every year, output/ outcome linked reviews of Ministry-wise budget performance and performance of IEBR component of plan will be conducted by Planning Commission with participation from Ministry of Finance.

- In September, based on the outcome of performance review, MTEP allocations and resource projections for current Financial Year (FY) and the following year, Ministry of Finance would ask the Ministries/ Department to prepare their Revised Estimates and Budget Estimates.

- Administrative Ministries prepare their Revised Estimate (RE) for the current FY based on performance of the first half of the FY and expected performance of the second half. They prepare their BE proposals for the following year along with output/ outcome targets. The expenditure budget proposals are based on tentative budget ceilings, overall priorities, performance reviews and operational efficiency. The State-wise grants on account of different plan schemes are also estimated on tentative basis. Separately, the IEBR of the PSEs and implications for the PPPs are also estimated. The RE and Budget Estimate (BE) proposals are made to both MoF and Planning Commission.

- The MoF holds meetings with Ministries in November-December to consider RE for the current FY and BE for the following year formulated by Ministries based on tentative budget ceilings respectively communicated by MoF. Planning

Commission is to represent in these meetings at senior level.

- Following these budget meetings by the end of December, RE ceilings are communicated to all Ministries by the MoF. Based on the observations on BE for the following year, as scrutinised in the meeting, MoF prepares proposed allocations for Ministries with broad scheme-wise allocations and committed items and sends it to Planning Commission for their feedback and scrutiny. The Planning Commission scrutinises these allocations based on the overall development priorities, outcome targets and sectoral requirements. On the receipt of the comments of Planning Commission, the budget allocations are further reviewed and communicated by Ministry of Finance to Ministries.
- In January, revenue projections for the current year and next year may be finalised and the MTFP projections may be made for next two years. Based on revenue projections, if any changes need to be made to the expenditure budget ceilings, the same may be incorporated by Ministry of Finance in consultation with Planning Commission.
- Ministries revise their proposals based on final ceilings and submit them to MoF by end of January.

Role of State Governments

2.35 The main responsibilities of the State Governments in the formulation of the FYP may continue to be as follows:

- Assist Planning Commission in preparing overall FYP and plans for various Sectors and Services in accordance with priorities approved by Planning Commission.
- Project resource availability and requirements for respective State Plan.
- Prepare respective State Plan in accordance with national and State priorities keeping in view availability of total budgetary resources of the State and likely central transfers (without the earlier distinction of Plan and Non-Plan), resources and outlays of PSEs, local bodies, SPVs and PPPs.

2.36 The State Governments may continue to have following responsibilities in the implementation of the plan:

- Prepare annual budgets (now synonymous with annual budgetary component of the plan) consistent with priorities of the State Plan within the total availability of resources including central transfers indicated by Planning Commission/Central Ministries.
- Prepare estimates of IEBRs as well as investments of SPSEs and local bodies.
- Provide information on budgetary component and IEBRs to Planning Commission. Also, share best practices.
- Share links with CPSMS to provide expenditure information on Central releases.
- Respond to reviews/ strategy meetings of Planning Commission and Central Ministries.

2.37 The State Governments may review their organizational arrangements between State

departments following the removal of distinction in Plan and Non-Plan in the budget and make necessary changes in annual budgeting process if necessary.

OTHER ISSUES

2.38 The Plan/Non-Plan separation in the budget and the accounts is something that has existed for so many years that many systems that should not have been dependent on this bifurcation also depend on this bifurcation. These will have to be reoriented after merger. One of them is delegation of powers and the procedure for sanction of expenditure. Second such system is the certificate for utilization of grants. However, such issues are not very complicated as the easiest solution would be to adopt one of the two systems that exist separately for Plan and Non-Plan expenditure. Review of financial and budget manuals such as DFPRs, GFRs, Civil Accounts Manual will be essential and such review may be undertaken in a time bound manner.

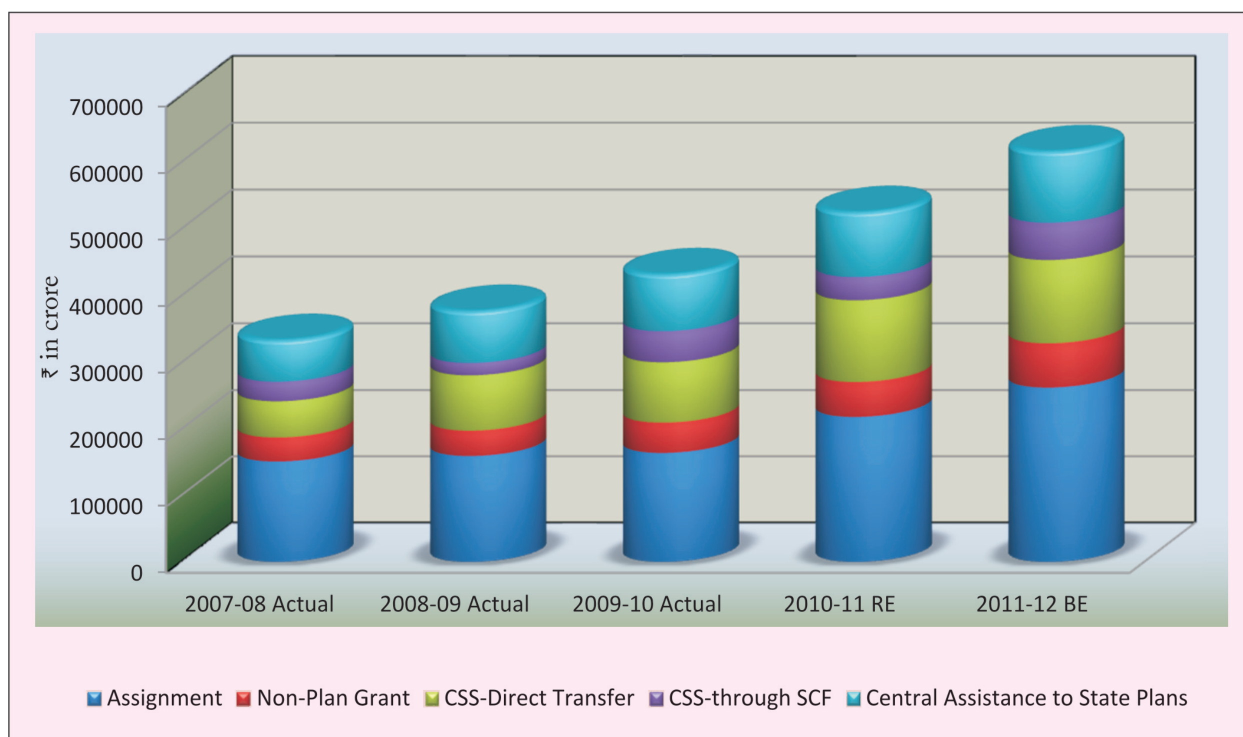
CHAPTER 3

COMPREHENSIVE FRAMEWORK FOR THOROUGH OVERVIEW OF TRANSFERS TO STATES

BACKGROUND

3.1 The resources flow from Centre to States by way of assignments and transfers. The States' share in central taxes (tax devolution) is an assignment. The transfer of resources from the Centre to States may also be classified as Non-Plan and Plan transfers. The Non-Plan transfers comprise (1) finance commission grants and (2) other Non-Plan grants. The important plan grants that are transferred from Centre to the States are of four types: (1) State Plan Schemes that include Normal Central Assistance (NCA) and other Scheme based Central Assistance (CA)-which are also known as ACA Schemes; (2) Centrally Sponsored Schemes (CSS) for which funds are routed through consolidated fund of States and (3) Centrally Sponsored Schemes (CSS) for which funds are transferred directly to State/ District Level Autonomous Bodies/Implementing

3.1. Assignments and Transfers to States* during 11th Plan



*All figures in ₹ Crore

** CSS figures are BE Figures

Source: Budget Documents – Government of India

Agencies and (4) A small portion of FC grants treated as plan grants. In addition, the Central Ministries also implement some schemes directly in States/UTs which are called Central Sector Schemes but resources under these Schemes are not generally transferred to States. Among the plan transfers, the distribution of the Normal Central Assistance is formula based (Gadgil-Mukherjee formula is used) and untied, but funds made available under other State Plan (ACA) or CSS are tied to schemes in particular sectors and are subject to centrally prescribed guidelines. The chart above provides a glimpse of different types of central resources (Plan and Non-Plan) being assigned/transferred to States.

3.2 The Non-Plan transfers such as finance commission grants and other Non-Plan grants are transferred to the States through treasury route. As regards plan schemes, resources are transferred through treasury route or direct transfer/society route. A clear framework is needed for a comprehensive view of the total transfers to States and accounting and reporting issues linked to these transfers. This issue is intimately connected to the budget and account classification.

PRESENT STATUS

3.3 A major problem faced by the Controller General of Accounts today is in generating scheme-wise information from the accounting classification due to absence of a one to one correspondence with schemes and heads of accounts. As a result, the Demands for Grant and the accounts do not explicitly present budgetary allocations and outruns on plan schemes and sometimes culling out this information may require extensive manual intervention.

3.4 The existing system of classification divides the Consolidated Fund of India into Revenue and Capital Sections and requires that all expenditures be categorized into these two broad divisions at the highest level. At the operational level, all expenditures are classified using a six-tier hierarchical classification structure, which is as under:

- Major Head – represents major functions of the Government
- Sub-Major Head – represents sub-functions of the Government
- Minor Head – represents programmes of the Government
- Sub Head – represents schemes
- Detailed Head – represents sub-schemes and
- Object Head – represents the economic type of expenditure.

3.5 Under this system of classification, functions are repeated under the Revenue, Capital, and Loans sections. Transfers to States are recognized separately under a common head. Thus, if a plan scheme has components of revenue and capital expenditure incurred directly by the Centre and also has transfers (including loans) to States/UTs, the data in the accounting books will be scattered under a number of heads and requires tremendous manual effort in aggregation to generate scheme-wise information. Thus, considerable effort is required to translate accounting information into plan formats. Also, there is no standardization in classification of schemes under different Major heads. Often, a scheme appearing under more than one major heads is represented through different codes under different Major heads. This lack of uniformity further complicates computerized processing of data.

3.6 A related issue is absence of explicit recognition of plan schemes at the appropriate levels in the classification structure. Some schemes, despite having significant outlays, are not reflected at Minor Head level and, therefore, do not get explicitly reported in the Finance Accounts.

3.7 A significant proportion of Union Government expenditure takes place in the form

of transfers to States. These transactions are recorded under the Major Heads 3601 and 3602. The sub-classification under these heads has not kept pace with the changing pattern of plan assistance. Also, there is no provision to show State-wise breakdown of such transfers. This lacuna leaves several information gaps in the accounts, in so far as this area is concerned. Similarly, heads like 3601-Grant-in-Aid to States also interfere with the functional requirement where even grants for urban development (JNNURM) or Irrigation (AIBP) is classified under this head. Actually, Grants-in-Aid should be only an object head.

3.8 Further, functional heads should be really functional and any other dimension should not interfere with this quality. For example, there is no reason why a functional major head like 2552-North Eastern Areas, exists as it does not signify any function of the Government. Increasingly, since there has been an expressed identified need of demarcating the expenditure of the Government on North Eastern Area, even expenditure on education in North Eastern areas is shown in the budget under 2552. This is a geographical attribute camouflaged as functional attribute.

3.9 The minor head is a very critical level and needs an extensive review. There has to be some level of budgeting and accounting that relates to broad objectives of the Government for a given function to which eventually outcomes can be linked. This would also enable reporting on cost incurred by Government under various items of expenditure for a particular objective and to achieve a desired outcome. This purpose can be served at the minor head and the minor head should align with broad objectives of the Government for the function represented by the major/sub-major head. Below minor head, can be schemes represented by sub heads and detailed heads that have been taken up to meet the particular objective indicated by the minor head.

3.10 Thus, while Education can be a major head, elementary education may be a sub major head under education (as it is today) and universalization of primary education may be a minor head. Schemes like Sarva Shiksha Abhiyan and Mid-Day Meals scheme should be below this minor head. It also may happen that a scheme is targeted towards more than one main identifiable objectives of the Government. In such a case, the scheme should separately be shown under all the relevant minor heads with separate allocations.

3.11 A related issue is non-reporting / non-availability of information in the State Finance Accounts of significant amount of resources being devolved on States through direct Central assistance outside the State Consolidated Funds. The problem gets compounded due to lack of uniform coding for plan schemes across the States. There have been suggestions to introduce uniform accounting codes for all plan schemes across the Union and the States so that each scheme is identified uniquely throughout the system. This is seen to help consolidate information on plan expenditures incurred at the grass-root level and correlate actual expenditures with the Central releases.

3.12 To ensure that this system works without distortions, there are certain prerequisites. The first is that the integrity and compliance of the classification maintained is impeccable. For this, it has to be ensured that the initial set of accounting heads are as exhaustive as possible and any addition to this set is done only after careful consideration and ensuring that the addition meets the basic principle of accounting classification. Then, whenever a new item of expenditure is added, its classification needs to be correctly decided as per the classification structure laid out and finally, whenever expenditure is incurred, it is classified under the correct head. Lack of such effort has made heads like "other items" and "other expenditure" as the most commonly used heads.

3.13 Another issue that leads to weakening of the accounting classification is the structure of Finance Accounts. As of now, the Finance Accounts show the expenditure details up to the minor head level across all sectors. This is one of the reasons for bringing major schemes, or any other set of expenditure for which there has been a demand to be reported separately in the Finance Accounts, to the minor head level since this way they can find place in the Finance Accounts as a separate entry. There is no reason why the Finance Accounts should report expenditure till the minor head uniformly. Finance Account can be reformatted in a relatively flexible format where the detailing should depend on the importance of the line item. This way, the classification hierarchy need not adjust to the reporting requirement.

3.14 The sixth tier denoted by the object head, is the most important tier of accounting. It provides another dimension to the accounting classification common across the entire spectrum of functional classification. This classification is very important to ascertain the nature of expenditure under each scheme. Thus, this tier is very important for distinguishing expenditure on salaries, establishment, travel, subsidies, grant-in-aid, major and minor works, maintenance, materials and supplies etc. Since the object heads are common, they provided consolidated information on the expenditure of Government on each of the class across a collection of schemes. This classification is essential to indicate the cost of inputs in delivering a service or a certain set of service and achieving a certain set of objectives.

3.15 Planning Commission has also been suggesting that accounting classification should distinctly recognize the various categories of transfers, namely, (a) untied transfers, (b) grants for specific purposes against which States are not required to submit utilization certificates, and (c) advances for incurring expenditure that require submission of utilization certificates. Suggestions have also been made that the grants under Centrally Sponsored Schemes to States and other sub-national implementing agencies be shown in the books of Union Government as 'Transfers' and not as 'Expenditure'.

3.16 A uniform coding is expected to facilitate identification of each scheme uniquely throughout the system of devolution of money from the Centre to the grass-root level agencies and help consolidate information on plan expenditures incurred at the grass-root level and correlate actual expenditures with the central releases.

CENTRAL PLAN SCHEME MONITORING SYSTEM (CPSMS)

3.17 One of the major actions taken to mitigate this challenge has been the inception of the Central Plan Scheme Monitoring System (CPSMS). The Central Plan Scheme Monitoring System (CPSMS) is being currently setup by the Controller General of Accounts in collaboration with the Planning Commission to serve as a comprehensive management information and decision support system for monitoring of the plan schemes of the Government. A web-based application has been developed and deployed by the CGA for real time on-line tracking of funds disbursed by the Union Government under various development schemes. CPSMS has the challenging task of integrating tens of thousands of implementing agencies through a common system, so that fund movement is tracked at each successive stage starting with the initial release from the Centre till the money actually reaches the ultimate beneficiaries.

3.18 CPSMS portal is operational now. Over 1000 plan schemes of the Government of India have been mapped on this system and more than 75,000 sanctions for release of funds have been captured. Nearly 20,000 programme implementing agencies have been registered with the system. Ministry-wise, Scheme-wise, State-wise, District-wise, NGO-wise, Individual-wise data of releases from GOI are now centrally

available on CPSMS on a real-time basis. With this, CPSMS now has complete information on releases made by the Union Government.

3.19 A unique feature of CPSMS is its close interfacing with the banking network in the country. In a way, it is designed to link with the Core Banking Solution (CBS) of the individual banks to obtain information on movement of funds from one level to another and from one agency to another on a real-time basis. This feature has the benefit to give us the capability to introduce near 'Just-in-Time' release of funds to implementing agencies, which can result in huge efficiency gains from the point of view of cash management.

3.20 Several major banks in the country have agreed to join the CPSMS interface and it is expected that all banks would be part of this network. With the banks joining in the system, the second phase of the project would capture the utilization of Central funds by the implementation agencies. CPSMS also seeks to have interface with state treasuries and State AGs to obtain real time expenditure information for schemes for which funds are transferred from the Central Ministries to the consolidated fund of the States.

3.21 On full implementation, the system would provide a platform on which the management at each level would be able to monitor fund utilization under various developmental schemes operated through treasury route or society route. CPSMS is expected to provide customized information of fund deployment and utilization vertically under each scheme to programme managers and horizontally across schemes in one geographic area for senior management and political functionaries. Inputs provided by the system would be vital for programme management and policy planning.

3.22 The information on fund utilization is also planned to be placed in the public domain for greater public awareness, public participation in the policy making and execution and towards enhanced transparency in Government operations.

CHANGE IN CLASSIFICATION OF BUDGET AND ACCOUNTS

3.23 A Committee headed by Controller General of Accounts has been constituted by the Government recently for revision of the List of Major and Minor Heads of Accounts of the Union and the States. The Committee has representations from the Office of the C&AG, the Budget Division, Planning Commission, National Institute of Public Finance and Policy and the state Governments of Assam, Maharashtra and Tamil Nadu. The Committee has been tasked to suggest a new list of accounting heads in replacement of the existing list of major and minor heads keeping in view the needs for simplification, rationalization and standardization across national and sub-national Governments and improved reporting of transfer payments from one level of Governance to another.

3.24 Accordingly, the issues related to accounting of plan schemes and the need for developing a mechanism which could provide a comprehensive view of the transfers to States are under active consideration of the Committee. Internally, office of the Controller General of Accounts is working on a revised classification structure, with the objective of simplifying the accounting of schemes and bridging the existing information gaps. The endeavor is to address the structural deficiencies of the current system and develop a new design which will be computer friendly and which will enable flexible multi-dimensional views of expenditure data.

RECOMMENDATIONS

3.25 The Committee has noted that the process for a comprehensive review in the present budget

and account classification is in an advanced stage and has been circulated to all States with requests for furnishing comments. Some of the entities have also provided suggestions regarding coding and technical aspects. The comments of the various stakeholders are under consideration.

3.26 The proposed multidimensional framework with independent hierarchies for every dimension is a much desired improvement over the current single dimensional structure. The proposed framework may include independent dimensions in respect of Functions, Programmes and Schemes, Economic Object, Recipient of funds, Geography and Beneficiary. It should take into consideration proposals put forward by an IMF Mission in 2007 on the request of the Ministry of Finance and the structure proposed under UN's Classification of Functions of Government[1] (COFOG) and compatible with Government Statistics and Finance Manual[2] (GSFM, 2001). It will facilitate easy slicing and dicing of information. Various obstacles posed by current classification in presenting a comprehensive view of Central resources transferred to States can be addressed through this new framework. For example, functional classification should be truly functional. The economic classification should enable all sorts of information to prepare improved costing of schemes and linking the outlays/expenditure to outcomes. The recipient classification may provide State-wise or district-wise information on transfer of resources. It can potentially provide information even on cash transfers to individuals. The Committee also recognizes that successful development and implementation of the new classification will require adequate consultation with multiple stakeholders, changes in existing software of Central and State Governments and widespread training to staff.

3.27 The Committee recommends that proposed classification and coding system must provide uniform codes for Central programmes, sub-programmes and schemes which are implemented in States so that comprehensive view across the country is facilitated.

3.28 The Committee recommends that the CPSMS should be extended to enable tracking of utilization of funds for all Central Schemes in all States for which resources are either transferred through treasury route or society route. There should be a clear distinction between releases of funds and their actual utilization so that mere releases from a higher level entity to a lower level entity are not a subterfuge for expenditure. The information flow should be seamless, real-time and transaction-based using information technology. This may require interface of Central IT systems such as CPSMS with State treasuries and AG offices as well as CBS of banks. When implemented, it would be possible to have utilization certificates to be linked with and supported by transaction-level information to ensure tracking of funds up to the final beneficiary.

3.29 The Committee is of the view that changes in budget classification and accounting being worked out by a Committee (headed by CGA) and the new IT interfaces being planned between Central, State and Banks to keep track of resource flow together have the potential to provide a comprehensive view of the extent of Central resources transferred to States and their agencies and their utilization across different Schemes. The same system can also provide similar information for schemes of State Governments. The citizens can also be empowered with information on flow of resources and utilization through a portal. This will effectively promote transparency and accountability.

[1]Please refer to http://unstats.un.org/unsd/cr/registry/regcst.asp?Cl=4

[2]Government Finance Statistics Manual 2001-GFSM 2001, IMF

CHAPTER 4

TRANSFER OF FUNDS TO STATES/DISTRICT LEVEL BODIES AND ACCOUNTABILITY CONCERNS

BACKGROUND

4.1 As stated in Chapter 3, States receive plan funds from the Central Government via support to States' Plans called Central Assistance (CA) or Additional Central Assistance (ACA) and via the Centrally Sponsored Schemes (CSS). Grants for CSS are meant to supplement the resources of the State Governments, who are responsible for the implementation of these schemes and who are expected to contribute a matching contribution. These schemes are designed by the Central Ministries, who then pass on the funds to the States from the central plan budget that the Ministries control. The outlay and nature of the individual schemes is determined by the provisions and guidelines attached to schemes, are relatively inflexible, and cannot be altered by the States.

MODES OF FUND TRANSFER UNDER CSS

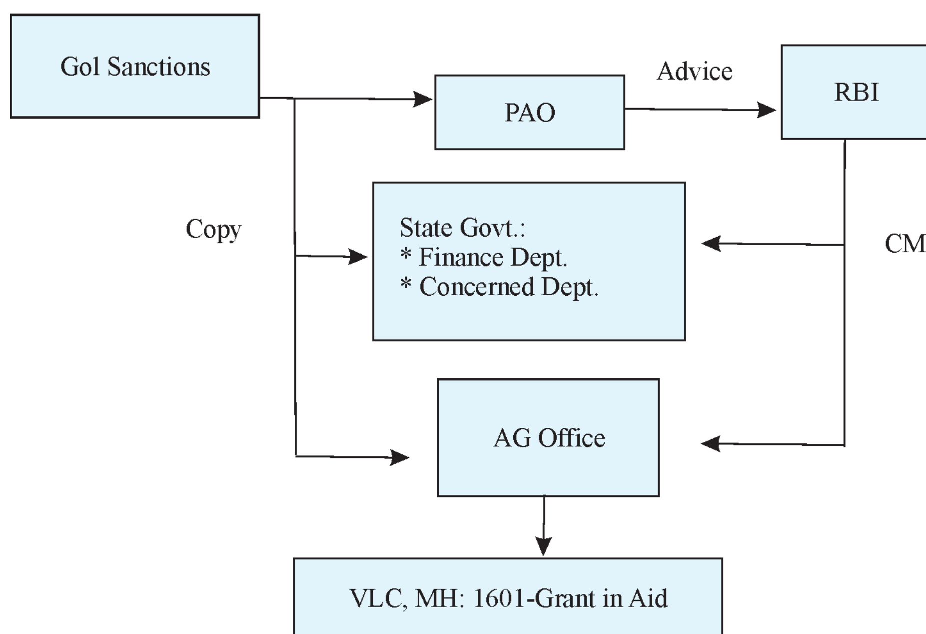
4.2 The Government of India releases funds under CSS through the following two methods; treasury mode and society mode.

Treasury Mode

4.3 In the treasury mode, after the sanction of funds by the concerned administrative ministries/finance ministry of the Union Government, the RBI is intimated to transfer the funds to the State Government. This is depicted in the flow chart given below. As a confirmation of the fund transfer a clearance memo from the RBI is received by the State Government and the Accountant General of the State. The finance department of the State approves the budgetary allocation if required and conveys a sanction for withdrawal of funds. The concerned department/agency withdraws funds. The expenditure is routed through the treasury and is captured by the AG office through the vouchers received for the same. As accounts compilation in the States have been computerized by the State treasuries (States' treasury computerization projects) and AG offices (Voucher level computerization project, VLC), funds can be tracked till the State Government spends through State departments or transfers the fund to the Implementing Agencies (IAs) (mostly local bodies).

4.4 The funds transferred to local bodies are captured at the time of release and booked as expenditure. The actual expenditure by the local bodies is not fed back into the treasury system. However, an accounting format for all PRIs has been developed with the active support of the CAG and software (Priasoft) has been developed by NIC and accepted for State wide implementation by the Ministry of Panchayati Raj. The accounting format developed is patterned so that it can be easily integrated into the State accounts. Once this is adopted, we would be able to present a consolidated picture of State finances including the PRIs.

4.1. Grants released through State Budget



Society Mode

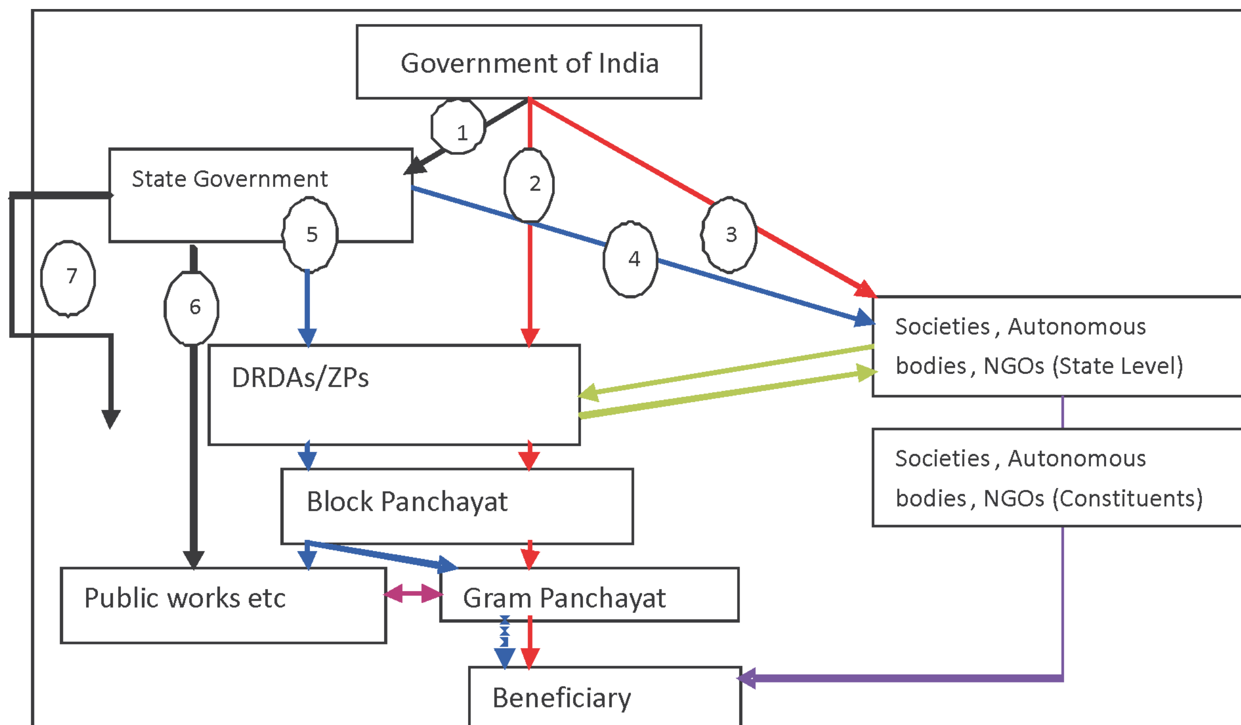
4.5 Starting from the mid-nineties, the Central Government has been following the practice of transferring the money required for the implementation of the several CSSs direct to bank accounts of IAs (Societies, autonomous bodies, NGOs etc), set up at the State and district levels that maintain funds outside of the Consolidated Fund of the States. This method of transfer is called the society mode of funds transfer.

4.6 In case of the society mode the funds are sanctioned by concerned administrative ministries and released by them. The funds are credited directly to the bank accounts of concerned agencies, i.e. DRDAs, Societies, NGOs (first recipients mostly functioning at the State level etc) which function at the State level. These funds are subsequently released further by these first level recipients to their constituents at the district, block (taluk) or village level. The expenditure of funds is monitored by the concerned central administrative ministry/department by keeping a watch over the Utilization Certificates provided by the agencies. The audit of such bodies is conducted by chartered accountants.

4.7 The mechanism of fund flow from the GOI to the ultimate beneficiary today involves several channels as illustrated in the flowchart that follows.

4.8 Releases: In the existing accounting framework, GOI's releases to State Government and State level implementing agencies marked by 1, 2, and 3 are captured as final expenditure in the GOI accounts. Similarly releases by State Government to State level Societies (4) and DRDAs (5) etc are booked as final expenditure in the accounts. The subsequent flow of fund depicted by unnumbered arrows is not captured in the State accounts. Actual expenditure is captured in State accounts only in respect of expenditure incurred by State Departments (6, 7).

4.2. Fund Flow Mechanism



GOI funds released through State Budget

GOI funds released directly

Releases by State

GOI and State funds interplay through Societies

Funds interplay between Gram Panchayat and Works Divisions

QUANTUM OF DIRECT FUND TRANSFER UNDER THE SOCIETY MODE

4.9 The following table gives an idea of the quantum of direct transfers (society mode) by the GOI, outside of State budgets, over the five years.

ISSUES AND CONCERNS

4.10 In practice the fund release mechanism is faced with the following shortcomings, which make accurate assessment of plan scheme expenditure difficult.

Treasury mode

4.11 There are several advantages of the treasury mode of fund transfer. The treasury accounting system is a robust system that tracks down expenditure up to the object level as vouchers for each transaction are available with the treasury/AG. The expenditure, as compiled by the Auditor General, goes through a process of validation and is audited by the CAG. There is assurance on end use and the system is amenable to monitoring and review at all stages. There is a well-defined system of cash management and bank reconciliation which provides information on cash flows at any point of time. However, this mode has a

4.3. Direct transfers by Government of India

Year	Amount of Direct Transfer (₹ in crore) (As in Exp Budget, Vol.I, Statement No.18)	Total Plan Exp (₹ in crore) (As per Union Finance Accounts)	% of Col.2 to Col.3
(1)	(2)	(3)	(4)
2005-06	NIL	1,40,637	-
2006-07	43,816	1,86,060	24.55
2007-08	54,776	2,05,082	26.71
2008-09	83,224	2,75,235	30.23
2009-10	90,521	3,03,391	29.83
2010-11	1,22,199 (RE)	3,95,024 (RE)	30.93
2011-12	1,24,605 (BE)	4,41,547 (BE)	28.22

few shortcomings as listed below.

a) As mentioned in Chapter 3, in GOI accounts, the transfer to States is treated as Grants-in-Aid and booked as final expenditure under the major head 3601. Similarly releases by the States to implementing agencies (IAs) are treated as final expenditure in the State accounts.

b) The central ministries are concerned about avoiding lapse of budget which acts as an incentive for them to spend (release moneys) not correlated with utilization in States/IAs. The State Government also releases grants to lower level IAs, releases again not connected with the actual expenditure.

c) The tracking of central releases is rendered difficult in the treasury mode also. These are often budgeted by the State Governments in the normal course with spending powers delegated to lower levels and the expenditure pattern is un-related to the timing of central releases. In such cases, there may be no specific action of intermediate level release at all. Even if there is a specific release, it may bear no relationship at all with the central release since it may pertain to more than one installment or part of an installment of central release. Actual expenditure at implementation level cannot be correlated with central releases in these circumstances. However, since the States and the Accountant Generals have formulated the plan budget link documents, the GOI scheme can be correlated with the corresponding State scheme in the State budgets. This was not always the case prior to the mapping facilitated by the plan budget link document as the nomenclature of the central scheme could vary in the State or funds for a particular central scheme could be distributed in more than one state plan scheme.

d) At times due to procedural delays

data pertaining to releases, available with different agencies varies due to carryover amounts from previous years released in successive periods. Correlating implementation level expenditure with central releases is difficult since even with one intermediate level release, the number of agents involved at the lower level may be very high.

e) Misclassification and mix up of amounts relating to central shares of different schemes occurs in the case of both types of release mechanism.

f) Exact dates of interim stages like administrative/financial sanction in the state Government (often involving Finance Department concurrence) are almost impossible to obtain.

g) The statements of expenditure provided to the GOI, even where funds are routed through the State budget, are often not reconciled with the accounting records available with the State AG raising concerns about the accuracy of actual expenditure reported.

h) The issue about lack of assurance on end use of funds arises here too, though on a limited scale, as the State also releases funds to IAs, which are booked as final expenditure in State accounts.

Society Mode (Direct Transfer mode)

4.12 The agencies to which funds flow directly from GOI are PRIs, ULBs, societies/ autonomous bodies at State level, central autonomous bodies, NGOs etc. Collectively these Bodies are known as Implementing Agencies/IAs.

4.13 Once again, in GOI accounts, the transfer to States is booked as final expenditure under the functional major heads of accounts belonging to respective departments. In this case, unlike the treasury mode, the trail of fund release and utilization ends here. In the treasury mode, the amounts are booked under major head 3601 in the Union accounts and can be traced to corresponding receipts in the State Budgets under the major head 1601. The expenditure against this release is budgeted for under various heads of account and is captured through vouchers. Hence, under the treasury mode, the utilization of fund released by the Union can be traced in most cases. The Society Mode (Direct Transfer Mode) suffers from several drawbacks as follows.

a) The central ministries are concerned about avoiding lapse of budget which acts as an incentive for them to spend (release moneys) not connected with utilization by IAs.

b) There is no uniform formal accounting framework for these IAs.

c) There is no assurance whether the amount has actually been spent by the IAs on the schemes or not.

d) Assets created in the system go unaccounted for. Although it appears to be a problem of the accounting classification where all grants are treated as revenue expenditure, but it is actually a problem of definition of ‘State’. So long as they are treated separate from the ‘State’, this problem would remain. The issue is discussed in detail later in this Chapter.

e) Even when funds are released by the GOI/SG on the basis of utilization certificates provided by the IAs, there is no assurance on whether the UCs

are authentic or complete. In any case the UCs cannot serve as instruments of financial monitoring.

f) There is no centralized data on expenditure available in any financial statement, either with the State or the Union Government. Until the CPSMS project, there was no centralized information on releases by various Ministries of the GOI.

g) Since the funds are not spent fully by the IAs in the same financial year, there remains substantial amount of unspent funds in their bank accounts. The aggregate amount of the unspent balances in the bank accounts of the implementing agencies kept outside the Government accounts is not readily ascertainable and to that extent the Government expenditure as reflected in the accounts is overstated.

h) The unspent balances with the IAs constitute the float outside and the carrying cost of the float is substantial. While the GOI borrows to keep the programmes running, the unspent balances are not available to the Government to manage its cash balance.

i) There is no formal/regular system of getting monthly expenditure figures.

j) Audit of the IAs is carried out by Chartered Accountants (CAs), appointed locally by the State level societies or the District level IAs. In case of PRIs/ULBs, the responsibility is usually on Director, Local Fund who is a functionary of the State Government.

k) CAG's audit jurisdiction is not comprehensive over all sub-grantees, i.e. down the line implementing agencies which receive funds from first level IAs at State level.

SHORTCOMINGS IN THE IMPLEMENTATION OF CSS

4.14 The CAG has studied the implementation of many CSS and observed a common pattern of shortcomings in their execution. As early as 1999, the CAG's Union Audit Report pointed out various constraints in CSS. Unfortunately, these have not been rectified over the years. The absence of a clear institutional framework which governs accounting policies, format of financial statements and disclosure requirements is a direct contributor in most of these cases. The shortcomings noticed were as under:

a) Inability of the Union Ministries to control and monitor the execution of the schemes with a view to ensuring the attainment of the stated objectives and outcomes in the most cost effective manner and within the given time-frame. As a result, programs continue to be executed in uncontrolled and open-ended manner without quantitative and qualitative evaluation of delivery.

b) The controlling Union Ministries confined their role to the provision of budget and release of the funds to the State Governments and IAs rather mechanically without reference to the effective utilization of the funds released earlier in accordance with the guidelines and capacity of the respective State Governments and IAs to actually spend the balance from the previous years and releases during the current year.

c) The Ministries were unable to ensure correctness of the data and facts reported by the State Governments. Over-statement of the figures of physical and financial performance by the State Governments was common. No system of accountability for incorrect reporting and verification of reported performance was in vogue. The internal audit function in both the departments implementing the projects as well as the societies was inadequate or nonexistent.

d) The Ministries were more concerned with expenditure rather than the attainment of the objectives. Large parts of funds were released in the last month of the financial year, which could not be expected to be spent by the respective State Governments during that financial year.

e) The State Government's emphasis was more on release of assistance by the Central Ministries rather than ensuring the quality of expenditure and attainment of the objectives.

f) Misuse of the funds provided for vulnerable sectors and sections of the society was evident. The State Governments' attention towards such misuse left much to be desired. The controlling Union Ministries had little clue to such misuse. Thus, in many cases, the figures of expenditure booked in accounts assumed precedence over the bonafide and propriety of the expenditure.

g) The DRDAs, State level societies, NGOs or the autonomous bodies which receive funds directly from the GOI, release the amounts further to their constituents (PRIs, District level societies etc). It has been observed that the amount of fund reported as received by a taluk or Block panchayat from a DRDA, or a district level society from a State level society differs from the amount stated to have been released by the DRDA. Opening and closing balances in bank accounts differ across these agencies. Expenditure figures given by down the line IAs do not tally with the figures reported by the District level agencies. On the whole, expenditure information is unreliable.

h) This is undermines the very foundation of our parliamentary system i.e. lack of legislative control and oversight over such expenditures.

i) These views were endorsed in an address to the NDC by the then Finance Minister[1] –"Lack of an accurate, transparent, reliable and regularly updated monitoring mechanism also adversely affects the efficacy of any plan scheme. In 2005, the Planning Commission estimated that the Government spends ₹3.65 to transfer ₹1 worth of food, suggesting leakage of about 70 percent."

RECOMMENDATIONS

4.15 The connection between release of funds by the Central Government and the actual expenditure for physical inputs by the implementation agency is currently very

[1]Text of intervention of then Finance Minister Shri P. Chidambaram at the National Development Council meeting held on December 19, 2007 available at http://pib.nic.in/release/release.asp?relid=34136)

obscure. The present monitoring mechanism, as has been highlighted above, suffers from several shortcomings.

4.16 The Central Plan Scheme Monitoring System (CPSMS) initiated by the Controller General of Accounts is a step forward. Presently it captures all releases by PAOs of all Central Ministries and has a database of IAs. It is envisaged that it will capture the expenditure information from all the agencies involved in the implementation of plan schemes. As it builds into a Management Information System (MIS), it helps fill the information vacuum which exists in respect to financial information of central schemes.

4.17 However, the implementation of CPSMS in itself will not be able to address all the accountability concerns of direct transfer of funds. An MIS can complement audited accounts/financial statements but not supplement it. There is a need for properly audited accounts of these IAs. Adequate validation along with independent oversight of central schemes funds is required at all levels in order to provide satisfactory assurance.

4.18 The Committee, therefore, proposes interventions to improve the (I) accounting and (II) audit of the funds released for implementation of plan schemes.

I ACCOUNTING INTERVENTIONS

4.19 Presently, the expenditure by the State in respect of a few important central schemes and state plan schemes is being included in the State Finance & Appropriation Accounts in the form of an appendix. However, it would be realized that the State Finance and Appropriation Accounts do not account for about 30% of the total public expenditure in the State. One of the important parameters in evaluation of the impact of programmes and its compliance with policy objectives is the availability of reliable data on expenditure. As on date, absence of credible data on total public expenditure in States in sectors of health, education and rural development chokes any meaningful review or impact assessment.

a) Route funds through Treasury

4.20 Benefits of routing funds through the treasury cannot be over emphasized. While this may not address all the ills plaguing the system, it is definitely better than a system with multiple agencies and players over whom the 'State' has little control. The superstructure required today to oversee these IAs which receive funds directly and the cost at which the systems will be built should be evaluated to see if it will actually benefit over the existent treasury system. Presently the IAs, especially societies, have an ambiguous status; while these agencies are manned by State officials, the State Governments do not want to share responsibility for the financial management of these agencies. Instead, most State Governments have been demanding that funds for CSS should be transferred through treasury route. This results in lack of accountability and leads to the issues mentioned above.

4.21 The 13th Finance Commission have stated that the optimal solution would be to route funds through the State Budgets so that the treasury system can report utilization of funds and the State Government can monitor implementation of schemes. At the 23rd Conference of State Finance Secretaries at Mumbai held in May 2010, there was a resounding demand from the State Governments to route funds through the treasury with the Finance secretaries of Punjab, Himachal Pradesh, Haryana, Kerala, Assam, Andhra Pradesh, J&K raising the issue during

the conference. Similar demands were made by several States in Chief Secretaries' Conference convened by Cabinet Secretary.

4.22 The major motivation behind setting up State and/or district level agencies outside of the Government to receive funds for implementation of Centrally Sponsored Schemes was mostly so as to not allow CSS transfers to be utilized by the States for their ways and means purposes, avoid delays in obtaining a second legislative approval before the amounts that are credited to the Consolidated Funds of the States can be utilized and avoid delays of administrative nature. The States' finances in the meanwhile have improved considerably. Many States have now online treasury systems enabling authorization of resources to the spending units without delay. Besides, conditionalities may be prescribed for plan transfers, in the similar manner as those for Finance Commission grants, to ensure that administrative delays in making resources available to spending units will be disincentivized. As the approval by State legislature is any case required for State share of the CSS, it will be appropriate that State legislature also authorizes the total outlay on the CSS meant for the State.

4.23 With the MoF embarking on the State Treasury Computerization as a Mission Mode Project under the NeGP, with central assistance to each district, it is an appropriate time to ensure that the necessary linkages/interfaces with CPSMS are put in place to ensure that the whole of the public expenditure is captured by the treasury system.

b) Separating out transfers from final expenditures

4.24 Under the present accounting system, any money transferred by the Government of India for CSS schemes is booked as final expenditure in the Union Government Accounts. This presents an anomalous picture because:

- It is not certain that the money transferred by the GoI has actually been spent for implementation purposes or exists as float in the accounting period in which the transfer was made.
- As GoI is not the implementing agency it would not be correct to depict the expenditure as final expenditure in its books.

4.25 In order to bring about greater transparency, it is essential that the money transferred by the Government of India for implementation of schemes is depicted as a "transfer" in the books of account at the first instance. However, it may not be practicable to do so by booking expenditure twice – once as advance and as expenditure when the accounts are submitted. This is because the Head of Accounts under Consolidated Fund of India close every year and the balances are not carried forward.

4.26 Also, it would not be sufficient that the expenditure is booked as "transfers" in the books of GoI, the same principle would be equally applicable for agencies such as state Governments, DRDAs, societies which also merely transfer funds to implementing agencies/ other intermediate agencies.

4.27 A suitable accounting methodology, to bring out the distinction between "final expenditure" and "transfers" and to enable a view of final expenditure through the books of accounts needs to be worked out by the CGA and office of CAG.

4.28 To sum up, the Committee unanimously supports the treasury mode of transfer of central

plan funds along with changes separating out advances from final expenditures. The budget classification and accounting changes and effective linkages of CPSMS with State treasury systems should be able to provide an effective Management Information System (MIS) on releases/advances and expenditure on plan schemes.

4.29 The switch over to complete treasury mode of transfer of funds may be made straightforward possibly beginning all new schemes from the 12th Five Year Plan. For existing schemes, a short transition period is required to allow for necessary adjustment. However, till complete switch over to treasury mode is done, accounting, submission of Utilisation Certificates and auditing of the Schemes under Society mode should be rationalized in the manner discussed below.

c) Mechanism during Transition Period for Existing Schemes: Agree To Consolidate Expenditure at State Level Pending Routing Funds through Treasury

4.30 Underlying the above contention is the logic that the IAs (Societies, PRIs etc.) are bodies funded largely by the Central and State Governments and are engaged with carrying out massive expenditures in the social sector. The work is overseen by senior State Government functionaries performing the same roles as they would have in the Government. These are in effect discharging the functions of the 'State' and hence, expenditure on central schemes by these agencies should be consolidated at the State level.

4.31 Similarly the accounts of the ULBs and PRIs, insofar as they implement schemes of the GOI/State Government, should also be amenable to 'integration' with the accounts of the State Government. As mentioned above, the accounting format developed for the PRIs is patterned so that it can be easily integrated into the State accounts. The same format can be applied to Societies/NGOs etc. and even to autonomous bodies for accounting for the Government grants. The XII FC has also endorsed this view when it stated that "all States adopt an accounting framework and codification pattern consistent with the Model Panchayat Accounting System developed by the MoPR and the CAG."[2]

4.32 Accounting format for the ULBs, prepared in consultation with the CAG, is also amenable to integration with State accounts and necessary modifications as may arise can be made.

4.33 Format of accounts for central autonomous bodies is laid down; formats are nonexistent for autonomous bodies at the State level.

4.34 Presently, the assets created from the grants made by the GOI and the States to local bodies, societies are not taken into account anywhere, which is a highly anomalous situation. The solution is not to change the classification of grants given by the Government from revenue expenditure to capital expenditure, as is being suggested, but to recognize that assets are reflected in the books of the entity which owns it. If ownership of assets vests with the Government (Central or State), which should be the case with all grantees except perhaps PRIs and ULBs, it is only logical that the accounts of these bodies are consolidated at the State level. However, in case of the PRIs/ULBs, the XIII FC noted that "the responsibility of maintaining the

[2] Twelfth Finance Commission report

services and assets created under CSS ultimately rests with the States. There are substantial direct transfers to implementing agencies in States under the CSS. The assets created by local bodies through direct transfers have to be ultimately maintained by States as own revenue generation by these local bodies is very poor." This simply underscores the need for consolidation at the State level.

4.35 These consolidated statements should form a part of the State's Finance accounts, which after integration of accounts of PRIs and ULBs, would reflect the entire gamut of receipts and expenditure in the State.

4.36 Once the above concept is accepted, formats for depiction of allocation of budget, releases, expenditure and recipient agency-wise or in any other manner can be devised and adopted. A uniform accounting procedure would have to be devised for all schemes as it would bring about fundamental changes in accounting policy, some of which are discussed below:

a. For instance grants by Government could be treated as a transfer pending actual utilization and not final expenditure upfront in the Union/State accounts.

b. Given the multiplicity of agencies and difficulties in collecting accounts individually from them, it would have to be made mandatory for the ULBs/ PRIs/autonomous bodies/societies and NGOs to maintain their accounts in prescribed formats and provide access to the AGs. Presently the multiplicity of efforts by the various Ministries in prescribing formats for providing accounting information should be streamlined into one acceptable set of formats.

c. Given multiple bank accounts of each agency, a system of bank reconciliation would have to be devised.

d. Suitable mention would have to be made in GFRs of both GOI and the States and in sanctions issued by GOI/ States for compliance to accounting formats as mentioned above , failing which further grants are to be stopped.

e. In respect of the societies, the Societies Registration Acts may require amendments to incorporate provisions regarding maintenance of accounts and disclosure requirements, compliance with IAS, filing of accounts, and appointment of auditors and constitution of audit committees.

f. An objective assessment of the comparative performance of different modes of financing as also of the IAs can be made with reference to

   i. The time taken through the treasury mode vis-a-vis the society mode for the budgeted amounts, being released and reaching the implementing agencies.

   ii. The time taken by the State Government and the different implementing agencies in converting the funds released into capital assets.

   iii. The quantum and percentage of funds kept by the State Government, societies and other IAs in capital works in progress and unspent cash balances. This information would be readily available from the proposed accounting system and the MIS. A capital asset would be so

recognized on the basis of a completion certificate duly validated by an audit check.

g. At present UCs issued by a State-level agency are inadequate, as, in-turn, it treats releases to lower level agencies as expenditure, without obtaining documentary evidence. Consequently, in the absence of a "pyramid' of UCs from the grass root level implementing agency upwards, the UC issued at State-level is largely meaningless. Rule 212 (1), note 1, of the GFR States that the UCs of Central Autonomous Organizations shall disclose separately the actual expenditure incurred and the loans and advances given to suppliers of stores and assets, to staff, to construction agents etc. that do not constitute expenditure at that stage. This should be applied to the DRDAs, Societies etc. which too do not incur expenditure at their level but extend loans, grants etc. to down the line implementing agencies. In essence, the UCs submitted by all levels of agencies should clearly specify whether funds released/received have been converted into capital assets/ actually spent in case of revenue expenditure or is accounted for in capital works in progress or lying as unspent balances.

   i. In case of actual expenditure, some broad categories of expenditure could be specified (assets creation, construction, maintenance, wages, grants to beneficiaries etc.).

   ii. A copy of the UCs, along with audited statement of accounts, should be endorsed to the State AGs.

   iii. More importantly, UCs should be based on audited accounts.

h. At present the AGs are required to certify plan scheme expenditure in respect of the funds routed through the State budget and send the certificates to the GOI ministries for further release of funds. However, CAG's audit reports indicate a lag in the issue of these certificates due to the failure of the implementing agencies in providing statements of expenditure. The expenditure booked in the accounts is sent by the AG, Accounts to the AG, Audit but in cases where the components of schemes are not properly delineated in the budget or where the State Government is merely transferring funds to other implementing agencies, the accounts would reflect the gap. Hence there is a need to codify major central schemes and its components and ask the States to adopt the detailed classification so that progress of expenditure can be easily retrieved for the country as a whole. Detailed and prescribed classification would enable tracking of the amount actually utilized as against transferred to deposit accounts, given out as advances, diverted to other uses etc.

i. In addition, the process of certification of plan scheme expenditure should serve actually as an instrument for further release of funds and needs to be accorded due sanctity by the field AGs and the Central and State Governments for it to be an aid to ensuring accountability.

II AUDITING ARRANGEMENTS

4.37 While most central plan schemes involving releases to societies/autonomous bodies have a provision for audit (by Chartered Accountants) of accounts of such societies, the results of such audits are not wholly satisfactory. Annual audit of such societies are carried out by chartered accountant appointed by the governing body of the State or district society or State Government. There is an issue of lack of independence of auditors as the auditors are usually appointed by the societies themselves. The CAs are also not required to assert or confirm that the funds have been utilized for intended purposes.

4.38 In case of the local bodies, XIII FC recommended that the Technical Guidance and Supervision (TG&S) of maintenance of accounts and audit was to be entrusted to the C&AG. The components of TG&S, defined by XIII FC include:

(i) Setting audit standards & audit planning;

(ii) Adoption of improved audit methodologies;

(iii) Training in audit and accounts and

(iv) Annual transactions audit by random selection and supplementary audit of institutions audited by the State Director of Local Fund Audit.

4.39 Presently, 18 States have entrusted all tiers/categories of both Panchayati Raj and urban local body audit to the technical guidance and supervision of the C&AG. The C&AG issues an Annual Technical and Inspection Report which is laid before the legislature. Four States have partially entrusted this responsibility to the C&AG, excluding variously, different parts of PRIs, ULBs or both. Third group comprises three States (Rajasthan, Maharashtra and Punjab) which have not entrusted any audit to the C&AG at all. The XIII FC further observed that "the lack of audited comparable data across local bodies limits their effective utilization by State Finance Commissions and prevents comparability across States."

4.40 Audit of local bodies is conducted by the Director, Local Fund Audit (DLFA) in the States. However, there is an issue of the independence of the auditor as he is a functionary of the State Government. There are also capacity issues that have to be addressed. Audit by CAG is superimposed over the initial audit by the DLFA. The Second Administrative Reforms Commission (SARC), in its second report on 'Local Governance – An Inspiring Journey into the Future', has also noted the need for providing functional independence to the Director, Local Fund Audit at the State Government level. It further recommended to institutionalize the existing arrangements under which the C&AG provides technical guidance and supervision over maintenance of accounts and audit of PRIs and ULBs. It proposed that FC grants be released to local bodies only after State Governments accept the technical guidance and supervision (TG&S) of the C&AG.

4.41 In order to improve accountability through audit in case of societies, the following measures can be thought of:

a. An element of independence may be brought in the process of selection of auditors for the societies by a process similar to that in PSUs where the auditors are appointed by the CAG.

b. Guidelines may be formulated in consultation with the CAG for the auditors to cover a list of additional

issues such as internal control, control over assets, inventory, reconciliation of expenditure, physical verification, etc.

c. Provision should be made for preparation of annual reports of the agencies reflecting the performance for the year together with audited financial statements within a specified time frame after the close of financial year.

d. As funds are often released further to down the line implementing agencies by the first recipient (grantee), CAG's audit jurisdiction over the sub-grantees in such cases can be made mandatory and placed beyond doubt by making suitable changes in GFRs/ sanctions as under:

   i. The GFR may prescribe that it shall be the duty of the grantee to make available the relevant books of accounts and records for CAG's audit including the related books of accounts and records of the sub-grantee, if any, to whom a part or whole of Government assistance may be transferred by the original grantee; and the grantee shall incorporate a suitable back-to-back condition to this effect in the order of release of any amount that may be so transferred to the sub-grantee; and include a suitable condition in the Government sanction on the above lines.

   ii. The CAG should have free and complete access to the accounts, accounting documents and other related documents of the State/ Central autonomous bodies, societies, NGOs, PRIs and Urban Local Bodies.

CHAPTER 5

REVENUE AND CAPITAL CLASSIFICATION

BACKGROUND

5.1 The Revenue-Capital classification has been incorporated since the inception of the budget. However, this classification has also given rise to following issues.

(a) First, the classification has implications for the post-FRBM scenario. The revenue expenditure component of the Gross Budgetary Support (GBS) to plan cannot exceed the Balance from Current Revenue (BCR) if the revenue deficit is to be eliminated (as per the FRBM Act). The negative BCR observed in the last few years, thus, becomes a constraint in the ability of the Centre to direct resources at national priorities. In this regard, it needs to be explored whether some components of what is booked as revenue expenditure that lead to capital asset creation in the economy could be identified for separate treatment for the purpose of FRBM Act.

(b) Second, the Constitution distinguishes only between 'expenditure on revenue account' and 'other expenditure'. But in practice, 'expenditure on revenue account' has been taken to mean revenue expenditure. Similarly capital expenditure may not always be investment. For example, injection of equity into loss making units, which is conceptually a subsidy, treated as capital expenditure.

(c) Third, the revenue capital classification may be dysfunctional from an economic management perspective as it militates against the principal of sound and efficient management of the entire expenditure in an integrated manner. Over the years, essential maintenance expenditure has become a casualty of the revenue – capital distinction.

5.2 The Committee has also been asked to consider the merit of classifying expenditure as revenue or capital depending on the end use. The Committee examined two aspects of this issue: (a) the need for separating current and capital components of the budget and accounts, and (b) principles for recognition of capital expenditures. An assessment of prevailing international practices and the accounting concepts and principles related to classification of expenditures as capital has been articulated in this chapter.

RATIONALE FOR REVENUE CAPITAL SEPARATION

5.3 Arguments for separation of current and capital portions of budgets are offered on the following considerations:

(a) Separation provides greater control over public debt and its utilization. The central idea implicit behind the

current and capital segregation is that current expenditures should be funded out of Government revenues, i.e., the current account should be balanced[1], and that borrowed funds are used for creation of durable and self-financing assets[2]. Viewed from this perspective, the separation between current and capital expenditures helps in clear identification of borrowing and its utilization and facilitates greater control over public debt.

(b) Separation facilitates implementation of the Golden Rule. Many countries follow the 'Golden Rule' that requires that current account is balanced over an economic cycle and Governments borrow only to invest and not to pay for current spending, i.e., the increase in stock of debt does not exceed net public investment. The basic premise behind the balanced budget is that the current generation should not be paying (through taxation) for benefits that would accrue to the future generations. Debt financing of capital expenditures is, thus, seen to take care of intergenerational equity concerns. Although, considerations such as debt sustainability, the impact of debt financing on the monetary policy, etc. would be important in determining the size of the budget deficit.

(c) Separation facilitates strategic allocation of borrowed funds. As capital expenditures are primarily funded from borrowed resources and it can be argued that separate consideration of capital expenditures allows strategic prioritization among capital projects with the objective of selecting the best value for money projects. Separate consideration of capital expenditure proposals has the inherent feature of ensuring outlays that are financed by loans yield return higher than the cost of raising them. Capital budgets force decision makers to evaluate the respective returns and recognize implicitly the capital shortage and the need for its apportionment to obtain the highest returns. It, thus, provides a framework for the best use of borrowed resources.

(d) Capital expenditures need greater care in selection and execution of capital projects. Often, countries follow capital-specific procedures for appraisal of proposals, procurement, project management, subsequent monitoring and management and disposal of assets.

(e) Separation enables better determination of responsibility within Government and implicit separation of funds, phased over a period, to be spent on a project.

(f) Separate disclosure facilitates economic analysis of the budget and spending, besides generating information on capital formation.

CRITIQUE FOR REVENUE CAPITAL SEPARATION

5.4 The case against the bifurcation can be elaborated as follows:

(a) The criteria for economic returns

[1] The FRBM Act, 2003 also contemplates a balanced current account.

[2] Self-financing assets are those that have the potential to service future interest payments; Self-liquidating assets have the potential to service both interest and principal repayments

should be applied to all expenditures and not just to capital expenditures. From the stabilization point of view, it is the size of the overall deficit and the pattern of its financing that is far more important.

(b) Capital budgets may contribute to a shift in emphasis toward 'brick-and-mortar' projects. Consideration of current account system on the same basis as an operating surplus in a commercial firm might systematically bias allocation of resources towards capital expenditures without adequate provisioning for essential maintenance and operating costs.

(c) Investment proposals need to consider both capital and operating costs together for a holistic view of the costs involved and the benefits. Budget policy and planning requires a unified consideration of all budgetary proposals. It does not necessarily require the consolidation of budget execution responsibilities.

(d) Borrowing spending can be more expansionary than taxation spending.

(e) Information on capital formation can be presented in supplementary tables to the main budget.

5.5 On balance, it can be said that the need for separation of revenue and capital budgets should be seen not merely as a rationalization of borrowing but in the wider context of the formulation of fiscal policy, in terms of overall expenditures and the appropriate mix of taxation and borrowing.

INTERNATIONAL PERSPECTIVE

5.6 Empirical evidence suggests that the international practices vary considerably with regard to budgeting for capital expenditures. At least seven discernable categories can be identified[3] :

(i) Countries, such as Australia, New Zealand, the UK, Chile etc. that have moved or are moving to accrual accounting and budgeting and make distinction between operational and investment budgets.

(ii) Countries, such as the United States[4], that make distinction between current and capital in their accounts (based on accrual system) but their budgets make no such distinction, although data on capital formation is disclosed extensively in the budget through supplementary tables.

(iii) Certain countries that have adopted modified accrual accounting record expenditure on commitment basis but do not show depreciation.

(iv) Most industrial nations and many developing countries that distinguish between current and capital expenditures also distinctly show transfer payments that are of capital nature.

(v) The fifth category comprises countries that have multi-year investment budgets. For example, Denmark has an investment budget that can be spent beyond the fiscal year.

[3] A. Premchand, Capital Budgets: Theory and Practice in Anwar Shah edited "Budget and Budgetary Institutions", The World Bank, 2007

[4] The budget documents in the United States present a special analysis of investment expenditures that is larger in scope than the tangible asset approach. This analysis is for information only and has no implication for accounting or the budget structure.

(vi) Countries such as Japan, the Republic of Korea and other Southeast Asian countries that use special accounts with selected features of capital budgets.

(vii) Finally, countries such as India that distinguish between current and capital budgets but do not maintain depreciation allowances. In China, the capital budget is limited mainly to construction outlays.

5.7 In general, the shift to program budgets in developed countries in the 1960s and 70s led to some dilution of the need for separate capital budgets, as unified presentation of capital expenditures alongside related current expenditures and outputs became the norm in these countries. This approach was based on the premise that both capital and current expenditure would contribute jointly to the achievement of Government's policy goals and an appropriate mix of the two was needed, although, program budgets in many developed countries continued to have separate capital and current components[5] .

5.8 However, the need for distinguishing capital and current budgets seems to have been strengthened in the last decades or so with the introduction of accrual based accounting and budgeting techniques, particularly in the OECD countries. Premchand[6] mentions that even in countries like the United States, opinions have been expressed that the absence of this distinction has led to unintended neglect of infrastructure and accumulated assets. This new paradigm requires this distinction for an assessment of the operating costs and efficiency of Government activities. It is also considered necessary for clear understanding of the stream of future costs that the investment expenditure generates.

5.9 While there is no unanimity of opinions on this issue and no uniformity in the country practices, there seems to be general agreement on the following two points:

(a) The process of planning and budget formulation needs to take an integrated holistic view of capital and current expenditure proposals so that there is a logical consistency between capital and current budgets and the current and investment spending decisions are well balanced and mutually supportive of each other[7].

(b) A clear distinction between capital and current expenditures facilitates the budget execution and analysis.

The literature on public expenditure management, therefore, recommends a unified presentation of budget with a clear distinction between capital and current expenditures.

THE INDIAN PERSPECTIVE

5.10 In India, the classification of budget and accounts into current and capital portions is governed by various Constitutional and rule provisions on the subject.

5.11 Article 112 (2) of the Constitution requires that "The estimates of expenditure embodied in the annual financial statement

[5] Davina F. Jacobs, A Review of Capital Budgeting Practices, IMF Working Paper, WP/08/160, IMF, 2008

[6] A. Premchand, Capital Budgets: Theory and Practice in Anwar Shah edited "Budget and Budgetary Institutions", The World Bank, 2007

[7] David Webber, Integrating Current and Development Budgets: A Four Dimensional Process, OECD Journal of Budgeting, Vol 7 No. 2, OECD 2007

shall show separately –

(a) The sums required to meet expenditure described by this Constitution as expenditure charged upon the Consolidated Fund of India; and

(b) The sums required to meet other expenditure proposed to be made from the Consolidated Fund of India, and shall distinguish expenditure on revenue account from other expenditure."

The same provision is repeated under Article 202 under the State Section.

5.12 The Fiscal Responsibility and Budget Management Act, 2003 clause 2(e) indicates two components of expenditure in the Government – (a) the revenue expenditure, and (b) those which result into increase in assets of the Government. The Act aims to ensure inter-generational equity in fiscal management and long-term macro-economic stability by achieving sufficient revenue surplus.

5.13 The Act defines Revenue Deficit as "The difference between revenue expenditure and revenue receipts which indicates increase in liabilities of the Central Government without corresponding increase in assets of that Government". The Act, therefore, seems to conform to the classical view about use of borrowed funds and implicitly aims at balancing the current and capital sides of the budget in its application to the Union Government as a distinct budgeting and accounting entity.

5.14 The Constitutional requirement is elaborately reflected in the financial rules.

- GFR Rule 46(2) while discussing expenditure estimates mentions that "The estimates shall also distinguish provisions for expenditure on revenue account from that of other expenditure including expenditure on capital account, on loans by the Government and for repayment of loans, treasury bills and ways and means advances".
- GFR Rule 79 defines capital expenditure as "Significant expenditure incurred with the object of acquiring tangible assets of a permanent nature (for use in the organization and not for sale in the ordinary course of business) or enhancing the utility of existing assets". The rule requires that "Capital and Revenue expenditure shall be shown separately in the Accounts".
- GFR Rule 90 further maintains that "Expenditure on a temporary asset or on Grants-in-Aid cannot ordinarily be considered as capital expenditure and shall not, except in cases specifically authorized by the President on the advice of the Comptroller and Auditor General of India, be debited to a Capital Head".

5.15 Consistent with the provisions of the GFR, the Government Accounting Rules (Rule 30) require that "Expenditure of a capital nature to be classified in the Capital Section shall broadly be defined as expenditure incurred with the object of either increasing concrete assets of a material and permanent character" and that "Expenditure of a Capital nature shall be distinguished from Revenue expenditure both in the Budget Estimates and in Government Accounts". The note below Rule 30 of GAR further reiterates that the "Expenditure on a temporary asset or expenditure on Grants-in-Aid to local bodies or institutions (for the purpose of creating assets which will belong to these local bodies or institutions) cannot ordinarily be classifiable as capital expenditure, and shall not, except in

cases specifically authorized by the President on the advice of Comptroller and Auditor General be debited to a capital head of account".

5.16 The essence of these rule positions and the provisions in the FRBM Act is that in order to be classified as capital, an item of expenditure must result in acquisition of asset(s) of material and permanent character for the Government. This position seems to be consistent with the generally accepted accounting principles and international standards on the subject.

PRINCIPLES OF CLASSIFICATION

5.17 The other important and related issue is measurement of capital expenditure and there seems to be greater uniformity among the expert bodies in this area. The International Public Sector Accounting Standards (IPSAS) issued by the International Federation of Accountants (IFAC) defines an asset as the "Resources controlled by an entity as a result of past events and from which future economic benefits or service potential are expected to flow to the entity[8]". According to this definition the fundamental characteristics which assets possess under any accounting basis would be:

(i) The existence of service potential or future economic benefits;

(ii) The service potential or the future economic benefits must arise from past transactions or events (i.e. future assets cannot be recognized); and

(iii) The service potential or future economic benefits must be controlled by the entity.

5.18 The term "economic benefits" is generally interpreted as the ability to contribute directly or indirectly to cash flows of the entity. However, in its application to Government its meaning could be enlarged to encompass delivery of services and programmes.

5.19 From an economic perspective[9], assets must satisfy the criteria of productivity and longevity, i.e., they should be used in the production or supply of goods and services (productivity criterion) and their life should normally extend beyond a fiscal year (Longevity criterion), and they should not be intended for resale in the ordinary course of operations. In addition, emphasis is placed on the self-liquidating nature of the activity as an additional feature of assets.

5.20 The Government Financial Statistics Manual (GFSM), 2001 of IMF recommends inclusion of only those assets "over which general Government units enforce ownership rights and from which they may derive economic benefits by holding or using them over a period of time. Assets not owned and controlled by a general Government unit and assets that have no economic value are excluded[10]." Though the IMF manual refers to a general Government balance sheet, the same principles would apply to the balance sheets of the constituent entities.

5.21 The GFS Manual (2001) provides for separate disclosure of capital and current grants. Current grants have been defined as those made for purposes of current expense and are not linked to or conditional on the acquisition of an asset by the recipient. Capital grants are stated to involve the acquisition of assets by the recipient and may consist of a transfer of cash that the recipient is expected or required

[8] Accounting Issues and Practices, International Federation of Accountants, May 2002, Page
[9] Davina F. Jacobs, A Review of Capital Budgeting Practices, IMF Working Paper, WP/08/160, IMF, 2008
[10] The Government Financial Statistics Manual, International Monetary Fund, 2001, Page 44.

to use to acquire an asset or assets (other than inventories), the transfer of an asset (other than inventories and cash), the cancellation of a liability by mutual agreement between the creditor and debtor, or the assumption of another unit's debt. If doubt exists regarding the character of a grant, the Manual suggest that it should be classified as current. It may be noted that both current and capital grants are classified in the GFSM as expense.

5.22 IFAC also clarifies that "Public Sector entities may make grants to another entity to permit the recipient to acquire or construct assets. Such expenditure has been known to be reported by the Public Sector Body making the grant as capital expenditure, although it has obtained no rights of ownership or control. In such a case, the Public Sector entity making the grant has no asset and the description is likely to mislead users of the financial report[11]."

5.23 The draft Indian Government Accounting Standard (IGAS) on Accounting and Classification of Grants-in-Aid prepared by the Government Accounting Advisory Board (GAAB) in the C&AG's office maintains that "Grants-in-Aid are part of the operating expenditure of the grantor and thus classified and accounted for as revenue expenditure in the Financial Statements irrespective of its ultimate application by the grantee. This position holds true even in those cases where Grants-in-Aid are utilized by the grantee for the purpose of creation of assets[12]".

5.24 The UK presents a typical case where capital grants are included in the capital budget but shown as recurrent expenses in the accounts. This treatment means that there is difference in classification of grants between the budget and accounts. However, it is noteworthy that the appropriations treat all grants as current. In so far as the national income accounts are concerned such grants are classified as capital.

5.25 The above discussion suggests that apart from durability and productivity considerations ownership of and control over assets is the key factor in deciding whether the expenditure incurred on its acquisition can qualify to be classified as capital expenditure. It is considered important because ownership decides the convertibility of the asset to cash in the hands of the owner. Purely from an accounting point of view, assets that are financed by an entity but not owned by it should be excluded from its financial statements since they neither are available to the entity for financing its liabilities nor provide any future financial benefit to it. Inclusion of such assets in the financial statements of the entity would present a mismatch between its liabilities and assets.

PREVIOUS ATTEMPTS TO RECONSIDERATION

5.26 The issue of classification of grants based on end-use has been examined in detail by the Expert Group constituted by the Government in the year 2004. The Group was headed by Dr. Ashok Lahiri, the then Chief Economic Advisor, Government of India and comprised Controller General of Accounts, Additional Secretary (Budget), representative of the Comptroller & Auditor General of India, and Principal Finance Secretaries of Governments of Andhra Pradesh, Karnataka and Uttar Pradesh. The terms of reference of the Group, inter alia, included a review of the existing

[11] Definition and Recognition of Assets, Public Sector Committee, International Federation of Accountants, 1995, Page 16.
[12] Draft Indian Government Accounting Standard 2 – Accounting and Classification of Grants-in-Aid, Government Accounting Advisory Board, 2007, Para 15.

norms for classification of expenditure between capital and revenue and suggesting improvements with a view to reflecting a true and fair view of Government Accounts.

5.27 The Expert Group, in its report submitted in July 2004 concluded that "The current norms for distinguishing revenue and capital expenditures are based on sound accounting principles and are in line with the international practice. The Group held the view that the Union Government as transferor and States as transferees are two different accounting entities and while a grant from the former to the latter may result in the creation of a national asset(s), it is the ownership of assets that decides whether the expenditure is treated as capital or revenue expenditure. Expenditure can be classified as capital if it results in creation of assets that are controlled by the entity incurring the expenditure and that are likely to serve the entity over several accounting cycles[13]".

5.28 The Group suggested that for the sake of disclosure such transfers that are meant for capital expenditure by the transferee may be classified as "Capital Grants" under the Revenue Section in the books of the transferor.

5.29 This suggestion of the Group has been recently implemented by the Government. A new Object Head "Grants for creation of capital assets" has now been opened and the existing Object Head "Grants-in-Aid" has been renamed as "Grants-in-Aid-General". This would distinguish and explicitly disclose grants meant for capital creation from the rest in the budget and accounts.

ISSUES FOR DELIBERATION

5.30 It is generally agreed that strategic allocation requires an integrated and holistic view of expenditure proposals and a balance between revenue and capital allocations is critical for optimally achieving public spending outcomes. The objectives of efficient planning and budget formulation are, thus, better served by a unified budgeting process without any inbuilt bias for any section of expenditures. The contention that separation of capital and current leads to a bias towards the former seems to be based on exaggerated fears. The so called ill effects of the system are caused only if the practices degenerate below a certain level. Moreover, the separation between current and capital has distinct utility in budget presentation/analysis and budget execution.

5.31 With regard to measurement of capital expenditures and classification of grants based on their end use, there seems to be universal recognition of grants as current expenditures at least in the financial statements. Even in the UK, where capital grants are included in Capital budgets, this treatment is more for the purpose of budget formulation and consideration of expenditure proposals, while the appropriations as well as the accounts treat all grants as current. It may also be pointed out that the classification of transfer payments according to their end use in the accounts of the transferor could lead to their double counting in the national income accounts as such transfers are also shown as capital in the books of the transferee.

5.32 The separation of grants into general grants (current) and grants for creation of capital assets in the budget and accounts, which has been introduced in the Union Budget from this year, is further expected to fill in the information gaps that existed in economic analysis of the budget. A logical extension of this change would be to expect the sub-national agencies (including State Governments) to

[13] Report of the Expert Committee constituted to review the classification system for Government Transactions, July 2004, Pages 3,4

make clear distinction between general grants and grants for creation of capital assets in their respective budgets both on the receipt and the expenditure sides. A directive could be issued by the Ministry of Finance to all States to uniformly follow this practice.

5.33 The existing framework, thus, seems to be capable enough to meet the requirements of sound budgeting and economic analysis. The principles of classification of expenditures into revenue and capital adopted in the GFR, GAR etc. in India are fully consistent with the internationally accepted norms and there seem to be little justification for their modification.

5.34 In a strong federal structure like ours with increasing policy thrust on social sector spending and greater involvement of private participants in the developmental activity, the importance of transfer payments from the Union to the States is only likely to increase in the coming years both in terms of its absolute size and as proportion to total expenditure, as the level of Governmental activity goes up and more and more such investments are undertaken at the sub-national level. In such a scenario, the utility of revenue deficit of the Union Government as a true measure of Government's savings and as an aggregate fiscal control can be reconsidered.

5.35 A. Premchand[14] has argued that the measure of revenue deficit/surplus in Government cannot be used in the same manner as the operating surplus in a commercial firm to judge its profitability and capacity to augment its net worth and that from an economic consideration it is the overall budget balance and its financing that are more important for stabilization. Experts have also expressed reservations against use of current balance based fiscal rules; often these arguments are constructed around the issues related to conceptualization and measurement of capital expenditures and transparency in its application

5.36 Rakshit[15] recommends use of two additional measures of revenue deficit (RD1 and RD2) in addition to the conventional revenue deficit measure (RD0). These measures have been defined as follows:

1. RD1 = RD0 – Government "revenue" expenditure for creation of tangible assets; and
2. RD2 = RD1 – Government expenditure for HRD

It has been argued in his paper that the conventional revenue deficit measure is "inappropriate for examining the impact of the budget or framing policies", as it treats as current the expenditures routed through the various agencies for creation of productive assets and the outgoes on human resource development (HRD). As suggested in his paper, "the solution lies in not abandoning the revenue deficit altogether as a target variable but in having an estimate that conforms to economic logic".

DISCUSSION BY THE COMMITTEE AND FINAL RECOMMENDATIONS

5.37 Upon deliberation on various aspects of the revenue capital classification, the Committee is unanimous in favour of continuing the revenue-capital classification as such a distinction is important to have information on capital formation. Capital expenditure should relate to creation of assets and be determined by ownership criterion. While all transfers should

[14] A. Premchand, Government Budgeting and Expenditure Controls - Theory and Practice, IMF, 1983.

[15] Mihir Rakshit, Budgetary Rules and Plan Financing – Revisiting the Fiscal Responsibility Act, Economic & Political Weekly, November

be treated as revenue expenditure in accounts, the Committee also considered the need and merits of classifying revenue expenditure by end use only for the purpose of FRBM compliance.

5.38 Funds transferred from Centre to States/ UTs for execution of various projects/schemes are treated as revenue expenditure irrespective of whether they are current expense or utilized for creation of assets. The State Governments also treat transfers of funds to local bodies and other implementing agencies in similar way. This not only has impact on the quantum of revenue expenditure but also does not provide fair picture of the resources being put for capital formation. On the other hand, desired revenue balance as prescribed by FRBM act implies limitations on the Government in transferring resources to other tiers (State/local bodies/ implementing agencies) even for creating capital assets. The ownership criteria is also difficult to strictly apply in case of public assets particularly in the States. For example, a substantial portion of grants from the Centre and States to the implementing agencies/local bodies in case of programmes like PMGSY, NRHM, SSA and MGNREGS is meant to create assets that belong to the State Governments and not to the implementing agencies. A simple change in mode of release of funds can also change the revenue expenditure (grants to IAs) into capital expenditure (if resources are directly expended by the State departments). Thus, the Committee is of the view that there is a merit in classifying grants in more categories depending upon end use instead of clubbing all grants into one object head. One of the categories may be 'Grant for Creating Assets'. This category may broadly meet the requirements specified for capital grants in GFS Manual, 2001 as discussed in the foregoing paragraph (6.21). This category would need to be defined precisely leaving no scope for ambiguity. To operationalize the principle a small group (similar to the 2004 GOI Expert Group) of the Ministry of Finance may be set up. The Expert Group will be tasked to formulate the precise definition and criteria for classifying expenditure as "Government revenue expenditure for creation of tangible assets". There is a need to ensure a fairly rigid compliance to the requirements to prevent misclassification. The recipient of the capital grants must be required to maintain assets records/registers, which should be made available in public domain.

5.39 As it is the FRBM act that lends the Revenue Deficit concept some rigidity, amendments to the act may be considered to provide scope for adjustment. An "adjusted revenue deficit" may, therefore, be possible for FRBM compliance. i.e. adjusting the revenue deficit to the extent of grants for creating assets and applying aggregate controls to this parameter (RD1above). In essence, Government may disclose two measures of revenue deficit - the conventional measure and one adjusted measure, and the aggregate control may shift from the conventional measure to one of the adjusted measures, i.e. RD1. However, it should be clearly understood that the FRBM prescribed limits on fiscal deficit stay undisturbed and as it is. In other words, there will be status-quo as regards the definition and limits on fiscal deficit. In addition, the principle embodied in the proposed classification of "Government revenue expenditure for creation of tangible assets" will also be applicable in respect of the state Governments.

5.40 Although, implementation of this suggestion would require amendment to the FRBM Act and the rules framed under the Act, such a position would be consistent with both the economic rationale and the accounting principles and it would allow overcoming the constraints presently imposed by the FRBM Act on Centre's capacity to direct resources at national priorities, without presenting an inflated picture of Government asset holding.

CHAPTER 6
THE SCOPE OF THE PUBLIC SECTOR PLAN

BACKGROUND

6.1 The process of having a plan of the Government began with the launching of the First Five Year Plan. The Annual Plans are the operational phase of the Five Year Plans. Over the years, both the scope of public sector plan and the administrative machinery involved have undergone changes. The setting up of Panchayati Raj Institutions (PRIs) and the establishment of special purpose vehicles (SPVs) have emerged as important elements of the plan implementation machinery which did not exist earlier. Recently, there is a strong advocacy for public–private partnerships (PPP) for infrastructure building such as roads, ports, airports and delivering other public services such as health and education.

THE PROCESS OF PLANNING IN INDIA: THE FIVE YEAR PLAN AND THE ANNUAL PLANS

6.2 The National Plan consists of Five Year Plan as well as Annual Plans. The Five Year Plan being formulated by the Planning Commission indicates the national objectives and sectoral targets to be achieved through effective and balanced utilization of resources of the country. Since the Centre and the State Governments operate in term of annual budgets, the Five Year Plan is broken up into Annual Plans[1].

Annual Plan of the Centre

6.3 The Annual Budget of the Union Government consists of plan expenditure and Non-Plan expenditure. The Annual Plan is the plan expenditure including internal and extra budgetary resources (IEBR) of PSEs which is prepared by Planning Commission in consultation with Central Ministries concerned. This practice started right from the First Five Year Plan when Planning Commission was associated with the preparation of the Union Budget especially for the developmental (plan) outlay. Presently, a systematic procedure is followed in preparing the plan outlay of the Union Government. In the months of September-October, Planning Commission requests the Ministries to submit their proposals for the next year's Annual Plan. The Proposals submitted by the Ministries are then examined by the subject divisions concerned in Planning Commission and detailed discussions are held between the Members in-charge of the subjects and the representatives of the Ministries.

6.4 The size of the plan outlay of the Centre is determined by the estimated plan resources. The total resources of the Centre are made up of estimated revenue receipts and capital receipts. The total revenue receipts consist of both tax revenues and non-tax revenues. The amount of revenue receipts left after meeting the estimated Non-Plan revenue expenditure is called Balance from Current

[1] Annual Plans are also formulated for periods not covered by Five Year Plans. There are, as many as six such Annual Plans formulated in 1966-67, 19967-68, 1968-69, 1979-80, 1990-91 and 1991-92.

Revenue (BCR). The estimated capital receipts, on the other hand, may be divided into debt capital receipts and non-debt capital receipts. The non-debt capital receipts less the estimated Non-Plan capital expenditure is called miscellaneous capital receipt (MCR). For financing the plan budget, the Centre also resorts to borrowings.

6.5 The BCR, MCR and the fiscal deficit put together determine the size of Gross Budgetary Support (GBS) for Plan. Out of total GBS, a portion is provided to States as central assistance for State Plan. The Public Sector Enterprises (PSEs) also mobilize some resources in the form of Internal Resources (IR) and Extra Budgetary Fesources (EBR), commonly known as IEBR. The GBS (net of assistance to State Plan) and the IEBR constitute the plan resources of the Centre.

6.6 Conventionally, different components of Non-Plan expenditure which are usually committed in nature are estimated at the time of budgeting. After providing for the committed expenditures like interest payment, salary, pension, operation and maintenance of assets etc., what is left out of the total resources (non-debt and debt) is allocated for plan budget. In this sense, plan budget may be called residual in nature.

Annual Plan of the States

6.7 Like the Centre, the Annual Budgets of the States comprise Non-Plan expenditure and plan expenditure. As evolved over the years, the Annual Plans of the States are decided through Annual Plan discussions between Planning Commission and the States/UTs concerned. The process of finalizing Annual Plans of the States includes financial resources discussions, working group meetings and finally Annual Plan meetings between the Deputy Chairman of Planning Commission and the Chief Ministers of Individual States (or their representatives).

6.8 The Annual Plan process begins in the months of September-October when request is sent to State Finance Secretaries to submit structured information on the position of financial resources of the States. State Planning Secretaries are also requested to submit proposals in designed formats for the Annual Plans along with the draft Annual Plan.

6.9 The Financial Resources (FR) Division of Planning Commission is responsible for the estimates of financial resources of States and discussions are held between Adviser (FR), Planning Commission and State Finance Secretaries to assess the resource position of the States in November-December. A representative from Department of Expenditure also participates in the discussions. This is followed by Working Group meetings. The subject divisions of Planning Commission examine the sectoral proposals of the State in view of the Draft Annual Plan and discuss with departmental heads of the State concerned. The Member in-charge of that State then chairs a meeting (wrap-up) with Chief Secretary and his colleagues in-charge of different departments to sum up the proposals and issues of the State concerned.

6.10 The Annual Plan size of a State is finally decided based on the estimated resources in a meeting held between Deputy Chairman, Planning Commission and the Chief Minister of the State. The plan resources of the States may be put as budgetary resources and IEBR of State's Public Sector Enterprises (SPSES) and Resources of rural and urban Local bodies. The Budgetary Resources comprise three main components. State's Own Resources, the first component, comprises Balance from Current Revenue (BCR), Miscellaneous Capital Receipts (non-debt capital receipts) and some

Finance Commission grants recognized as plan grants. The second component is State's net borrowings, the ceiling of which is fixed by the Ministry of Finance. The third component, Central Assistance to State Plan, comprises the assistance from the budget for State Plan Schemes. BCR is the difference between Non-Plan revenue receipts (including Central tax devolution, finance commission grants of Non-Plan nature, State's own tax and non-tax revenue) and Non-Plan revenue expenditure. It is pertinent to point out that the assistance provided from the Central Plan to the States and other implementing agencies (IAs) either through consolidated funds of States or through direct transfer/society mode on account of centrally sponsored schemes (CSS) are not part of the State Plan although States' share for the CSS contributed by the State Governments to these IAs are included in the State Plan. This is done to ensure that there is no double counting of resources between Central Plan and State Plans.

ISSUES RELATING TO PUBLIC SECTOR PLAN

6.11 The main issues regarding the scope of Public Sector Plan of the Centre and States relate to:

- Budgetary Plan of the Centre and States
- Plan of the Public Sector Enterprises of the Centre and States
- Plan of rural and urban local bodies
- Plan of the Implementing agencies/ SPVs
- Public Private Partnerships (PPP)

BUDGETARY PLAN OF THE CENTRE AND STATES

6.12 The budgetary plans of the Centre and States are the main component of the Five Year or Annual Plans. Due to distinction in Plan and Non-Plan in the budget of the Central and State Governments, the budgets of the Central and State Governments have two main divisions – Plan and Non-Plan, with each division having revenue and capital parts. This Committee has already examined this issue and has recommended that the distinction between Plan and Non-Plan in the budget may be done away with. The Committee has also proposed that following removal of Plan and Non-Plan distinction in the budget, the Budgetary component of the FYP will be the sum total of the projected aggregate budget expenditures for five years of Centre and State Governments. The annual budgetary component of the plan of the Centre or a State will have a one-to one relationship with the Government budget of the Centre or of a State respectively. The plan classification/heads of development and budget classification/heads of expenditure should become the same. Consequently, there will be no longer any necessity of any other plan-budget link document.

PLAN OF THE PUBLIC SECTOR ENTERPRISES OF THE CENTRE AND STATES

6.13 In the Public Sector are included the development programmes of the Central and State Governments and also of the commercial enterprises owned by them[2]. Right from the First Five Year Plan, PSEs (both Centre and State) were considered part of the Public Sector Plan.

[2] First Five Year Plan, 1952 pg.46

6.14 The Centre has consistently followed the practice of including the investment plans of a large number of Central Public Sector Enterprises (CPSEs) as Central Plan outlay in the annual budgets. However, there is apprehension that the resource estimates of the CPSEs do not capture the entire quantum of resources available- a portion of the available resources being treated outside the plan. Even the PSEs that are included in the plan show minor variations from year to year[3].

6.15 It appears quite reasonable that all the CPSEs may not get included in the Central Plan outlay in the annual budget of a particular year, as only the CPSEs having investment plans in that year need to be included. CPSEs incurring losses or not generating resources (IEBR) will not contribute to plan resources or plan outlays.

6.16 At the State level, the practice of including the State Public Sector Enterprise (SPSE) plans in the Annual Plans of the States has not been followed uniformly by different States. While some States include the SPSE plans in their Annual Plans, quite a few States are keeping them outside their Annual Plans.This is due to different planning practices adopted by different States. Planning Commission takes into account the estimated IEBR of the State PSEs as resources for the FYP for States. The Planning Commission's guidelines issued to the States for assessing financial resources for Annual Plans also require that the estimates of resources for SPSEs and local bodies should be included in the Annual Plans of the States. But so far, States have not uniformly rationalized their definitions of the Public Sector Plan on these principles. Besides, most States do not provide the information on investments/IEBR of the SPSEs in the State Budgets.

6.17 This Committee has noted that the plan investments and resources (IEBR) of the CPSEs have always been important components of the Central Plan. In the Eleventh Plan, out of the total projected Central Plan resources of ₹21.5 lakh crore, the CPSE resources (IEBR) was projected at 10.6 lakh crore (49% of the total). The resources of SPSEs in the 11th Plan were projected at ₹128824 crore, which was 8.7% of the total plan resources of States and UTs. The 11th Plan projections for resources of CPSEs and SPSEs taken together amounted to ₹11.9 lakh crore, which was 32.6% of the total resources of Public Sector Plan of ₹36.4 lakh crore (**Reference: 11th Plan document, Vol. 1, Page 42**). Moreover, in several economic and even some social services, public sector investments are made and services delivered through CPSEs and SPSEs. More importantly, the size of the plan of the public sector should be neutral as regards medium and mode of delivery of functions/services.

6.18 The Committee noted that the PSEs are generally companies registered under Companies Act or statutory corporations/ entities. Most of them follow the accrual system of accounting different from the cash system of accounting followed in Central and State Budgets. As per the current practice, the whole of operations (sales turnover) of the PSEs are not included in the Central or State Plan outlay. The PSEs have their separate income/ expenditure and balance sheets for this purpose. However, investment outlays, which are planned through their IEBR, are included in the Central or State Plan outlay. The Committee recommends that the Central or State Plan should continue to include investment outlays (funded by IEBRs) of CPSEs and SPSEs.

6.19 The Committee notes that it is difficult to make vertical, horizontal and time series

[3] 11th Five Year Plan pg-50

analyses of State Plan outlays and expenditure arising from non-uniform practices across States on inclusion of outlays/investments/IEBRs in their plans. The Committee, therefore, recommends that all States must include information about investment outlays of SPSEs (funded out of IEBRs) in their budgets as a separate annexure. With this obligation, it will be possible to get a true sense of SPSE component of State Plan of each State making horizontal, vertical and temporal comparison more meaningful.

PLAN OF THE LOCAL BODIES

6.20 Although the First Five Year Plan itself mentioned that public sector plan should cover local authorities, but the developmental programmes of the local bodies got included much later[4]. After the 73rd and 74th amendments which conferred constitutional status to Panchayati Raj institutions in rural and urban areas, all States (except some States and some scheduled areas in a few States) have elected rural and urban local bodies. In most States, some financial resources are transferred to the local bodies usually on the recommendations of State Finance Commissions to meet their committed expenditure and implement development programmes and the expenditures thereto are being accounted in the annual budgets of the States. But the local bodies also raise some resources of their own and incur expenditure for various programmes which are not reflected in the State Budget.

6.21 In almost all the States which have local bodies, there are provisions of having separate budgets for Municipal Authorities/other Urban Local bodies and Rural Local Bodies. In most States, the Annual Plans of the local bodies include resources transferred to them by the State Government as well as resources raised by them. Thus the State Budget does not reflect the entire expenditure of the local bodies.

6.22 As prescribed by the guidelines of Planning Commission, some States specifically indicate the plan resources of the local bodies separately in the State Annual Budget. But generally, all development resources allocated from the State Budget to local bodies are subsumed in the Annual Budgets of the States. As a consequence, it is difficult to ascertain the expenditure and developmental programmes of the local bodies from the Annual Budgets of the States.

6.23 Local bodies are legal entities recognized by the constitution and they need to have financial delegation and autonomy to function independently. They need to have their separate Annual Budgets and Plans. However, there is a strong merit in the view that local bodies are but different organs of the State/UT Governments and the State/UT Annual Plans should reflect the resources and expenditures of all the organs, including local bodies, in a comprehensive manner.

6.24 The Committee noted that Rural and Urban Local Bodies have broadly following resources:

- Transfers from State Governments of grants recommended by Central Finance Commission;
- Transfers from State/UT Governments of grants recommended by respective State Finance Commissions for administrative or development purposes;

[4]First Five Year Plan in a footnote-"Strictly speaking, public sector should cover also Municipal Corporations and other local authorities; it has not been possible, however, to include their developmental programames in the present Five Year Plan"

- Own internal resources such as taxes, fees and charges for services;
- Extra budget resources such as bonds issued or loans raised;
- Transfers received for implementation of development programmes on account of State Plan or Centrally Sponsored Schemes either through State Budgets or as direct transfers from State Government agencies or Central Government or its agencies.

6.25 The rural and urban local bodies deploy these resources for the following:

- Own administrative expenses such as compensation to employees, office expenditure;
- Provide general, economic, social, recreational, cultural and environmental services to the people through capital and current expenditures from their budgets;
- Provide services to people as implementing agencies of development programmes for which these bodies have received transfers.

6.26 The Committee also observed that recommendations of the 13th Finance Commission have linked performance grants for local bodies interalia to State Governments' providing supplements to budget documents for local bodies containing details of Plan and Non-Plan wise classification of transfers from major head to minor heads as well as maintenance of accounts in a prescribed manner (Para 10.161 of the 13th FC Report). Further, finance accounts of the local bodies should contain head wise details of expenditure (Para 10.177 of the 13th FC Report).

6.27 In Chapter 3, the Committee has recommended multi-dimensional budgeting and accounting classification that may include the recipient dimensions, at least at the accounts level. It will provide consolidated and programme-wise information on transfers to urban and rural local bodies from the Central and State Governments. Apart from transfers, many local bodies, especially large municipal corporations, raise substantial tax, non-tax and debt resources on their own. These Internal and Extra Budgetary Resources (IEBR) also finance the expenditure on various services of these local bodies.

6.28 The Committee, therefore, notes that it may be feasible to have consolidated information on the resources (transfers and IEBR) and expenditure of rural and urban local bodies on an annual basis. It recommends that this information may be provided through special supplements to the budgets of State/UT Governments. The total expenditure of these bodies, net of transfers from Central and State/UT Governments, may be added to the State/UT Plan as a separate component.

PLAN OF THE IMPLEMENTING AGENCIES/SPVS

6.29 The Committee notes that Implementing Agencies/SPVs are generally societies of the State/UT Governments which have been created to operate bank accounts so that they are able to receive Central and State Governments' resources by way of direct transfers mainly on account of Centrally Sponsored Schemes and in some cases, States' Plan Schemes. The senior management of these agencies comprises invariably Government officers. The resources are spent by these agencies to deliver public services and to augment public assets such as schools, hospitals, roads and other infrastructure belonging to State or local Governments.

6.30 The Committee, in Chapter 4, has recommended that resources meant for Centrally Sponsored Schemes from the Central Government, with the exception of transition period for existing schemes, should flow only through State Governments' treasuries instead of through direct transfer route. If this recommendation is accepted, there will be little relevance for these implementing agencies to have their own balance sheets/profit & loss account. They can effectively become one of the layers within the State Governments without the need to transfer resources out of treasuries for them and the budget and accounts fully integrated with State/UT Plan.

6.31 The Committee also recommends that during the transition period when resources are still being transferred to them by way of direct transfer, their budget and accounts should be shown as separate supplements to the budget. However, the resources transferred to them by the Central and State Governments have already been accounted for in the budgetary component of the Central or State Plan or both, so there may not be any need to add their expenditure to the Central/State Plan.

PUBLIC PRIVATE PARTNERSHIPS (PPP)

6.32 There has been huge gap in the demand and supply of essential social and economic infrastructures and services. These infrastructure shortages are key constraint in sustaining and expanding India's economic growth and making it more inclusive for the poor. Given the large resource requirements for investment and the budgetary constraints, Government of India has been encouraging private sector investment and participation in all sectors[5].

6.33 PPP is a mode of providing public infrastructure and services by Government in partnership with private sector. It is a long term arrangement between Government and private sector entity for provision of public utilities and services. The investments being made or management provided by private sector entity, there is risk sharing as well as performance linked payments to be paid by Government to private entity. PPP concessions can either be sustained by user charges to be collected by the concessionaire or through annuity payments to be made by the Government. In case Annuity payments are made they are typically borne by the Government out of the annual budgetary allocations spread over time and are essentially in the nature of deferred budgetary payments.

6.34 The projects that can be amenable to PPP include construction projects, high value projects which need to be completed on time and within budget, projects where quality of service is very poor, etc. Projects such as highways can be taken up on toll as well as annuity basis depending on the revenues they are likely to generate. Projects with real estate component would normally be user charge based as against social sector projects such as education, health, irrigation, water supply, which would not yield sufficient revenues, hence, need to be considered on an annuity basis

6.35 The essential features of a PPP arrangement are:

- A contract binding the public and

[5] National Development Council (NDC) passed a resolution which mentions that "increased private participation has now become a necessity" to mobilize the resources needed for infrastructure expansion and up-gradation "One has to reach out to the private sector, and private savings, and to the other mechanisms available in the market today to raise funds" -Approach Paper to 11th Plan

private partners over a length of time ranging from 10 to 40 years;

- Output-based contracts (rather than input-based) for provision of assets and/or services. In this system the quality and level of service is specified and standards and specifications are laid down rather than specifying the methodology and means of delivery of services.The private partner may be compensated for provision of assets/services through user charges like road tolls or water fees or through annuity payments by the Government/ sponsoring authority.
- Risks are allocated to the party most able to carry them.
- Fixed and operational assets are adequately maintained over the project's lifetime

6.36 PPP projects may be executed through different financial arrangements-contractual payment (i.e. advance payment, progress payment, final payment, annuities etc.), grant-in-aid (i.e. block grant, capital grant, matching grant, institutional support, etc.). Annuity or unitary charge refers to the periodic payment received by the concessionaire for financing, construction, operation and maintenance of the project.

ANNUITY CONTRACTS

6.37 In annuity contracts, the private entity is paid regularly from public funds, based on its performance throughout the contract period. In the event of private service provider missing performance targets, there is reduction of payment. Annuity payments create a burden on future budgets for the period of contract which is longer than several plan periods. The effect of annuity payments is similar to public borrowings which require debt servicing over a long period. The annuity contracts do transfer some risks, such as construction and maintenance risks, yet they are akin to public sector projects as Government funds are assured through the budgets.

USER CHARGE BASED CONCESSIONS

6.38 In the case of concessions based on user charges, the demand risk is transferred to the concessionaires, thereby exposing them to considerable commercial risk in recovering their capital. Concessions based on user charges lead to mobilization of additional resources.

CURRENT GOI SCHEMES FOR FINANCIAL SUPPORT TO PPPS

a) Viability Gap Funding (VGF)

6.39 Private investors find it difficult to invest in infrastructure projects because of lumpiness of investment coupled with long gestation periods. Further, they are not in a position to capture in monetary terms the externalities that such projects generate. If the above issues were compensated for, perhaps it would be easier to attract private investment. In this context the Indian Government evolved the scheme of financial support to PPP projects through Viability Gap Funding (VGF). The scheme aims at supporting infrastructure projects that are economically justified but fall short of financial viability.

6.40 The Scheme involves providing grant to the private investors by the Central Government to the extent of 20% of total project cost. The sponsoring authority is also permitted to provide an additional grant of 20%. In PPP projects approved at the level of the Central

Government, the projects are normally bid out on VGF as the bidding parameter. In some projects which are financially very attractive, the Government receives a premium which is commonly called positive grant. The entire effort in this scheme is to make the projects financially viable and, therefore, bankable after providing the grant. The added advantage is that provision of this grant releases scarce budgetary resources for the Government to invest elsewhere since the VGF is able to leverage a large amount of private capital.

b) India Infrastructure Finance Company Limited (IIFCL)

6.41 Long term debt instruments are required to ensure that cost recovery takes place across the project life. However, Indian capital markets have been deficient in making such instruments available to the investors. Pension and provident funds are yet to be developed as financing instruments for lending to infrastructure projects. IIFCL was established with the intention of bridging this gap. It was to make available long term debt to essentially PPP projects either by way of refinance to banks and financial institutions or by direct lending to project companies. IIFCL can lend up to 20% of the total project cost for PPP projects that are competitively bid out. Borrowings by IIFCL are from the domestic or international market and Government guarantees are made available, where necessary.

FINANCE COMMISSION RECOMMENDATIONS

6.42 The 13th Finance Commission (FC) has observed that PPPs create explicit and implicit obligations on the part of the public entity that is party to them so that, in the final instance, they become contingent liabilities of the Government of India. The fiscal fallout of such partnerships could reflect on the health of the aggregate balance sheet of the public sector and may create demands for enhanced budgetary support to the public sector entities contracting such liabilities. Explicit contingent liabilities, which may be in the form of stipulated annuity payments over a multi-year horizon, should be spelt out[6].

6.43 The 13th FC also recommended that the grant for PRIs be utilized to improve service delivery in respect of water supply and sanitation schemes subject to their recovering at least 50 per cent of the recurring cost in the form of user charges. It also stipulated that at least 50 per cent of the grants provided to each State for ULBs should be earmarked for solid waste management through public-private partnership[7].

TASK FORCE ON BUDGETARY CEILING FOR ANNUITY PAYMENT FOR PPP PROJECTS

6.44 As annuity based PPP projects pre-empt budgetary resources for future years, it has been considered necessary to suggest ceilings on annuity commitments to achieve fiscal prudence. An inter-Ministerial Task Force constituted under the chairmanship of Shri B.K.Chaturvedi, Member, Planning Commission has gone into the issue and made following main recommendations recently (October, 2010):

[6] 13th Finance Commission pg.134
[7] 13th Finance Commission pg.151

(1) Ceiling on annuity commitments

6.45 Commitments for annuity payment by each Department may be made subject to the following ceilings to be applied individually and collectively to all annuity projects:

(a) The sum of total annuity commitments for a particular grant or scheme of the Department for the next five years should not exceed 25 per cent of the current Five Year Plan outlay of such grant or scheme of the Department. For example, if the allocation for a particular scheme of a Department under the current Five Year Plan is ₹20,000 crore, its committed annuity payments for the next five years should not exceed ₹5,000 crore. This would ensure that enough resources are available for future programmes.

(b) Assuming that the Annual Plan outlay of a Department would increase at a CAGR of 10 per cent, the annuity commitments that may be made in any one year should not lead to outflows of more than 20 per cent of the projected Annual Plan outlays for the respective grant or scheme in any subsequent year. For example, if the projected Annual Plan outlay in the third year from the current year is Rs. 10,000 crore, the maximum annuity commitments from all projects awarded during and before the current year should not exceed ₹2,000 crore per annum in the said third year. This discipline would ensure a gradual roll-out of PPP projects within prudent financial limits.

(c) In any given year, the annuity projects awarded should not involve a total capital expenditure exceeding the total plan outlay of that grant or scheme for that year. For example, if the Annual Plan allocation for any grant or scheme of a department is ₹10,000 crore, then the annuity projects awarded in that year under such grant or scheme should not involve a total capital investment of ₹10,000 crore. This would help avoid excessive bunching in the award of projects.

(d) For revenue projects such as in health, education etc., the revenue expenditure during the current Five Year Plan and for the following Five Year Plan period should be treated as plan expenditure and should also be governed by the above ceilings.

(e) Some of Ministries/Departments, such as the Ministry of Home Affairs have a comparatively smaller plan budget accompanied by a large Non-Plan budget. In such cases, it may be useful to look at the total budget (both Plan and Non-Plan) of a Department prior to fixing a limit for annuity projects under Plan and Non-Plan outlays. In the case of Non-Plan expenditure such as on modernization of police, housing for police, accommodation for judiciary, jails, etc., the ceiling of annuity commitments may be fixed at 5 per cent of their annual non-plan budget or such lower proportion as the Department of Expenditure may determine from time to time.

(f) There may be schemes that acquire urgency during the course of a Five Year Plan and may require enhanced outlays in the current and subsequent Five Year Plans. In such cases, the aforesaid ceilings may have to be suitably increased. A Department

seeking such enhanced ceilings may, in consultation with the Finance Ministry and the Planning Commission, submit its proposals for consideration of the Cabinet.

(g) Any project which has been approved upto October 2010 will not be reviewed on the ground that it exceeds the above ceilings.

(2) Plan and Non-Plan outlays

6.46 All expenditure on annuity payments for the first ten years may be booked as plan expenditure and, thereafter, shifted to the Non-Plan side. To give effect to this broad principle, projects that commence during the first three years of a Five Year Plan will be booked under the plan head during the current plan period and the subsequent Plan period. In effect, this would mean that such projects would be booked under plan expenditure for 7 to 10 years depending on their year of commencement. Projects commencing in the last two years of the plan period should be treated as plan projects during the current plan period and two subsequent plan periods. In effect, such projects would be booked under plan for 11 to 12 years.

(3) Standards and Specifications

6.47 The standards and specifications to be adopted for annuity projects should be similar to those followed for similar conventional contracts. The deferment of payment liability should not lead to more expensive specifications and standards as that would only add to budgetary commitments.

(4) Disclosure of annuity commitments

6.48 The actual annuity commitments entered into by all the Departments may be compiled by the Budget Division of Finance Ministry annually and the statement of annuity commitments may be depicted transparently in the budget documents. This would conform to the recommendations of the 13th Finance Commission. Creating an object head for ease of accounting of annuity pay-outs may also be considered.

(5) Treatment of annuity commitments as debt

6.49 Annuity projects imply a committed liability for annual payments over the concession period. These are akin to debt service or charged expenditure because annuity payments are a form of deferred budgetary liability. As in the case of debt, the Finance Ministry would review the annuity commitments from time to time and lay down further ceilings as may be necessary in the interest of prudent fiscal management.

RECOMMENDATIONS OF THE COMMITTEE ON PPP AND SCOPE OF PUBLIC SECTOR PLAN

6.50 The Committee broadly agrees with most of the recommendations of the Task Force on the ceiling on annuity payments on the grounds of fiscal prudence, standard and specifications and disclosure of annuity commitments. However, some of the recommendations of the Task Force on Plan/Non-Plan treatment may not be relevant if the recommendation of this Committee on abolition of Plan and Non-Plan distinction in budget (Chapter 2) is accepted. The annuity commitments may form a part of committed expenditure of the budget of the function/service (and corresponding Ministry/ Department) under which the PPP is

undertaken. For example, if PPP is for a road project, annuity may form the expenditure budget under Transport service of the Ministry of Road transport. Similarly, viability gap funding (VGF) or any other form of support for PPP projects may form the expenditure budget of relevant function/service to which the PPP belongs. Annuity payment is a unitary charge (for both capital asset and maintenance). However, in some cases it may be possible for it to be split into capital and maintenance components based on details of the project cost. Therefore, separate object heads for annuity (capital) and annuity (current) may be created and outgo on these accounts may be treated as capital or revenue expenditure respectively. If, the components between capital and maintenance are not separable, the whole annuity may be treated as capital expenditure. As regards Viability Gap Funding (VGF), it is a grant provided to private concessionaire of the PPP project. It can be a separate object head and treated in the same manner as the grant for cretaion of capital assets. Further, as both annuity payments and VGF are to be provided from the budgetary support, these are automatically included in the budget/plan of the Centre.

6.51 The Committee also recommends that it is important to have regular information on the investment crystallized through PPPs. Therefore, there should be supplement to the Central/ State budgets providing project-wise, Ministry-wise and Sector-wise information on PPPs.

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ANNEXURES

Annexure I

Composition and Terms of Reference of the Committee

(Order No. No.12/1/2009-FR dated 22.04.2010 of Planning Commission)

Subject: Constitution of a High Level Expert Committee to suggest measures for efficient management of public expenditure.

The Eleventh Plan document has discussed at length the various anomalies and inconsistencies that arise out of the present classification of expenditure into the categories of Plan and Non-Plan. These anomalies have hindered the efficient management of public resources. The Plan document has also referred to the major changes in the implementation machinery of the Plan that have occurred in the past several years and has emphasized the need to clarify the scope of the public sector plan.

2. Keeping the above in view, it has been decided to set up a High Level Expert Committee, with the following composition, to suggest measures for the efficient management of public sector expenditure.

(1) Dr. C. Rangarajan, Chairman, Economic Advisory Council to the Prime Minister- **Chairman**
(2) Member (FR), Planning Commission (Prof. Abhijit Sen)
(3) Secretary, Planning Commission (Smt. Sudha Pillai)
(4) Deputy Governor, Reserve Bank of India (Dr. Subir Gokarn)
(5) Secretary, Department of Expenditure, Ministry of Finance (Smt. Sushama Nath*)
(6) Chief Economic Adviser, Department of Economic Affairs, Ministry of Finance (Dr. Kaushik Basu)
(7) Controller General of Accounts, Ministry of Finance (Sh. C.R. Sundaramurti)
(8) Reprsentative of Comptroller and Auditor General of India (Ms. Rekha Gupta, Deputy Comptroller and Auditor General of India)
(9) Dr. M.G. Rao, Director, National Institute of Public Finance and Policy, New Delhi
(10) Dr. Nitin Desai, Honorary Professor, ICRIER, New Delhi
(11) Prof. D.K. Srivastava, Director, Madras School of Economics
(12) Prof. Ravindra Dholakia, Professor, IIM Ahmedabad
(13) Principal Finance Secretary, Government of West Bengal (Sh. C.M. Bachhawat)
(14) Principal Finance Secretary, Government of Tamil Nadu (Sh. N.K. Shanmugan)
(15) Principal Finance Secretary, Government of Madhya Pradesh (Sh. G.P. Singhal)

* Superannuated before submission of Report and succeeded by Shri Sumit Bose

(16) Principal Finance Secretary, Government of Assam (Sh. Himanshu Shekhar Das)
(17) Principal Finance Secretary, Government of Maharashtra
(18) Adviser (FR), Planning Commission (Sh Tuhin. K. Pandey) – **Member Secretary**

The Terms of Reference of the Committee are as follows:

(i) To clearly define the scope of the Public Sector Plan and the expenditures incurred there-under keeping in view the changes in the administrative machinery for implementation of the plan, and the new mechanisms that have evolved such as special purpose vehicles and public-private partnerships.

(ii) To suggest an action plan for the abolition of the classification of expenditure into Plan and Non-Plan, which includes the detailing of the changes in the mandates of the various organizational units in the Government that deal with allocation of public resources and the management of public expenditure.

(iii) To suggest a proper framework for taking a comprehensive view of the total transfer of resources from the Centre to the States, including ensuring its accounting and reporting in a uniform manner.

(iv) To examine the accountability concerns arising out of the direct transfer of the funds to the States/ district-level bodies under Centrally Sponsored Schemes and to suggest an appropriate mechanism to guard against dilution of accountability.

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

Annexure II

Current Expenditure Classification by Broad Functions

Current expenditure classification by broad functions on Revenue Account

A. GENERAL SERVICES

(a) Organs of State

- Parliament/State/Union Territory Legislatures
- President, Vice President/Governor, Administrator of Union Territories
- Council of Ministers
- Administration of Justice
- Elections
- Audit

(b) Fiscal Services

- Collection of Taxes on Income and Expenditure
- Collection of taxes on property and capital transaction
- Land Revenue
- Stamp and Registration
- Collection of Estate duties, taxes on wealth, gift tax and securitytransaction
- Tax
- collection of other taxes on property and capital transaction
- Custom
- Union Excise Duties
- State excise
- Taxes on sales, trade etc.
- Taxes on vehicles
- Other Taxes and Duties on Commodities and Services
- Other Fiscal Services
- Currency, coinage and mint
- Other Fiscal Services

(c) Interest Payment and Servicing of Debt

- Appropriation for Reduction or Avoidance of Debt
- Interest Payments

(d) Administrative Services

- Public Service Commission
- Secretariat-General Services
- District administration
- Treasury and account administration
- Police
- Jails
- Supplies and Disposals
- Stationery and Printing
- Public Works
- External Affairs
- Other Administrative Services

(e) Pensions and Miscellaneous General Services

- Pensions and other Retirement Benefits
- Miscellaneous General Services

(f) Defence Services

- Defence Services - Army
- Defence Services - Navy
- Defence Services - Air Force
- Defence Services - Ordnance Factories
- Defence Services - Research and Development

B. SOCIAL SERVICES

(a) Education, Sports, Arts and Culture

- General Education
- Technical Education
- Sports and Youth Services
- Art and Culture

(b) Health and Family Welfare

- Medical and Public Health
- Family Welfare

(c) Water Supply, Sanitation, Housing and Urban Development

- Water Supply and Sanitation
- Housing
- Urban Development

(d) Information and Broadcasting

- Information and Publicity
- Broadcasting

(e) Welfare of Scheduled Castes, Scheduled Tribes and Other Backward Classes

- Welfare of Scheduled Castes, Scheduled Tribes and Other Backward Classes
- Labour and Employment
- Social Security and Welfare
- Nutrition
- Relief on account of Natural Calamities
- Other Social Services
- Secretariat-Social Services

C. ECONOMIC SERVICES

(a) Agriculture and Allied Activities

- Crop Husbandry
- Soil and Water Conservation
- Animal Husbandry
- Dairy Development
- Fisheries
- Forestry and Wild Life
- Plantations
- Food Storage and Warehousing
- Agricultural Research and Education
- Agricultural Financial Institutions
- Co-operation
- Other Agricultural Programmes

(b) Rural Development

- Special Programmes for Rural Development
- Rural Employment

- Land Reforms
- Other Rural Development Programmes

(c) Special Areas Programmes

- Hill Areas
- North Eastern Areas
- MPs Local Area Development Scheme
- Other Special Areas Programmes

(d) Irrigation and Flood Control

- Major Irrigation
- Medium Irrigation
- Minor Irrigation
- Command Area Development
- Flood Control and Drainage

(e) Energy

- Power
- Petroleum
- Coal and Lignite
- New and Renewable Energy
- Energy Coordination and Development

(f) Industry and Minerals

- Village and Small Industries
- Industries
- Non-Ferrous Mining and Metallurgical Industries
- Other Industries
- Other Outlays on Industries and Minerals

(g) Transport

- Indian Railways-Policy formulation, Direction, Research and Other Miscellaneous Organisation
- Indian Railways-Commercial Lines-Working Expenses
- Indian Railways-Strategic Lines-Working Expenses
- Indian Railways-Open Line Works (Revenue)

- Payments to General Revenues
- Appropriation from Railway Surplus
- Repayment of Loans taken form General Revenues
- Ports and Light Houses
- Shipping
- Civil Aviation
- Roads and Bridges
- Road Transport
- Inland Water Transport
- Other Transport Services

(h) Communications

- Postal Services
- Telecommunication Services
- Dividends to General Revenues
- Appropriation from Telecommunications Surplus
- Repayment of Loans taken form General Revenues -by Telecommunications
- Satellite Systems
- Other Communication Services

(i) Science, Technology and Environment

- Atomic Energy Research
- Space Research
- Oceanographic Research
- Other Scientific Research
- Ecology and Environment

(j) General Economic Services

- Secretariat-Economic Services
- Tourism
- Foreign Trade and Export Promotion
- Census, Surveys and Statistics
- Meteorology
- Civil Supplies
- General Financial and Trading Institutions

- International Financial Institutions
- Other General Economic Services

D. GRANTS-IN-AID AND CONTRIBUTIONS

- Grants-in-aid to State Governments
- Grants-in-aid to Union Territory Governments
- Compensation and Assignments to Local Bodies and Panchayati Raj Institutions
- Technical and Economic Co-operation with Other Countries
- Aid Materials and Equipment

Current expenditure classification by broad functions on Capital Account**

A. CAPITAL ACCOUNT OF GENERAL SERVICES

- Capital Outlay on Currency, Coinage and Mint
- Capital Outlay on Other Fiscal Services
- Capital Outlay on Police
- Capital Outlay on Stationery and Printing
- Capital Outlay on Public Works
- Capital Outlay on Other Administrative Services
- Capital Outlay on Miscellaneous General Services
- Capital Outlay on Defence Services

B. CAPITAL ACCOUNT OF SOCIAL SERVICES

- Capital Outlay on Education, Sports, Art and Culture
- Capital Outlay on Medical and Public Health
- Capital Outlay on Family Welfare
- Capital Outlay on Water Supply and Sanitation
- Capital Outlay on Housing
- Capital Outlay on Urban Development
- Capital Outlay on Information and Publicity
- Capital Outlay on Broadcasting
- Capital Outlay on Welfare of Scheduled Castes, Scheduled Tribes and Other Backward Classes
- Capital Outlay on Social Security and Welfare
- Capital Outlay on Nutrition

C. CAPITAL ACCOUNT OF ECONOMIC SERVICES

(a) Capital Account of Agriculture and allied activities

- Capital Outlay on Crop Husbandry
- Capital Outlay on Soil and Water Conservation
- Capital Outlay on Animal Husbandry
- Capital Outlay on Dairy Development
- Capital Outlay on Fisheries
- Capital Outlay on Forestry and Wild Life
- Capital Outlay on Plantations
- Capital Outlay on Food Storage and Warehousing
- Demand 45
- Investments in Agricultural Financial Institutions
- Capital Outlay on Co-operation
- Capital Outlay on Other Agricultural Programmes

(b)
- Capital Account of Rural Development
- Capital Outlay on Other Rural Development Programmes

(c)
- Capital Account of Special Areas Programmes
- Capital Outlay on North Eastern Areas

(d)
- Capital account of Irrigation and Flood Control
- Capital Outlay on Minor Irrigation
- Capital Outlay on Flood Control Projects

(e)
- Capital Account of Energy
- Capital Outlay on Power Projects
- Capital Outlay on Petroleum
- Capital Outlay on Coal and Lignite
- Capital Outlay on New and Renewable Energy

(f)
- Capital Account of Industry and Minerals
- Capital Outlay on Village and Small Industries
- Capital Outlay on Non-Ferrous Mining and Metallurgical Industries
- Capital Outlay on Cement and Non-Metallic Mineral Industries
- Capital Outlay on Fertilizer Industries

- Capital Outlay on Engineering Industries
- Capital Outlay on Telecommunication and Electronic Industries
- Capital Outlay on Consumer Industries
- Capital Outlay on Atomic Energy Industries
- Capital Outlay on Other Industries
- Other Capital Outlay on Industries and Minerals

(g)
- Capital Account of Transport
- Capital Outlay on Indian Railways - Commercial Lines
- Capital Outlay on Indian Railways - Strategic Lines
- Capital Outlay on Ports and Light Houses
- Capital Outlay on Shipping
- Capital Outlay on Civil Aviation
- Capital Outlay on Roads and Bridges
- Capital Outlay on Other Transport Services

(h)
- Capital Account of Communications
- Capital Outlay on Postal Services
- Capital Outlay on Satellite System
- Capital Outlay on Other Communication Services

(i)
- Capital Account of Science Technology and Environment
- Capital Outlay on Atomic Energy Research
- Capital Outlay on Space Research
- Capital Outlay on Oceanographic Research
- Capital Outlay on Other Scientific and Environmental Research

(j)
- Capital Account of General Economic Services
- Capital Outlay on Tourism
- Capital Outlay on Foreign Trade and Export Promotion
- Capital Outlay on Meteorology
- Investments in General Financial and Trading Institutions
- Investments in International Financial Institutions
- Capital Outlay on Other General Economic Services

D. EXPENDITURE OF UTs

E. Loans And Advances

(a)
- Loans For Social Services
- Loans for Education, Sports, Art and Culture
- Loans for Urban Development
- Loans for Broadcasting
- Loans for Other Social Services

(b)
- Loans For Economic Services
- Loans for Agriculture and allied activities
- Loans for Forestry and Wild Life
- Loans for Food, Storage and Warehousing
- Loans for Cooperation
- Loans for Special Area Programme
- Loans for North Eastern Areas
- Loans for Energy
- Loans for Power Projects
- Loans for Industry and Minerals
- Loans for Village and Small Industries
- Loans for Iron and Steel Industries
- Loans for Non-Ferrous Mining and Metallurgical Industries
- Loans for Cement and Non-Metallic Mineral Industries
- Loans for Fertilizer Industries
- Loans for Petro-Chemical Industries
- Loans for Chemical and Pharmaceutical Industries
- Loans for Engineering Industries
- Loans for Telecommunication and Electronic Industries
- Loans for Consumer Industries
- Other Loans to Industries and Minerals
- Loans for Ports and Light Houses
- Loans for Civil Aviation
- Loans for Other Transport Services
- Loans for Science Technology and Environment
- Loans for Other Scientific Research

- Loans for General Economic Services
- Loans for Other General Economic Services

(c)
- Other Loans
- Loans and Advances to State Governments
- Loans and Advances to Union Territory Governments
- Advances to Foreign Governments
- Loans to Government Servants, etc.
- Miscellaneous Loans
- Loans of UTs

** Total Capital, Public Debt and Loans

Annexure III

The following table refers to chart 3.1 and enumerates absolute values corresponding to the items plotted on the graph.

₹ in Crore

Sl. No.	Item		2007-08 Actual	2008-09 Actual	2009-10 Actual	2010-11 RE	2011-12 BE
A		**Assignment**	**151800**	**160179**	**164832**	**219303**	**263458**
B		**Transfers *(of which)***	**182150**	**217320**	**267574**	**306069**	**352726**
	(i)	Non-Plan Grant	36431	38421	45947	52606	66311
	(ii)	CSS-Direct Transfer	54776	83224	90521	122199	124605
	(iii)	CSS-through SCF*	29329	18601	46617	34853	55784
	(iv)	Central Assistance to State Plans	61614	77075	84490	96412	106026

*BE, Source: Union Budget Documents