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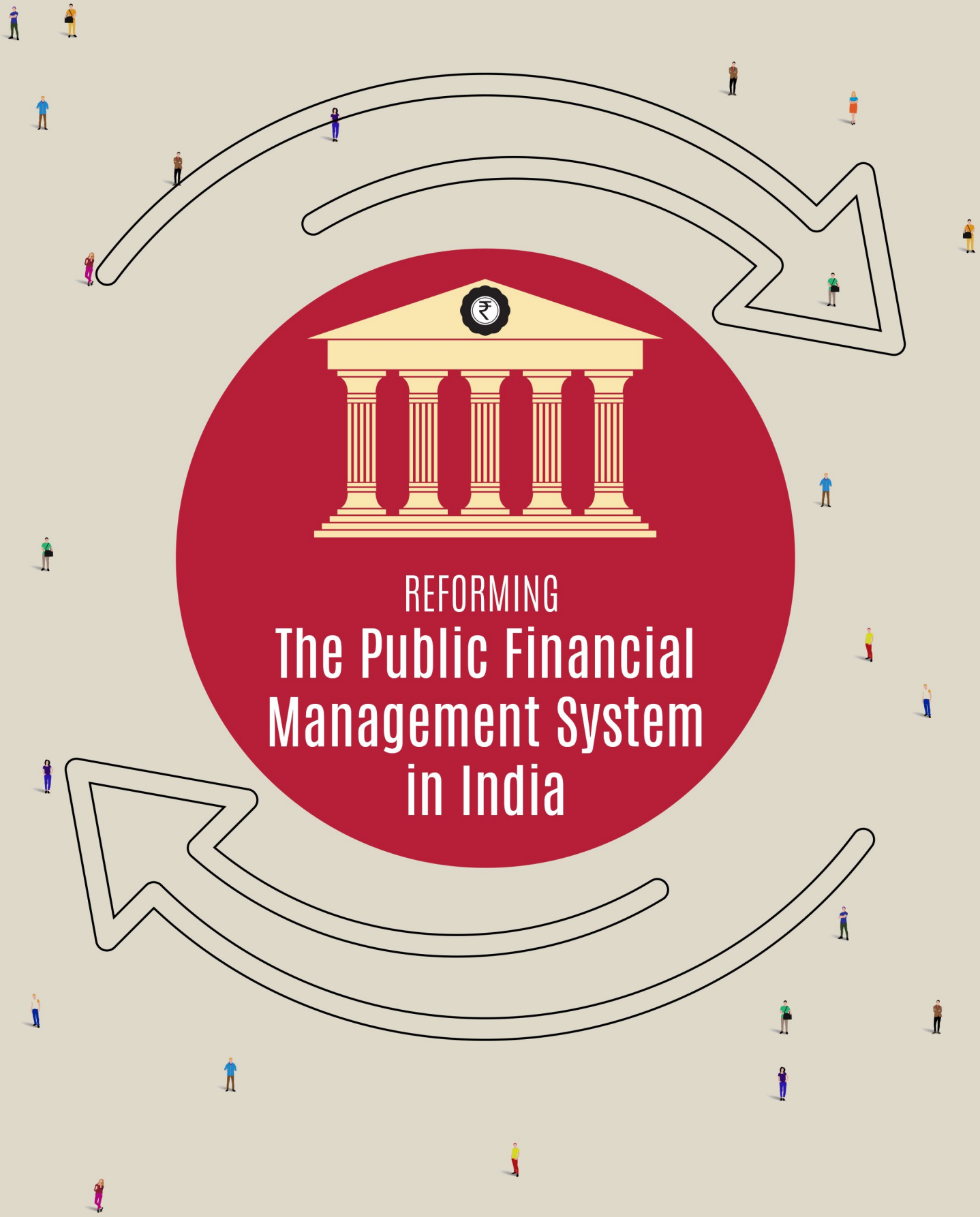

REFORMING The Public Financial Management System in India

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I. Overview

A. The scope and importance of public financial management

Public financial management (PFM) has been defined as "the way governments manage public resources (both revenue and expenditure) and the immediate and medium-to-long-term impact of such resources on the economy or society" (Andrews et al, 2014, p. 2). While initially, PFM was more about financial control and compliance, it has now grown to include maintaining a sustainable fiscal position, effectively allocating funds, and efficiently providing public goods. PFM's "financial management" role has transformed into a more comprehensive "finance management" function. Cangiano, Curristine, and Lazare (2013) observed that PFM has now broadened to include "all aspects of managing public resources, including resource mobilisation and debt management, with a progressive extension to the medium to long term implications and risks for public finances of today's policy decisions." PFM now covers all governmental tiers and also the public sector, including public-sector enterprises (PSEs) and public–private partnerships (PPPs). As described by Cangiano, Curristine, and Lazare (2013), "PFM is now seen as an umbrella definition, covering a set of systems aimed at producing information, processes, and rules that support fiscal policymaking as well as provide instruments for its implementation."

There is a consensus in the literature that the objectives of PFM are achieving aggregate discipline, allocative efficiency, and operational efficiency (Kristensen, Bowen, Long, Mustapha, & Zrinski, 2019). Along similar lines, the Fifteenth Finance Commission (2020) identified four overarching objectives of PFM: aggregate fiscal discipline, strategic budgeting and planning, operational efficiency, and accountability and transparency.

- Aggregate fiscal discipline refers to the need for adequate and consistent fiscal coverage and reporting and accurate macroeconomic and fiscal forecasting
- The strategic budgeting and planning objective highlights the need to move towards the performance orientation of budgets
- The operational efficiency objective covers strengthening cash management practices
- The accountability and transparency objective indicates the importance of timely public information being made widely available

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

Thus, good PFM can be a "linchpin that ties together available resources, delivery of services, and achievement of government policy objectives" (Public Expenditure and Financial Accountability [PEFA] Secretariat, 2016, p. v). The urgent need for PFM reform has been accentuated by the impacts of COVID-19 on public finances, especially at the sub-national level, and its "scissors" effect on revenues and expenditures: while revenues are declining, spending pressure in critical areas such as health and education is increasing (Fifteenth Finance Commission, 2020).

B. Public financial management in India

India's existing PFM framework encompasses a wide canvas of provisions including constitutional provisions, legislations, rules and regulations, and other documents. The basic framework for PFM in India is enshrined in the Constitution. This constitutional structure is supplemented by many statutes, subordinate legislations, guidelines, manuals, government orders, and other instruments that were framed at various times (Fifteenth Finance Commission, 2020).[1] Even though multiple reforms have been undertaken over the years, they have largely been piecemeal and driven by the need to incorporate developments in information and communications technology (ICT), such as integrated financial management information systems (IFMIS). So far, reform efforts have not targeted the underlying PFM structure in any significant way.

There is a gap between the broad PFM structure as set in the Constitution and the operational PFM guidelines, rules, regulations, and manuals. The Constitution establishes the relative powers of the executive and legislature on financial matters, the independence of constitutional authorities; an independent external audit by the Comptroller & Auditor General of India (C&AG); distribution of powers between the union and states, the institutional mechanism of finance commissions to divide financial resources between the two levels of government (and to provide for the third tier as well); the preparation, presentation, and management of the annual budget; and so on. On the other hand, operational guidelines are found in other instruments such as the General Financial Rules, 2017 (GFR), Government Accounting Rules, 1990 (GAR), Receipt and Payment (R&P) Rules, 1983, Delegation of Financial Powers Rules, and budget and treasury manuals, at the levels of both the union and states. As recommended by the Fifteenth Finance Commission (2020), there is a need to bridge this gap and consolidate and organise the core PFM principles succinctly.

Apart from this, since existing PFM provisions were developed at different points in time and at various levels, there are *inter se* inconsistencies in the underlying provisions and processes. Moreover, many such provisions are outdated. For instance, while the GFR was amended in 2017 to incorporate new changes in ICT, the GAR and R&P Rules still need updating to accommodate new ICT systems.[2] There is thus a need to rationalise existing rules and regulations, make them internally consistent, and address any gaps and infirmities.[3] At the same time, there is a need to develop overarching, multi-level, binding standards that will increase consistency and accountability in governance across the tiers of government.

Hence, several structural adjustments are needed, such as upgrading internal audits, clearly specifying and increasing fiduciary duties of all stakeholders such as relevant ministers, secretaries and other public servants, and managerial heads of PSEs, and enhancing transparency. The crucial role of legislative oversight needs to be better recognised and enhanced. This can be achieved by mandating *ex-ante* reporting through strategies, plans, and budgets to shed light on the government's medium- to long-term intentions, coupled with *ex-post* reporting through budget execution reports, mid- and end-year reporting, as well as reporting on the achievement of—as well as deviation from—fiscal objectives. Essentially, governments need to be held accountable for their decisions regarding spending and revenue. While the existing Fiscal Responsibility and Budget Management (FRBM) laws at the union and state levels do this to a significant extent, this regime needs to be consolidated and made consistent across all governmental levels.

Thus, to address the gaps in transparency and meaningful fiscal analysis, it is essential to have common, comprehensive definitions and formulations of fiscal indicators and standard reporting across levels of government. In practice, the fiscal rules contained in the FRBM Acts are circumvented

[1] See Table A1 in the Annex for a list of existing laws, rules, regulations, and guidelines that govern select PFM practices in India.
[2] The Government of India's Civil Accounts Manual, which supplements the R&P rules, incorporates process changes that were brought out in pursuance of adopting ICT systems and electronic transactions.
[3] See Table A3 in the Annex for a list of illustrative gaps and infirmities in the existing PFM framework.

by, for instance, using entities outside the government for off-budget borrowings and misclassifying revenue expenditure as capital expenditure. This is partially due to the problem of inconsistent definitions across state FRBM Acts, which creates room for differences in reported deficits and debt, making them non-comparable, and thereby, difficult to consolidate. Fiscal deficit or public debt needs to be defined and calculated in the same way across governments.

In this context, the Fifteenth Finance Commission (2020) recommended a range of PFM reforms for India. It also cited a draft law, prepared by an expert group, that could potentially serve as a comprehensive, overarching legal framework for PFM in India and usher in these reforms (Alamuru & Vidhi Centre for Legal Policy, 2020). Our paper builds on the provisions of this draft law and takes a close look at the key areas where India needs PFM reforms. These include fiscal responsibility, the annual budget, financial management, reporting and accounting, and legislative and executive oversight (Chapters III, IV, V, VI, & VII of the draft PFM law). It studies the existing frameworks in these areas and argues for reform, drawing from a wide range of international PFM experiences. On this basis, and elaborating on the provisions of the draft PFM law, it presents various recommendations for these reforms. Overall, it aims to chart a comprehensive way forward for PFM in India.

II. Fiscal responsibility

At the union as well as state levels, the government's fiscal policy framework needs strengthening to ensure that governments make credible and prudent decisions about their spending and revenue, and do so in a transparent manner over a medium-term horizon. Governments need to be held accountable against clear fiscal responsibility principles, such as achieving a sustainable budget balance over a reasonable period, maintaining a prudent level of public debt, managing fiscal risks prudently, ensuring value for money in the use of resources, and pursuing macroeconomic stability, inclusive growth, environmental sustainability, and intergenerational equity (Section 11(1) of the draft PFM law). These principles should not be time-bound but should allow governments to manage and tide over the economic cycle or the period during which an adverse situation persists, such as the COVID-19 pandemic.

The draft PFM law cited by the Fifteenth Finance Commission complements the existing regime of FRBM laws at the union and state levels (Sections 20 & 21 of the draft PFM law). These existing FRBM laws, along with the rules issued under them, typically include a range of numerical fiscal targets, including fiscal deficits and debt ceilings. The draft PFM law can support both the present numerical-based fiscal rules framework as well as a principles-based one, as is the case in New Zealand.[4]

To strengthen the existing FRBM regime, governments should be required to prepare and table a fiscal strategy before their legislatures that is linked to the budgeting exercise (Section 12 read with the Second Schedule of the draft PFM law). The fiscal strategy should be accompanied by a suite of allied strategies and plans, including a medium- to long-term outlook in terms of sustainability reporting of existing policies, an investment statement to explain the significant assets and liabilities of the government, and a Public Investment Programme (PIP) to provide a medium-term list of

[4] Under New Zealand's Public Finance Act, 1989, the government's fiscal policy needs to comply with certain specified principles of responsible fiscal management. These include fiscal sustainability principles such as managing fiscal risks prudently, fiscal structure principles such as managing resources effectively and efficiently, and stabilisation principles such as having regard to the interaction between fiscal and monetary policies. In contrast to legislated numerical fiscal rules, the New Zealand government has to articulate how its fiscal strategy is consistent with these principles, including by self-setting measurable, numerical, fiscal objectives in the strategy document. This approach has been successful as governments are more likely to achieve principles-based fiscal objectives that they have determined and set for themselves, as opposed to legislatively stipulated numerical rules (Parkyn, 2019). For India to move towards this framework, changes would be needed in its existing FRBM laws and rules.

prioritised programmes and projects (Sections 13, 14, & 15 of the draft PFM law). While the fiscal strategy does exist under the existing FRBM regime, albeit in a limited manner, the other documents represent new proposals that do not have any parallels in India currently.[5]

These are not mere reporting requirements. To implement these, governments would need to strengthen underlying issues through reforms such as public investment management, financial reporting and accounting, and the introduction of e-governance applications. It is critical, especially post-COVID-19, that governments re-evaluate and take medium- to long-term views of their assets and liabilities.

Consistent with international practices, compliance with these strategies and principles should be reviewed by an independent institution created and mandated by law. These reviews should include an analysis of the achievement of, and compliance with, the fiscal responsibility principles; an analysis of the trends in economic and fiscal forecasts; a review of the accounting and forecasting methods used; and an analysis of the reports and disclosures made to meet transparency requirements. In the first instance, the government should conduct such a review of its own performance, followed by reviews by relevant legislative committees of their respective government's performance, and supplemented by an independent fiscal institution's review (such as by a fiscal council).[6] Currently, the C&AG is legally mandated to review the union government's compliance with the provisions of the union FRBM Act. This arrangement could continue, for the time being, until an independent fiscal institution is established for this purpose (Section 19 of the draft PFM law). The state FRBM Acts do not require the C&AG to perform this review function. Until independent fiscal institutions are established at the State level as well, it may be desirable to legally mandate such a function to the C&AG in the States as well.[7]

A. Fiscal strategy

It is critical that governments be required to lay down well-defined fiscal strategies so that there is public information regarding their intentions. Their performance can then be judged against their declared strategies. Presently, the union FRBM Act and most state FRBM Acts do require their respective governments to table a document similar to a fiscal strategy in their legislatures. To take the example of the union FRBM Act, its fiscal policy strategy statement is expected to include government policies relating to taxation, expenditure, market borrowings, lending and investments, pricing of administered goods and services, securities, and guarantees; the government's strategic fiscal priorities; key fiscal measures and the rationale for any major deviation in fiscal measures relating to taxation, subsidies, expenditure, administered pricing and borrowings; and an evaluation of how current governmental policies conform with fiscal management principles and the objectives set out in the medium-term fiscal policy statement, as specified in the FRBM Act. The draft PFM law seeks to strengthen and enhance this critical document and introduce an element of uniformity in this practice across union and state levels.

[5] The erstwhile Planning Commission (dissolved in 2014), through its five-year plans, used to perform a part of this function. For example, the five-year plans charted out a long-term and strategic vision, set priorities with specific sector-wise targets, and aimed to facilitate effective and balanced utilisation of resources. Our proposals, especially the long-term fiscal sustainability report and PIP aim to take some of this forward, in a holistic manner that is adequately integrated with the fiscal strategy.

[6] For a discussion on fiscal councils, see Singh, Patel, & James (2021).

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

The fiscal strategy should incorporate the aforementioned fiscal principles in the form of measurable fiscal objectives and monitoring indicators. It should include:

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

The fiscal strategy can serve as a key accountability document and be considered the front-end of the budget process.[8] It can capture governments' intentions regarding economic and fiscal performance in terms of the budget balance and debt objectives, along with their long-term fiscal objectives and short-term goals with fiscal forecasts for up to the next 10 years. It should also include a fiscal risk statement detailing the risks to the forecasts, contingent liabilities, and other material risks including mitigation strategies. This will provide governments with more scope to use the fiscal policy to meet emerging economic and fiscal situations such as the ongoing COVID-19 pandemic. Consistent with this view, this paper proposes that while the strategy document must contain a minimum set of fiscal objectives that are numerically measurable, legislatively stipulating such fixed numerical values may not be desirable.

This strategy must be prepared by the time the budgeting exercise commences as opposed to submissions made at the time the budget is presented. In the future, the union FRBM Act's four-part fiscal policy statement, comprising the medium-term fiscal policy statement, the fiscal policy strategy statement described above, the macroeconomic framework statement, and the medium-term expenditure framework statement could be subsumed within the comprehensive fiscal strategy proposed in the draft PFM law. This would help in reducing avoidable complexity.

It is important to note that in certain circumstances, deviations from the fiscal objectives contained in the fiscal strategy might be justified (Section 18 of the draft PFM law). Such circumstances must be clearly specified, and, crucially, there should be a mitigation and reporting process that gets triggered in the event of such deviations. For example, such circumstances might include events that are truly outside the control of governments and severely affect their fiscal positions; for instance, national security issues, natural calamities, structural reforms in the economy, severe economic shocks, and significant downturns in a productive sector. This need for flexibility was made apparent by the COVID-19 pandemic. This flexibility should be accompanied by a reporting process that requires the deviating government to specify its plans to address the deviation and secure its path back to compliance. The aim should be to allow governments some leeway to act during crises, while also requiring them to explain their actions transparently. This should facilitate both flexibility as well as accountability.

[8] For an illustrative example, see the fiscal strategy section in New Zealand's Wellbeing Budget 2022 (New Zealand Government, 2022).

B. Long-term fiscal sustainability report

The long-term fiscal sustainability report should attempt to assess the impacts and implications of the country's demographic, economic, environmental, and other factors on fiscal metrics in various scenarios. To move towards long-term fiscal sustainability, we need to assess whether a government has the ability to finance its future policies and debt obligations without casting an undue burden on future generations. To achieve such sustainability, there needs to be greater economic growth compared to public debt over time. The need for this arises on account of foreseeable demographic trends and their impact on the country's public finances in the long term, requiring governments to adapt their fiscal strategies accordingly.

The assessment should identify significant actions that need to be taken by various players as well as which sectors will put pressure on government finances. This report should provide long-term projections of public finances and debt sustainability, and it should include a discussion on fiscal risks. Ultimately, this report should help governments in understanding how to reorient their fiscal policy in a manner that prevents the accumulation of unsustainable government debt in the long term. This requires governments to prioritise based on the relative risks to public finances. Many countries are now reporting on fiscal sustainability over different time horizons such as Brazil (10 years), Canada (70 years), Ireland (25 years), Switzerland and the United States of America (30 years), Slovakia and the United Kingdom (50 years), Portugal (15 years), and Lithuania (20 years). The frequency of these reports varies from annually to once every two or three years.

The benefits of such reporting are seen in the case of Switzerland's Long-term Sustainability Report, 2016. This report noted that if Switzerland's economy, demographic structure, and net immigration rate develop in line with forecasted scenarios, then its ratio of general government expenditure to GDP will rise from 32 percent to 36 percent by 2045 (Federal Department of Finance, 2016). It also observed that the foreseeable upward pressure to increase spending on healthcare and long-term care will make reforms inevitable. To make these burdens manageable, the report argued for the need to secure financing for the country's social security mechanisms in a timely way. On a positive note, it noted that the disposable income of the working-age population was set to rise further as a consequence of continued economic growth.

Similarly, Canada's Fiscal Sustainability Report, 2020, concludes that "the ageing of the population will move an increasing share of Canadians out of their prime working-age years and into their retirement years, resulting in slower growth in the Canadian economy. Slower economic growth will put downward pressure on government revenues as growth in the tax base slows. At the same time, population ageing will put upward pressure on other government programmes such as health care, Old Age Security, and pension benefits. Programmes targeted to younger age groups will face reduced pressure as the population ages" (Office of the Parliamentary Budget Officer, 2020, p. 1).[9]

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

C. Investment statement

The investment statement should provide details of the state and value of the governments' assets and liabilities, both current and forecasted, and explanations for changes. These investment statements should lay out how public resources have been or will be used. They should feature good balance sheet management, which includes efficient asset management, sustainable funding, and prudent risk management, accompanied by information that can guide subsequent government decisions and actions.

[9] For an example from an emerging market, see Indonesia's long-term fiscal sustainability report (Badan Kebijakan Fiskal, 2019).

New Zealand is a pioneer in implementing this futuristic reporting framework, producing such a report every four years. New Zealand's 2018 investment statement, titled "Investing for Wellbeing (*He Puna Hao Patiki*)", noted that the task of policymakers is incomplete without considering how the application of good balance sheet management principles supports current and future living standards (The Treasury, 2018). It observed that the government's balance sheet is currently strong, which provides resilience in the face of adverse events. It stated its long-term aim and vision to further broaden its approach of linking balance sheet management to well-being, using the organising principles of New Zealand's Living Standards Framework.

India should consider adopting this practice and producing an investment statement every two years. However, to prepare the government balance sheet, India would need to follow the accrual basis of accounting. Presently, India continues to follow a cash-based system. This issue is addressed in a subsequent section of this paper.

D. Public Investment Programme

The Public Investment Programme (PIP) should contain a rolling list of priorities and costed programmes/projects in the medium term that are aligned with the government's fiscal strategy. It should translate the strategies and policies into concrete, prioritised programmes and projects over a 5–6-year horizon, and it should be based on an overarching long-term plan or vision statement of the government.

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

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

The preparation of a PIP would be largely facilitated through an online ICT application with a database of programmes and projects. This could serve as a tool to link planning, budgeting, and monitoring to move toward performance-based resource allocation, monitor project implementation, and generate reports. For example, the Philippines uses an ICT tool called PIP Online or PIPOL, which contains a database of government programmes and projects.[10]

Beyond serving as a database of projects, the PIP should cover project identification, project screening, and project prioritisation. It should also categorise projects into those that are to be financed by the government's budget, development assistance, and PPPs. It could also serve as a valuable source of data for commitment control by facilitating some much-needed control over multi-year public investments. Presently, the Infrastructure and Project Monitoring Division in the Union Ministry of Statistics and Programme Implementation performs this role to an extent. A legally mandated PIP would strengthen this function considerably.

[10] For additional details, see National Economic Development Authority (2018).

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

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

E. Financial memorandum for extra-budgetary proposals

A cardinal principle in financial management requires the spending ministry or department not to enter commitments or incur expenditure beyond its remit or above those approved in the annual budget. This emanates from the principles of authority, regularity, propriety, and value for money. However, there is an increasing tendency in India to incur expenditures or introduce policies or measures that were neither proposed in the annual budget nor accompanied by a detailed explanatory note justifying the proposal and its impact on government finances. This is a cause for concern, especially because many such proposals carry significant multi-year financial implications.[11]

There is a need to create a formal requirement that whenever a ministry or department proposes any policy or measure that would require expenditure beyond what was authorised by the legislature in the annual budget, it must prepare a financial memorandum that contains projections of financial implications for the government over the short, medium, and long term (Section 16 of the draft PFM law). This memorandum must be submitted to the finance minister, who must then provide a written opinion to the Council of Ministers as to whether to proceed with the proposal. If approved, the government should then table a new statement before the legislature regarding the additional expenditure that will be incurred on account of the new policy. The additional expenditure would then need to be formally approved by the legislature through a new grant and Appropriation Act.

III. The annual budget

The broad principles and directions concerning the annual budget are laid down in the Constitution for both the union (Articles 112–117) and the states (Articles 202–207), while the detailed procedures and processes are provided in the respective budget manuals and financial rules of the union and the states. The Constitution requires the executive to annually present a statement of the estimated receipts and expenditures of the government, and this is referred to as the "annual financial statement". It seeks to distinguish revenue from other expenditures, and lists expenditures charged on the Consolidated Fund, which the legislature may discuss but not vote upon. The Constitution also provides for supplementary and excess grants, vote-on-account, and vote-on-credit to enable the government to manage the need for funds during budget execution. The budget manuals, on the other hand, stipulate the responsibilities of the Finance Ministry or Department and the line departments in preparing the budget, the timelines, formats for submitting the budget/revised/supplementary estimates, the principles guiding re-appropriation, and so on.

[11] A recent CRISIL Ratings study that looked at 11 major states found that off-budget borrowings had reached a decadal high of around 4.5 percent of gross state domestic product (CRISIL, 2022).

The annual budgeting exercise is undoubtedly the most important component of PFM, as it is through this exercise that the government seeks to fulfil its promises to the electorate. Important social and economic obligations and aspirations of citizens are met through this annual exercise of raising resources and spending them on various government programmes. However, between the very broad guidelines in the Constitution and the minute details in budget manuals, essential principles and necessary good practices are often obscured. As with PFM generally, there is a need to bridge the existing gap between budgeting guidelines and principles on the one hand and budgeting practices on the other.

A. The budget calendar

One of the main issues concerns the dates of presentation and approval of the budget. The PEFA programme's methodology for assessing PFM performance identifies the budget preparation process as a key indicator in assessing a country's PFM system. It notes the importance of an orderly budget process that allows budget proposals to be developed in a manner that adequately takes into account all relevant factors (PEFA Secretariat, 2018). PEFA notes that this increases the likelihood of the budget process being supportive of both, fiscal discipline as well as efficient resource allocation and service delivery. Conversely, it observes that delays in the process and ultimate passing of the budget tend to create uncertainty about approved expenditure and, in turn, delays in government activities. The International Monetary Fund (IMF, 2019), in its fiscal transparency code, also highlights the importance of timeliness for budget documents, so that the legislature and wider public are consistently given sufficient time to scrutinise and approve the annual budget.

These observations are borne out in India's experience. Until 2017, while the union annual budget was presented on the last day of February, the State Governments did not follow a single fixed date for the presentation of the budget. After the presentation of the union budget, the Parliament would go into a recess, and the departmental standing committees would examine the estimates. Then, Parliament would reconvene sometime in April, and the budget would be finally passed in the second half of May. Parliament would, in the meantime, pass a vote-on-account that allowed the government to draw funds from the Consolidated Fund until the budget was approved. Because of the delayed presentation of the union budget, the States would not have a clear idea of their share of devolved funds and grants-in-aid. This led to the States also delaying their budget presentations, sometimes even beyond the start of the new financial year. As a result, governments were unable to start public spending before the monsoon season, which would effectively put the brakes on public expenditure (especially expenditure on public works).

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

B. Budget comprehensiveness and guiding principles

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

Presently, except for the requirement that revenue expenditures must be distinguished from other expenditures, there is no other legal stipulation regarding what information should be included in

the budget. There is merit in specifying these to ensure comprehensiveness and uniformity and also to enable more effective legislative oversight (Section 23 read with the Third Schedule of the draft PFM law). PEFA (2018) identifies four basic elements of fiscal information that are critical for enabling the legislature to adequately comprehend and scrutinise the government's fiscal position. These are:

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

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

In India, the union and state budgets should provide information relating to budgeted and actual receipts and expenditures for the two preceding financial years, the budgeted and revised estimates of receipts and expenditures for the current financial year, budget estimates of receipts and expenditures for the ensuing financial year, and projected estimates of receipts and expenditures for one financial year thereafter. The estimates of receipts should show revenue estimates as well as financing estimates, with the latter including information on external financing in the form of borrowing and grants, domestic issuance of government bonds, issuance of guarantees, divestment of government assets, and approval of new PPP contracts. The expenditure estimates should separately show the expenditure charged on the Consolidated Fund and other expenditures, and distinguish expenditure on revenue accounts from other expenditures (Section 23 of the draft PFM law). The issue of comprehensive reporting is elaborated upon in section V of this paper.

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

- The government should ensure that the budget is consistent with the fiscal responsibility principles and the fiscal strategy as mentioned in the previous section, and any deviation should be explained in the budget itself.
- All public servants responsible for preparing or approving budget submissions should ensure that the submissions support the efficient, effective, and economical use of public resources
- The budget should be prepared on a cash basis (for the time being, and subject to the eventual transition to accrual-based accounting as discussed in section V of this paper), and all amounts that are expected to be received or paid during a financial year should be budgeted in that financial year, including arrears of previous financial years.
- Generally, the budget should present receipts and expenditures on a gross basis (IMF, 2019).
- Generally, receipts should not be assigned to specific types of expenditure.
- All appropriations should be authorised in the Appropriation Act and made for one financial year.

C. Performance and outcome orientation

Fundamentally, annual budgeting in India remains an input-based incremental budgeting exercise. There is now an increased focus on linking the budget with performance in terms of outputs and outcomes, but these have largely remained an academic exercise. The underlying budget structures and processes have not been reformed in light of this approach. For instance, the departments of the union government have been preparing an "outcome budget" since 2005, and many States have since started preparing outcome budgets themselves. Yet, the main budget continues to be the same as in the past. The outcome budget is prepared separately and tabled in the legislature along with the main budget. This replaced the performance budget that was hitherto being prepared following the recommendation of the First Administrative Reforms Commission in 1968. The expected outcome is identified against each outlay, and sometimes, indicators to measure the outcomes and targets are mentioned. There is no consistency in either the form or content of these documents between the union and the states.

There are several issues with this practice, the most significant being that it is an offline *ex-post* exercise that does not result in the prioritisation of expenditure based on the desirability of outcomes. Although termed "budget", it is essentially not a budgeting exercise. If the desired objective of prioritisation of expenditure outlays is to be realised, then the expenditure must be aggregated around a larger or broader objective or a programme. As noted by the Fifteenth Finance Commission (2020), "there is a misalignment between the annual budget exercise, medium-term planning, and outcome budgets." Outcomes, output indicators, and targets need to be defined and integrated into the budget documentation process at the union as well as state levels. The focus of legislative oversight in this regard also needs to shift towards intended outcomes. To facilitate these changes, and to build outcome-based spending more generally, the underlying budget structures and processes will require reform.

The critical impediment has been the archaic chart of accounts,[12] which is completely at odds with internationally followed good practices like the Classification of the functions of government (COFOG)[13] and the Government Financial Statistics (GFS) Manual.[14] India must move towards outcome-oriented budgeting. In consultation with the C&AG, the budget classification and chart of accounts need to be reformed to facilitate budgeting based on programmes and their expected outcomes. Legislative appropriation should be changed to the programme level instead of the current "object head" (Section 26 of the draft PFM law).

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

[12] There have been attempts in the past to revise the chart of accounts. The Sundaramurti Committee's report made recommendations for amending the economic segment of the chart of accounts to ensure compliance with the IMF's Government Financial Statistics Manual (CGA, 2016). The CGA was in the process of updating the chart of accounts as proposed by this report, but these changes have not been implemented yet.

[13] COFOG was issued by the United Nations (2000) and developed by OECD. It provides a classification of functions of government (Major Heads in the Indian context).

[14] The GFS Manual, issued by the IMF (2014), provides guidance for economic (object head) classification.

D. Supplementary grants and rush of expenditure

Another issue is linked to supplementary grants. The Constitution enables the legislature to approve supplementary grants during the year for an existing scheme or new services or instruments of service (Articles 115 and 205). Supplementary grants are required to recoup funds to the Contingency Fund. Such grants are expected to be few and far in between so that the sanctity and integrity of the original budget remain intact. However, in the absence of limits in terms of the frequency and volume of such supplementary estimates, the presentation of several supplementary estimates has become quite common. There is thus a need to restrict supplementary estimates, ideally to no more than two in a financial year. Additionally, the finance minister should be required to disclose the impact of such additional expenditure or financing on the performance of the government against the fiscal objectives contained in the fiscal strategy (Section 29 of the draft PFM law).

One major concern in expenditure management has been unproductive expenditure in the last month of the financial year, mainly to avoid budgetary allocations from lapsing. The present system of appropriations lapsing at the end of each financial year encourages undesirable practices such as a rush of expenditure at the year-end, procurement of unwanted and unnecessary items that may result in lower quality of public expenditure, transfer of funds from the Consolidated Fund to either the Public Account[15] or parking them outside. There is a distortion in accounts as cheques are drawn but not issued to vendors. This also results in an indeterminate cash liability, as no record of such withdrawal is maintained in the books of accounts. These practices are a legacy from the past and need to be phased out. Based on international experience, it is evident that the annularity of the budget is a crucial principle and should not be distorted. In summary, the accounts should close at year-end, with payments authorised only for commitments made and goods or services delivered before year-end.[16]

E. Facilitating participation

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

They should prepare a simplified summary of the budget, which would be more accessible to the common citizen, and make it available on the government website soon after the presentation of the budget (Section 28(c) of the draft PFM law) (IMF, 2019). This should help in providing for an "inclusive, participative, and realistic debate on budgetary choices", and governments should additionally facilitate engagement by legislatures, citizens, civil society organisations, and other stakeholders in realistic debates about priorities, trade-offs, and opportunity costs (OECD, 2015b, p. 8).

The union government does promptly upload budget documents on a dedicated union budget website, immediately after presentation. It publishes a "Budget at a Glance" document, comprising broad aggregates from the budget for easy understanding (Ministry of Finance, 2022a). And it also provides a key to the budget document and a document on budget highlights, which lists key

[15] Article 266(2) of the Constitution provides that all public money that is received by or on behalf of the government, and is not to be credited into the Consolidated Fund of the union or state as per Article 266(1), shall be credited into their respective public accounts. The Public Account is supposed to contain funds that the government is holding in trust, such as provident funds, reserve or special funds, and small savings. These funds do not belong to the government, but rather have to be eventually repaid to their original depositors. Unlike the Consolidated Fund, legislative approval is not required to appropriate money out of the Public Account.

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

features using infographics (Ministry of Finance, 2022c, 2022b). However, state governments do not follow most of these good practices when it comes to their budgets, and there is considerable inter-state variation as well (Transparency International India, 2020). Like with other aspects of budget procedure, it would help to create a common legal obligation that ensures that best practices are followed across the board.

IV. Financial management

A. Debt management

Achieving and maintaining a prudent level of public debt is a fundamental fiscal responsibility principle.[17] In addition to the union and state FRBM Acts, the current regulations and practices concerning debt management in India stem from the Government Securities Act, 2006(which focuses on government securities and the management of public debt by the central bank) and the Government Guarantee Policy of 2010, supported by operational details mentioned in the Government Financial Rules, 2017. However, to truly operationalise this principle, there needs to be a comprehensive and consolidated framework for the determination, approval, and risk management of public debt. In particular, principles need to be established for the issue of government guarantees to PSEs and other parastatals (Sections 64–67 of the draft PFM law). Some of the borrowings by parastatals become contingent liabilities for the government, thereby exerting pressure on the government's debt sustainability levels. To increase transparency in debt reporting, governments should be required to disclose all the guarantees that they have given. With respect to parastatals, debt not only includes guarantees but specifically also their off-budget borrowings.

While the union FRBM Act as well as some state FRBM laws have been amended to change the definition of debt to include the aforementioned understanding, other States must still incorporate this change. Such borrowings need to be accounted for explicitly in the overall debt of the government, depending on the relationship of the entity with the government. To accurately capture the full picture, public debt should be defined as the total outstanding liabilities of the government on the security of the Consolidated Fund, including external debt, the total outstanding liabilities in the Public Account, and such financial liabilities of any body corporate or other entity owned or controlled by the government, which the government is to repay or service from the annual budget (as made clear in the union FRBM Act after its amendment in 2018) (Section 2(ee) of the draft PFM law). The financing needs of the government and payment obligations should be made at the lowest possible cost and with a prudent degree of risk over the medium to long term (Section 56(1) of the draft PFM law).

For effective debt management, it might be helpful if governments prepare a medium-term debt management strategy (MTDMS) as part of their annual budget documentation (Section 56 of the draft PFM law). The MTDMS framework typically comprises a methodology and an analytical tool aimed at facilitating prudent debt management. It can help governments formulate, adjust, and effectively implement their debt management strategy (World Bank & IMF, 2017). While the Reserve Bank of India had issued a debt management strategy for 2015–18, it was not laid before Parliament. No State Government prepares such a document. An MTDMS could be the first step in liability management and can help in appraising the government's performance on public debt, re-assesses debt sustainability conditions, and continue to guide debt policy over the medium term.

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

Besides having developmental aspects, the MTDMS can also serve as an annual performance evaluation of government debt management activities. These developmental aspects can include guidelines and specified targets for the composition of the government's debt portfolio and new debt to ensure that portfolio risks remain at acceptable levels. It can also include planned measures to support a functioning domestic market for government securities, and policies and guidelines for lending, on-lending, and the issuance of debt guarantees. The MTDMS should be prepared in line with the previously mentioned fiscal responsibility principles mentioned previously and with the fiscal strategy. In many countries, the broader coverage provided by the MTDMS was crucial in identifying the true extent and trajectory of vulnerabilities by capturing and highlighting debt management issues linked to PSEs (World Bank & IMF, 2017).

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

- *Derivatives*: Derivatives are complex financial instruments and include swaps, futures contracts, options, foreign currency contracts, and forward agreements. The union finance minister could be empowered to enter derivatives that are authorised by the Cabinet in consideration of the risks involved along with public interest. The ultimate objective is to lower the cost of public debt by anticipating interest and/or foreign exchange movements or managing the average maturity of public debt, particularly when exposed to foreign markets. Derivatives have long been used in the private sector, but they are now increasingly being introduced in government operations. However, in the context of public debt, they should be used sensibly, responsively, and transparently. New Zealand and Sweden are examples of sovereign borrowers that frequently use derivatives; other examples include Ireland, Denmark, and Australia. In Sweden, active debt management is achieved by separating decisions on funding and characteristics of the debt portfolio. Sweden's National Debt Office seeks low-cost funding, irrespective of the currency or maturity, and then transforms the cash flows using derivatives. Credit risks are managed using credit support annexe agreements, which is a system of bilateral exchange of cash based on the current market value of the net position.

- *Hedging:* India's public debt comprises a significant portion of external debt, and hence, risk management of this external debt assumes significance. Hedging may be a good option for countries whose debt portfolios have a significant proportion of foreign currencies, given their exchange risk exposures. India could also consider entering hedging transactions or arrangements to avoid or reduce the effect of currency or interest rate fluctuations. Such transactions or arrangements should, however, be consistent with the aforesaid MTDMS.

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

In India, provisions relating to guarantees are currently provided in the union and state FRBM Acts (and some standalone state legislations such as the Kerala Ceiling on Government Guarantees

Act, 2003), the Government Guarantee Policy of 2010, with operational details in the Government Financial Rules, 2017. In addition to these, guarantees should comply with the fiscal responsibility principles mentioned earlier, the MTDMS, and be subject to risk assessment. The sole authority for issuing guarantees should be vested in the finance minister, and the government should not be liable to pay any liability under a guarantee unless it is a formal guarantee (Sections 64 & 65 of the draft PFM law). In other words, documents such as a "letter of comfort" or a communication conveying the intent of the government should not be considered guarantees under any circumstances.

All debt recording and reporting need to be formalised, such that all loans taken or guarantees given are disclosed in the annual accounts of the government (Section 67 of the draft PFM law). While this is currently being followed both at the union and state levels, and disclosures are made in the Finance Accounts and the annual budget documentation, there is merit in making this a mandatory requirement. Additionally, a quarterly report on public debt should be presented to the Cabinet, summarising the debt operations during the reporting quarter. While this is currently being followed at the union level, there is a need to make this mandatory at the state level too. The Finance Ministry/Department should be vested with the formal responsibility of debt recording, including recording information on the principal, terms of payment, drawls, interest and other charges, repayment of the principal and payment of interest, alteration of the terms, and outstanding balance. Lastly, parastatals should also be vested with the responsibility of maintaining debt records and submitting periodical reports to their concerned administrative ministry/department.

B. Commitment control

It is critical to implement commitment control as part of the overall budget control framework (Section 37 of the draft PFM law). In India, excess levels of commitment plague government finances and result either in expenditure payment arrears or resources being thinly spread over large items. Commitment is a financial liability to the government and could also be a contingent liability, including in the case of PPPs. Public servants need to be given certain responsibilities, which can serve as checks and balances, before they take actions that result in committing the government to financial liabilities. They should only commit the government to financial liabilities if they are expressly authorised to do so; the commitment should not exceed the approved amount and should follow all relevant procedures; and they must maintain a proper record of all commitments linked to the appropriation and expenditure line.

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

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

C. Internal audit

The government's internal audit system needs to be institutionalised. Internal audits at the union level are spearheaded by the Controller General of Accounts (CGA). While there are operational guidelines regarding this vital function in Chapter 12 of the Civil Accounts Manual of the union government, they are not presently legally binding. The current system includes a decentralised

internal audit institutional structure that has been implemented under the chief controller of accounts of each ministry reporting to the financial adviser, under the overall responsibility of the relevant secretary. The CGA has brought out a Generic Internal Audit Manual and some instructions that are followed by the ministries. On the other hand, internal audit functions in the States follow different institutional structures and practices, with a few States having their own audit legislations. Some States are pursuing reforms that aim to strengthen their internal audit mechanisms.

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

Specifically, annual internal audit reports that include organisational structure, work done, and major findings should be published along with risk-based internal audit plans. The CGA should develop standards and guidelines for effective internal audits under the direction of the finance secretary, and these can be adopted by finance secretaries at the state level too. These standards and guidelines should be published. The scope of an internal audit should include an assessment of the risk management, control, and governance processes, including whether risks are appropriately identified and managed; public money and assets are adequately safeguarded and used as intended; financial and operating information is accurate, complete, reliable, and timely; ethical standards and values are established and followed; all applicable laws, policies, and procedures are complied with; and resources are applied to achieve the strategic objectives of the government (Section 71 of the draft PFM law).

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

V. Reporting and accounting

All governments should produce annual financial statements based on internationally recognised reporting and accounting standards. This is important for accountability, transparency, and decision-making. Article 150 of the Constitution provides that the accounts of the union and state governments would be kept in a manner prescribed by the president, on the advice of the C&AG. This function is exercised by the CGA, on behalf of the president. Thus, the CGA prescribes the form of accounts of the union and states and framing or revising the related rules and manuals in consultation with the C&AG.

The procedures for reporting and accounting are primarily contained in the GFR and the GAR. The C&AG (Duties, Powers and Conditions of Service) Act, 1971, also has provisions relating to financial reporting and accounting. The annual accounts of the union government comprise the Appropriation Account and the Finance Accounts. The former is prepared by each ministry and shared with the CGA for consolidation, and the latter is prepared by the CGA. At the union level, the responsibility of accounting for government transactions vests with the CGA; while at the state level, accounting is done by finance departments through the treasuries. These accounts are then supplemented and compiled by state accountant generals (A&E) to produce the monthly accounts and the annual accounts comprising the Finance Accounts and Appropriation Accounts.

Annual financial statements of the governments at the union and state levels in India are produced primarily based on the cash-based accounting system. The union government constituted the Government Accounting Standards Advisory Board (GASAB) in 2002 to act as an advisory body under the C&AG. GASAB's objective is to formulate standards relating to accounting and financial reporting by the union and the states. It works on two sets of accounting standards, based on cash and the accrual basis of accounting, and the standards formulated by it are recommended to the union government for notification.[18] These standards, however, are not consistent with international accounting standards such as the International Public Sector Accounting Standards (IPSAS), which are issued by the International Federation of Accountants.

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

A. Enhanced reporting

There needs to be a comprehensive and consolidated system of government reporting, including components such as a consolidated quarterly report that covers the government's financial performance integrating all public entities against the annual budget and the Appropriation Act; a mid-year review report that sets out the progress against the fiscal strategy and the annual budget; annual accounts comprising the finance and appropriation accounts; an annual report; and simplified summaries of the annual budget and reports (Sections 76, 77 read with the Fourth Schedule, 78, 80, & 83 of the draft PFM law).

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

Currently, in India, ministries and departments at the union and state levels produce annual administrative reports containing information regarding their mandate, achievements made during the year, their plans for the future, budgetary achievements, and staffing. These are then tabled in Parliament or the Legislative Assembly, as the case may be. However, in practice, these reports are often delayed. The practice of preparing and submitting annual financial reports by governments is internationally recognised and prevalent in countries such as the United States of America and South Africa. There is a need to mandate and institutionalise this practice, at the levels of individual ministries and departments, as well as the union and state governments, to ensure a whole-of-government approach to reporting. Moreover, the minimum contents for these reports should be specified. It should contain the government's views on major activities during the year, and its commentary on revenue, expenditure, budget balance, borrowings, and so on. To some extent, this is discussed in the budget speech, but the practice and extent of the discussion differ *inter se* between governments.

In addition to these components of reporting, clear timelines are needed for the production of accounts, completion of audits (Section 79 of the draft PFM law), and tabling before the legislature.

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

Presently, these matters are frequently delayed and there is no system to inform the legislature of the reasons for the delays and the actions proposed. Beyond establishing clear timelines, the finance minister should have to explain delays in the legislature; and in the case of delays in auditing annual accounts, the C&AG should submit an explanatory memorandum to the legislature (Section 81 of the draft PFM law).

B. Accounting standards

Several countries have established IPSAS-based accounting standards in their financial reporting framework. IPSAS aims to "improve the quality of general purpose financial reporting by public sector entities, leading to better informed assessments of the resource allocation decisions made by governments, thereby increasing transparency and accountability (Ahmad & Nassereddine, 2020). The adoption of IPSAS is expected to enhance financial accountability in the government and improve the quality of available information, on the basis of which governments can make better-informed decisions and improve service delivery. IPSAS is a benchmark for evaluating and improving government accounting (Kasoma, 2018).[19]

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

While, as mentioned, the GASAB currently formulates accounting standards in India, there is a need to change the present approach to implementing standards-based accounting. Rather than drafting new accounting standards, India could consider adopting cash-based IPSAS with minor adjustments for Indian systems. That way, it can spare more time and resources for the implementation of standards. The standards-setting body should also have the power to notify its standards after adequate stakeholder consultations. Apart from being set and notified by an independent body, the accounting standards should be implemented progressively, including the transition from cash-based to accrual-based accounting. They should also be uniformly applicable to government accounts at the union as well as state levels and should be duly notified and made publicly available. The annual accounts of the government should be prepared in accordance with these notified standards. In case any delay or temporary deviation from the accounting standards is required, details should be clearly specified in the published standards (Section 73 of the draft PFM law).

VI. Legislative and executive oversight

A. Legislative oversight of the executive

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

[19] There are three ways in which the IPSAS can be implemented:
(i) directly implementing IPSAS without altering any requirements;
(ii) indirectly implementing IPSAS through a national endorsement process that adjusts for any local features; and
(iii) developing national standards using IPSAS as a reference point. IPSAS are available both for cash and accrual basis of accounting.

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

In India, while there are constitutional provisions regarding legislative oversight of certain broad aspects of PFM, there remains considerable scope to strengthen and enhance this function. Legislative oversight measures exercised in India include debates and reviews by legislative committees, particularly Parliament's Standing Committee on Finance and its Public Accounts Committee, and their counterparts in state legislatures. The legislature should be adequately empowered to approve the annual budget and the supplementary estimates, authorise borrowing and investing in public entities, and review audit reports. For legislative oversight to be effective, there first needs to be an effective system of reporting by the executive. The existing system in India requires the executive to table specific reports before the legislature, including performance reports and audit reports. The FRBM Acts also contain some requirements in this regard.

However, there is a need to bolster these requirements, and the government should table a range of *ex-ante* strategies and plans in the legislature, including an investment statement, a financial asset management strategy, a liability/debt management strategy, and a PIP. The current framework casts responsibility on the government to provide *ex-post* reports for legislative oversight such as actual spending to budget approvals. As argued in this paper, the *ex-post* reporting framework should also be strengthened by introducing certain additional responsibilities for the executive to supplement the FRBM Acts. The discussion in the fiscal responsibility section of this paper regarding the need to report deviations from fiscal objectives to the legislature, and the review role that can be played by the C&AG (for the time being), are also relevant for increasing legislative oversight.

B. Executive oversight of public sector enterprises and other government bodies

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

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

For example, the C&AG noted in its state finances audit report for Gujarat in 2016-17 that the Knowledge Consortium of Gujarat (KCG), a society registered under the Societies Registration Act, 1860, had poorly utilised the grants-in-aid that it had received from the government (C&AG, 2018). Spending was very low, with substantial amounts of unutilised balance having accumulated by the end of the financial year, and a lot of its funds being parked with the Gujarat State Financial Services company. In addition, the C&AG found that KCG was not submitting utilisation certificates in the required format, and that it had no mechanism for certifying that the grants-in-aid it received were indeed being used for intended purposes. The C&AG concluded with a cautionary note that "high pendency of utilisation certificates was fraught with the risk of misappropriation and fraud" (C&AG, 2018, p. 70).

For the union government as well, the C&AG noted in its audit report for 2014-15 that there were numerous discrepancies in the figures relating to the government's equity holding in government companies and societies, and the corresponding figures reflected in the balance sheets and annual accounts of those entities (C&AG, 2015). The C&AG also flagged that while a substantial amount of plan funds was being released to registered societies, most of these entities did not come under the direct statutory audit jurisdiction of the C&AG. Noting that the government did not have a mechanism in place to obtain the annual accounts of the bodies it substantially funded, the report highlighted that this made it difficult for the C&AG to conduct timely audits of such entities.

Clearly, the ultimate result is poor oversight. Financial reporting by PSEs under the union government is still relatively strong, but there are significant gaps when it comes to state-level bodies, where the consistency, uniformity, and reliability of information need considerable improvement. This creates gaps in the timely reporting of liabilities, improperly informed policy decisions, and delayed reforms in the sector. While the Department of Public Enterprises, now in the Union Ministry of Finance, plays a role in oversight and information collection, such a central body is generally lacking at the state level. In cases where such a body exists (such as a bureau of public enterprises), it is usually, effectively non-operative and/or lacks statutory authority. This points to the importance of extending these reforms to the state level.

The OECD guidelines on corporate governance of state-owned enterprises (SOEs) provide that, "The state should act as an informed and active owner, ensuring that the governance of SOEs is carried out in a transparent and accountable manner, with a high degree of professionalism and effectiveness" (OECD, 2015a). They further elaborate that, to perform such a role, the state should set and monitor the implementation of broad mandates and objectives for SOEs, reporting systems that enable regular monitoring, auditing, and assessment of SOE performance, and mechanisms for ensuring the quality of the information provided by SOEs (OECD, 2015a). In pursuance of these guidelines, Germany's Federal Ministry of Finance implemented a standardised monitoring system for state-owned small- and medium-sized enterprises. This monitoring system was designed to provide government authorities with an analysis and alert tool that could highlight potential financial risks associated with such enterprises (OECD, 2020).

Presently, in India, such bodies fall under the purview of their respective administrative ministries and the Ministry of Finance. The Board of Directors of PSEs play a critical role, and comprise functional directors who look after day-to-day functioning, government directors who are appointed by the administrative ministry, and non-official or independent directors who are usually technocrats, management experts, and professional managers. The Department of Public Enterprises had issued a detailed set of guidelines on corporate governance for central PSEs in 2010, which included a model code of conduct and ethics for board members and senior management (Department of Public Enterprises, 2010). A Parliamentary standing committee made a series of recommendations in 2018 regarding enhancing the role and effectiveness of independent directors in central PSE boards, including timely appointment, regular meetings, training programmes, and scrupulous performance evaluation mechanisms (Department-related Parliamentary Standing Committee on Industry, 2018).

In 2020, the Department of Public Enterprises issued a memorandum elaborating on the appropriate role of government directors on the boards of central PSEs (Department of Public Enterprises, 2020). It mentioned that in addition to working in the best interest of their PSE, they are also expected to safeguard the government's interest as a shareholder, take instructions from the government and articulate them in board meetings, and provide feedback on PSE decisions to the relevant administrative ministry.

Administrative ministries need to monitor the fiscal risks of PSEs proactively and effectively under their purview. To facilitate this, PSEs should be required to report, *ex-ante* and *ex-post*, matters

such as the preparation of corporate intent and annual plans, and mid-year and end-year reporting on actual performance (Section 90 of the draft PFM law). They should be allowed to borrow only in accordance with their approved annual plans, and they should additionally provide periodic debt reports to their respective administrative ministry for monitoring and oversight (Section 96 of the draft PFM law). Their annual plans should include strategic priorities, changes from the previous plan, outputs planned to be achieved, expected government contributions, human resource development, a statement of fiscal risks, and a budget (Section 89 of the draft PFM law). This should be a mandatory requirement; as presently, while some PSEs and government bodies do prepare annual plans, most do not. In terms of the bigger picture, there is a need for a comprehensive framework of control and oversight, covering both financial management as well as fiscal risks (Section 88 of the draft PFM law).

The responsibilities of the Finance Ministry and the administrative ministry, vis-à-vis PSEs and other government bodies, need to be clearly defined (Sections 85 & 86 of the draft PFM law). The finance minister should be formally responsible for approving loans and guarantees to be provided by the government and major financing and investment proposals, monitoring financial performance and risks, and enforcing the expectations of the government. The minister of the concerned administrative ministry, on the other hand, should have the power to issue relevant directions to the board of such bodies,[20] conduct performance reviews (Sections 87 & 91 of the draft PFM law), and fulfil the responsibilities that arise from the shareholding or ownership roles. The minister of the administrative ministry should also be responsible to the legislature of the performance of the bodies under their purview on matters relevant to PFM. The Committee on Public Undertakings in Parliament, and similar committees in state legislatures, would be in a better position to exercise effective scrutiny over PSEs if these changes were to be implemented.

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

VII. Conclusion and way forward

As argued in this paper, India needs to make its PFM system comprehensive, integrated, and consistent at the earliest. The case for PFM reform has only become stronger in light of the disruptions and strains caused by the COVID-19 pandemic and its continuing effects, which have highlighted and exacerbated the existing fault lines in national fiscal architectures around the world. The pandemic has also highlighted the importance of building resilient public finance frameworks that can effectively manage and mitigate future crises. A strong PFM framework, built on learnings from international experience and best practices—as highlighted in this paper—will help enhance accountability and transparency and ultimately contribute to improving governance. As India emerges from the pandemic, PFM reforms at the union and state levels are also essential for improving its human capital outcomes (Dahiya, James, Patel, Pathak, & Singh, 2021).

Our paper complements the Fifteenth Finance Commission's (2020) recommendations regarding building India's fiscal architecture for the 21st century, and specifically, the key elements of PFM reforms that the commission identified. It addresses various aspects of India's PFM architecture including fiscal responsibility, budgeting, financial management, reporting and accounting, and oversight, drawing extensively from global best practices. Based on this study and analysis, and

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

elaborating upon the provisions contained in a draft PFM law prepared by an expert group and cited by the Fifteenth Finance Commission (2020), we have suggested several recommendations for each of these areas (Alamuru & Vidhi Centre for Legal Policy, 2020).

Around the world, countries are enacting overarching, comprehensive, and modern legislative frameworks for PFM along the lines of the draft PFM law discussed in this paper. This approach is emerging as the preferred means for implementing PFM reforms; examples of countries that have enacted such laws include large, emerging markets such as Indonesia and South Africa, as well as advanced countries such as Canada, Australia, and the United Kingdom. For these reforms to be effective, they need to be implemented at the union and state levels with careful integration and coordination. Future research can assess how some of these PFM reforms may be appropriately extended to the level of India's third tier as well—comprising panchayats and municipalities.

While the need for these reforms is urgent, it would still be advisable, and perhaps practical, to proceed incrementally and sequentially. As recommended by the Fifteenth Finance Commission (2020), the Union Ministry of Finance is best placed to take the lead in conducting extensive and wide-ranging stakeholder consultations, bringing together state finance departments—the C&AG and its subordinate state accountant generals, the CGA, the Reserve Bank of India, research bodies, and civil society organisations that work in the area of PFM. These consultations could also be carried out through existing institutional fora such as the Inter-state Council or the NITI Aayog's governing council. Once the union and state Governments begin to reform their PFM systems, important learnings from their individual experiences should be widely shared, discussed, and benchmarked. In order to perform all these additional functions adequately, considerable capacity-building will also be required at various departments in the union and state governments, and especially in the finance ministry and departments.

Given the nature and scope of the suggested reforms, a long-term and holistic implementation strategy should be developed, and it must be designed and executed in the spirit of deliberation, inclusiveness, consensus, and transparency.

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Annex

Table A1: The existing framework for select PFM practices[21]

PFM dimension	Union Government	State Governments
Fiscal discipline and risk-management	Fiscal Responsibility and Budget Management (FRBM) Act, 2003 (with significant amendments in 2018)	State fiscal responsibility laws[22]
Budget formulation	Budget Manual, Department of Economic Affairs, Ministry of Finance (MoF), Government of India (GoI), 2010	State budget manuals, most of which are based on the union's budget manual
Internal control/audit	Generic Internal Audit Manual for Central Civil Ministries of Government of India, 2014; Internal Audit Hand Book for Central Civil Ministries / Departments, 2018; Operational Manual for Internal Audit for Central Civil Ministries / Departments, 2019. All issued by the CGA, MoF, GoI	State treasury codes issued under Article 283(2) of the Constitution, either as a statute passed by its legislature or as rules passed by its Governor
Public procurement	General Financial Rules (GFR), 2017 and various orders issued by Department of Expenditure, MoF, GoI	GFR, along with orders and instructions passed by State Finance Departments
Monitoring & reporting	Monitoring by departments/agencies as per fiscal rules in the FRBM Act, GFR 2017, Receipt & Payment (R&P) rules, 1983, accounting classifications and rules [like the Government Accounting Rules, 1990 (GAR)] Reporting as per statements prescribed under the FRBM Act, accounting manuals, formats and rules prescribed by C&AG/CGA	Accountant General of a State (AG), as a field officer of C&AG, compiles financial statements and presents to state legislature. AG (Audit) conducts various audits and submits reports to the legislature. Accounting formats are prescribed by C&AG, and include GAR
External Audit	C&AG (Duties, Powers and Conditions of Service) Act, 1971 [C&AG (DPC) Act] Audit Standards, rules and guidelines issued by C&AG The Public Accounts Committee (PAC) in the Parliament examines the C&AG's audit report	C&AG (DPC) Act Audit Standards, rules and guidelines issued by C&AG. PAC of state legislatures examines the C&AG's report on state finances

[21] Articles 112–117, 148–151, 202–207, 264–291 (Chapter I and II of Part-XII) of the Constitution define the broad framework for management of public finances in India, for the union and state levels.

[22] See Table A2 in the Annex for a list of such laws across states.

Table A2: List of State Fiscal Responsibility Laws

State	Fiscal responsibility law
Andhra Pradesh	Andhra Pradesh Fiscal Responsibility and Budget Management Act, 2005
Arunachal Pradesh	Arunachal Pradesh Fiscal Responsibility and Budget Management Act, 2006
Assam	Assam Fiscal Responsibility and Budget Management Act, 2005
Bihar	Bihar Fiscal Responsibility and Budget Management Act, 2006
Chhattisgarh	Chhattisgarh Fiscal Responsibility and Budget Management Act, 2005
Goa	Goa Fiscal Responsibility and Budget Management Act, 2006
Gujarat	Gujarat Fiscal Responsibility Act, 2005
Haryana	Haryana Fiscal Responsibility and Budget Management Act. 2005
Himachal Pradesh	Himachal Pradesh Fiscal Responsibility and Budget Management Act, 2005
Jharkhand	Jharkhand Fiscal Responsibility and Budget Management Act, 2007
Karnataka	Karnataka Fiscal Responsibility Act, 2002
Kerala	Kerala Fiscal Responsibility Act, 2003
Madhya Pradesh	Madhya Pradesh Fiscal Responsibility and Budget Management Act, 2005
Maharashtra	Maharashtra Fiscal Responsibility and Budgetary Management Act, 2005
Manipur	Manipur Fiscal Responsibility and Budget Management Act, 2005
Meghalaya	Meghalaya Fiscal Responsibility and Budget Management Act, 2006
Mizoram	Mizoram Fiscal Responsibility and Budget Management Act, 2006
Nagaland	Nagaland Fiscal Responsibility and Budget Management Act, 2005
Odisha	Orissa Fiscal Responsibility and Budget Management Act, 2005
Punjab	Punjab Fiscal Responsibility and Budget Management Act, 2003
Rajasthan	Rajasthan Fiscal Responsibility and Budget Management Act, 2005
Sikkim	Sikkim Fiscal Responsibility and Budget Management Act, 2010
Tamil Nadu	Tamil Nadu Fiscal Responsibility Act, 2003
Telangana	Telangana Fiscal Responsibility and Budget Management Act, 2005
Tripura	Tripura Fiscal Responsibility and Budget Management Act, 2005
Uttar Pradesh	Uttar Pradesh Fiscal Responsibility and budget Management Act, 2004
Uttarakhand	Uttaranchal Fiscal Responsibility and Budget Management Act, 2005
West Bengal	West Bengal Fiscal Responsibility and Budget Management Act, 2010
Jammu and Kashmir	Jammu and Kashmir Fiscal Responsibility and Budget Management Act, 2006
Ladakh	Jammu and Kashmir Fiscal Responsibility and Budget Management Act, 2006

Table A3: Select gaps and inconsistencies in the existing PFM framework

PFM dimension	Present coverage	Existing gaps/ inconsistencies	Existing gaps in implementation
Fiscal discipline and risk-management	Existing fiscal responsibility legislations (FRLs), at the union and state levels, cover a lot of ground in terms of numerical fiscal targets, mandatory disclosures, escape clauses, etc.	**Union FRL**: definitions of deficit and debt are inconsistent with each other. General government debt target is not consistent with wider definition of 'Central Government Debt.' **State FRLs:** Many states have not adopted a wider definition of debt and deficit that could cover extra-budgetary operations. Many state FRLs do not have debt as an anchor. Even where debt is a target anchor, it is not defined in alignment with the general government debt target adopted by the union FRL.	Union government debt is not calculated in full cognisance of the revised definition of debt (post-2018) in the union FRL. Medium Term Expenditure Framework and Fiscal Risk Statement are not published by the union or states
Budget formulation	Constitutional provisions under Articles 112–117 cover budgetary process in the parliament, and Articles 202–207 do the same for state legislatures. GFR, Delegation of Financial Powers Rules, and union and state budget manuals cover rules governing appropriations, sanctions, and allocations.	Constitution covers only broad mandate and provides a basic framework. However, downstream operational budgetary processes have no specific legal framework governing them. Documentation requirements and timelines for budget-making are not legally defined.	Budgetary processes are not oriented towards performance budgeting or outcome budgeting. Outcome budget document is prepared in a manner that is de-linked to the main budget outlay and performance.
Public procurement	GFR, 2017, R&P rules, and various orders issued by the Department of Expenditure, MoF, GoI, and finance departments in state governments	No overarching legal framework for public procurement. Fragmented rules, guidelines, and manuals make it difficult for public agencies to follow them comprehensively	Rules hamper efficient procurement rather than aiding competitive, transparent and efficient public procurement
Monitoring and reporting	Ex-post review and audit by C&AG under Article151 and C&AG (DPC) Act	**Both in union and states:** External assessment and evaluation mechanism for fiscal plans, performance and government's macro-economic and fiscal forecasts not in place. There is no provision or mechanism for mid-term review or correction of expenditure plan.	Ad hoc mechanism for year-end expenditure review (at the revised estimates stage), and only when driven by a pressing need. Year-end expenditure cuts are not effective, as payments get postponed to next financial year.

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