



Part - B
Chapter – III

**An Overview of the Functioning,
Accountability Mechanism and
Financial Reporting issues of
Urban Local Bodies**

Chapter III: An overview of the functioning, accountability mechanism and financial reporting issues of Urban Local Bodies

An overview of the functioning of the Urban Local Bodies (ULBs) in the State

3.1 Introduction

Constitution (Seventy-fourth Amendment) Act, 1992 conferred Constitutional status to Urban Local Bodies (ULBs) and established a system of uniform structure, regular election and regular flow of funds through Finance Commission etc. As a follow up, the States are required to entrust these bodies with powers, functions and responsibilities so as to enable them to function as institutions of Self-Government.

Article 243Q of the Constitution envisages that there shall be constituted in every State, Municipal Corporation for large urban areas; Municipal Councils for smaller urban areas; and Nagar Parishads for areas in transition from a rural to an urban area. There are 16 Municipal Corporations, 98 Municipal Councils and 265 Nagar Parishads in the State as of March 2016.

The basic demographic information relating to the State of Madhya Pradesh vis-a-vis National average is given below:

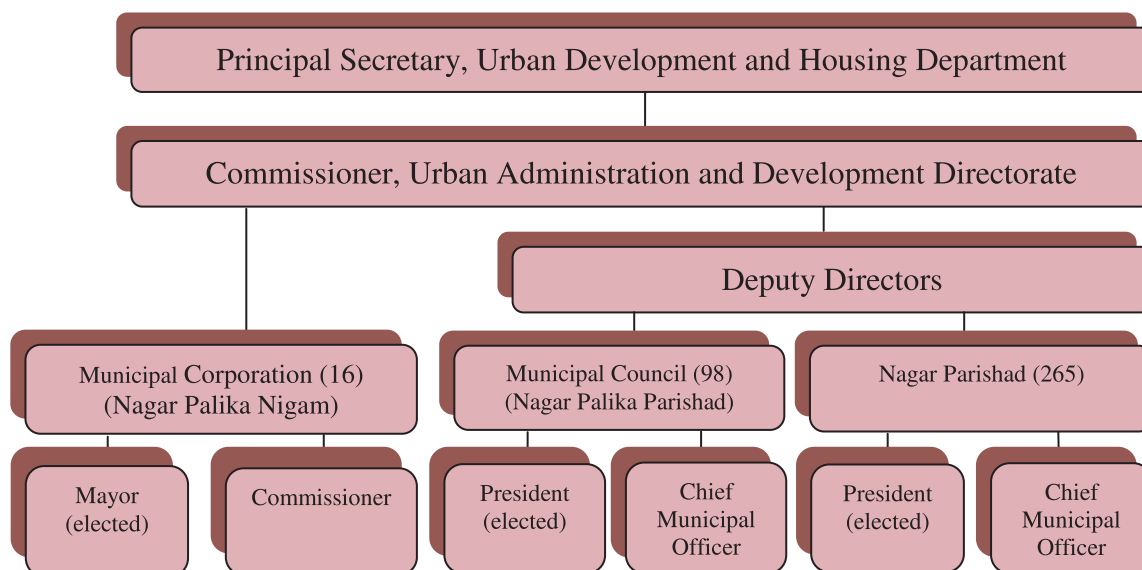
Particulars	Unit	Madhya Pradesh	All India
Population	crore	7.26	121.02
Share in country's population	<i>per cent</i>	6	-
Urban population	crore	2	37.70
Share of urban population	<i>per cent</i>	27.63	31.16
Urban literacy rate	<i>per cent</i>	82.85	85.00
Urban sex ratio (females per thousand males)	ratio	918/1000	926/1000

(Source: Census data 2011)

3.2 Organisational set up of ULBs

All the ULBs are empowered to discharge the functions devolved under the provisions of Madhya Pradesh Municipal Corporation Act, 1956 and Madhya Pradesh Municipalities Act, 1961, subject to monitoring powers vested in State authorities provided therein. At the Government level, Urban Development and Housing Department (UDHD) is the administrative Department for ULBs. The organisational set up of governance of ULBs is as under:

Organisational Chart of ULBs



3.3 Functioning of ULBs

Article 243W envisaged that the Legislature of a State may, by law, endow the Municipalities with such powers and authorities as may be necessary to enable them to function as institutions of Self Government and such law may contain provisions for devolution of powers and responsibilities upon Municipalities, including 18 functions listed in the Twelfth Schedule.

The State Government devolved all 18 functions (**Appendix-3.1**), enshrined in Twelfth schedule of the constitution, to ULBs. However, Urban Administration and Development Directorate (UADD) informed (August 2016) that funds and functionaries were yet to be transferred to ULBs.

Article 243X of the Constitution of India envisages that State Legislature may, by law, vest power in ULBs to impose various taxes for revenue collection. This constitutional provision has been incorporated in Clause 132 of Madhya Pradesh Municipal Corporation Act, 1956 and Clause 127 of Madhya Pradesh Municipalities Act, 1961. ULBs receive funds on monthly basis under *Chungi* Compensation Grant and Passenger Tax Special Grant by the State Government. In addition to this, at the ULBs level various types of taxes have been imposed including Property tax, Composite tax, Water tax, Market fee, Export tax etc.

3.3.1 Municipal Corporation

According to Section 9 of Madhya Pradesh Municipal Corporation Act, 1956, a Municipal Corporation shall consist of a Mayor and Councilors directly elected from the Municipal Corporation area. Section 37 of Act provides that there shall be a Mayor-in-Council for every Municipal Corporation constituted by the Mayor from amongst the elected Councilors to discharge the functions and conduct of business of the Mayor-in-Council, as may be prescribed.

According to Section 25 of Madhya Pradesh Municipal Corporation Act, 1956, the Mayor shall have administrative control over the officers and staff of his office and exercise such powers and perform such functions as described in the Act and Rule made thereunder.

The Commissioner of a Corporation shall be appointed by the State Government who is the Principal Executive Officer of the Corporation and shall have the right to speak at, and otherwise take part in any meeting of the Corporation or any committee thereof, but shall not be entitled to vote or to move any proposition. The office of the Commissioner shall have the administrative staff for the functions and duties as prescribed under the rules. Commissioner shall perform all the duties imposed or conferred upon him by this Act and exercise supervision and control over the acts and proceedings of all municipal officers.

3.3.2 Municipal Council and Nagar Parishad

As per Section 19 of Madhya Pradesh Municipalities Act, 1961, a Municipal Council, for a smaller urban area and Nagar Parishad, for a transitional urban area, shall have a President and Councilors elected from the respective areas by direct election. Under Section 70 of the Act, there shall be a President-in-Council (PIC) for every Municipal Council/Nagar Parishad, which shall be constituted by the President from amongst the elected councilors to discharge the functions and conduct of business of the PIC, as may be prescribed. The President of the Municipal Council/Nagar Parishad, who is the President of PIC, shall preside over all meetings, watch over the financial and executive administration and perform such executive functions as may be allotted under the Act.

As per Section 87 of the Act, the Chief Municipal Officer of a Council shall be appointed by the State Government, who shall be the Principal Executive Officer of the Municipal Council/Nagar Parishad and shall have such powers and perform such functions as described in the Act and Rule made thereunder.

Under Section 92 of the Act, Chief Municipal Officer of a Municipal Council/Nagar Parishad subject to the general control of the President, watch over the financial and executive administration of the Council and perform all the duties and exercise all the powers specially imposed or conferred upon him, by or delegated to him, under this Act.

3.4 Audit arrangement

The State Government has appointed (November 2001) Director, Local Fund Audit (DLFA) for audit of accounts of ULBs and who shall work under the Technical Guidance and Support (TGS) of the Comptroller and Auditor General (C&AG) of India. As per the standard terms and conditions of TGS, C&AG of India has the right to conduct such test check of the accounts and to comment on and supplement the report of the Statutory Auditor, as he may deem fit. Further, the C&AG of India or his representative has the right to report to State Legislature, the result of audit at his discretion.

Madhya Pradesh State Legislative Assembly has constituted (April 2016) Local Bodies and Panchayatiraj Accounts Committee (LBPAC) for examination of Appropriation Accounts of local bodies in the State. LBPAC is also responsible for examination of reports of C&AG laid on the table of the Legislative Assembly.

- **Technical Guidance and Support provided by Indian Audit and Accounts Department**

Section 152 of Regulations on Audit and Accounts, 2007 envisages the following arrangements regarding technical guidance and support to ULBs:

- Local Fund Auditor would prepare an annual audit plan for audit of ULBs and forward it to the Accountant General (Audit) of the State.
- The audit methodology and procedure for audit of ULBs by the Local Fund Auditor would be as per various Acts and Statutes enacted by the State and guidelines prescribed by the C&AG.
- Copies of inspection reports in respect of selected local bodies shall be forwarded by the Local Fund Auditor to the Accountant General (Audit) for advice on system improvements.

The Annual Audit Plan for 2015-16 was prepared by DLFA, which was forwarded to the Accountant General (Audit). DLFA followed the methodology and procedure as suggested by the AG (General and Social Sectors Audit), Madhya Pradesh from time to time. Inspection reports were forwarded to the AG (G&SSA) Madhya Pradesh for vetting.

- **Audit Report on Local Bodies**

Para 10.121 of the recommendations of Thirteenth Finance Commission (ThFC) envisages that Annual Technical Inspection Report of C&AG as well as the Annual Report of DLFA should be placed before the State Legislature. Accordingly, amendments were made (January 2012) in the Madhya Pradesh Municipal Corporation Act, 1956 and Madhya Pradesh Municipalities Act, 1961, which lays down that the Annual Audit report of DLFA on Local Bodies along with the Annual Technical Inspection Report of the C&AG of India shall be submitted to the Governor, who shall cause the reports to be laid on the table of the Legislative Assembly.

The report of the Comptroller and Auditor General of India on Local Bodies for the year ended 31 March 2015 was tabled in the Legislative Assembly of Madhya Pradesh in July 2016. However, reports of DLFA for the year 2012-13 and onwards are under process for laying before the State Legislative Assembly (February 2017).

3.5 Response to audit observations

During 2015-16, compliance audit of six out of 16 Municipal Corporations, 18 out of 98 Municipal Councils and 39 out of 265 Nagar Parishads were conducted by the office of the Accountant General (General and Social Sector Audit) Madhya Pradesh, Gwalior (*Appendix-3.2*). For providing technical guidance and Support under TGS arrangement, Inspection Reports (IRs) of Accountant General (G&SSA), Madhya Pradesh were sent to DLFA. As per TGS arrangements, DLFA was to follow up compliance with the audit paragraphs of IRs. However, 3,954 paragraphs in 757 IRs, including 1,023 paragraphs in 96 IRs issued during 2015-16 were pending for settlement as of January 2017, as detailed in **Table 3.1**.

Table - 3.1: Status of outstanding Inspection Reports and Paragraphs

Sl. No.	Year	Opening balance and addition during the year				Settled during the year		Closing balance	
		OB IRs	Addition IRs	OB Paras	Addition paras	No of IRs	No of Paras	No of IRs	No of Paras
1	Up to 2011-12	530	--	3,265	--	2	139	528	3,126
2	2012-13	528	59	3,126	448	2	143	585	3,431
3	2013-14	585	69	3,431	682	4	301	650	3,812
4	2014-15	650	67	3,812	805	55	1,633	662	2,984
5	2015-16	662	96	2,984	1,023	1	53	757	3,954

(Source: Monthly Arrear Reports compiled by the AG (G&SSA), Madhya Pradesh)

Financial reporting issues

3.6 Sources of funds

As per provisions of Section 105 of MP Municipalities Act, 1961 and Section 87 of MP Municipal Corporation Act, 1956, there are mainly two sources of revenue for ULBs, viz. Government grants and own revenue. The Government grants include:

- grants assigned under the Fourteenth Finance Commission of India; and,
- devolution of one *per cent* of divisible tax revenue¹ of the State Government as per recommendations of the Third State Finance Commission (SFC).

The Third State Finance Commission (SFC) recommended (accepted by State Government in February 2010) that one *per cent* of divisible tax revenue of the State Government should be devolved to ULBs. During the year 2015-16, the devolution of SFC grants by the Finance Department to ULBs is shown in **Table 3.2**.

Table - 3.2: Devolution of funds to ULBs

(₹ in crore)

Year	Divisible funds of State Government	Funds were to be devolved	Funds actually devolved	Short devolved
1	2	3	4	(4-3)
2015-16	28,944.50	289.45	271.31	18.14

(Source: Information provided by Finance Department and UADD)

It can be seen from **Table 3.2** that there was short devolutions of ₹ 18.14 crore to ULBs during 2015-16. The Finance Department informed (October 2016) that reason for short release would be intimated after finalisation of accounts.

3.7 Budgetary allocation and expenditure of ULBs

Funds (share of tax revenue of the State and grants for implementation of schemes) allocated to ULBs by the State Government through State budget during last five years were as follows:

¹ Divisible Fund: Total tax revenue of previous year minus ten *per cent* of expenditure for collection of taxes and deduction of assigned revenue to PRIs and ULBs.

Table – 3.3: Statement showing receipt and expenditure of ULBs

(₹ in crore)

Year	Grants in aid			Actual Expenditure			Unspent balance	Percentage of savings
	Revenue	Capital	Total	Revenue	Capital	Total		
2011-12	4,148.30	208.00	4,356.30	3,743.23	152.54	3,895.77	460.53	11
2012-13	5,271.89	215.09	5,486.98	4,879.63	138.50	5,018.13	468.85	9
2013-14	6,547.97	124.21	6,672.18	5,435.55	53.18	5,488.73	1,183.45	18
2014-15	6,718.54	33.27	6,751.81	5,281.52	12.63	5,294.15	1,457.66	22
2015-16	8,896.56	366.40	9,262.96	8,350.63	139.51	8,490.14	772.82	8
Total	31,583.26	946.97	32,530.23	27,690.56	496.36	28,186.92	4,343.31	

(Source: Appropriation Account -Grant No. 22, 53, 68 and 75)

As evident from **Table 3.3**, the grant allocation increased by 113 *per cent* for ULBs during the year 2015-16 as compared to the year 2011-12. However, ULBs could not spend the entire allocated grants and savings ranged from eight *per cent* to 22 *per cent* during the period 2011-16 mainly due to considerable unspent balances in the Revenue Head.

3.8 Accounting arrangement

3.8.1 Maintenance of Accounts in formats prescribed by C&AG

On recommendation of the Eleventh Finance Commission, Comptroller & Auditor General (C&AG) of India constituted a Task Force to recommend budget and accounting formats for ULBs. The Task Force constituted by C&AG, suggested the adoption of National Municipal Accounting Manual (NMAM) for accrual basis accounting by ULBs. The Urban Development and Housing Department (UDHD), Government of Madhya Pradesh (GoMP), published (July 2007) Madhya Pradesh Municipal Accounting Manual (MPMAM), as suggested in NMAM, for adoption of accrual basis accounting system by ULBs from 1 April 2008.

Test check of records of 63 ULBs during the year 2015-16 revealed that four ULBs² prepared their budget and accounts as per MPMAM and 24 ULBs³ did not prepare their budget and accounts as per MPMAM but they were preparing their accounts as per the existing accounting rules of Madhya Pradesh Municipal Corporation, Act 1956 and Municipalities Act, 1961. Remaining 35 ULBs did not produce relevant records/information to Audit.

In reply, UADD stated (August 2016) that MPMAM was implemented in 154 ULBs⁴ out of 379 ULBs of the State. Thus, only 41 *per cent* of ULBs could implement MPMAM as of August 2016, though it was adopted by State Government in April 2008.

² **Municipal Corporations:** Bhopal, Burhanpur and Gwalior; **Municipal Council:** Manawar

³ **Municipal Corporations:** Dewas, Satna; **Municipal Councils:** Bijuri, Kareli, Mandideep, Pasan and Sidhi; **Nagar Parishads:** Baiher, Betulbazar, Bilaua, Chandameta (Butaria), Chhapiheda, Depalpur, Kari, Khilchipur, Khujner, Lovkushnagar, Majholi (Jabalpur), Rajnagar, Rampurnekin, Ratangarh, Sehora, Singoli and Tendukheda

⁴ 16 Municipal Corporations, 80 out of 98 Municipal Councils and 58 out of 265 Nagar Parishads

3.8.2 Annual Budget of ULBs

As per Section 98 of Madhya Pradesh Municipal Corporation Act, 1956 and Section 116 of Madhya Pradesh Municipalities Act, 1961, every ULB shall prepare budget estimates covering all receipts and expenditure and send the same to the State Government.

Test check of records of 63 ULBs revealed that 34 ULBs prepared their budget estimates. However, 22 ULBs out of 34 ULBs did not send their budget estimates to State Government as envisaged in the Act. The remaining 29 ULBs did not furnish relevant information/records.

In reply, UADD stated (January 2017) that instructions would be issued to all ULBs from State level.

3.9 Bank reconciliation statement not prepared

Madhya Pradesh Municipal Accounting Rules prescribe for reconciliation of any difference between the balances of cash book and bank accounts on monthly basis.

Test check of records of 63 ULBs revealed that 33 ULBs⁵ did not prepare bank reconciliation. There were unreconciled differences in the closing balances of cash books and bank books of these 33 ULBs as of March 2015, as detailed in (*Appendix-3.3*). Failure to reconcile the differences was fraught with the risk of misuse of funds.

The Commissioner/CMO of respective Municipal Corporation/Councils and Nagar Parishads stated (2015-16) that the bank reconciliation of difference between the balances of cash book and bank accounts would be carried out.

In reply, UADD stated (January 2017) that commercial audit of ULBs had been started from this year. Conversion to double entry system was under process and monitoring was being done from State level. Instructions would be issued to concerned ULBs to prepare bank reconciliation statement.

3.10 Tax revenue/non-tax revenue not realised

As per Section 87 of MP Municipal Corporation Act, 1956 and Section 105 of MP Municipalities Act, 1961, the source of own revenue of ULBs are through taxes, rent, fees, issue of licenses etc. In case of unrealised tax and non-tax revenue, the Municipal Corporations are required to take necessary action for recovery as envisaged in section 173 to 183 of the MP Municipal Corporation Act, 1956.

Audit observed that in 50 ULBs out of test checked 63 ULBs, tax revenue of ₹ 101.95 crore imposed up to March 2015 remained unrealised. Remaining 13 ULBs did not furnish information to Audit. The amount included ₹ 93.60 crore on account of property tax, composite tax, education cess, urban development cess, market fees and show tax imposed in 50 ULBs (*Appendix-3.4*) and ₹ 8.35 crore on account of rent and premium imposed by 40 ULBs as detailed in *Appendix-3.5*.

⁵ Municipal Corporation: 1 Municipal Council: 11 Nagar Parishad: 21

Similarly, non-tax revenue (water charges, license fees, land and building rent etc.) amounting to ₹ 77.60 crore remained unrealised in 50 ULBs (**Appendix-3.6**). Remaining 13 ULBs did not furnish information to Audit.

In reply, the Commissioner/CMOs of respective Municipal Corporations/ Councils and Nagar Parishads stated (2015-16) that effort would be made to recover unrealised revenues of ULBs. UADD stated (January 2017) that instructions would be issued to concerned ULBs from state level for recovery.

Diversion of Education cess for purchase of electrical items

As per instruction of UADD (October 2012), ULBs had to utilise education cess on maintenance of government schools with ensuring pure drinking water and toilet facilities within the jurisdiction of ULBs. Audit scrutiny revealed that Gwalior Municipal Corporation utilised education cess amounting to ₹ 7.85 lakh on procurement of ACs, fans and other electrical items for new building of the Corporation.

In reply, the Commissioner stated (October 2015) that the electrical items were purchased as per order of the Mayor in Council (MIC).

The reply is not acceptable, as the utilisation of education cess on procurement for the buildings of Corporation was in violation of instructions of UADD.

3.11 Temporary advances not adjusted

Rule 112 (2) of the MP Municipal Accounts Rules, 1971 stipulates that no advance shall be drawn unless expenditure is likely to be incurred within one month. The CMO/Accounts Officer of Municipalities would review unadjusted advance quarterly and submit before Finance Committee/Standing Committee of ULBs.

During test check of records of 63 ULBs, audit noticed that temporary advances of ₹ 1.15 crore provided by 19 ULBs to individuals remained outstanding as on 31 March 2015, as detailed in **Appendix-3.7**. In 8 ULBs no temporary advance was outstanding, whereas remaining 36 ULBs did not furnish the relevant information to Audit.

The Commissioner/CMOs of the concerned ULBs stated (2015-16) that instructions for recovery and adjustment of outstanding advances had been issued. In reply, UADD stated (January 2017) that instructions would be issued to concerned ULBs for recovery.

3.12 Fourteenth Finance Commission Grants

Fourteenth Finance Commission (14th FC) Grants-in aid were released to the State in the form of Basic Grants during 2015-16. As per 14th FC recommendations, allocations among various ULBs within the State were to be made by the respective States. Further, States were required to release the grants to the ULBs within fifteen days of it being credited to their accounts by the Union Government. In case of delay, the State Government must release the instalment along with interest at the bank rate of Reserve Bank of India paid from its own funds.

Audit scrutiny revealed that State Government received ₹ 496.79 crore of basic grant as per entitlement from Government of India (GoI) in two equal instalments of ₹ 248.395 crore in July 2015 and March 2016. However, State

Government delayed the release of first instalment of grants to ULBs, as detailed in **Table 3.4**.

Table – 3.4: Entitlement and release of 14th FC Basic Grant during 2015-16

(₹ in crore)

Entitlement of State	Receipt from GoI		Release to ULBs		Delayed (Days)	Interest
	Date	Amount	Date	Amount		
496.79	13.07.2015	248.395	05.08.2015	248.395	8	0.45
	02.03.2016	248.395	05.03.2016	248.395	-	-

(Source: Information provided by Finance Department and UADD)

As a result of delays in release of grants to ULBs, State Government sanctioned ₹ 44.92 lakh as interest. However, the interest was not released to ULBs along with instalments as recommended by 14th FC.

In reply, UADD stated (September 2016) that sanction order for the interest amount was issued by Finance Department but interest was not received. It further informed (January 2017) that efforts would be made to disburse the 14th FC grant within schedule time.

Fact remains that the failure of State Government to release Basic Grants received from GoI within the prescribed time to ULBs resulted in additional liability of ₹ 44.92 lakh towards interest.