Executive Summary

Background

The State Government enacted the Kerala Fiscal Responsibility Act, 2003 with a view to ensure prudence in fiscal management and fiscal stability by progressive elimination of revenue deficit and sustainable debt management consistent with fiscal stability, greater transparency in fiscal operations of the Government and conduct of fiscal policy in a medium-term framework. The Act came into force on 5 December 2003. According to this Act, the revenue deficit had to be eliminated by the end of March 2007 and fiscal deficit reduced to two *per cent* of the estimated gross State domestic product (GSDP) by the same period. Subsequently, the Twelfth Finance Commission (TFC) recommended elimination of revenue deficit and fiscal deficit to three *per cent* of GSDP by March 2009. The State Government could not adhere to these targets primarily due to adoption of the State Pay Commission's award. Therefore, the State had to postpone the achievement of its targets till the end of March 2011.

The Comptroller and Auditor General of India's Audit Reports have been commenting upon the State Government's finances for over five years since the Fiscal Responsibility legislation. Since these comments formed part of the Civil Audit Report, it was felt that the audit findings on State finances remained camouflaged in the large body of audit findings on compliance and performance audits. The obvious fallout of this well-intentioned but all-inclusive reporting was that the financial management portion of these findings did not receive proper attention. In recognition of the need to bring State finances to centre stage once again, a stand-alone report on State Government finances is considered an appropriate audit response to this challenge. Accordingly, from the report year 2009 onwards, the Comptroller and Auditor General of India has decided to bring out a separate volume titled "Report on State Finances".

The report

Based on the audited accounts of the Government of Kerala for the year ended March 2009, this report provides an analytical review of the Annual Accounts of the State Government. The report is structured in three Chapters.

Chapter 1 is based on the audit of Finance Accounts and makes an assessment of the Kerala Government's fiscal position as at 31 March 2009. It provides an insight into trends in committed expenditure, borrowing pattern besides a brief account of Central funds transferred directly to the State implementing agencies through off-budget route.

Chapter 2 is based on audit of Appropriation Accounts and it gives a grant-by-grant description of appropriations and the manner in which the allocated resources were managed by the service delivery departments.

Chapter 3 is an inventory of Kerala Government's compliance with various reporting requirements and financial rules. The report also has an appendage of additional data collated from several sources in support of the findings.

Audit findings and recommendations

Fiscal discipline: During the current year, the revenue deficit decreased marginally by Rs 73 crore as the growth of revenue receipts was 16.1 *per cent* while growth of revenue expenditure was 13.4 *per cent* over the previous year. The Government has to make concerted efforts to contain the fiscal deficit.

Non-Plan Revenue Expenditure: Non-Plan Revenue Expenditure (NPRE) increased by 10.6 *per cent* over the previous year. The NPRE exceeded the normative assessment made by TFC by 20.3 *per cent*. The expenditure on salary and wages was 49 *per cent* of the revenue expenditure net of interest and pension payments which was higher than the norm of 35 *per cent* as recommended by TFC. Pension payments exceeded the normative assessment made by TFC by 25 *per cent.* The Plan revenue expenditure (PRE) also showed an increase of 41 *per cent* over the previous year.

The Fiscal Responsibility Act, 2003 enacted on 5 December 2003 envisaged elimination of the revenue deficit and reduction of the fiscal deficit to two *per cent* of the estimated GSDP by 31 March 2007. Though TFC recommended elimination of the revenue deficit and reduction of the fiscal deficit to three *per cent* of GSDP by March 2009, the State Government could not adhere to the targets primarily due to the financial impact of the State Pay Commission's award. However, the State Government aims to achieve these targets by the end of 2010-11 in the Medium Term Fiscal Plan for the years 2008-09 to 2010-11 presented to the Legislature with the budget for 2008-09. In order to achieve these targets, the Government needs to mobilise additional resources both through tax and non-tax sources, make efforts to collect revenue arrears and prune unproductive expenditure in the ensuing years.

Priority to capital expenditure: The capital expenditure increased during the year by 15 *per cent* over the previous year. The State may consider enhancing capital expenditure as a proportion of aggregate expenditure as this ratio is lower for Kerala than the all State's average (Table 1.10).

Review of Government investments: The return on Kerala Government's investments in Statutory Corporations, Government Companies, Joint Stock Companies and Co-operatives varied between 0.8 and 1.4 *per cent* in the last five years while the Government paid interest of 7.5 to 8.7 *per cent* on these borrowings (Para 1.6.3). It would be advisable for the State Government to seek better value for money in its investments. Otherwise, high-cost borrowed funds invested in projects with low financial returns will continue to strain the economy.

It would also be prudent to review the working of State Public Sector undertakings which are incurring huge losses and work out a revival strategy.

In view of the heavy losses of two departmental commercial undertakings, the Government should review their working so as to wipe out their losses in the short run and to make them self-sustaining in the medium to long term.

Debt sustainability: The ratio of fiscal liabilities to GSDP at 36.7 *per cent* during 2008-09 was higher than the norm of 30 *per cent* recommended by TFC.

Borrowed funds should be used to fund capital expenditure and revenue expenditure should be met from revenue receipts.

Funds transferred from the Government of India to the State implementing agencies: Government of India directly transferred Rs 913.47 crore to the State implementing agencies during the year. As long as these funds remain outside the State budget, no agency can monitor their utilisation. There is no reliable data to capture the amounts actually spent on major flagship schemes of the Government of India and other important schemes which are being implemented by State implementing agencies but are being funded directly by the Government of India. A system has to be put in place to ensure proper accounting of these funds.

Financial Management and Budgetary Control: During 2008-09, expenditure of Rs 36,877.37 crore was incurred against total grants and appropriations of Rs 44,596.19 crore, resulting in savings of Rs 7,718.82 crore. The savings were the net result of overall savings of Rs 7867.81 crore, offset by excess of Rs 148.99 crore. The excess requires regularisation under Article 205 of the Constitution of India. In 20 cases, Rs 111.02 crore was surrendered in excess of the actual savings. In 33 cases, surrenders of funds amounting to Rs 1509.87 crore were made on the last two working days of the financial year, while in 29 grants/appropriation savings amounting to Rs 901.69 crore were not surrendered. In 72 cases, augmentation/reduction of provision by re-appropriation proved either in excess of requirement or insufficient as the final expenditure of the re-appropriated sub-heads resulted in savings/excess by more than Rupees two crore. Budgetary controls should be strengthened in all the Government departments and particularly in the departments where savings have persisted for the last five years. Issuance of re-appropriation/surrender orders at the end of the year should be avoided.

Financial reporting: There were delays in submission of annual accounts by autonomous bodies and departmental undertakings. There were instances of losses due to theft and misappropriations. Departmental enquiries in such cases should be expedited to bring the defaulters to book. Internal controls in all the organisations should be strengthened to prevent such cases in future.