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 highest (0.790) in the Human Development Index as against the All India value of 0.467. The literacy rate of 93.91 *per cent* and life expectancy at birth of 74 years are the highest in the country. Further, the infant mortality rate of the State (12 per thousand) is the lowest in the country. The State has also less population below poverty line as compared to All India average. The State has shown marginally lower economic growth in the past decade. However, its Gross State Domestic Product (GSDP) for the period 2002-03 to 2011-12 has been 15.85 *per cent* as compared to 14.46 *per cent* in General Category States (GCS). During this period, its population also grew by 5.03 *per cent* only (lowest among General Category States) against 13.90 *per cent* in General Category States. The per capita income compound annual growth rate in Kerala (15.22 *per cent*) has been higher than that of the GCS (13.09 *per cent*) in the current decade. 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 2011-12 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 budget estimates of 2011-12.

The Report

Based on the audited accounts of the Government of Kerala for the year ended March 2012, this Report provides an analytical review of the Annual Accounts of the State Government. 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 on 31 March 2012. It provides an insight into trends in committed expenditure and borrowing pattern, besides giving a brief account of Central funds transferred directly to the State implementing agencies through the off-budget route.

Chapter 2 is based on the 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 compiles the data collated from various Government departments/organizations in support of the findings.

Audit findings and recommendations
Chapter I
Finances of the State Government

Revenue Receipts : During the current year, the State's Revenue receipts (₹ 38,010.36 crore) increased by 22.65 *per cent* over the previous year. There was increase in Tax revenue (₹ 3,996.91 crore) and Non-tax revenue (₹ 661.39 crore) during the year. The State's revenue receipt as a percentage of GSDP marginally declined from 12.1 *per cent* in 2007-08 to 11.6 *per cent* in 2011-12, which indicates that the growth in tax revenue had not kept in pace with that of GSDP.

Revenue Expenditure : Revenue expenditure recorded a steep growth of 32.83 *per cent* during the year. Of the total expenditure of ₹ 50,896 crore during 2011-12, share of revenue expenditure was 90.47 *per cent* (₹ 46,045 crore). Nearly 70 *per cent* of the Revenue expenditure was incurred on salaries, wages, pension payments, interest payments and subsidies.

Capital Expenditure : During the year Capital expenditure (₹ 3,853 crore) increased by ₹ 489.23 crore (14.54 *per cent*) over the previous year and it accounted for eight *per cent* of the total expenditure of the State. Proportion of Capital expenditure has been much lower as compared to General Category States during 2008-09 and 2011-12.

Investment and returns : As of 31 March 2012, the State had invested ₹ 4,206.43 crore in Statutory Corporations, Government companies, Joint Stock Companies and Co-operatives. The average return on these investments was 1.3 *per cent* during the last five years while the Government paid an average interest rate ranging from 7.2 *per cent* to 7.9 *per cent* on its borrowings during the same period.

It is not uncommon for a State to borrow for increasing its social and economic infrastructure support and creating additional income generating assets. However, increase in non-developmental expenditure like salaries, interest payments, pension and subsidies year after year reduces the net availability of funds from the borrowings for infrastructure development. The State's low return on investments indicates an implicit subsidy and use of high cost borrowings for investments, which yields low return and is not sustainable.

Loans and Advances : Outstanding loans and advances given by the State Government to Statutory Corporations, Government companies and Co-operative Societies was ₹ 9,404 crore, recording an increase of ₹ 943 crore over the previous year. Sixty five *per cent* of the outstanding loan balance was pertaining to Kerala State Road Transport Corporations (₹ 449.51 crore), Kerala Water Authority (₹ 2,410.17 crore), Kerala State Electricity Board (₹ 2,661.65 crore) and Kerala State Housing Board (₹ 617.67 crore). Before release of loans to statutory corporations/

Government companies, Government should review the repaying capacity of these institutions and alternate methods may be considered for releasing funds.

Deficit : All the key fiscal parameters, i.e., revenue, fiscal and primary deficits increased during 2011-12 when compared to previous year. The revenue, fiscal and primary deficit increased to ₹ 8,035 crore, ₹ 12,815 crore and ₹ 6,521 crore in 2011-12 from ₹ 3,674 crore, ₹ 7,731 crore and ₹ 2,041 crore respectively in 2010-11. The ratio of revenue deficit to fiscal deficit increased from 47.5 *per cent* in 2010-11 to 62.7 *per cent* in 2011-12. As a proportion of GSDP, the revenue deficit increased to 2.5 *per cent* and fiscal deficit to 3.9 *per cent* in 2011-12 from 1.3 *per cent* and 2.8 *per cent* respectively in 2010-11.

Increasing revenue and fiscal deficit shows growing fiscal imbalance of the State. Similarly, increase in the ratio of revenue deficit and fiscal deficit indicates that the application of borrowed funds has largely been to meet current expenditure.

Debt Management: Fiscal liabilities at the end of the current year worked out to ₹ 93,132 crore and stood at 28.5 *per cent* of GSDP in 2011-12, which was better than the target of 32.3 *per cent* fixed in the Kerala Fiscal Responsibility (Amendment) Act, 2011. During 2008-09 to 2011-12, the quantum spread together with primary deficit was positive indicating a declining trend in Debt-GSDP ratio. During 2011-12 though the State Government borrowed ₹ 8,880 crore from the market, the net availability funds was only ₹ 4,426 crore. Larger part of the borrowings in 2011-12 could not be used for developmental activities and used for non-developmental purposes only. The maturity profile of debt of the State shows that the State will have to repay 49.6 *per cent* of its debt between one and seven years.

There has been a decline in net availability of funds from its borrowings as large portion of these funds are being used for debt servicing. The ratio of financial assets to liabilities has also deteriorated indicating the greater part of liabilities was without an asset backup. The Balance from Current Revenue (BCR) which plays a critical role in determining its plan size and a negative BCR adversely affects the same and reduces the availability of funds for additional infrastructure requirement.

Monitoring of funds transferred directly from the GOI to the State implementing agencies: Government of India directly transferred ₹ 2,474 crore to the state implementing agencies during the year. But transfer of funds from Government of India to the state implementing agencies directly ran the risk of inadequate monitoring of utilisation of funds by these agencies in the absence of uniform accounting procedures and effective monitoring system. The State Government have to put in place an appropriate control mechanism to ensure proper accounting and timely utilisation of funds flowing directly to implementing agencies through off-budget route.

Chapter II

Financial Management and Budgetary Control

Against the total provision of ₹ 64,271.36 crore the expenditure was ₹ 54,414.63 crore, which led to a saving of ₹ 9,856.73 crore (15 per cent). An excess of ₹ 771.01 crore was also incurred under 17 Grants/Appropriation, requiring regularization under Article 205 of the Constitution. An excess expenditure of ₹ 333.74 crore incurred during 1990-91 to 2010-11 was also not regularized so far. While supplementary provision of ₹ 793.63 crore obtained in 22 cases was unnecessary, re-appropriation of funds in 127 cases was made injudiciously resulting in either unutilized provision or excess over provision. In 39 cases, ₹ 3,020.18 crore was surrendered on the last day of the financial year. Expenditure of ₹ 142.75 crore under 'Special Development Fund for MLAs' was wrongly classified under Capital Section instead of under Revenue Section of the accounts during 2011-12, resulting in understatement of revenue deficit to that extent.

Budgetary control should be exercised in all the departments to avoid cases of budget provision remaining unutilized. Expenditure in excess of budget allocation should be avoided. Excessive/unnecessary supplementary grant and injudicious re-appropriation of funds should be avoided. Budget provision should be made for transfer of Subventions from Central Road Fund, released by the Government of India.

Chapter III
Financial Reporting

The Government's compliance with various rules, procedures and directives was lacking in various departments, which was evident from delays in furnishing of utilisation certificates against loans and grants by various grantee institutions. Delays were also noticed in submission of annual accounts by autonomous bodies and departmentally managed commercial undertakings. There were instances of outstanding cases of losses and misappropriations for which departmental action was pending for long periods. Significant amounts of expenditure and receipts under Central and State schemes, booked under the Minor head '800-Other Expenditure' and '800-Other Receipts' were not distinctly depicted in the State Finance Accounts of 2011-12, affecting the correctness in financial reporting.

The departments should ensure timely submission of utilisation certificates in respect of the grants released for specific purposes to the grantee institutions and the annual accounts in respect of the autonomous bodies to the Principal Accountant General (Accounts and Entitlement), Kerala and the Principal Accountant General (Social and General Sector Audit), Kerala respectively. Departmental enquiries in respect of all fraud and misappropriation cases should be expedited to bring the defaulters to book. Internal controls in all the organisations should be strengthened to prevent such cases. Large amounts received or expended under various schemes should be depicted in the accounts distinctly, instead of clubbing the same under the Minor head '800-Other Expenditure' and '800-Other Receipts' to ensure correctness in financial reporting.