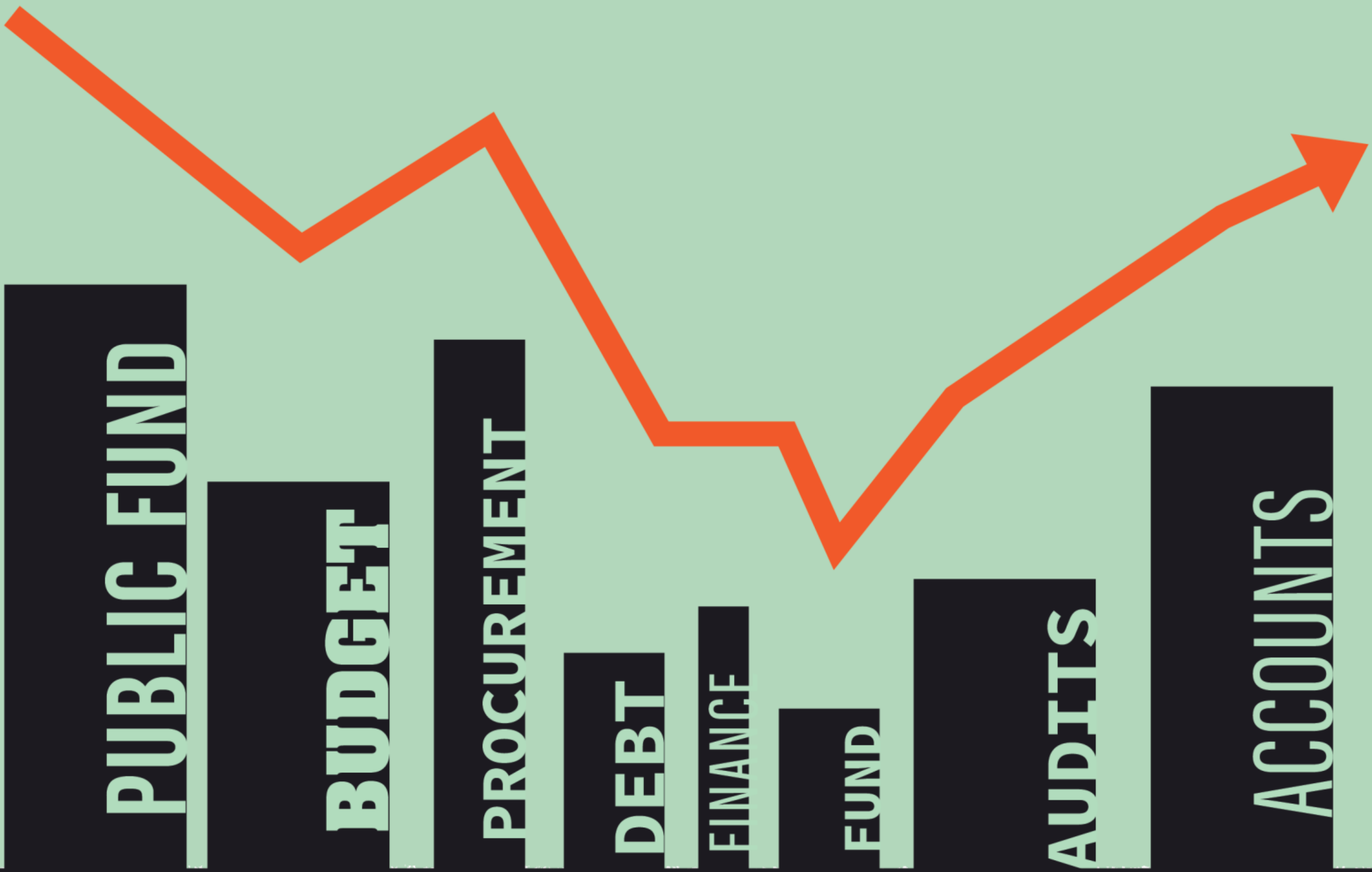
PUBLIC AFFAIRS CENTRE
Committed to good governance

Online Training on

Understanding Public Finance

January 13, 15 and 16, 2021



Delivered to Participants from

Department of Public Enterprises
Government of Karnataka

Online Training

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(Report)

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Preface

Public Affairs Centre (PAC) engages in action research focussing on Sustainable Development Goals (SDG) in the context of India. PAC is a not for profit Think Tank established in 1994 with a mandate to improve the quality of governance in India. The Centre is also a pioneer in deploying innovative Social Accountability Tools (SAT) to measure the quality and adequacy of public services. Over the years, its scope of work has expanded to include the whole gamut of research-advocacy-action to lead evidence-based research on governance across sectors, geographies and populations in India.

PAC was one of the first civil society-led institutional initiatives to mobilise demand for good governance in India. Dr. Samuel Paul (Founder Chairman) was instrumental in establishing PAC with a select group of friends. PAC is registered under Karnataka Societies Registration Act 1960 as a Society.

Designing and Editing by: PEC

Disclaimer

While every effort has been made for the correctness of data/information used in this report, neither the authors nor PAC accept any legal liability for the accuracy or inferences for the material contained in this report and for any consequences arising from the use of this material.

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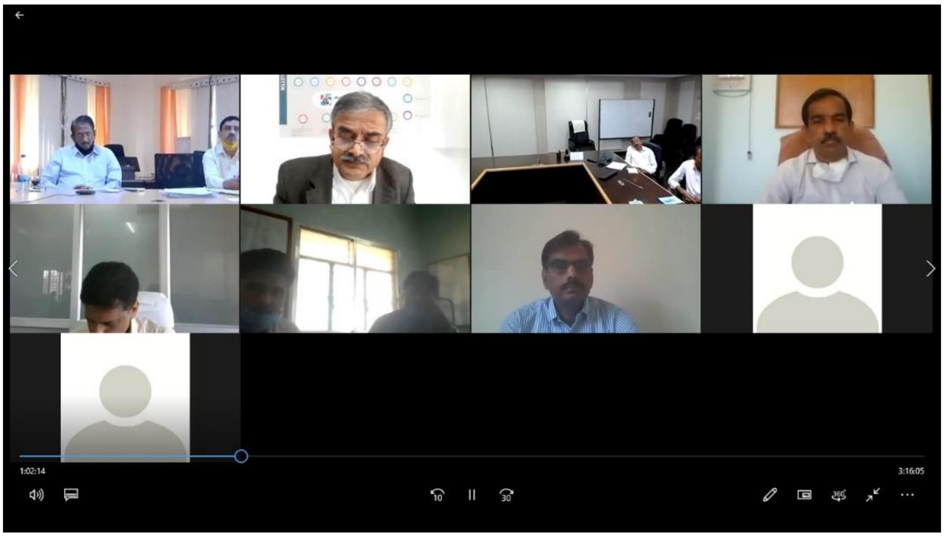
Introduction

On invitation from Department for Public Enterprises, Public Affairs Centre (PAC), conducted a three-day workshop on Public Financial Management. The meeting was attended by executives (annex 1 for list of participants) nominated from KSPAML, KFDC, BMTC, KSSC, KPTCL, NWKRTC and KSMCL.

The training on Public Finance Management (PFM) was conducted by G. Gurucharan - Director, Public Affairs Centre. It had 6 modules (refer annex 2 for details on module) covered various aspects of PFM like introduction to PFM, government budgeting, components of internal control, etc. At the end of the training, all participants were made to take a knowledge quiz (refer annex 4 for the questionnaire)

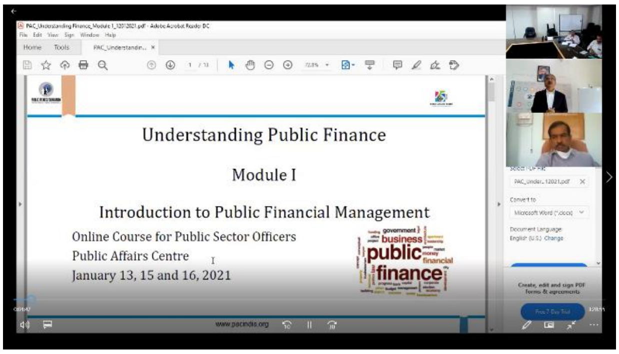


Day One

Introductory discussions

The session began with introductions from participants and the trainer. Before getting into the modules, the trainer offered a brief overview to Public Financial Management (PFM). PFM is essentially a balance between public income, public expenditure and public debt. It requires creating a balance between growth, equity and sustainability based on principle of maximum social advantage. The trainer then introduced the issue of resource constraint and how to deal with expenses within this constraint; thus, introducing the importance of PFM.

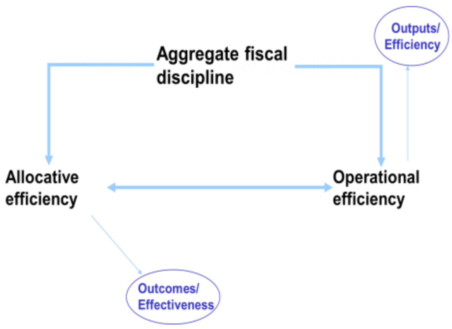
Module 1: Introduction to Public Financial Management



This module gave an overview of Public Financial Management (PFM). The key concepts of PFM like strategic planning, Medium Term Fiscal Framework, Revenue Deficit and Fiscal deficit were introduced. This was followed by an introduction to the objectives of PFM.

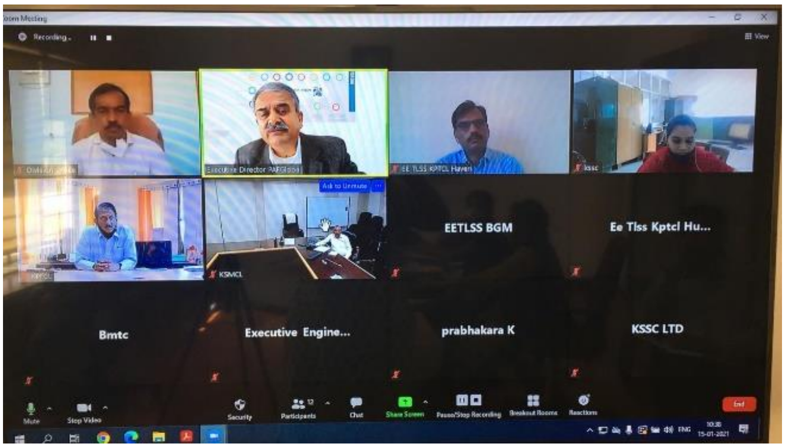
PFM is an instrument to deliver public policies. It helps in:

- **Maintaining aggregate fiscal discipline -** Maintaining balance between revenues, expenditure and public debts.
- **Ensuring allocative efficiency -** Allocating and spending public resources in an optimal manner such that the outcomes of the government policy objectives are maximised.
- **Enabling operational efficiency** - Ability to make efficient and effective use of resources in the implementation of strategic priorities.



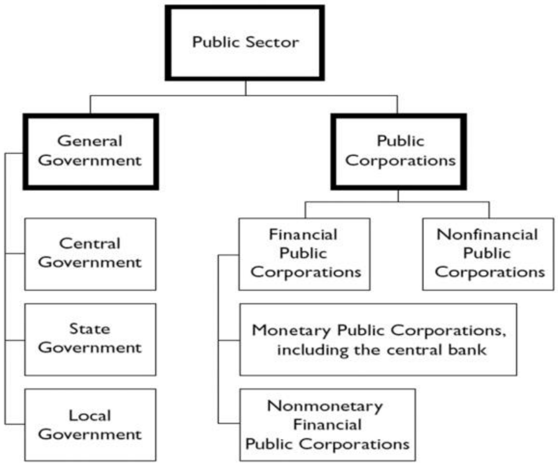
Limitations of PFM

PFM cannot stop corruption. However, several tools that are implemented as a part of PFM creates more accountability. It helps in identifying where there are failings. The various systems also help in curbing administrative corruption. PFM processes should aim to establish rule-based management, as opposed to discretionary decision-making. Following set standards and procedures makes it difficult for individuals to engage in fraudulent activities. Attention should be also paid to external (to the executive) control.



The module introduced internal tools (cost benefit analysis, revenue forecasting and project monitoring), financial implementation (cash management, bank reconciliation statement update) and financial reporting (debt capacity analysis, prime areas of income/expenditure, inventory management).

Module 2: Government Financial Management



The Government accounting system in our country is rule based and follows primarily, cash basis accounting

In India the accounting policies followed by Government entities are outlined in the Government Accounting Rules (GAR) and the General Financial Rules (GFR). These set out the guidelines to be followed the government entities accounting for any receipt or expense or receipt.

The Comptroller and Auditor General (CAG) of India has constituted Government Accounting Standards Advisory Board (GASAB) that oversees Government Accounting.

The preparation of government accounts in India is governed by the Government Accounting Rules, 1990 framed under Article 150 of the Constitution of India. As per the Government Accounting Rules, 1990, the accounts are to be kept on Cash basis

IPSAS standards for Cash basis of accounting (popularly known as Cash IPSAS) prescribe the manner in which the financial statements are to be presented under the cash basis of accounting.

Rule 23 of the Government Accounting Rules prescribes the form of accounts to the prepared which shall include the receipts and disbursements for the year. The accounts prepared in this manner are certified by the CAG. The report of the CAG is then passed in the legislative assembly.

Case Study

The trainer used the example of the recent scam in the Karnataka Agricultural Marketing Board where an official employed there and a private bank employee allegedly siphoned off Rs 48 crore in public funds to help understand the importance of standard procedures, internal controls and internal audits.

The trainer used the example of an anganwadi in Maharashtra where supplementary nutrition that were privately procured were diverted to poultry farms to feed chicken it was found that the number of children enrolled in the anganwadi was much lesser than that shown in official records. This case study was used to help explain the need for internal controls, procedural methods and regular evaluation of the number of beneficiaries.

Day Two

Recap of Day 1

Broad areas covered	Sub-topics	
PFM deals with	Public revenues	Delivery of goods and services
	Public expenditure	
	Borrowings/ debts.	
Objectives	Controlling aggregates/ totals and balancing the budget	
	Allocative efficiency	
	Operational efficiency	
	Transparency	
Internal controls and Internal audits	Cash Management	
	Inventory Management	
	Procurement	
External Audit		
Accounting and Reporting	Balance Sheet	Assets – Liabilities and Equity
	Income Expenditure statement	Revenues/ Expenditure Profit or loss
	Cash flow statement	Operating Cash
		Investing Cash
		Financing
Medium Term Fiscal Framework (MTFF)	Expenditure	Controlling Fiscal Deficit and Revenue Deficit
	Taxes	
	Borrowings	

Introductory Discussions

Internal controls act as barriers to political interference. The trainer stressed on the importance of regular monitoring and evaluation, risk assessments, control activities and Management Information System (MIS).

Day 2 Training on Understanding Public Finance for Department of Public Enterprises, Government of Karnataka

Tips:

Practical ways to implement basic control systems:

1. Separation of duties- For example, the person sanctioning the fund should be different from the person issuing the fund should be different from the person conducting internal audits. For transfer of large amounts of money, bring in double check systems like double signatories on cheques for release of funds.
2. Assets audits- Regularly compare stock books and actual stock in store rooms/ field and in transit. Constantly conduct a stock check on all movable and immovable assets.
3. Use standard templates while reporting – This would make it easier to compare and analyse. It also gives greater control over what data is generated.
4. Procurement – Mandate a standard procedure for procurement, delivery of the goods procured and in payment of bills. This would ensure transparency.

Module 3: The Budget Process

This module covered the budget process: Preparation of Budget > Passing of Budget by Legislature> Budget Implementation > Budget Accountability.

Budget preparation is a multiannual framework. The various stages in budget preparation are:

- Setting the macroeconomic and fiscal policy framework
- Estimating Revenues – Tax and Non-tax
- Setting initial ceilings for expenditure in the aggregate and by sector
- Submission of detailed budget requests
- Approval of the budget by the legislature.

Budget Execution

- The budget should be executed in compliance with the authorizations provided in the law.
- During implementation, unforeseen changes in the macroeconomic environment, like natural disasters, may require reallocation of funds.
- Resolving shifts in priorities during execution should be transparent and in compliance with the law.
- Public procurement efficiency is another important aspect of budget implementation.

Treasury and Cash Management

Treasury and cash management would help assess liquidity and gain understanding on financial standing of the organisation. It also helps in managing unexpected revenue and expenditure more efficiently.

Performance-based budgeting

Performance-based budgeting (PBB) aims to improve the efficiency and effectiveness of public expenditure by linking the funding of government organizations to the results they deliver. This would help prevent the common problem of underestimation of expenses and overestimation of budgets.

Accounting

Account reports communicates financial results and the financial health of an organisation by means of financial statements. Public sector accounting can be classified into two main systems: cash-basis and accrual-basis. Of these, accrual-basis accounting is more complex but offers a more complete picture of PFM.

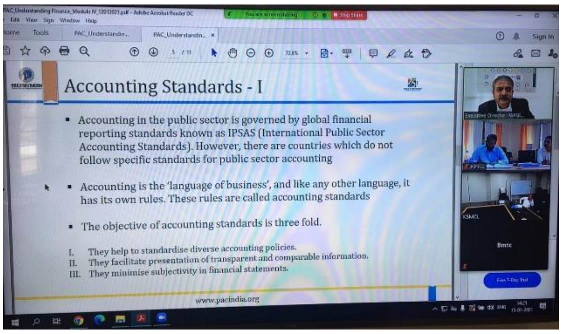
The module concluded with a case study based work for participants that helped them understand the concepts earlier mentioned in the course of the module.

Module 4: Public Sector Accounting

This module dealt with Accounting Standards. There are two main accounting systems: Accrual basis and Cash basis. Accounting in public sector is governed by a global financial reporting standard called IPSAS (International Public Sector Accounting Standard).

Objective of accounting standards is three fold. It helps in:

- Standardising diverse accounting policies.
- Facilitating presentation of transparent and comparable information.
- Minimising subjectivity in financial statements.



Financial and Accounting reports

- Annual budget - Issued at or near the beginning of a fiscal period to reflect the legally approved annual budget.
- Budget execution report - It is issued at the end of the fiscal period to reflect the actual use of resources compared to those resources that had been approved by the legislative body.

The module also stressed on the importance of management reports submitted by statutory auditors which highlights systemic problems in financial reports and the failures in internal controls.

Case Study

The trainer used a case study of Mysore lamps (refer to Annexure 3) to help participants understand how PFM tools can be used in practical scenarios. It focused on the importance of adequate controls even over the top management, importance of controlling totals and maintaining a rule based system.

Day Three

Recap of Day 2

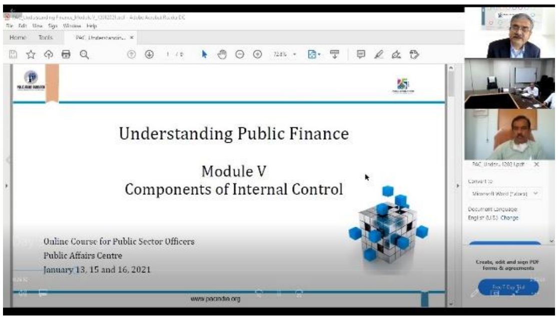
Broad areas covered	Sub topics
Components of Internal Control	Control Events
	Risk assessment
	Control Activities
	Information and Communication
	Monitoring
Internal Control Activities	Separation of duties
	Assess controls
	Asset Audit
	Templates
	Reconciliation
Budget Process (Multi-year Framework)	Estimating revenues
	Projecting expenditure
	Setting ceilings
	Budget Execution
	Importance of authorisation
	Flexibility to make changes
	Transparency
	Compliance with law
Importance of Procurement and Inventory management	Rule based
	Verification of stock
	Queuing system
Importance of Cash management	Liquidity
	Surplus investment
	Reduce borrowings
Performance based budgeting	Cost-benefit analysis
	Project monitoring and evaluation
	MIS – Exception Analysis
Accounting systems and standards	Cash basis and Accrual basis
	Receivables and Payments
	Depreciation of assets
Internal Audit	

Discussion question:

How to decide budget provisions, priorities, etc.?

The main issue with budget preparation is spillage of projects to the consecutive year because adequate budget was not allocated to the project. Follow principles of cost-benefit analysis for every project. Before fund allocation, determine a fixed period in which the project completion is anticipated. For example, say 300 metre electricity line will be completed in 2 years. Second way is to follow queuing system. The project that was first formulated should be prioritized and completed first. This would prevent spillovers. Try to not add new projects unless old projects are completed. With respect to maintenance, unplanned breakdowns may occur. Establish a system for such procedures that are transparent and rule bound.

Module 5 - Components of Internal Control



This module offered a deeper dive into the five interrelated components of internal control -

- Control environment,
- Risk Assessment
- Information and Communication
- Control Activities
- Monitoring.

The module then offered insights on how to read a balance sheet. Irrespective of the position one holds within an organization, he/she should have good control over three documents - cash flow statement, Income Expenditure statement and Balance Sheet.

Using information from the above documents, ratio analysis (a quantitative analysis method using data) must be undertaken to analyse the performance of organisations over a period of time. Ratio analysis helps assess operational efficiency, profitability, liquidity.

Some of the important ratios used in ratio analysis are:

Debt: Equity ratio - It is calculated by dividing total liability by shareholder equity. Higher operations financed by own fund signifies better financial health; and, vice-versa.
Efficiency ratio - It is calculated by dividing net credit sales (non-cash) by average receivables. It offers insights into whether one should stop giving credit sales.
Liquidity ratio - It is calculated by dividing current assets with current liabilities. If the ratio is greater than or equal to one, it is of lower risk. If the ratio is greater than 1, it means it is of higher risk.
Operating margin ratio - It is calculated by dividing operating income with net sales.

Tips:

Develop financial modules using excel based on cash flow statement, income expenditure statement and balance sheets.

Step 1: Include three-year financial data from the documents
Step 2: Calculate the ratios mentioned above.
Step 3: Based on nature of work, makes assumptions about factors that would impact your operational efficiency. (e.g. Impact of lower industrial consumption due to COVID-19 on electricity board)

Internal Audits

While internal controls are parts of preventive actions, internal controls give insights into why internal controls failed due to inefficiency or fraud. Internal controls have to be conducted by an objective and independent entity who reports to someone outside the organization. It has to be conducted in a systematic and disciplined manner. The two models of internal controls are: centralised model (reports to the centrally located Finance Department) and decentralised model (reports to head of institutions).

External Audits

External audits are conducted by the Comptroller and Auditor General (CAG) which is the supreme auditing institution of India. CAG is legally unanswerable to the Government of India. Responsibilities of CAG includes:

- Responsibility for accountability
- Ensuring maintenance of accounts according to standard procedures and templates.
- Reporting to the parliament/ judiciary whether or not public funds are used properly following due diligence.

There are three kinds of audits: Compliance audit (ensures statutory compliance), Financial audit (focuses on whether or not financial reports adhere to standards/ prescribed laws) and Performance audit (evaluates whether expenditure is economic, efficient and effective).

Tips:

Have a brief discussion with auditor in order to:

1. To help auditor understand the functions of your institution.
2. Assure transparency
3. Discuss audit observations before audit para.

Module 6 - Government Budgeting

The primary goal of government budgeting is economic growth, sustainability and equity insurance. Expenditure planning is difficult because of competing demands. The annual financial statement, better known as budgets, are a forecast of projected revenues and projected expenditure.

The budget allocation is based primarily on principles of equity and efficiency. Based on these principles, the finance commission determines how much money is transferred to different states. While preparing budgets, the following three steps can be followed to create more efficient plans.

Step 1: Categorise your activities into:

- Projects that were once relevant but are irrelevant now.
- Activities/projects that other organisations do, therefore multiplicity.
- Any new activities/projects that should be undertaken by the organisation.

Step 2: Scheme mapping

- Discontinue schemes/ projects that have lost relevance
- Discontinue schemes/projects that other organisations have taken up.
- Continue schemes that do not fall into the above two categories.

Step 3: Rationalisation of schemes

- Reduce all schemes into broad themes and reduce into seven or eight core schemes.
- Show savings from schemes that were discontinued.
- Based on the savings, propose new schemes. Less number of schemes means more allocation of funds per scheme.

- Categorisation of schemes under broader themes allows greater flexibility for fund allocation.

Tips:

Reduce budgetary allocation for low priority schemes. Zero or nominal allocation can be given to such projects.

Do not take works you cannot do. Define overall ceilings.

Discussion Questions

What are the elements to be considered in preparation of budgets?

The most important point to be kept in mind is balancing the budget. Stop overestimating revenues. Overestimating revenues would lead to shortfall in revenue. If your plan shows requirement of Rs.75 crores, ask for Rs.100 crores. Try to be conservative about your revenues and aggressive about your expenditure.

Always maintain a state of progress report for projects. Periodically examine whether the project is compliant to the plan. If the project does not show expected progress, treat it as a dead investment and close it for the time being.

Conclusion

PFM helps in:

- Balancing the three conflicting goals of growth, equity and sustainability.
- Defining roles and responsibilities.
- Offering predictive analysis for future improvements.
- Offering a basis for resource allocation.

What is the importance of the participants in PFM

- Believe in the importance of work one does as a government employee handling public money.
- Believe in the importance of your individual contribution in that work.
- Understand the importance of following standard procedures and be aware of the rules.
- Strive for excellence in your work using data analytics and evidence based research in your work.

Annexures

Annexure: 1 (List of participants)

Sl no.	Name (Mr/Mrs)	Designation	Department
1	Mallappa. B	A.O.	KSPAML
2	Abhilash Kumar	Accounts Officer	
3	Nagaraj Hiregoudar	Agriculture Officer	
4	Sheelavati	Computer Operator	
5	Nithin Kumar	Accounts Assistant	KFDC
6	Manoj Kumar		
7	Vijayalakshmi Hiremath	Dy.CAO(I/c)	BMTC
8	K. Gopalkrishna	G.M.(FA&MIS)	KSSC
9	Uma M.B.	Junior Assistant	
10	Sri B. S Hebbal	Superintending Engineer (Elecl)	KPTCL
11	Sri G K Gotyal	Superintending Engineer (Elecl)	KPTCL
12	Sri Ramesh L Bendegeri	Superintending Engineer (Elecl)	KPTCL
13	Sri S M Sasalatti	Superintending Engineer (Elecl)	KPTCL
14	Sri Girish Kumashikar	Executive Engineer (Elecl)	KPTCL
15	Sri VeereshKumar Hebbal	Executive Engineer (Elecl)	KPTCL
16	Sri H Rudranna	Executive Engineer	KPTCL
17	Sri Harish R Naik	Executive Engineer	KPTCL
18	Mr. Ramesh	Accounts Officer	KPTCL
19	Shyamala C	Assistant Engineer	KPTCL
20	Rajendra Prasad	Assistant Engineer	KPTCL
21	Reshma.K.S	Assistant Engineer	KPTCL
22	Harisha	Assistant Engineer(Elecl)	KPTCL
23	Sunila vadeker	Assistant Accounts Officer	NWKRTC
24	Shivanagowda Rayanagowdra	Accounts Supervisor	
25	Yogarajaiah	Assistant Manager	KSMCL

Annexure 2 (Training Outline)

Understanding Public Finance

January 13, 15, and 16, 2021

Time	Day 1: What is Public Finance Management	Facilitation
10.00 to 10.30 a.m.	Module 0 – Introduction Objectives of the course; Presentation of participants and facilitators	Presentation and short ice-breaker exercise
10. 30 to 11.30 a.m.	Module 1 – PFM and the core concepts	Presentation; questions and answers
11.30 to 11.45 a.m.	**Coffee/Tea Break**	
11.45 a.m. to 12.45 p.m.	Module 2– Core concepts (continuation)	Presentation; questions and answers
12.45 – 1.00 p.m.	**Recess**	
1.00 to 2.00 p.m.	Module 1 and 2– Core concepts (continuation)	Discussions; questions and answers; experience sharing

Time	Day 2: Budget preparation and execution	Facilitation
10.00 to 10.30 a.m.	Recap Day 1	Participants
10. 30 to 11.30 a.m.	Module 3 – The Budget Process	Presentation; questions and answers
11.30 to 11.45 a.m.	Coffee Break	
11.45 a.m. to 12.45 p.m.	Module 4 – The Budget Process (continuation)	Presentation; questions and answers
12.45 – 1.00 p.m.	Recess	
1.00 to 2.00 p.m.	Module 3 and 4 – The Budget Process (continuation)	Discussions; questions and answers; Presentation by Participant(s) with practical experiences

Time	Day 3: Performance Management; Internal Controls; and External Audit	Facilitation
10.00 to 10.30 a.m.	Recap Day 2	Participants
10. 30 to 11.30 a.m.	Module 5 – Performance Management, Accounting, and Internal Controls	Presentation; questions and answers
11.30 to 11.45 a.m.	Coffee Break	
11.45 a.m. to 12.45 p.m.	Module 6 – (continuation)	Presentation; questions and answers
12.45 – 1.00 p.m.	Recess	
1.00 to 2.00 p.m.	All Modules (1 – 6)	Knowledge Quiz; questions and answers. Feedback and Concluding Remarks

Annexure 3 (Excel Lamps Case Study)

Excel Lamps Limited – Case Study

Introduction

Excel Lamps Limited was established in 1951 and specialised in the production of incandescent light bulbs. The company maintained the high quality of its products till 2010, and due to good marketing and sales efforts the company had captured a 30 percent market share in its product segment by 1990. In 1991, a new CEO Mr. A, decided on major expansion by introducing the manufacture of florescent tubes. The company spent Rs 150 crores on the new manufacturing facility. At the same time, the new CEO also recruited 700 new employees increasing the staff strength to 1100. For the next 5 years the new plant could not be made operational due to two reasons – technology related problems, and non-availability of staff trained in florescent technology.

Mysore Lamps Limited was set up with an authorized capital of Rs. 110 crores and faced heavy competition in the initial years of business. Though it had emerged as a market leader by 1990, in the 2000, the company was in serious financial crisis and required funding support from the Government. It was found that the fluorescent technology-based new plant was defective and had to be scrapped. It was also found that none of the employees - new or old - knew how to operate the new machinery and equipment.

By 2006, the company operations were suspended. As on December 31, 2006, the position was:

Balance Sheet (Rs in Lakhs)

Liabilities	Rs	Assets	Rs
Capital	1500	Fixed Assets	1000
Reserves	762	Current Assets	1862
Long Term Loans	550	Raw Materials	200
Current Liabilities	200	Work –in-progress	287
Finished Goods	250	Accounts receivable	675
Bank Overdraft	962	Cash	200
Total	4224	Total	4224

During the year 2006, the company was compelled to make a distress sale of 50 lakh pieces of fluorescent lamps at less than cost price to reduce its stock of unsold finished goods. The company was holding material inventory in excess of 12 months' requirement as against the industry standard of two months. Its receivables were eight months' value of monthly sales as against the industry standard of 2 months. The Government has now appointed you as the Finance Manager to study the Public Financial Management of the company and:

Report the main causes for the financial crisis from the perspective of Public Financial Management

Recommend steps that can be taken as part of the Public Financial Management to revive or liquidate the company.

Which of the tools of PFM will prove useful in any attempt at revival?

Annexure 4: (Knowledge Quiz)

Understanding Public Finance: Knowledge Quiz

Name of the Participant:

Designation:

Organisation:

Which of the following are the objectives of PFM? (Select all the correct options}

Option A Control public expenditure, optimize revenue, and manage public debt.

Option B Allocate budgetary resources so that ministers can nurture their constituencies.

Option C Provide open and transparent access to financial decisions and data.

Option D Allocate budgetary resources for public expenditure priorities.

Which of the following budget activities represent budget preparation stages? (Select all correct options)

Option A Setting the macroeconomic and fiscal policy framework

Option B Setting initial ceilings for expenditure in aggregate and by sector

Option C Submission of detailed budget requests by line ministries and negotiation with the finance ministry

Option D Approval of the budget by the Prime Minister/Chief Minister

The Education department in state Z has an approved budget for purchasing new text books worth Rs. 5 crores. The ministry has placed an order for purchase of the books with a major textbook publishing company. During the year it has received an invoice for Rs. 4 crores for books supplied, out of which the ministry has made payment for Rs. 3.5 crores. The publisher has also delivered books worth approximately Rs. 1 crore for which it has yet to raise an invoice.
Country Z follows the accrual-basis system of accounting.

Which of the below accurately describes the entries in country Z's books of accounts? (Select the correct option)

Option A Record expenditure of Rs. 3.5 crore, without creating a liability for Rs. 0.5 crore or Rs. 1 crore.

Option B Record an expenditure of Rs. 5 crore, cash payment of Rs. 3.5 crore, liability for Rs. 1.5 crore

State whether the following sentence is true or false.

IPSAS Board has issued standards for modified accrual accounting.

Option A True

Option B False

Most countries prepare which type of financial statements at the end of the financial year? (Select the correct option)

Option A Financial Statement comprising Balance Sheet, Statement of Operations and Net Cost

Option B Budget Execution Report

Option C Profit and Loss Account and a Cash Flow Statement

Option D None of the above

Which control activities ensure that the Ministry of Agriculture in country X pays only for the equipment ordered and received in good condition? (Select all the correct options)

Option A Ministry invites bids from a single source even though there are multiple suppliers

Option B Engineering Department checks the quantity and quality of equipment received

Option C Accounting Department compares invoice quantities with only the packing slips

Option D Accounting Department compares invoice with engineering goods acceptance note

Option E Engineering Department Head approves the invoice and issues check to supplier

A report by an investigative journalist revealed that a senior Treasury staff, in collusion with the minister, had misappropriated Treasury funds in excess of Rs. 3 crores by approving payments for goods and services that were never delivered. Which is the weakest component of the internal control framework? (Select the correct option)

Option A Control environment

Option B Risk assessment

Option C Information and communication

Option D Control activities

Option E Monitoring

The countries highlighted below follow either a centralized or decentralized internal audit model. Select the countries following the centralized model.

France

The Office of the Inspector General of Finance (IGF) oversees the decentralized services of the finance ministry.

The inspectors of finance are responsible for verifying the quality of financial procedures and their implementation, the regularity of operations, combating fraud, and monitoring the ethical behaviour of civil servants.

Ukraine

The State Control and Revision service (KRU) is an inspection and audit body (having regional offices) responsible for financial control/audit and verifying the credibility of accounting and financial reporting.

United States of America

Departments and agencies are required to have an Inspector General who employs criminal investigators, auditors, forensic auditors, and others to detect and prevent fraud, waste, abuse, and mismanagement.

Although they serve under the department/agency head, they have a dual and independent reporting relationship to the agency head and to Congress.

United Kingdom

Every government department/agency is required to have an internal audit unit.

The Head of Internal Audit (HIA) reports to the head of the department.

The internal audit activity provides an objective evaluation of the overall effectiveness of the organisation's framework of governance, risk management and control.

Country Z has a team of inspection officers to monitor compliance and identify instances of misuse of public funds. Which could be true for country Z? (Select all the correct options)

Option A There is no need to link the establishment of Internal Audit function to the broader PFM reforms.

Option B The government should dismantle the inspection agency as internal audit is now established.

Option C Internal audit function should be phased over a period of time and sequenced.

Option D There must be a way to exchange plans and work between the inspection agency and internal audit function.

Option E The agencies may suffer from a lack of clarity as to their role.

Classify the following audit activities of the CAG as a compliance audit, financial audit or Performance audit (Select the correct option)

1. Report on the General and Social Sector for the year ended March, 2019
2. Report on State Finance of Karnataka, 2020
3. Report on the Implementation of 74^{th} Constitutional Amendment Act in Karnataka

Annexure 5 (Discussion Questions)

Introduction

PFM is frequently seen as a 'technical' issue, when it is much more fundamentally an institutional issue. What can be done to promote a better understanding of the institutional essence of PFM?

It is a commonplace statement that leadership is needed for PFM reform to succeed. The question is what type of leadership? Does there always need to be political leadership of financial management reforms or can leadership take more varied forms at other levels?

PFM reforms should address the problems perceived on the ground by the actual users of the system. There must be a sense of urgency to resolve these problems. What is the way forward?

PFM reforms should represent locally developed solutions to locally perceived problems; hence, they should be based on a diagnostic process. Hence there is also a need for learning and adaptation.

Therefore, how can we use standard operating practices – Standards, Processes, and Templates - to improve Public Financial Management?

The PFM Process

Why is PFM important?

A strong PFM system is an essential aspect of the institutional framework for an effective state.

Effective delivery of public services is closely associated with poverty reduction and growth, and countries with strong, transparent, accountable PFM systems tend to deliver services more effectively and equitably and regulate markets more efficiently and fairly. In this sense, good PFM is a necessary, if not sufficient, condition for most development outcomes.

A key element of statehood is the ability to tax fairly and efficiently and to spend responsibly. These are fundamental characteristics of 'inclusive' state institutions, which generate trust, promote innovative energies and allow societies to flourish.

How do we know whether a PFM system is performing adequately or not?

In practice, the assessment of PFM systems focuses one level down from final outcomes – that is on the examination of the institutions, rules and procedures most likely to ensure the achievement of the key objectives of the PFM system.

Recent research and evaluation suggests that three critical ingredients are needed for successful PFM reform:

Leadership – a strong political and technical commitment, clear communication and coordination of reform, and a widening group of reform leaders who manage fears, expectations and differences of opinion

Policy space for developing appropriate reforms – a thorough understanding of the context, a focus on the functionality of the system and not just the form, and teams and organisations that experiment and take risks, interrogating both the problem and the proposed solutions

Adaptive, iterative and inclusive processes – where monitoring, learning and adaptation are key.

Some key areas for attention include:

Procurement Practices

Pillar I. The Legislative and Regulatory Framework

Pillar II. Institutional Framework and Capacity

Pillar III. Procurement Operations and Public Procurement Market Practice

Pillar IV. Integrity and Transparency of the Public Procurement System

Budget Implementation – Typical problems

Cash Budgeting

Cash budgeting creates rents for those who control the process and enhances their power. Bribes paid by contractors to ensure release of funds for a major project may be shared between the line ministry and ministry of finance officials.

An effective cash flow management system requires good fiscal reporting, which line ministries may not comply with, and the finance ministry may not be prepared for the political conflict arising from denying a ministry funds.

Internal Audit

Internal audit staff can be found in most poor countries' governments, but they are low skilled and relegated to voucher checking tasks. Few, anyway, would be capable of assessing the functioning of control systems and advising the head of the ministry or agency.

In some countries there may be an internal audit cadre, headed by a Director of Internal Audit (or the Accountant-General), who supervises their professional development, and posts them to line ministries. This system is supposed to give them some professional independence, and enable them to "speak truth unto power" in the ministries where they work.

Accounting

Produce timely and accurate accounting reports, both from the perspective of better financial management by government, and also for democratic accountability.

External Audit

Pay attention to the AG Paras

Annexure 6: Reading List

Mandatory Reading:

4. Fiscal Prudence for what? Analysing the state finances of Karnataka. NIPFP Working Paper Series, No. 293; Jacob and Chakraborthy, 2020.
5. Public Finance in India in the context of India's Development. NIPFP Working Paper Series, No. 219; M. Govinda Rao, 2017

Suggested Reading:

1. CAG Report 1 of 2020; State Finance, Government of Karnataka, September 2020
2. CAG Report 2 of 2020; Implementation of the 74th Constitutional Amendment Act, Government of Karnataka, September 2020
3. CAG Report 5 of 2019; PSU, Government of Karnataka, February 2020

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