EXECUTIVE SUMMARY

Background

In October 2005, Uttarakhand Government responded to the Twelfth Finance Commission's recommendation by legislating its "Fiscal Responsibilities and Budget Management Act (FRBM)." It sets out a reform agenda through fiscal correction path in the medium term with the long-term goal of securing growth stability for its economy. The State Government's commitment to carry forward these reforms is largely reflected in certain policy initiatives announced in the budgets subsequently. While the benefits of FRBM legislation have been realised to a great extent already, in terms of reduction in major deficit indicators etc, the State Government's resolve to implement VAT, introduction of New Pension Scheme, ceilings on Government guarantees and a host of other institutional and sectoral reform measures will go a long way in building up the much needed 'fiscal space' for improving the quality of public expenditure and to promote fiscal stability.

The State Government has done well in establishing an institutional mechanism on fiscal transparency and accountability as evident from the year-on-year presentation of outcome budgets. These outcome indicators tend to serve the limited purpose of measuring the department-wise performance against the targets. They do not, however, give the 'big picture' of the status of financial management including debt position, off- budget liabilities and cash management etc. for the benefit of the State Legislature and other stakeholders.

The Comptroller and Auditor General's civil audit reports step in to fill this gap. C&AG's reports have been commenting upon the Government's finances for over three years since the FRBM legislation and have published three reports already. 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 center-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, C&AG has decided to bring out a separate volume titled "Report on State Finances."

The Report

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

Chapter I is based on the audit of Finance Accounts and makes an assessment of Uttarakhand 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 II is based on audit of Appropriation Accounts and it gives the grant-by-grant description of appropriations and the manner in which the allocated resources were managed by the service delivery departments.

Chapter III is an inventory of Uttarakhand 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

Return to fiscal correction: Uttarakhand is one of the earliest of States to have passed the Fiscal Responsibility and Budget Management Act. The State of Uttarakhand achieved the target of attaining revenue surplus in 2006-07 and continues to be so. Fiscal deficit of the State government at 4.90 *per cent* in 2007-08 was lagging behind the target of 3 *per cent* as envisaged in FRBM, Act but has shown some appreciation in 2008-09 and is pegged at 4.59 *per cent*.

Greater priority to capital expenditure: Though no specific norms regarding prioritisation of capital expenditure have been laid in FRBM Act, the Government had made a budget provision of Rs.2,802 crore under the Capital Head during 2008-09.This shows the government's commitment to provide the basic infrastructure in the state. However, the actual capital expenditure during the year had to be restricted on account of rise in the revenue expenditure. Even though Capital expenditure both in Social and Economic sectors decreased by 3.48 *per cent* from 20.96 *per cent* in 2007-08 to 17.48 *per cent* in 2008-09, it was still higher than the national average.

Adequate thrust to development and social sector expenditure: The per capita development expenditure and per capita social sector expenditure in Uttarakhand is higher than the national average. Further analysis may be required by the state government to see whether the capacity of the state to utilize expenditure for developmental and social outcomes can be improved by better design of schemes, reducing administration costs, timely implementation, careful monitoring etc. Cost and time overruns of incomplete projects will have to be reduced so that people of Uttarakhand benefit from these sunk costs.

Review of Government investments: The average return on Uttarakhand Government's investment in Statutory Corporations, Rural Banks, Joint Stock Companies and Co-operatives was almost negligible in the past three years while the Government paid an average interest of 7.84 *per cent* on this investment. It would be advisable for the State Government to ensure better value for money in investments, otherwise high cost borrowed funds will continue to be invested in projects with low financial return. Projects which are justified on account of low financial but high socio-economic return may be identified and prioritized with full justification on why high cost borrowings should be channeled there.

Prudent cash management: The cost of holding surplus cash balances is high. In 2008-09, the interest received on investment of cash balances in RBI Investment in Treasury Bills and Auction Treasury Bills was only 2.20 *per cent* while the Government borrowed on an average at 7.75 *per cent*. Proper debt management through advance planning could reduce the need for the State government to hold large cash surpluses. Ways and Means facility of RBI can also be judiciously resorted to as long as the State does not avail of overdraft facility.

Debt sustainability: The Government of Uttarakhand should keep the debt-GSDP ratio stable by adhering to the FRBM principle. Borrowed funds should be used as far as possible only to fund capital expenditure and revenue expenditure should be met from revenue receipts. Efforts should be made to return to the state of primary surpluses and to maintain revenue surplus. Maintaining a calendar of borrowings to avoid bunching towards the end of the fiscal year and a clear understanding of the maturity profile of debt payments will go a long way in prudent debt management.

Oversight of funds transferred directly from the GoI to the State implementing agencies: As long as these funds remain outside the State budget, there is no single agency monitoring its use and there is no readily available data on how much is actually spent in any particular year on major flagship schemes and other important schemes which are being implemented by State implementing agencies but are funded directly by the GoI. A system has to be put in place to ensure proper accounting of these funds and the updated information should be validated by the State Government as well as the Accountant General (A&E).

Financial management and budgetary control: Slow pace of programme implementation in the State left an overall saving of Rs.2,124.56 crore in grants and appropriations in Revenue section (59 cases) and under Capital section (4 Cases), offset by excess of Rs.461.02 crore in one grant under Public Debt Repayment. 'Water Supply, Housing and Urban development and Medical health and Family Welfare' sectors posted large savings persistently for the last five years. There were also instances of inadequate provision of funds and unnecessary/ excessive re-appropriations. Rush of expenditure at the end of the year is another chronic feature noticed in the overall financial management. In many cases, the anticipated savings were either not surrendered or surrendered on the last two days of the year leaving no scope for utilizing these funds for other development purposes. Detailed bills were not submitted for large amount of advances drawn on abstract contingent bills. Budgetary controls should be strictly observed to avoid such deficiencies in financial management. Last minute fund releases and issuance of re-appropriation/ surrender orders should be avoided.

Expenditure to the tune of Rs.32.02 crore was met from the advances from Contingency Fund during the year and had not been recouped to the fund at the end of the year. The expenditure purely seemed unjustified as the Government could not foresee even its debt repayments, which are obligatory on the part of the Government and the expenditure on advertising and providing housing facilities to Scheduled Castes cannot be termed as of emergent nature requiring drawal from Contingency fund. The Government should sanction advances from the contingency fund only for meeting expenditure of an unforeseen and emergent character.

Financial reporting: State Government's compliance with various rules, procedures and directives was unsatisfactory as evident from delays in furnishing utilization certificates against the loans and grants from various grantee institutions.