Executive Summary

Background

The State of Kerala, located at the southern end of the country, accounts for one *per cent* of the total area of the country and about three *per cent* of the population. The State ranks high in the human development index with a literacy rate of 90.92 *per cent* and life expectancy at birth of 74 years when compared to the General Category States' average. The infant mortality rate (13 per thousand) of the State is very low compared to the General Category States' average. The Gross State Domestic Product (GSDP) of Kerala State has been growing at a compound annual growth rate (12.76 *per cent*) as compared to other General Category States' growth rate (12.54 *per cent*). However, the State has slightly higher urban and rural inequality compared to the All India average.

This Report of the Finances of the Government of Kerala is being brought out with a view to assess objectively, the financial performance of the State during 2009-10 and to provide the State Government and the State Legislature with timely inputs based on audit analysis of financial data. In order to give a perspective to the analysis, an effort has been made to compare the achievements with the targets envisaged by the State Government in the Fiscal Responsibility Act, 2003 and in the budget estimates of 2009-10.

The Report

Based on the audited accounts of the Government of Kerala for the year ended March 2010, this Report provides an analytical review of the Annual Accounts of the State Government. The financial performance of the State has been assessed based on the Fiscal Responsibility Act 2003, the Medium Term Fiscal Plan, budget documents, Economic Review 2009, the Twelfth Finance Commission (TFC) Report and other financial data obtained from various Government departments and organizations. This 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 2010. It provides an insight into trends in committed expenditure and borrowing pattern, besides a brief account of Central funds transferred directly to the State implementing agencies through the off-budget route.

Chapter 2 is based on audit of Appropriation Accounts and 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 the 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 increased by ` 1311 crore over the previous year due to disproportionate growth of revenue expenditure (10.3 *per cent*) vis-à-vis revenue receipts (6.5 *per cent*). The low growth rate of revenue receipts during the year was mainly due to decrease of ` 453.81 crore in grant-in-aid from the Government of India. The Government has to make efforts to realise arrears of revenue amounting to ` 4422.81 crore so that the revenue deficit can be reduced to a considerable extent.

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 Gross State Domestic Product (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 the target for elimination of revenue deficit and keeping the fiscal deficit to 3.25 *per cent* of GSDP by the end of 2010-11, in the Medium Term Fiscal Plan presented to the Legislature with the budget for 2009-10. 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.

Revenue Expenditure: The revenue expenditure constituted 91 *per cent* of the total expenditure and increased by 10.3 *per cent* during the year over the previous year. Non-Plan Revenue Expenditure (NPRE) increased by 7.8 *per cent* over the previous year. The NPRE exceeded the normative assessment made by TFC by 19.5 *per cent*. The ratio of salaries and wages, pension liabilities, interest payments and subsidies to revenue receipts was 78 *per cent*, an increase of one percentage point from the previous year. Interest payments as a percentage of revenue receipts ranged between 19 and 25 *per cent* during the TFC award period as against the TFC recommendation to keep the ratio to 15 *per cent* by 2009-10. The Plan revenue expenditure (PRE) also showed an increase of 30 *per cent* over the previous year.

Capital expenditure: The capital expenditure increased during the year by 21.5 *per cent* over the previous year but constituted only six *per cent* of the total expenditure. The priority given to capital expenditure continued to be much lower in comparison with the General Category States' average during 2005-06 and 2009-10. The Government may consider enhancing the proportion of expenditure on the economic and capital sectors as a proportion of the aggregate expenditure in order to create the much needed assets to stimulate growth.

Review of Government investments: The average return on the Kerala Government's investments in Statutory Corporations, Government Companies, Joint Stock Companies and Co-operatives was one *per cent* in the last five years while the Government paid an average interest rate ranging from 7.5 to 8.4 *per cent* on its borrowings during this period. It would be prudent to review the performance of State Public Sector undertakings to improve the average rate of returns on the capital invested.

Fiscal liabilities: The ratio of fiscal liabilities to GSDP at 34.6 *per cent* during 2009-10 was higher than the norm of 30 *per cent* recommended by TFC. The

State Government may consider adopting a well-planned strategy to review the stock of fiscal liabilities in order to adhere to the target of reducing it to less than 25 *per cent* of GSDP by 2014-15 set by the Thirteenth Finance Commission.

Funds transferred from the Government of India direct to the State implementing agencies: Government of India directly transferred ` 1634.72 crore to State implementing agencies during the year. Direct transfer of funds from the Government of India to the State implementing agencies ran the risk of improper utilisation of funds by these agencies in the absence of uniform accounting policies and an effective monitoring system. The State Government needs to build a system to monitor the funds directly received by the implementing agencies of the State Government from the Government of India.

Financial Management and Budgetary Control: During 2009-10, expenditure of ` 36887.50 crore was incurred against total grants and appropriations of ` 50115.55 crore, resulting in savings of ` 13228.05 crore. The overall savings were the net result of savings of ` 13317.11 crore, offset by excess of ` 89.06 crore. Excess expenditure of ` 23.07 crore in eight grants and two appropriations during 2009-10 required regularisation under Article 205 of the Constitution of India. Apart from this, regularisation of excess expenditure under Article 205 of the Constitution of India was pending for ` 530.12 crore from 1990-91 to 2008-09 as of October 2010. In 33 cases, surrenders of funds amounting to ` 3477.53 crore were made on the last two working days of the financial year, while in 19 grants/appropriations, savings amounting to ` 870.72 crore were not surrendered. In 21 cases, ` 167.32 crore was surrendered in excess of the actual savings. In 87 cases, augmentation/reduction of provisions 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 ` two crore.

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.