

# Enhancing CAG's Role in Public Financial Management

Making CAG a part of improving India's PFM can address the governance deficit, say **M Asher, A Patnaik, and S Sheikh**

**I**n a well functioning system of Public Financial Management (PFM), financial reporting and Analysis on the use of resources which concerns the Comptroller and Auditor General (CAG), is an integral part. This is along with mobilisation of resources, allocation of resources according to various priorities, and administration, and control of resources.

## CAG and the Public Financial Management

The PFM must be regarded as an integrated system, as weakness in one part of the PFM can have an adverse impact on the functioning of the other aspects. The weaknesses of government organisations, and of autonomous agencies in performing the other aspects of PFM, particularly in better administration and control of resources, and ensuring that spending is in accordance with priorities, can put undue burden on the supreme audit institution of the country.

The first Auditor General (AG) of India was appointed in 1860. A statutory independent status was, however, given only with the passing of the Government of India Act in 1919. The AG's powers and duties were regulated by the Government of India Audit and Accounts Order, 1936. This continued until 1971 when the Comptroller and Auditor General's (CAG's) Duties, Powers, and Conditions of Service Act were passed by Parliament. Earlier, the CAG had the mandate to undertake only expenditure audit, but in 1961, the scope of the CAG's work was extended to revenue audit as well. Thus, recent activities of the CAG include system-oriented performance audit of the Value Added Tax (VAT);

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and extent of preparedness to shift to Goods and Services Tax (GST).

The current Constitutional responsibility of the CAG is to provide Parliament and, through it, to the citizens, independent assurance on the way in which the government has used and accounted for funds voted by Parliament and on the examination of the tax system. The CAG's mission statement reads: "Mandated by the Constitution of India, we promote accountability, transparency, and good governance through high quality auditing and accounting, and provide independent assurance to our stakeholders, the Legislature, the Executive and the Public, that public funds are being used efficiently and for the intended purposes." (<http://www.cag.gov.in/html/unionaudit.html>).

Various reports of the CAG of India have played an important role in the ongoing debates on weak governance and corruption in the country. CAG's reports on the 2G spectrum allocation; fertilizer subsidies; schemes under Mahatma Gandhi National Rural Employment Guarantee Act (MGN-REGA), and others, have lent much

needed substance, and quantitative basis to these debates.

It is, therefore, lamentable that high level policymakers of the UPA government, including the Prime Minister, and the political operatives of the Congress Party, have given priority to short term requirements of narrow partisan politics over longer term national interest, by publically questioning CAG's commendable efforts to fulfil its Constitutional role. The Prime Minister's criticism of the CAG for holding a press conference is particularly deplorable as it ignores that the citizens are explicitly stakeholders in fulfilling the CAG's responsibilities and that press conferences have been a part of CAG's external communication policies for the last several years.

The policymakers should realise that policies and their administration or implementation cannot be neatly de-linked from each other. Indeed in public finance literature it is well accepted that in many situations, tax administration is tax policy. The standard excuse that policy was 'good', but implementation was not, lacks merit. This is a lazy, unscientific basis for designing public policies or schemes, where prior assumptions and ideology trump empirical evidence and good sense.

A policy should take current and prospective institutional and organisational capacities into account. Without it, policy objectives will be difficult to achieve.

While it is indeed the prerogative of the executive branch of government to design and implement policies, the CAG's role in analysing both the transactional integrity and the extent to which programmes or schemes under these policies can achieve better out-

puts and outcomes with given outlay of budgetary expenditure should also be recognised. Indeed the CAG has increasingly been emphasising the performance or value-for-money (VFM) audit, where the economy (input per unit cost), efficiency (output per unit input), and effectiveness (outcome per unit output) of an activity are assessed, and this trend needs to be encouraged.

## Enhancing the effectiveness of CAG

To enable the CAG to pursue its role in India's PFM with greater effectiveness, there are several measures which merit consideration.

First, CAG is an external audit institution which follows international benchmarks. It can play its role better if internal audit functions of the covered government organisations are strengthened. This is the responsibility of the executive branch at all levels of government. If the internal auditing function is strengthened, considerable efficiencies can potentially be attained at a much earlier date in the policy cycle. This will also help reduce over reliance on the CAG. The executive branch should be required to be transparent and accountable about the measures which are designed to strengthen internal auditing. Establishing internal controls and ensuring proper organisation in autonomous government agencies such as universities, port trusts, and organising committees of events such as the 19th Commonwealth Games could well reduce the auditing burden of the CAG, strengthening public finances.

Substantial experience in countries whose supreme audit institutions have been undertaking performance audit can provide a solid foundation for learning for India's CAG. Activities of the International Organisation of Supreme Audit Institutions (INTOSAI) can facilitate such learning and knowledge sharing on a regular basis. Though details of government schemes and contexts differ across countries, collaboration with relevant supreme audit institutions abroad can help CAG in establishing public service delivery benchmarks for India.

Second, the current CAG Act

enacted in 1971 requires modifications. Currently, only the government agencies, and bodies substantially financed from the Consolidated Fund are included within the purview of the CAG. However, changing the focus of the CAG Act from funding to governance, needs to be considered.

The current CAG Act creates ambiguity concerning the auditing requirements of certain urban and local bodies, Development Authorities, Special Purpose Vehicles (SPVs), and those involving Public Private Partnerships (PPPs). As India becomes increasingly urbanised, and as the role of Development Authorities and PPPs among others, increases, their inclusion in the CAG Act to ensure that significant proportion of the expenditure does not escape auditing requirements merits serious debate.

Furthermore, extending the CAG's jurisdiction to government appellate authorities deserves deliberation. Thus, if officers like the Commissioner Appeals of income, customs, and excise taxes, and Tax Tribunals are brought under the CAG, potential tax revenue can be better tapped. As an example, the decisions of ITAT (Income Tax Appellate Tribunal), the highest fact finding body, cannot be challenged to higher judiciary, except on questions of law. Any error in ITAT's decision, whether deliberate or inadvertent, can result in potential loss of tax revenue. If ITAT and similar bodies are brought under the CAG, such an outcome can be mitigated.

Increasingly, government activities are requiring greater vertical and horizontal coordination among multiple government and quasi-government agencies. A case in point is the 19th Commonwealth Games (CWG) held in Delhi in 2010, which required more than 30 departments and, or, agencies to work together. In such a scenario, the role of a central auditing agency that ensures accountability increases. The auditing need not be necessarily undertaken by the CAG.

There is provision under section 619(4) of the Companies Act for private auditing firms to undertake the audit function of certain public sector organisations, such as the PSUs. How-

ever, these audits are supplemented by a CAG audit; and the performance audit is undertaken by the CAG.

Whether the key infrastructure organisations such as power and water utilities, even if privately owned, be subject to the above section of the Companies' Act is an issue requiring further reflection and debate.

The CAG sent specific proposals for amendments to the Act in 2010. These were in areas concerning the speed at which government departments respond to audit requests, mandatory disclosure of final audit reports, and clarifications on the CAG's powers to audit new forms of government activity and currently uncovered organisations. These will include PPPs, urban development bodies, and SPVs whose activities involve government expenditure or may give rise to contingent fiscal liabilities.

However, the government has been silent on these proposals. It is time that public pressure is brought to bear on the UPA government to reform the current CAG Act providing greater independence and powers to enforce compliance to the CAG.

The Westminster audit model, adopted in India, does not allow the supreme audit institution to impose its recommendations directly on the executive. This a crucial factor which distinguishes this audit model from the Judicial or Napoleonic audit model where audit courts can legally enforce recommendations. The courts are completely independent of the legislature and executive; and have judges as their members, who judge the legality of actions of Finance Ministry officials based in line ministries and other government bodies, and accordingly administer sanctions.

The Judicial Audit Court model is present in France, Spain, Italy, and the Francophone countries in Africa and Asia and Latin American countries including Brazil and Columbia.

While there are advantages and disadvantages associated with each of the above two models, there is merit in the argument that the ultimate effectiveness of the CAG office in India hinges on the willingness of the legislature to hold the executive

answerable.

As a result, the issue of giving quasi-judicial powers to the CAG needs to be deliberated further. In this context, the powers given to the AG for tackling financial losses in the Orissa Co-operative Societies (OCS) Act of 1962, as amended in 1991 and 2004, and laws governing audit of local bodies under the Local Fund Act in most states, deserves a thorough study.

The OCS Act thus provides for summoning and enforcing the attendance of any person and to examine him on oath or affirmation, and to compel production of records by various departments. There is also provision to file criminal cases in some circumstances; and to initiate what are called 'surcharge proceedings' to recover the loss caused by officials of co-operatives. This is a civil procedure but is fairly powerful.

Third, the audits undertaken by the CAG are classified as either regulatory or performance audits. However, while assessing 'performance' or VFM and in particular, when judging 'effectiveness' of a government programme, the CAG will have to be mindful of the thin line of difference between passing an opinion on policy implementation and on policy making.

Fourth, the arrangements for the CAG to play an advisory role when a large programme or a scheme is being designed or implemented, also merit debate and consideration. As an example, the ambitious and expensive Aadhaar programme being implemented by the Unique Identification Authority of India (<http://www.uidai.gov.in>) led by its Chairman Nandan Nilekani, can lend itself to CAG's advisory role. The danger of such an advisory role, however, is that the concerned public sector department might hold the CAG responsible for decision making. Therefore, a possible ex-ante advisory role of the CAG's office should include suggesting measurable indicators or targets to judge a programme's success or failure, hence making it more 'auditable' and reducing disputes between the executive, ministers, and the CAG's office that may arise at the time of audit.

The CAG can also give crucial ad-

vice on timelines for various stages of projects. Timelines can help link policy-making and policy-implementation and aid audit at a later date while assessing actual progress.

There have been proposals to include Audit officials in the appraisal committees of plan schemes; and for the provision of VFM audit to be built in the plan schemes of the Planning Commission. These deserve serious consideration.

The importance of the above can be highlighted while considering CAG's report on the Railways which noted that projects of the Indian Railways sanctioned 15-20 years ago are still incomplete leading to high economic costs, including opportunity cost of time to the country. The Railway Minister and the Railway Board should be made accountable for acts of omission and commission which impose high and inequitable burden on the citizens. The Indian Railways must also realise that 'policies designed in the name of the poor, are most often poor policies'.

Additionally, the CAG can compare and contrast government projects within the same sector to emphasise on factors contributing to success and repeated oversights and wrong doings. This has been specifically done by the CAG report wherein the 19th commonwealth Games held in Delhi in 2010, and Commonwealth Youth Games of Pune are audited together.

Fifth, the CAG's work is often constrained by poor quality of data, and limited data management and data mining capabilities of the government organisations. Data limitations are particularly crucial in the case of VFM audits because if data is missing on inputs and cost of procurement, or if data is not provided in a timely manner, auditors will be unable to express an opinion on efficiency and effectiveness of the policies and programmes. Hence, it is of utmost importance that the CAG auditors exercise adequate due diligence in accepting the accuracy, integrity, and completeness of such data before using them for analysis. This needs to be clearly brought out in CAG's report at the beginning.

In this context, it is encouraging

that the Rural Development Ministry has recently expressed interest in its programmes and schemes being audited by the CAG. It is hoped the CAG will be encouraged to undertake VFM audits as well. The Ministry can also consider involving the CAG at an earlier stage of its policy and programme cycles; strengthening its data gathering and monitoring systems; and improve its internal financial management and auditing skills to realise maximum benefit from CAG's expertise.

Sixth, the role of the Public Accounts Committee (PAC) and the Committee on Public Sector Undertakings (PSUs) (<http://parliamentofindia.nic.in/ls/intro/13.pdf>), which are representatives of the legislature and question the executive based on audit reports submitted to them by CAG, also need to be strengthened and made more active with particular emphasis on ensuring accountability. That no one has been held responsible for the current state of affairs at Air India, and at the oil PSUs strongly suggests the need for this, with emphasis on answerability. This is crucial because in the Westminster audit model adopted in India, the CAG cannot impose its recommendations on the executive. In other words, the ultimate impact of the CAG's work depends on the keenness of the legislature to participate and engage with the findings and recommendations of audit reports, fix responsibility and take punitive action. Indifference to such recommendations of the PAC should be treated as 'legislative contempt', much the same as 'judicial contempt'. Time has probably come for such a reform.

Seventh, the CAG has an important role at the state level as well. In 1976, the CAG was relieved of the responsibility of keeping the accounts of the union government but not of the state governments. This implies that the accounts of the states continue to be compiled by the State Accountants General (SAG) under the CAG. In 2009-10, states accounted for more than half the expenditure of the central and state governments combined.

This suggests an urgent need to revamp the role of PACs of the

state legislatures. Their deliberations should be made public, and perhaps be considered for live telecast to assist in wider dissemination and public accountability. It might also be suggested that the SAGs be given legal status to strengthen their position and reduce the legal burden of the CAG. The states can more over benefit from CAG's expertise by involving them in an advisory role at earlier stages of policy and programme.

As India's GDP continues to rise, even if government expenditure to GDP ratio remains constant, the budgetary revenue and expenditure will rise substantially in absolute amounts. India is fiscally severely constrained, with high propensity for disregarding fiscal probity and discipline.

The casualness with which the current UPA government has set aside the targets of the Fiscal Responsibility and Budget Management (FRBM) Act of 2003; and the manner in which the National Advisory Council (NAC), an extra-Constitutional body of civil society activists, aligned with the Congress party, which is the dominant party in the current UPA government, has been permitted to influence adoption of fiscally unsustainable and economically unsound policies and schemes in the country are worrisome.

India's combined fiscal deficit is over 10 per cent of GDP and its debt to GDP ratio exceeds 80 per cent. Wasteful expenditures and opportunity costs in terms of lost revenue of policy decisions (such as in 2G, 19th Commonwealth Games, and Dabhol Power Plant) bear ample evidence of a lack of fiscal probity.

The strong fiscal discipline and probity are essential in an environment where sovereign default risk, often reflected in high risk premiums paid for rolling over government debt have become the new normal.

In spite of (some would argue because of) large scale social schemes of the UPA government which it erroneously regards as substitutes for substantive economic reforms, have predictably led to minimal job creation in recent years. Thus only 2.6 million jobs were created between 2004-05 and 2009-10, as compared to planned

50 million jobs, and the prospects are not encouraging.

Eighth, the CAG also needs to undertake organisational reforms, designed to vastly improve its human skills and capacities comfortable in operating in sophisticated technology-enabled work process and environment; and one which is in tune with global developments in accounting, auditing, and VFM analysis and techniques. As with the overall civil service composition, the CAG currently has too few officials in 'A' and 'B' level positions among its 60,000 strong staff. Indeed the CAG has only around 500 officials from the Indian Audit and Accounts service.

As CAG increasingly focuses on the VFM or performance audit, the restructuring of the organisation, particularly augmenting the number of officials at middle and higher levels, is urgently needed. The staff will need to be multi-skilled with professionals from diverse fields, each of whom is equipped with unique skill sets, rather than having only accountants. The CAG needs to involve outside domain experts right from the initiation of crucial and complex-domain VFM or Performance Audits for increased accuracy and acceptability of its recommendations.

## Concluding remarks

An important aspect of India's large governance deficit is the weak integration between the various components of the PFM. Of its four components, financial reporting and analysis on the use of resources most concerns the CAG. The other components are mobilisation of resources, and allocation of resources. Greater competence in the other components by government organisations can help in reducing the extraordinary burden the CAG is currently shouldering.

This article has indicated several measures which can enhance CAG's effectiveness and help it to integrate better with the other components of the PFM. There is a strong case for expanding CAG's role and powers, especially concerning poverty, health, and education programmes, which are largely implemented through lo-

cal bodies and currently outside the purview of CAG.

Aspirational politics, combined with new technology of social media have increased the urgency of ensuring that the taxpayers' money is spent judiciously, and the revenue generation process is sound. As India's supreme audit institution, the CAG can act as an independent body capable of providing greater assurance to the general public that the above concerns are being addressed.

The above will require change in the current mind-set of those in charge of governmental organisations, and revamping of governance structures. The recommendations of the Administrative Reform Commission should carry much greater weight than is the case currently.

Addressing India's governance deficit will require that those in positions of responsibility in all sectors, political, economic, and civil society organisations, strive to deserve trust of the society. Deserved trust requires both competence and integrity, with a sense of public shame. That there has been large deficit in deserved trust among those in position of public responsibility has been in evidence in ample measures.

Indian citizens deserve much better. Making CAG an integral part of improving India's Public Financial Management (PFM), while improving all components of the PFM could assist in addressing India's governance deficit, while strengthening its public finances. ■

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