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# UNIT 1 NATURE AND SCOPE OF FINANCIAL ADMINISTRATION

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## 1.0 OBJECTIVES

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After studying this unit, you should be able to :

- discuss the meaning, importance of financial administration
- explain the nature of financial administration
- highlight the enlarging scope of financial administration; and
- identify the components of financial administration.

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## 1.1 INTRODUCTION

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Finance is the life blood of every organisation. Personnel and materials which are needed for the functioning of any office, industry, enterprise can be made available only if money is provided.

The efficiency of operating systems and maintenance systems depends upon the effectiveness of financial system as every administrative act may have financial implications. The significance of finance to public administration is quite obvious as is evident from the remark of Lloyd George: "Government is finance".

Financial administration, as an important aspect of public administration is as ancient as organised governments all over the world. In its rudimentary form, it was performing certain limited functions till medieval times. In the pre-modern times, it was conceived within the structure of legislative control over executive. Socio-economic forces unleashed by industrial revolution have given a new meaning and a dynamic content to financial administration. In the changed context, it is expected to meet dynamic needs of planned development and social change.

In this unit we shall discuss the meaning, importance, nature and scope of Financial Administration. The unit will also give us an idea about the various components of Financial Administration.

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## 1.2 FINANCIAL ADMINISTRATION : MEANING

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The term Financial Administration consists of two words viz. 'Finance' and 'Administration'. The word 'administration' refers to organisation and management of collective human efforts in the pursuit of a conscious objective. The word 'Finance' refers to monetary (money) resource. Financial Administration refers to that set of activities which are related to making available money to the various branches of an office, or an organisation to enable it to carrying out its objectives. Whether it is the Department of Agriculture, Railways, Road Transport Corporation, Primary Health Centre, Municipality or Gram Panchayat, or for that matter, a family, its day-to-day activities would depend upon the availability of funds with which financial administration is concerned.

Now let us get to know some more accurate definitions of Financial Administration. According to L.D. White, "Fiscal Management includes those operations designed to make funds available to officials and to ensure their lawful and efficient use."

According to Jaze Gaston "Financial Administration is that part of government organisation which deals with the collection, preservation and distribution of public funds, with the coordination of public revenue and expenditure, with the management of credit operations on behalf of the State and with the general control of the financial affairs of public household."

Though this definition covers some important aspects of fiscal management, it fails to project a comprehensive scope of financial administration. Perhaps, after realising this limitation, G.S. Lall states that financial administration is concerned with all the aspects of financial management of the State. Since public administration is more and more concerned with public affairs and public interest, the frontiers of financial administration are expanding and therefore there is a need for a comprehensive definition of financial administration. As an attempt towards this direction, the following definition is presented.

"Financial Administration includes all the activities which generate, regulate and distribute monetary resources needed for the sustenance and growth of the members of a political community."

#### **The Distinction between Public Finance and Private Finance**

Finance function appears to be a generic process which takes place in both public and private organisations. But, one should not conclude that the principles and norms which are applicable to private finance are equally applicable to public finance, for despite the challenge to the historic "separate but equal doctrine" from the integrationist movement of recent times, public organisations continue to possess certain distinct characteristics. Dissimilarities between public finance and private finance are quite sharp and clear. According to Sundaram, these dissimilarities can be outlined as follows:

<b>Public Finance</b>	<b>Private Finance</b>
1) Adjustment of income to expenditure	1) Adjustment of expenditure to income
1a) Popular control	1a) Corporate control
2) Elastic resources	2) Limited resources
3) Resource mobilisation through coercive power	3) No such power
4) Tendency towards deficit	4) Tendency towards balanced budgets
5) Direction of expenditure towards public service	5) Towards profit maximisation

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### **1.3 FINANCIAL ADMINISTRATION : IMPORTANCE**

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The importance of Financial Administration was not considered till after industrial revolution. The concept of minimum government as an offshoot of laissez faire doctrine, dictated observance of minimum taxation. When social life became more complex as a result of industrial revolution, the role of the government increased manifold. Further, the concept of welfare state has caused phenomenal increase in state activity. The governments have entered into new areas which were kept out of the purview of the State. In this changed context, financial administration has gained greater significance for exploring ways and means to generate resources to meet the ever-increasing public expenditure.

The Great Depression (1929-33) had exposed the weaknesses of neutral economic stance of the governments. It enhanced the quest for stability in income and employment as well as for equality and social justice. Based on Keynesian perspective, the State has assumed an active and positive role for expanding national income and employment. It has also taken up the task of ensuring equity and equality. Fiscal policy of the government has become a powerful instrument in

influencing the socio-economic life of the people. Defence and administrative expenditure lost its nonproductive label and assumed a new significance as a lever for stimulating income and employment levels. Financial administration was entrusted with the responsibility of formulating effective policies to achieve these new objectives of the State. It was called upon to transform financial resources into public purposes and thus to improve the lot of the individual through distributive justice.

With the advent of democracy, as a popular social institution, the concept of 'parliamentary control over public purse' has received universal acceptance. The principles of "no taxation without representation", i.e. "no public expenditure without parliamentary sanction" have become the guiding canons of modern political communities. There appeared an urgent need to devise a simple and systematic financial procedure in order to make financial system intelligible to the common person. Financial administration became an instrument of modern governments for making "popular sovereignty" a social reality.

The concept of planned development has enabled public administrators to play an active and dynamic role in the formulation and implementation of development schemes and projects. The time and cost of implementing these projects have become critically important. The accent of financial administration has shifted from one of controlling the disbursement of funds to one of management of various development projects and programmes. The rise of performance budgeting and other related budgetary innovations represent remarkable achievements of financial administration in meeting this challenge. From the early eighties onwards, resource crunch has become a very serious problem of modern governments. While there is a tremendous pressure on the modern governments to increase their expenditure outlays to meet the ever expanding ambitions and demands of the people the taxpayers are unable or unwilling to bear additional tax burdens. In this dilemma, a need has arisen for a careful prioritisation of public expenditure. Hence a study of financial administration and management which are a part of public administration has become important to seek out ways for eliminating unwanted expenditure and ensuring optimisation of output on a limited resource base. Zero Base budgeting is an attempt in this direction.

To sum up, financial administration is playing a dominant role in modern times.

**Check Your Progress 1**

- Note :** i) Use the space given below for your answers.  
ii) Check your answers with those given at the end of the unit.

1) Explain the meaning of Financial Administration.

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2) List any three points of distinction between public and private finance.

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3) Why has the study of financial administration become important in recent times?

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## 1.4 NATURE OF FINANCIAL ADMINISTRATION

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There are two different views regarding the nature of financial administration. These are i) Traditional view; ii) Modern view.

### i) Traditional View

Advocates of this view conceive financial administration as a sum total of activities undertaken in pursuit of generation, regulation and distribution of monetary resources needed for the sustenance and growth of public organisations. They emphasise upon that set of administrative functions in a public organisation which relate to an arrangement of flow of funds as well as to regulating mechanisms and processes which ensure proper and productive utilisation of these funds. When one looks at this view from systems perspective, it represents an integral sub-system of supportive system. A financial administrator shoulders responsibility for ensuring adequate financial backing for running public organisation in the most efficient manner. His/her job is to plan, programme, organise and direct all financial activities in public organisations so as to achieve efficient implementation of public policy. The participants of this system are considered as financial managers and they discharge managerial functions of financial nature. Further, this view reflects the stand taken by pure theorists of public finance like Seligman. The central thesis of pure theory of public finance is that public finance should deal with the problems of public income, public expenditure and public debt in an objective manner without any relation to a set of values and premises of the political party in power. Accordingly, theorists of financial administration subscribing to this view take a value-neutral stance. For instance, Jaze Gaston reflects this view when he says that financial administration is that part of government organisation which deals with the collection, preservation and distribution of public funds.

### ii) Modern view

The modern view considers financial administration as an integral part of the overall management process of public organisations rather than one of raising and disbursing public funds. It includes all the activities of all persons engaged in public administration, for quite obviously almost every public official takes decisions which are bound to have some direct or indirect consequences of financial nature. Further, it rejects the value-neutral stand of the traditional theory. It combines in itself three prominent theories of public finance, viz., the socio-political theory as expounded by Wagner, Edgeworth and Pigou, the functional theory of Keynesian perspective and activating view of modern public finance theorists. According to this view financial administration has the following roles.

- a) **Equalising Role** : Under this role financial administration seeks to demolish the inequalities of wealth. It seeks, through fiscal policies, to transfer income from the affluent to the poor.
- b) **Functional Role** : Under normal circumstances the economy cannot function on its own. Under this role, financial administration seeks to ensure, through taxation, public expenditure and public debt, and proper functioning of the economy. It evolves policy instruments to maintain high economic growth and full employment.
- c) **Activating Role** : Under this role financial administration involves the study of such steps that will facilitate a smooth and rapid flow of investment and its optimal allocation to increase the volume of national income.
- d) **Stabilising Role** : Under this role, the objective of financial administration is the stabilisation of price level and inflationary trends through fiscal as well as monetary policies.
- e) **Participatory Role** : According to this view, financial administration involves formulation and execution of policies for making the state a producer of both public and private goods with the objective of maximising social welfare of the community. It also seeks to promote economic development through direct and indirect participation of the State.

Thus, financial administration provides a framework of choices regarding ends and means which reflect the nature and character of the State and its ideological base as well as its values. For instance, financial administration of socialist countries differ from that in democratic countries. Thus, the essence of financial administration would differ under different socio-political systems depending upon particular mode of operation of socio-economic and political forces.

## 1.5 SCOPE OF FINANCIAL ADMINISTRATION

In Section 1.2 where we have discussed the meaning of financial administration, Gaston Jaze's definition, quoted in that context, points out that the government organisation which deals with the following four aspects constitutes financial administration. These include :

- 1) The collection, preservation and distribution of public funds.
- 2) The coordination of public revenues and expenditure.
- 3) The management of credit operations on behalf of the State.
- 4) The general control of the financial affairs of the government.

In modern governments all the above aspects are dealt with by the Finance Department and its subordinate agencies. Though the Finance Department may be considered as central financial agency of modern governments, it cannot be equated with financial administration. Its role constitutes financial management rather than financial administration. As a financial manager it deals with the systems, tools and techniques contributing to economic decision making in government. These processes are, in fact, the integral part of financial administration. The scope of financial administration is much wider than what these processes suggest.

According to some authorities on public administration, the term financial administration refers to the financial processes and institutions involved in legislative financial control. In their view, the scope of financial administration encompasses the preparation of estimates, appropriation of funds, expenditure control, accounting, audit, reporting, review and so on. In a democratic context, this view may gain wider acceptance as it ensures executive responsibility to legislature. But, the experience of modern democracies has shown that the legislative involvement in the determination of the desired volume, range and direction of programmes, the use of independent judgement relating to the financial resources required by administrative agencies is becoming nominal day by day. It is a known fact that the average member of the legislature is not adequately informed to ensure effective control over executive. Thus, the view appears to be of no significant validity. Further, legislative control of financial aspects of the government does not represent the scope of financial administration in its entirety.

Yet another view advocates a budget oriented outline for the scope of financial administration. According to them the scope of financial administration is limited to the preparation of budget, the enactment of budget and execution of budget. Though the budget is the core of financial administration, certain operations which precede budget preparation are equally important. There is a pertinent need to include planning process as an integral part of financial administration.

In the ultimate analysis, there is a need to adopt an integrated approach so that all the above views are incorporated into the scope of public administration. As an outcome of such an approach, the following aspects emerge as the core areas of financial administration.

- i) Financial planning
- ii) Budgeting
- iii) Resource mobilisation
- iv) Investment decisions
- v) Expenditure control
- vi) Accounting, Reporting and Auditing

**i) Financial Planning :** In a restrictive sense one may consider budgeting as planning since its basic concern is to facilitate the formulation and adoption of policies and programmes with a view to achieving the goals of government. But planning, in a broad sense, includes the concerns in terms of whole range of government policy and it demands a time frame and a perception of the inter relationships among policies.

It looks at a policy in the framework of long-term economic consequences. There is a need to coordinate planning and budgeting. The concept of Planning-Programming-Budgeting System (PPBS) represents an attempt in this direction. Financial Administration, under this phase, should consider the sources and forms of finance, forecasting expenditure needs, desirable fund flow patterns and so on.

ii) **Budgeting** : This area is the core of financial administration. It includes examination and formulation of such important aspects as fiscal policy, equity and social justice. It also deals with principles and practices associated with refinement of budgetary system and its operative processes.

iii) **Resource Mobilisation** : Imposition of taxes, collection of rates and taxes etc. are associated with resource mobilisation effort. Due to the ever increasing commitments of government, budgetary deficits have become regular feature of government finance. In this context deficit financing assumes greater importance. But deficit financing, if used in an unrestrained manner, may prove to be a dangerous problem for a nation's economy for it can cause galloping inflation. Another challenge faced by administration is tax evasion and growth of parallel economy. Finally public debt constitutes yet another element of state resources. The proceeds of debt mobilisation effort should be used only for capital financing. Thus, modern financial administrator has to be fully conversant with all the dimensions of resource mobilisation efforts.

iv) **Investment Decisions** : Financial and socio-economic appraisal of capital expenditure constitutes what has come to be known as project appraisal. Since massive investments have been made in the public sector a thorough knowledge of the concepts, techniques and methodology of project appraisal is indispensable for a financial administrator.

v) **Expenditure control** : Finances of the modern governments are becoming quite inelastic. Almost every government is suffering from resource crunch. Further, the society cannot be taxed beyond a certain point without doing a great damage to the economy as a whole. Thus, there is an imperative need for careful utilisation of resources. Executive control is a process aimed at achieving this ideal. Legislative control is aimed at the protection of the individual tax payers interest as well as public interest. There is also the need to ensure the accountability of the executive to the legislature.

**Accounting, Reporting and Auditing** : These aspects are designed to aid both the executive control and legislative control. In India, the Comptroller and Auditor General (C & AG) and the Indian Audit and Accounts Department over which the C & AG presides ensure that the accounting and audit functions are performed in accordance with the provisions of the Constitution.

We shall be discussing in detail about these areas in subsequent blocks of this course.

**Check Your Progress 2**

- Note : i) Use the space given below for your answers.
- ii) Check your answers with those given at the end of the unit.

1) What, according to traditional view, is the role of financial administration?

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2) Discuss any two roles of financial administration as propounded by modern public finance theorists.

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3) What are the financial processes and institutions involved in legislative financial control?

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4) Highlight the comprehensive view regarding the scope of financial administration.

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**1.6 COMPONENTS OF FINANCIAL ADMINISTRATION**

Theorists of public finance have identified three elements of public finance. They are :

- a) Public Revenue
- b) Public Expenditure
- c) Public Debt

Since financial administration concerns itself with public finance and deals with the principles and practices pertinent to the proper and efficient administration of the state finances, the thinkers of financial administration have included the administrative aspects in the scope of financial administration.

Some other thinkers, taking clue from Luther Gulick, have tried to project POSDCORCs view wherein :

- P — Stands for Financial Planning
- O — Stands for Financial Organisation such as Finance Ministry
- S — Stands for Financial Personnel
- D — Stands for Direction such as Financial advise
- CO — Stands for Coordination of Income and Expenditure
- R — Stands for Financial Reporting such as accounting
- C — Stands for control which includes executive control, audit control and legislative control.

The above exposition does not reveal the exact picture related to the elements of financial administration. An organisational system consists of the following basic elements :

- a) The People
- b) Work and structure
- c) Systems and procedure

People represent human resources of the organisation. Work and structure represent efforts and processes concerning definition of tasks and roles, and organisation of reporting relationships. Systems and procedures represent framework to facilitate interactions between the people and the work. These interactions result in organisational output. It is possible to identify the following elements of financial administration :

- a) **Human Element**
  - Tax payers
  - Fee Remitters
  - Suppliers (Funds and materials)
  - Employees (Public Officials)
  - Entrepreneurs (Politicians)
  - Customers & Common person

**b) Work and Structures**

- The Legislature and its financial committees
- The Cabinet
- The Finance Department
- The Administrative Departments
- The Executive Departments
- The Audit Department

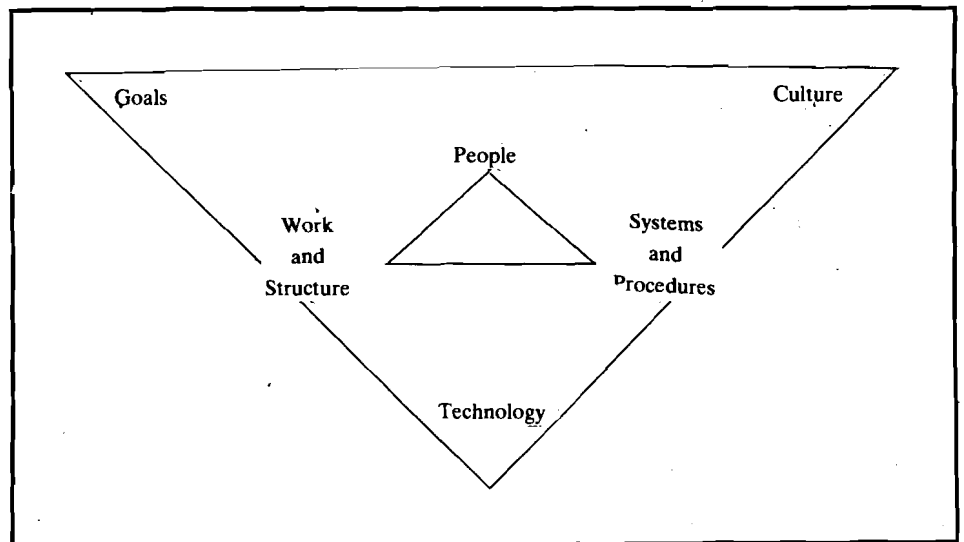
**c) Systems and Procedures**

- Planning Systems
- Budgeting systems and procedure
- Controlling systems such as accounting and auditing.

Human element consists of participants whose involvement is determined by contribution-inducement equilibrium. This consideration implies that people, for instance, wish to contribute their money (tax etc.) and support the government as long as there is a feeling on their part that they are suitably rewarded for their sacrifice and support. No public organisation can easily overlook this consideration. Work and structure refer to the organisation processes viz. divisional processes and integration processes by means of which organisation subdivisions are created with a provision for mutual interaction. Systems and procedures are the devices which link the people to the work and structure. These three components interact with each other to produce organisational outcomes.

No discussion on administration's components would be complete unless there is a reference to the environment which affects content, character and capabilities of the components. Financial administration is enveloped by two environments. Every one is aware of suprasystem known as socio-economic and political environment in which the financial administration operates.

There is an intermediary sub-system comprising the goals pursued by financial administration, the norms, values, beliefs and behaviour as reflected in the culture of financial administration and the nature of technology employed by financial administration. The overall picture may be presented in the form of the following illustration :



**Check Your Progress 3**

**Note :** i) Use the space given below for your answers.  
 ii) Check your answers with those given at the end of the unit.

1) What, according to POSDCORB view, are the major elements of financial administration?

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2) Identify the elements of an organisational system.

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## 1.7 LET US SUM UP

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All societies have their financial administrative systems as an integral component of its public administrative system. In contemporary societies, financial administration began to assume the multifaceted role in order to secure maximum human welfare. Public finance and private finance have much in common although there are certain distinct differences. Financial administration, in its evolutionary process, has proved to be a dynamic entity capable of developing itself into a potential measure to meet requirements of changing socio-economic demands from time to time. Of late, financial administration has assumed the role of a provider of choices with regard to ends and means for a society. As we have discussed, its scope is expanding day by day and at present it encompasses many dynamic aspects such as financing, planning and budgeting, resource mobilisation and its investment, public expenditure, control including financial control etc. The human element, work and structure, and systems and procedures constitute its important elements.

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## 1.8 KEY WORDS

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**Comptroller and Auditor General (C & AG) :** The C & AG is one of the Constitutional authorities appointed by the President of India. The C & AG performs such duties and exercises such powers in relation to the audit of accounts of the union and of the states and of any other authority or body as may be prescribed by or under any law made by Parliament.

**Deficit Financing :** It refers to means of financing the deliberate excess of expenditure over income through printing of currency notes or through borrowing.

**Fiscal Policy :** It is that part of economic policy which is concerned mainly with the revenues and expenditure of the government. It spells out the application of taxation, public expenditure and public debt to realise certain public objectives.

**Functional Theory :** The doctrine which advocated that government should pursue whatever fiscal measures are necessary to achieve non inflationary, full employment and economic growth without regard to budget balancing.

**Galloping inflation :** It occurs when a persistent inflation gets out of control and there is decline in value of money. In this situation each increase in prices becomes the signal for an increase in wages and costs which again pushes prices up still further.

**Great Depression :** The World wide depression that started in 1929 and lasted till 1935. It was characterised by low economic activity and mass unemployment.

**Laissez Faire :** Non-interference policy of the government in economic affairs.

**Performance Budget :** It is generally understood as a system of presentation of public expenditure in terms of functions, programmes, performance units viz., activities, projects etc. reflecting primarily the governmental output and its cost.

**Planning-programming-budgeting system (PPBS) :** It is a technique for optimising allocation of funds in the budget by exercising proper choices among programmes which compete for limited sources. It emphasises selection of best programmes out of a number of alternatives available, which could be implemented with a given quantum of resources.

**Socio-political theory** : This theory as advocated by Wagner laid emphasis on looking at each economic problem in its social and political context and thereby arriving at an appropriate solution. Wagner, for example, was in favour of using taxation for reduction of income inequalities.

**System** : An arrangement of interrelated and interdependent elements of a phenomenon so as to function as an organic whole.

**Zero base budgeting** : It is an operating, planning and budgetary process which requires each manager to justify his/her entire budget request in detail from scratch. It shifts the burden of proof to each manager to justify why any money should be spent at all, as well as how the job can be done better.

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## 1.9 REFERENCES

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## 1.10 ANSWERS TO CHECK YOUR PROGRESS EXERCISES

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### Check Your Progress 1

- 1) Your answer should include the following points :
  - Literal meaning of Financial Administration which refers to that set of activities which are related to making available money to the various branches of an office, or an organisation to enable it to carrying out its objectives,
  - Finance function as a managerial process
  - Finance function of the government
  - Finance function as a social process.
- 2) Your answer should include any three of the following points:
  - Adjustment of income to expenditure versus expenditure to income
  - Popular versus corporate control
  - Elasticity of resources
  - Coercion
  - Deficit versus balanced budgets
  - Motive of public expenditure—public service versus profit maximisation.
- 3) Your answer should include the following points:
  - Shift in accent of Financial Administration from controlling the disbursement of funds to management of various development projects and programmes
  - Financial Administration becoming an instrument of modern governments for making “popular sovereignty” a social reality
  - Rise of budgetary innovations in Financial Administration
  - Development of emphasis in Financial Administration on seeking out ways for eliminating unwanted expenditure and ensuring optimisation of output on a limited resource base

### Check Your Progress 2

- 1) Your answer should include the following points:
  - Arrangement of funds flow
  - Regulatory mechanism
  - Supportive system
  - Value neutral stance.
- 2) Your answer should include any two of the following points :
  - Equalising role
  - Functional role
  - Activating role
  - Stabilising role.
- 3) Your answer should include the following points :
  - Preparation of estimates
  - Sanction of appropriations
  - Expenditure control
  - Accounting and auditing.
- 4) Your answer should include the following points :
  - Financial planning
  - Budgeting
  - Resource mobilisation
  - Investment decisions
  - Expenditure control
  - Accounting and auditing.

### Check Your Progress 3

- 1) Your answer should include the following points :
  - Financial planning
  - Financial organisation
  - Financial personnel
  - Financial advice
  - Coordination of income and expenditure
  - Financial reporting
  - Executive, legislative and audit control.
- 2) Your answer should include the following points :
  - Human element
  - Work and structure
  - Systems and procedure.