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FINANCIAL CONTROL

The objects of financial control in the words of the First Report of the Planning Commission "are to ensure (i) that no wastage of resources occurs, (ii) that public money is not misapplied and (iii) that for the money spent adequate results are obtained." The system of financial control is enforced by the Ministry of Finance which is a focal point for financial administration and which is assisted by the Comptroller and Auditor General and the Parliamentary Committees namely, Public Accounts Committee, Estimates Committee and the Committee on Public Undertakings. Looking back at the system of financial control in the days prevailing in 1947 when this country was merely a colony of the British Empire, it must be admitted that we have made vast improvements in the methods of financial control. The magnitude of governmental expenditure then was of a small order; apart from the capital expenditure, the revenue expenditure was of the order of Rs. 200 crores only as compared to the expenditure of Rs. 736 crores in the fiftys when the First Five Year Plan was launched or the expenditure of Rs. 2400 crores at the end of the Third Plan.

The considerable increase in expenditure is a consequence of developmental planning which was initiated from 1951 - the first year of the First Five Year Plan. While the aim of the First Plan was mainly to

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rehabilitate the economy from the ravages of war, famine, and partition, the Second Plan stressed the need for industrialisation for which the rate of capital formulation had to be maximised. It accepted "a socialistic pattern of society ". The Third Plan defined the tasks of the next three Plans as laying the foundations of self-reliant economic growth, fuller employment and for ensuring a minimum level of living. The primary goal of economic development is then to increase the national income and in order to achieve it, stress may be made on the following three factors: (i) maximum savings out of the national income, (ii) direction of the savings to investment and (iii) selection of the production type of investments. As regards (i) national savings will not be adequate for the accelerated development of the country and so utilisation of the foreign capital become necessary for obtaining scientific, technical and industrial knowledge and for acquiring capital equipment. With reference to the selection of investments, it may be mentioned that investments can be canalised into three areas, viz., infrastructure or social overhead investments; (highways, transportation, education, etc.); investments for the production of commodities and services and investments for consumption (i.e. parks, gardens). Being given a certain level of investment the object of economic and financial policy must be to determine the best combination of three investments so as to maximise increase in production with a view to increasing the national income.

The Five Year Plans provide a basis for directing investments in the different sectors and the object of financial policy should be the promotion of economic development and accelerating the annual rate of growth.

An idea of the developmental expenditure in relation to the total expenditure in the various States in India for the years 1951-52 and 1966-67 can be seen from the following table:

SHARE OF DEVELOPMENT EXPENDITURES IN TOTAL EXPENDITURE (On Revenue Account)

(Rs. Lakhs)

STATE	1951-52 Total expenditure	1951-52 Development Expenditure	1951-52 % of (2) to 1	1966-67 Total Expenditure	1966-67 Development Expenditure	1966-67 % of 5 to 4
	1	2	3	4	5	6
Andhra Pradesh	3763	1878	50	168,56	107,19	64
Assam	1092	565	52	78,49	50,37	64
Bihar	3283	1761	54	121,97	69,57	.57
Bombay	7575	3686	49	368,08	181,08	49
Kerala	1897	976	51	97,58	68,11	70
Madhya Pradesh	2305	1107	48	132,77	80,72	61
Madras	3314	1905	57	178,00	110,95	62
Mysore	3682	2148	58	136,03	82,11	60
Orissa	1086	606	56	99,94	58,80	59
Punjab	2076	829	40	130,47	71,05	54
Rajasthan	1574	637	40	97,24	54,57	56
Uttar Pradesh	5546	2609	47	252,04	135,56	54
West Bengal	3733	1665	45	185,06	105,39	57
All States	40926	20381	50	2046,18	1175,47	57

Source-Reserve Bank of India.

It will be noticed that the percentage of development expenditure to total expenditure for all States taken together has increased from 50 in 1951-52 to 57 in 1966-67.

One of the pressing problems in a developing economy is the need to keep the non-developmental expenditure and developmental expenditure of a maintenance nature under strict control so as to release larger funds for the plan. In the calculation of financial resources, the assumption made in the draft outline of the Fourth Plan is that the rate of increase in the expenditure on administrative services, and tax collection as well as the non-plan development expenditure will be restricted to 5% per year. In the circumstances existing at present, the Commission is of the view that an even stricter control on such expenditure is necessary if public financial policy is to be of material assistance in achieving the objectives of development and stability. For additional resources mobilisation the draft outline has also suggested that the increase in these expenditures should be restricted to $3\frac{1}{2}$%.

In view of the magnitude and complexity of public expenditure the problems of financial control have become more intricate and the responsibilities of the Ministry of Finance "as the scrupulous guardian of the public purse against the spendthrifts and empire builders in government departments" have become much greater. A sound financial policy has other aspects than that of balance among competing development programmes of expenditure. Financial control prevents extravagance in one sector to enable to have more funds available for essential requirements in another sector of the economy. There has been a tendency to find fault with the methods of financial control - the delay in obtaining financial sanction caused sometimes due to the further details asked for - sometimes not very relevant - in justification of a proposal. While there might be some truth in this allegation, the fault does not seem to lie entirely at the door of the Ministry of Finance. The administrative authorities have also to take a share of the blame as they sometimes put forward proposals not fully supported by data. Consequently, financial control has not been effective. Further, the Finance Minister is just like any other Cabinet Minister and his views on financial matters, control of expenditure, etc. are not given sufficient authority as it should be. The idea, of course, is not to make the Ministry of Finance a 'Super-Ministry'. In order to strengthen the hands of the Finance Minister a convention should be established that his views on financial problems should be given sufficient weight as he has to find the wherewithal to finance the activities of Government. This has become a matter of very grave importance in the present context of rising prices and the imperative necessity for eschewing deficit financing.

The financial implications of all policy has to be considered by the Ministry of Finance before a final decision is taken. This is provided for in the Rules of

Business. Any proposal emanating from an Administrative Ministry having financial implications has to seek the concurrence of Finance Ministry before it can be implemented. Furthermore, proposals before presentation to the Cabinet or its Sub-Committees should either have been concurred in by the Finance Ministry, or if that Ministry has expressed certain views, those views should be incorporated in the paper to be circulated to the Cabinet. It is, no doubt, true that, since the Minister of Finance has ultimate voice on the availability of funds, he should have also a say in the desirability of the proposed expenditure. In fact, the Haldane Committee in U.K. (1918) reached the conclusion that "on the whole experience seems to show that the interest of the taxpayer cannot be left to a spending department." However, the system of centralised financial control was suitable so long as the Government was mainly concerned with problems of law and order but was found unsuitable when the country was faced with problems of developmental planning. The control of the Ministry of Finance conceived as not only for the application of the general financial economic criteria and principles but also for scrutiny of minor details of expenditure was found irritating to the Administrative Ministries. The financial delegation to the administrative authorities were rather negligible and experience was that the execution of developmental projects was sometimes held up due to lack of sanction

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from the Ministry of Finance. To meet the situation steps were taken during the First Five Year Plan to delegate more powers to Administrative Ministries. These powers were further enhanced during the Second Plan. Still it was realised that these delegations did not go far enough and so paved the way in 1959 for the institution of a system of internal financial advisers in each Administrative Ministry coupled with enhanced delegations of financial powers. Here a word about the system of internal financial advisers will be useful. For each Administrative Ministry one internal financial adviser was assigned whom the officials of the Administrative Ministry had to consult on financial matters. There was also a provision that in case of a difference of opinion between the Secretary of the Administrative Ministry and the Internal Financial Adviser such cases should be reported to the Ministry of Finance and the Comptroller and Auditor General. This perhaps acted as a break to the assumption of more responsibility on the part of the Administrative Ministries. This led to further reforms in September 1961. As an experimental measure, further delegations were made to four selected Administrative Ministries. The salient features of the scheme were:- (i) The control of the Ministry of Finance was actually exercised mainly through intensive pre-budget scrutiny of plans and budget proposals and through an adequate system of reporting and test checks, (ii) work study units should be established in the Administrative

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Ministry to assist in laying down norms for particular types of work and (iii) the head of the Administrative Ministry had also the final authority to decide all financial matters after consulting the Internal Financial Adviser. He was given the power to over-rule the advice given by the Internal Financial Adviser. These arrangements were extended in June 1962 to all other Administrative Ministries. Restrictions which were imposed in October 1962 on account of the Emergency were withdrawn in March 1966 and the scheme of enhanced delegations introduced in June 1962 is under operation now. The introduction of the system of internal financial advisers was an important landmark in the history of the relationship between the Finance and Administrative Ministries. It was recognised that the exercise of financial control was a partnership between the Finance and Administrative Ministries. Although every Minister is responsible to the Parliament and public for the conduct of the affairs pertaining to his Ministry and for the expenditure incurred by it, in the discharge of his responsibility, he could take the advice of the internal financial adviser and through him that of the Finance Ministry. In other words, the financial interest of all policies was not only the concern of the Finance Ministry but was also that of the Administrative Ministry. This development was welcome because it will be realized that it was utterly impossible for the Finance Ministry in view of the enormous increase in expenditure due to developmental planning to scrutinize and sanction every item. As Sir William Fisher once said that the Treasury should not act "as the single handed champion of solvency keeping ceaseless vigil on the buccaneering proclivities of the Permanent Heads of Departments" but that the Treasury and Accounting officers should work together as a team in the pursuit of economy in every branch and every detail of the public service." For the success of the scheme the administrative and finance officers have to work as a team. The idea is to "bring into closest possible contact at all levels the finance man and the technical man" so as to "make our finance men just slightly more technically minded and our technical men more financially minded."

The present delegations of financial powers to the administrative Ministries cannot be considered to be entirely satisfactory. It is necessary that the matter should be kept constantly under review and that the areas of responsibility of administrative Ministry should be further widened. In the ultimate analysis the success of any scheme depends on the Administrative Ministries having a financial conscience so that without any prodding from the Ministry of Finance, the cannons of financial propriety are observed. The present scheme of delegations of the Ministries which has been conceived on a uniform basis does not take into account the special requirements of certain Ministries/Departments. The delegations should be on the basis of the felt needs of the department concerned so that they are in a position to go forward without the shackles of unreasonable financial control. The delegations made to the Ministries and organisations thereunder for incurring foreign exchange expenditure should also be reviewed with a view to enhancing the limits to enable the administrative department to go forward with their projects / schemes without any delay.

Budget is employed to lay down fiscal policy and also is an instrument for achieving financial control. The preparation and presentation of the budget to the Parliament is the responsibility of the Ministry of Finance and involved in this process are also the Administrative Ministries, Planning Commission and the accounting authorities under the Comptroller and Auditor General. In view of the enlarged delegation of powers to the Administrative Ministries proper pre-budget scrutiny by the Finance Ministry is an essential feature of the budget process. The items are categorised into non-routine and routine and a time schedule for the preparation and submission of these items is laid down and arrangements are made so that the phased programme is adhered to by all concerned. The entire budget of the Government of India is spread through different demands and the budget under each demand is divided into two parts the standing charges and the new items. The first category relates to items that are of an ordinary type which occurs from year to year and which are known as standing charges. It is in respect of the new items that special analysis and examination is at present done. The Five Year Plans provide the "forward looks" of prospective resources and expenditure for the next five years and also the sectors in which the expenditure will be incurred. Further, the annual plans provide an opportunity for selection of programmes for among competing ones having regard to the policy and objectives of expenditure. The level of investment will have to be related to the resources available year by year. The significant point should be borne in mind that a plan scheme once started will involve expenditure of a recurring nature and cannot be discontinued. The planning of public expenditure is, therefore, one of the important tasks of the budgetary activity having regard to the existing level of current and capital expenditure, the need for expansion of the activities and the provision for maintenance and operation of existing activities and the total resources in sight. While stressing the need for strict control on public expenditure, the draft Fourth Plan refers to 'a functional approach to public expenditure which would involve a systematic review of various current activities in terms of the purposes actually served by them '. By such analysis it will be possible to 'identify expenditure of a non-functional nature and steps taken to eliminate them'. In this connection, the draft plan also emphasises the need for introduction of performance budgeting. This will remedy some of the defects in the formulation and execution of programmes and provide administrative authorities with analysis of expenditures in terms of activities. At the stage of execution, by the aid of performance reporting, linking of physical targets with financial outlays will be possible in order to ensure that the money's worth has been obtained. The performance approach to budgeting will also result in the merging of the standing charges and the new items, if they happen to be part of the same activity. At present the examination of the standing charges is purely from the actuals for past three years, the budget estimates and revised estimates for the current year. In this connection it will be of interest to refer to the zero-based or comprehensive budgeting which require that all aspects of every programme will be reviewed year by year, while in the case of conventional incremental system the examination is with a view to finding increases above some base, for example, the actuals during the preceding fiscal period. No doubt, there might be difficulties and complexities in the comprehensive approach and it is not the purpose of this article to go into them.

Briefly, in the context of our developmental planning, the main economic objectives in examining the budget estimates are:

(i) In the budget there are two components-plan and non-plan expenditure. The policy is to cut down the non-plan non-developmental expenditure what is known as civil administrative expenditure. The administrative and Finance Ministries have an important role in this respect. The Ministry of Finance issue generally guidelines to the effect that there should be a certain percentage reduction in this expenditure.

(ii) All plan programmes to be scheduled for implementation in the budget are included and required financial resources are provided.

(iii) Allocation of resources are made among the different sectors or services on the basis of priorities by the Planning Commission. The twin objects are conservation of resources and their most judicious utilisation.

(iv) Within each sector resources have to be allocated among individual projects. In the selection of such projects for execution important criteria are applied, viz; (a) the techniques of benefit cost studies should be applied, (b) the projects should be quick yielding; projects having long gestation period should be avoided. This is all the more important under the present economic conditions after devaluation, (c) there should be a stress on exports earning projects as the country is badly in need of foreign exchange, (d) in view of the need for additional resources for the plan, projects which are able to pay back capital investment, should be given priority so that their profits should be ploughed back for further investment, (e) evaluation of the costs and benefits of alternative projects should be undertaken with a view to selecting the best alternative (f) the details of total cost with annual break-down, planning of production etc. should be worked out so that the full financial implications are known before the project is sanctioned. Under the technique of performance budgeting for capital projects a'control schedule' is prepared giving details of the total cost for the project, the cost of the various components comprising it, the annual break-down and expected completion date. This will enable the project authorities to plan in advance for equipment and other material inputs and also provide the Government some basis for budgeting the future financial requirements.. The cost-benefit studies will promote economic consciousness and a sense of financial responsibility. The presentation of total cost and cost-benefit analysis will thus help the Ministry of Finance in its task of control expenditure as it could scrutinise the stream of proposals submitted to it by making a value judgement on such proposals on their comparative merits.

After approval of the budget estimates and voting by Parliament the next step is the important stage of implementation. As a result of the enhanced delegation of powers referred to earlier, the Departments of the Central Government are competent to sanction expenditure on any scheme, the total outlay on which does not exceed Rs. 50 lakhs. For the purpose of applying the limit of Rs. 50 lakhs the entire cost of the scheme up to the date of completion (both recurring and non-recurring) including the cost of works the provision for which may be made in another Demand will be taken into account. No doubt, this delegation has been useful, as this will cut out further references to Finance Ministry in those cases where the scope of the scheme is not altered. It is a matter of the highest importance for better implementation of the plan - if the gap between planning and performance has to be bridged - that there should not be any delay in the administrative Ministry going forward expeditiously in the execution of the development plan. In other words, if we want to have an action-oriented administration, the shackles of financial control should not affect the commencement of the scheme. The administrative and Finance Ministries have to work hand in hand as a team with a singleness of purpose. Full benefit of these enhanced powers may not have been realised now, because the administrative attitude of the operating officials who were subjected to strict financial control for a long time cannot be expected to change quickly. Even with the starting of a scheme, in the process of implementation, the operating agencies at the field are likely to experience difficulties in the matter of supply of inputs, establishment matters like officers or staff, or inadequacy of funds, etc. In order to enable the higher echelons in the administration to oversee the process of implementation, periodical progress reports are submitted giving the financial expenditure and the physical progress. These progress reports are useful in locating bottlenecks so that remedial action could be taken in time. The reports also enable to spot excesses and shortfalls in the requirements of funds so that timely action is taken to provide additional funds where necessary and surrender of amounts in cases where funds are surplus. The shortfalls will pinpoint the areas where the plan scheme is behind schedule. Quarterly Expenditure Control meetings are held between the representatives of the administrative ministries and internal Financial Advisers. These meetings consider, among other things, the progress of expenditure indicating the money spent and the balance of the amount in the budget which remains to be spent. The compilation of these amounts are made under each major amd minor head. This is of limited management use as the split-up is in terms of objective-wise classification and is not correlated to activities and so it is not possible to tie up financial expenditure with the activities. In order to serve the needs of the development plan a system of performance reporting has to be adopted which will bring together financial and physical aspects of a scheme together.

In view of the considerable investment in public undertakings (on the 31st March 1965 this was of the order of Rs. 2,000 crores) and also in view of the fact that there should be more effective contribution by the public sector to economic development it is of topical importance to consider the problems of financial control in relation to a project. Broadly, this could be divided into two stages namely, pre-project stage and the post-project stage. At the pre-project stage the project has to be conceived and matters like size of the project, location, processes, the products to be manufactured, etc. considered. Although these matters largely fall within the sphere of an administrative ministry, the financial sanction may be required for incurring expenditure connected with these investigations. In order to avoid infructuous expenditure, it is useful to work out before further work is undertaken, a rough idea of the benefits and costs. Location is of significance as the decision will have to be based not only on economic considerations but also on regional development and other relevant factors. Removal of regional disparity is one of the aims of national planning. Several sites may, therefore, have to be considered. On the basis of these preliminary investigations, if Government is satisfied that they should go forward with the project, a feasibility study id undertaken which consists of two parts - technical feasibility and economic feasibility. For undertaking a feasibility study also financial sanction will be required as the expenditure may not be within the powers of the administrative ministry. It may be necessary to enter into a technical consultancy agreement for the preparation of a feasibility study. This was the case of Dastur and Co., whose services were obtained for the preparation of a feasibility report for the Bokharo Steel Plant. Afterwards the same company was also requested to prepare a detailed project report. In this connection it may be pointed out that in the case of collaboration with East European Countries e.g., Russia, there is generally only one detailed project report which will spell out in detail the quantity of material, equipment, etc., and there is no problem of going out on tenders for the purchase of plant, equipment etc. In the case of other collaboration agreements after further approval of the detailed project report (in some cases it is only called the feasibility report although the study may be as much detailed as a detailed project report), the project authorities have to go out on tender for the purchase of machinery, etc.

As a result of studies and reviews made from time to time the public undertakings have been delegated full powers except in regard to a few items which have to be referred to the Government for sanction. Most important of these items are (1) the appointment to posts on a pay exceeding Rs. 2,500 p.m. (in the case of major companies like Hindustan Steel) and (2) the sanction of capital expenditure above Rs. 50 lakhs for each item. In the case of projects for which detailed project reports have been prepared and approved by Government the project authorities have been empowered to sanction such items in the detailed project report without any reference to Government, even if the actuals exceed the estimates up to 10% of each of the component items. Although it is some time now these powers have been delegated the project authorities have rarely been able to exercise these powers because the itemised detailed project report in all cases has not been prepared and approved by Government. Recently, however, in the case of the Bokharo Steel Plant the total estimated cost of the project of Rs. 620 crores has been sanctioned. For expenditure relating to offside facilities (for which the amount required has been put at Rs. 50 crores) they will have to approach the Government from time to time for sanction. With the total cost approved, the project authority in this case will be free to go forward with the construction of the project without any further reference to Government so long as the actuals do not exceed up to 10% of each of the component items in the detailed project report. This emphasises the point that the project authorities will be able to enjoy full autonomy in the construction stage, if total estimates of cost could be correctly assessed and sanctioned. While on this subject of preparation of itemised detailed estimates for a project, it may be mentioned that experience in the past has been that there is a tendency for an upward revision in the project estimates due to one reason or another. Some of the reasons given are, for example, change in the scope of the project or non-inclusion of certain important items in the project estimates. Whatever may be the reasons it need hardly be emphasised that incomplete estimates will not correctly throw up the results of the working of the projects and will thereby distort the benefit-cost analysis. As a result financial control becomes ineffective. The observations of the Committee on Public Undertakings which are relevant in this connection are given below:

"The upward revision of estimates necessitated by initial incomplete estimates has been the subject of criticism by this Committee and by the Estimates Committee in the past. Estimates of capital investment for setting up a project should, as far as possible, be complete in all respects. The practice of seeking approval of Government bit by bit is misleading. The Committee would suggest that the Government should refuse to sanction incomplete schemes."

"The Committee would also point out that the absence of such (complete) estimates vitiates financial control by Parliament as it does not enable it to look into the economic aspects of the investment on projects which they are called upon to approve. They, therefore, desire that, in the interest of financial control and economy as well as speedy execution of projects, detailed estimates should be prepared and sanctioned before any work is taken up for execution."

The Committee has also suggested that Government should conduct a past review of the reasons for under estimates in the past and issue necessary instructions to all the authorities concerned with the preparation of project estimates. In this connection, it may be mentioned that a check list of the items to be included in the project estimate was issued by the Ministry of Finance in 1960. Based on the findings of review this check list could be further revised so that administrative authorities will get proper guidance for the preparation of the project estimates.

After dealing with the mechanism of financial control in the Government, a reference to the Parliamentary control on finance seems necessary. Briefly, the system of parliamentary financial control applies in three stages; (i) approval of the annual budget estimates by Parliament, (ii) appropriation of funds under the demands as introduced in the Lok Sabha and (iii) supervision and control. At the last stage with assistance of the Comptroller and Auditor General a post-mortem examination is conducted to see that money had been spent in the manner in which it had been authorised by Parliament and in no other way. It seems unnecessary to refer to the important role of the Public Accounts Committee in improving the system of financial management and discipline and observing standards of financial propriety. Mention may, however, be made of the parliamentary financial control on new schemes / projects. It will be a salutary practice if schemes which are complete are only submitted to Parliament for approval. At present the position is that by including a token provision in the budget for a new scheme, the Executive can obtain the approval of Parliament to incur expenditure on it up to any amount, provided funds could be secured by reappropriation; it is not necessary for the executive to approach Parliament again for incurring expenditure beyond any limit. For a better Parliamentary control, it is felt that in such cases Government should again submit for parliamentary financial sanction when the scheme is complete. If the Parliament is not in session, an advance from the Contingency Funds could be secured to meet the expenditure in urgent cases. This procedure will, no doubt, make for better financial control. The Executive will thus be called upon to scrutinise the scheme in all its aspects before submission to Parliament,

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