

## CHAPTER I

### THE STRUCTURE AND FINANCES OF THE LOCAL SELF GOVERNMENT INSTITUTIONS

#### 1.1 Introduction

**1.1.1** In terms of the provisions of the Kerala Panchayat Raj Act, 1994 and the Kerala Municipality Act, 1994 Government devolved upon the Panchayats and Municipalities, the responsibilities, institutions and schemes relating to the matters enlisted in the schedules of the Acts with effect from 2 October 1995. Government have also transferred the assets and liabilities along with the officials relating to the transferred institutions. The Acts specify that the Panchayats and Municipalities shall administer the institutions so transferred and that they shall be known in the name of the respective Local Self Government Institution (LSGI). The LSGIs are not, however empowered to sell, transfer, alienate or pledge the properties transferred to them. As stipulated in the Act, the Government continues to pay the salary of the transferred employees.

#### 1.2 Decentralised planning

**1.2.1** The concept and philosophy of decentralised planning emanate from articles 243-G and 243-W of the Constitution which envisage preparation of plans and implementation of schemes for economic development and social justice by the Panchayats and Municipalities. The decentralised planning process in Kerala was given an impetus in July 1996 and several unique features were introduced like the Government's decision to earmark 35 to 40 *per cent* of the State's annual plan outlay for the projects drawn up by the LSGIs, the central function of planning being performed by the LSGIs and the planning system based on people's participation in the form of Working Groups, Grama/Ward Sabhas and Development Seminars. Kerala was selected\* for the Rs.5 crore award instituted by the Union Ministry of Panchayat Raj, in recognition of its initiative in ensuring the participation of all sections of society in planning and decision making.

**1.2.2** The LSGIs in Kerala have already started spending significant amounts of money (in the region of Rs.3000 crore annually) and with the strong, widely shared sense in Kerala that there should be greater decentralisation to LSGIs, there is an absolute necessity for an effective system of budgeting, accounting and financial reporting that would promote better accountability and stabilise local governance.

#### 1.3 Profile of the Local Self Government Institutions

**1.3.1** As on 31 March 2005, there were 1215 Local Self Government Institutions in the State. Details of the average area and population were as under:

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\*Economic Review 2005, Published by the State Planning Board.

Type of LSGIs	Number	Average area (Sq.km) <sup>@</sup>	Average population <sup>@</sup>
Grama Panchayats	991 <sup>§</sup>	37.50	26846
Block Panchayats	152	244.50	175030
District Panchayats	14	2654.68	1900324
Municipalities	53	23.06	51530
Municipal Corporations	5	95.15	500599

**1.3.2** The State Election Commissioner conducted elections to the LSGIs in 1995, 2000 and 2005. The newly elected members took charge on 2 October of the respective year.

## **1.4 Organisational Set Up**

**1.4.1** In the three-tier Panchayat Raj system in the State, each tier of Panchayat functions independently of each other.

**1.4.2** The members of the Panchayat elect the President, Vice President and Chairpersons of the Standing Committees. Similarly, Councillors of the Municipal Council/Corporation Council elect the Chairperson/Mayor, Vice Chairperson/Deputy Mayor and Chairpersons of the Standing Committees.

**1.4.3** The President/Chairperson/Mayor is an ex-officio member of every standing Committee and the Vice president/Vice Chairperson/Deputy Mayor is an ex-officio member and Chairperson of the Standing Committee for Finance.

**1.4.4** Each LSGI has a Secretary and supporting staff. The Secretary and staff of the three-tier Panchayats are Government servants. While the Secretaries of Municipalities and Municipal Corporations are Government servants, the staff belongs to the Municipal Common Service.

**1.4.5** Audit noticed instances of weak implementation of development programmes owing to a divided sense of accountability among officers assigned to LSGIs. Government have the authority to appoint, by a general or special order, any transferred officer as the ex-officio Secretary of the LSGI, having all the powers and functions of the Secretary on the subjects dealt with by him. Issue of such an order by the Government would have the advantage of integrating the transferred institutions with the LSGIs, more firmly.

## **1.5 Regulatory Environment**

### **Legal aspects – accounts and audit**

**1.5.1** The following procedure is prescribed in the Acts and Rules for the financial reporting by LSGIs.

- Submission of accounts to the auditor within four months after the completion of the financial year, that is before 31 July<sup>1</sup>.

<sup>@</sup> As per memorandum submitted by the Government to Twelfth Finance Commission.

<sup>§</sup> 999 Grama Panchayats and 1223 LSGIs from October 2005.

<sup>1</sup> (i) Rule 11 of Kerala Panchayat Raj (Manner of Inspection and Audit System) Rules, 1997 and the Kerala Municipality (Manner of Inspection and Audit System), Rules 1997, (ii) Section 9 of Kerala Local Fund Audit Act, 1994.

- Submission of abstract of annual report as certified by the auditor, showing receipts, charges and the balance remaining unexpended along with the audit report thereon to the officer authorised by Government in this behalf not later than the fifteenth day of the second month of the next financial year<sup>1</sup>, that is before 15 May.
- Consolidation of the report and submission to Government by the authorised officer forthwith<sup>1</sup>.
- Government causing the accounts together with the audit report thereon to be laid before the Legislative Assembly<sup>1</sup>.
- Government causing the accounts to be published<sup>1</sup>.

**1.5.2** In the report for the year ended 31 March 2004, audit referred to the conflicting provisions in the Acts and Rules and the necessity for suitable amendments; appropriate measures to comply with the provisions of the Acts and issue of orders in the interest of good governance. Government have not issued any orders in the matter except a notification dated 22 December 2004 regarding the authorisation of district level officers for receiving Annual Reports and Audit Reports of Panchayat Raj Institutions.

**1.5.3** The major ambiguities and the conflicting provisions in the existing regulatory framework are as follows:

- Inconsistency in the Acts and Rules regarding the date of submission of annual accounts by the LSGIs;
- Lack of clarity regarding time taken for audit and the eventual submission of audited accounts to Government and the Legislature;
- Ambiguity regarding Annual Accounts and Annual Report and the scope of the audit process, that is whether it covers the Annual Accounts, the Annual Report or both;
- The scope and contours of the consolidation process from the unit account upwards to obtain an overall picture of LSGI finances at the State level;
- Revision in the Budget and Accounts Rules in the light of Acts and the new formats of budget and accounts suggested by Comptroller & Auditor General of India.

**1.5.4** The legislative intention of publishing the consolidated accounts on an annual basis has never been fulfilled. Audit had proposed specific amendments to the existing legislation as early as March 2004 with a view to achieving some measure of clarity in the institutional and regulatory framework for Accounts and Audit of LSGIs. The proposals continue to be under the consideration of the State Government.

**1.5.5** The new formats for Budget and Accounts of Panchayat Raj Institutions (PRIs) prescribed by the Comptroller and Auditor General of India (CAG) have become operational from 1 April 2004. The new formats for

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<sup>1</sup> Sections 215 (15) to (17) and Section 295 (15) to (17) of the respective Acts.

Urban Local Bodies (ULBs) prescribed by the CAG though accepted by the Government in September 2003, are yet to be adapted to suit the local requirements. In the circumstances, accrual accounting in ULBs had not come into force with effect from 1 April 2006, the date notified by the Government for adoption of the new basis of financial reporting. Government have not framed so far the Rules and Manuals for Budget and Accounts of the PRIs. Consequently, the Kerala Panchayat (Budget) Rules, 1963 and the Kerala Panchayat (Accounts) Rules, 1965, which are at variance with the new formats, continue to be in force.

**1.5.6** The Director of Local Fund Audit (DLFA) is the primary Auditor of the LSGIs, as provided in the Acts. Complying with the request made by the State Government in October 2002 and in pursuance of the recommendations of the Eleventh Finance Commission, the CAG provides Technical Guidance and Supervision (TGS) for the audit of LSGIs. The CAG is empowered to audit the LSGIs under the provisions of sections 14 and 15 of the Comptroller and Auditor General's (DPC) Act, 1971 also.

**1.5.7** A separate committee of legislature under the name Committee on Local Fund Accounts has been constituted with effect from June 2003 to examine the Audit Reports on the LSGIs.

#### **Administrative aspects**

**1.5.8** Besides the Annual Report containing accounts, each Panchayat and Municipality is required under the respective Acts to prepare and publish an Annual Administration Report in each year within the 30<sup>th</sup> day of September of the succeeding year.

**1.5.9** The State Government does not exercise administrative control over the LSGIs. The higher tiers of Panchayats also do not exercise control over the lower levels in the three-tier Panchayat system. The co-ordination of the functions of the various LSGIs are in the following pattern: Government in the case of Municipal Corporations and District Panchayats; Director of Urban Affairs (DUA) in the case of Municipalities; the Commissioner for Rural Development (CRD) through the Assistant Development Commissioners (General) in the case of Block Panchayats and the Director of Panchayats through the Deputy Directors of Panchayats (DDPs) in the case of Grama Panchayats.

### **1.6 Financial Reporting**

**1.6.1** The principal means by which LSGIs can discharge their accountability for the stewardship and use of public money is through the production of timely audited accounts and the associated narratives and disclosures. In the report for the year ended 31 March, 2004, audit expressed concern about the standard of financial reporting in LSGIs.

**1.6.2** The experience of audit in the current year reinforces these concerns. The LSGIs did not appear to take the process of preparing and publishing their accounts seriously enough. The year-wise details of arrears in

the submission of accounts by the LSGIs and their audit by DLFA present a dismal picture. The details as at the end of November 2005 are given below\*:

Year	Number of LSGIs and the number of accounts due	Number of accounts received by DLFA	Number of accounts in arrears	Number of accounts received, but not audited by DLFA
1996-97	1214	1073	141	3
1997-98	1214	1028	186	10
1998-99	1214	980	234	5
1999-00	1214	957	257	15
2000-01	1215	893	322	46
2001-02	1215	768	447	105
2002-03	1215	544	671	233
2003-04	1215	323	892	242
2004-05	1215	109	1106	109
<b>Total</b>	<b>10931</b>	<b>6675</b>	<b>4256</b>	<b>768</b>

**1.6.3** The above table shows that as against 10931 accounts which were receivable during the nine year period of 1996-97 to 2004-05, 4256 accounts i.e. 39 per cent were outstanding. The earliest of arrears related to 1996-97. Ninety one per cent of the accounts relating to the latest year i.e. 2004-05 were in arrears. Audit by the DLFA was in arrears in the case of 11.50 per cent of the accounts received.

**1.6.4** The deficiencies in asset accounting also continued during the year 2004-05, though it was pointed out in the report for the year ended 31 March 2004. With effect from 2 October 1995, the Government transferred assets and liabilities of the institutions relating to the transferred functions to the LSGIs in the process of decentralisation. The transferred institutions included Krishi Bhavans, Primary Health Centres, Hospitals and Dispensaries, Schools and Agricultural Farms having considerable assets in the form of land, buildings and movable properties. Government have not taken any steps for the identification of the nature and location and for the valuation of assets and liabilities of the transferred institutions. The transferred assets have not been incorporated in the asset registers of the LSGIs and formal transfer in the revenue records has not been made. Government stated that the assets transferred had not been valued (January 2006).

**1.6.5** The LSGIs are reported to have spent Rs.51.73<sup>@</sup> crore during 2004-05, as per the certificate furnished by DLFA, for creation of assets. The details of assets created were not available for want of recipient wise details of expenditure incurred.

**1.6.6** In the absence of identification and valuation of assets and due to incomplete maintenance of Asset Registers, it was difficult for audit to obtain a reasonable assurance regarding the proper maintenance and safeguarding of assets by LSGIs. Government stated (October 2005) that as part of Decentralisation Support Programme, they had launched an initiative for

\* Source: Information furnished by the DLFA.

@ Information collected from DLFA.

mapping the assets transferred to LSGIs. Final outcome of the verification and valuation of assets is awaited.

**1.6.7** The inability to produce good quality accounts promptly at the end of the financial year reflects inadequate financial monitoring, reporting and forecasting arrangement of LSGIs. A pre-condition of proper accountability for the stewardship and use of public money is proper accounting in compliance with the best professional practices. This is an area in which the LSGIs need to substantially improve their performance.

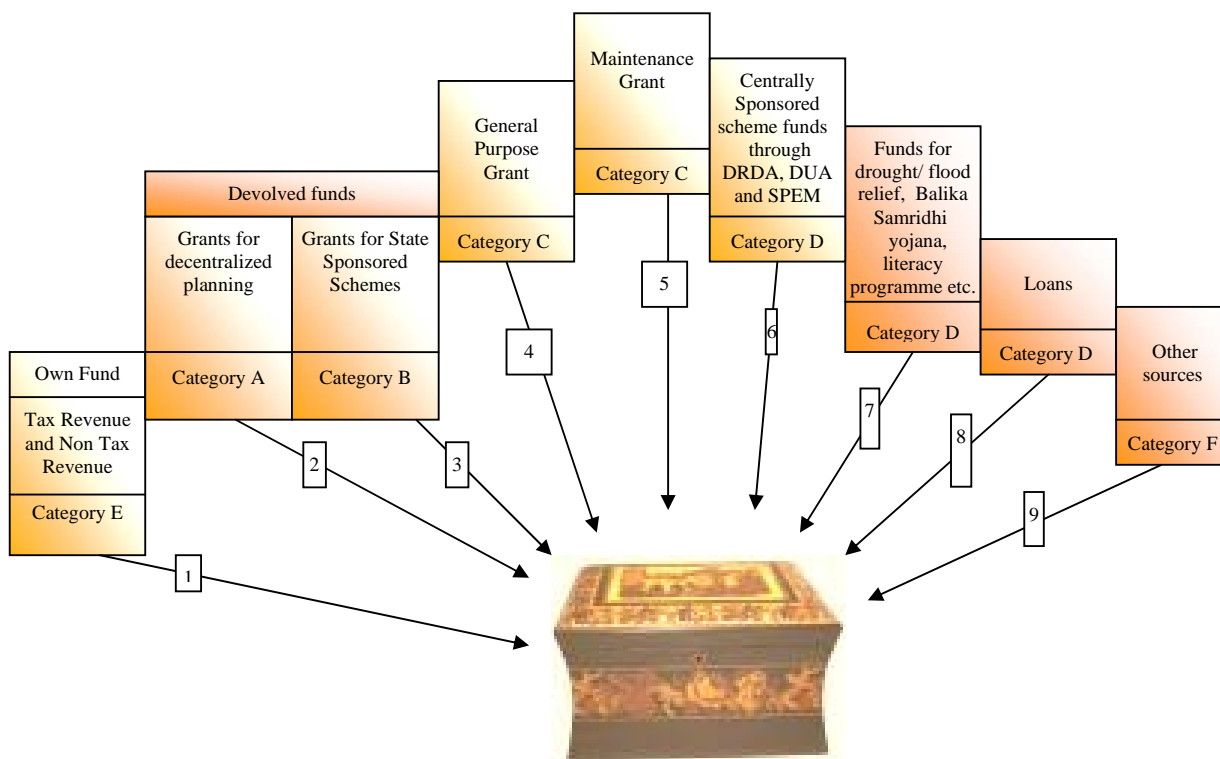
**1.6.8** An Annual Report to local tax payers and stakeholders including service users, that provides an objective, balanced and understandable assessment of the LSGIs' activities and achievements, its financial position and performance, is a key vehicle through which each LSGI can discharge its accountability for the stewardship and use of public money and the proper conduct of public business.

**1.6.9** The State Government has not shown encouraging signs of moving adequately in this direction. The fact that in spite of receiving Eleventh Finance Commission Grant of Rs.1.83 crore for the period 2000-01 to 2003-04 for maintenance of accounts of Grama Panchayats and Block Panchayats, their accounts were in arrears was brought to light in the report for the year ended 31 March 2004. The total amount of Eleventh Finance Commission Grant for the five year period of 2000-01 to 2004-05 was Rs.2.28 crore which is yet to be transferred to the Panchayats. Audit noticed that several LSGIs though keen to use their 'own funds' to bring their accounts up to date, were precluded from doing so for want of suitable direction in this regard from the State Government.

**1.6.10** The Government have to ensure that the Eleventh Finance Commission Grant for maintenance of accounts is transferred immediately to the Panchayats. They also need to consider permitting LSGIs to utilise their own funds for updating their accounts. Unless timely financial reporting receives the major importance it deserves and as legislatively envisaged, there may always remain valid arguments against democratic decentralisation of the kind practised in Kerala.

## **1.7 Funds of LSGIs**

**1.7.1** The nine sources of funds of LSGIs could be broadly broken up into two groups based on their degree of reliability. Reliable information is available for the first group consisting of five sources namely devolved funds under categories A and B, General Purpose Grant, Maintenance Grant and Centrally Sponsored Scheme Funds received through District Rural Development Agency (DRDA), DUA and State Poverty Eradication Mission (SPEM). In the second group for which there is no reasonable assurance, there are four sources namely, own fund; funds received through District Collectors and other agencies; loans and other sources. The sources of revenue are depicted in the diagram.



**Flow of funds to Grama Panchayats, Block Panchayats, District Panchayats, Municipalities and Municipal Corporations**

- 1 - Collection by LSGI
- 2 - Government to Municipal Corporations (MCs) and District Panchayats (DPs); through DUA to Municipalities; through Assistant Development Commissioner (General) to Block Panchayats (BPs) and through DDP to Grama Panchayats (GPs)
- 3 - Through the District officers of Department concerned
- 4 - As in the case of 2
- 5 - As in the case of 2
- 6 - Through DRDA to BPs, GPs and DPs; through DUA and SPEM to MCs and Municipalities
- 7 - Through District Collectors and various agencies.
- 8 - From Government and Financial Institutions
- 9 - Various sources

**1.7.2** The sources, their application and the manner of flow to LSGIs are briefly discussed below:

**Funds about which reliable information is available.**

**Funds devolved upon LSGIs for decentralised planning and State Sponsored Schemes.**

**1.7.3** In order to have 35 to 40 *per cent* of the State's plan schemes formulated and implemented by the LSGIs, Government in August 1997, decided to devolve upon the LSGIs 35 to 40 *per cent* of the State's Annual Plan outlay from the year 1997-98. This initiative was called 'Peoples

Campaign for the formulation of Ninth Five Year Plan' during the Ninth Plan period and 'Kerala Development Plan' during the Tenth Plan period. The funds devolved upon the LSGIs in this manner belong to two categories namely, Category A Funds and Category B Funds.

**1.7.4** Category 'A' Funds are Plan Grants for schemes formulated by the LSGIs relating to the functions entrusted to them under the schedules of the respective Acts. Government makes allotment direct to the District Panchayats and the Municipal Corporations. The DUA allots funds to the Municipalities. The CRD allots funds to the Block Panchayats through the Assistant Development Commissioner (General) of each district while the Director of Panchayats makes allotments to the Grama Panchayats through the DDP of each District. Category A Funds are to be applied for expenditure on the projects formulated and implemented by the LSGIs as part of the decentralised plan.

**1.7.5** Category 'B' Funds are Plan and Non-Plan Grants for State Sponsored Schemes. The State Sponsored Plan Schemes include Special Livestock Breeding Programme, distribution of house sites to rural landless workers, integrated housing subsidy for Scheduled Castes etc. The Non-Plan schemes are unemployment wages, agricultural workers' pension, widow pension etc. The District Officers of the Departments concerned allot Category 'B' Funds to each LSGI of the District. Category B funds can be applied only for the specified schemes.

**1.7.6** During the period 1997-98 to 2004-05, against a budget provision of Rs.12459.56\* crore, the State Government devolved upon the LSGIs a total amount of Rs.10525.02# crore as Plan and Non-Plan Grants and loans. The Plan Grants/loans shown in the table consist of Category A Fund and the Plan Component of Category B Fund. Details are given in *Appendix-I*.

Type of LSGIs	Budget provisions			Amount disbursed			
	Plan	Non-plan	Total	Plan	Non-plan	Total	Percentage of devolution over budget provision
Grama Panchayats	5200.09	1706.53	6906.62	4394.10	1644.53	6038.63	87.43
Block Panchayats	1787.30	122.68	1909.98	1338.03	125.29	1463.32	76.61
District Panchayats	1407.83	407.16	1814.99	1107.18	375.24	1482.42	81.68
Municipalities	835.23	308.98	1144.21	730.35	195.56	925.91	80.92
Municipal Corporations	529.62	154.14	683.76	468.47	146.27	614.74	89.91
<b>Total</b>	<b>9760.07</b>	<b>2699.49</b>	<b>12459.56</b>	<b>8038.13</b>	<b>2486.89</b>	<b>10525.02</b>	<b>84.47</b>

**1.7.7** As per the policy statement of 1996, implementation of 35-40 per cent of State's Plan Schemes through LSGIs from the year 1997-98 was envisaged with corresponding devolution of funds upon the LSGIs. As against budget provisions of Rs.4800 crore for state annual plan outlay for the year 2004-05, actual disbursement was Rs.3755.25 crore, of which devolution to LSGIs was Rs.1092.74 crore (29.09 per cent) as shown below:

\* State Budget.

# Finance Accounts.



(Rupees in crore)			
Sl No	Details	Budget provision*	Disbursement <sup>Ω</sup>
1	State's Annual Plan Outlay/Expenditure	4800.00	3755.25
2	Devolution upon LSGIs	1401.56	1092.74
3	Percentage of 2 to 1	29.20	29.09

### General Purpose Grant and Maintenance Grant

**1.7.8** From the year 2004-05 Government started disbursing to LSGIs, General Purpose Grant (Non-Plan) and Maintenance Grant (Non-Plan), under the recommendations of Second State Finance Commission. The flow of funds in the case of General Purpose Grant and Maintenance Grant was similar to that of Category A funds. General Purpose Grant which was equal to 3.5 per cent of the tax revenue raised by the State Government during the previous year was provided in lieu of the Basic Tax Grant, Surcharge on Stamp Duty, Rural Pool Grant, the Specific Purpose and General Purpose Grants to Urban Local Bodies and all other Non-Plan Grants devolved upon LSGIs. General Purpose Grant was to be utilised as part of own fund and for meeting all admissible expenditure of LSGIs as per the Acts and for office expenses, water charges, electricity charges etc. of the transferred institutions. General Purpose Grant was transfer credited in lump to the own fund account of the LSGIs.

**1.7.9** Maintenance Grant (Non- Plan) which was equal to 5.5 per cent of the tax revenue of the State Government was provided for the maintenance of assets under the control of LSGIs including the transferred assets. Maintenance Grant has two components namely, one for the road assets and the other for non-road assets.

**1.7.10** During the year 2004-05, Government paid General Purpose Grant and Maintenance Grant to LSGIs as shown below.

(Rupees in crore)		
Type of LSGI	General Purpose Grant	Maintenance Grant <sup>Ω</sup>
Three-tier Panchayats	151.53	132.19
Municipalities and Municipal Corporations	40.52	42.24

**1.7.11** From December 2004, Government introduced Bill system for the drawal of Plan/Non-Plan Grants under Plan Fund (Category A), State Sponsored Fund (Category B) and General Purpose and Maintenance Grants (Category C) from the Consolidated Fund by the LSGIs. For this purpose Government declared the Secretaries of LSGIs and the other implementing officers as Drawing and Disbursing Officers. The Personal Deposit Accounts maintained by the LSGIs for transfer crediting Plan/Non-Plan grants were closed from 1 December 2004. Under the Bill system, Panchayats are permitted to draw only the funds required for immediate disbursement except the allotments for General Purpose Grant, which can be transfer credited to the own fund. In all other cases, the unutilised fund lapsed at the end of the financial year, preventing the LSGIs from retaining unutilised grants.

\* Source: State Budget 2004 – 05.

<sup>Ω</sup> Source: Finance Accounts 2004 – 05.

Consequently, the disbursement by Government and the utilisation by the LSGIs in the case of these grants was equal.

**Centrally Sponsored Scheme Funds received through DRDA, DUA and SPEM.**

**1.7.12** District Rural Development Agencies, Director of Urban Affairs and State Poverty Eradication Mission disbursed funds to LSGIs for implementing Centrally Sponsored Schemes.

**1.7.13** Central shares of funds to LSGIs are generally not routed through the State budget. The Central and State shares distributed to the LSGIs and their utilisation during the period 2004-05 in respect of various schemes, were as follows:

(Rupees in crore)

Authority / Agency who disbursed the fund	Type of LSGI	Opening Balance	Distribution to LSGIs		Total available fund	Funds utilised by LSGIs	Balance	percentage of utilisation
			Central Share	State Share				
1. District Rural Development Agency	Panchayats	98.38	244.55	81.86	424.79	345.01	79.78	81.22
2. Director of Urban Affairs	Municipal bodies	--	25.65	1.60	27.25	17.83	9.42	76.03
3. Kudumbashree (The State Poverty Eradication Mission)	Municipal bodies	8.47	153.38	73.23	235.08	176.99	58.09	75.28
<b>Total</b>		<b>106.85</b>	<b>423.58</b>	<b>156.69</b>	<b>687.12</b>	<b>539.83</b>	<b>147.29</b>	

(Source: Information collected from the CRD; DUA and SPEM)

*The details are given in Appendix II*

**1.7.14** In the absence of consolidated accounts, it could not be ascertained as to whether these LSGIs incurred any loss of Central assistance and also the State share in the prescribed funding ratio.

**Funds about which reliable information is not available**

**1.7.15** In the absence of consolidated accounts of the LSGIs in the state, information about the remaining four sources was collected from various agencies. As such there was no assurance about the completeness, correctness and accuracy of the figures. The details relating to the four sources are given below.

**Own funds**

**1.7.16** Own funds consist of tax and non-tax revenue. The Grama Panchayats, Municipalities and Municipal Corporations collect tax revenue and non-tax revenue like licence fees and registration fees. The taxes collected are property tax, profession tax, entertainment tax, advertisement tax and timber tax. Non-tax revenue includes Dangerous and Offensive Trades licence fees, registration fees for private hospitals, paramedical institutions and tutorial institutions, rent on land and buildings, sale proceeds of river sand, bus stand fees, market fees etc. The LSGIs can apply own funds for all the objects incidental to their functioning. The revenue derived from transferred assets and transferred institutions can be applied only for their maintenance. The overall trend of tax and non-tax revenue of the Grama Panchayats, Municipalities and Municipal Corporations were as follows:

(Rupees in crore)

Year	Grama Panchayats		Municipalities		Municipal Corporations	
	Tax	Non Tax	Tax	Non Tax	Tax	Non-Tax
1997-98	81.46	72.88	47.97	34.13	43.71	12.73
1998-99	88.28	80.20	50.63	37.62	48.27	15.99
1999-00	100.21	138.28	57.20	37.93	65.44	23.19
2000-01	116.01	103.65	68.53	45.33	74.71	20.71
2001-02	114.49	79.25	75.84	51.47	52.53	46.15
2002-03	123.18	102.83	86.17	57.79	93.85	58.09
2003-04	*	*	*	*	*	*
2004-05	*	*	*	*	*	*

Source: Figures submitted to the Twelfth Finance Commission by Government of Kerala

### Funds for drought relief/flood relief, literacy programmes, Balika Samridhi Yojana etc.

**1.7.17** The funds under this category are received through District Collectors and various agencies. The amounts received are kept in separate Bank Accounts and are applied for the specified purposes. The absence of consolidated accounts has resulted in non-assurance about the funds received.

### Loans

**1.7.18** During the year 2004-05, Government and Financial Institutions paid a total loan of Rs.24.38 crore to the LSGIs as shown below.

(Rupees in crore)

Government/Financial Institution	Panchayats	Municipalities/Corporations
	Government	---
HUDCO <sup>@</sup>	---	1.95
KURDFC <sup>§</sup>	0.20	5.69
<b>Total</b>	<b>0.20</b>	<b>24.18</b>

Source: Finance Accounts 2004-05 and details furnished by HUDCO and KURDFC.

**1.7.19** As on 31 March 2005, loans of Rs.394.95 crore availed by LSGIs from various sources were outstanding as detailed below<sup>£</sup>:

(Rupees in crore)

Sl.No.	Source of Loan	Category of LSGI					Total
		GP <sup>1</sup>	BP <sup>2</sup>	DP <sup>3</sup>	Municipality	Municipal Corporation	
1.	Government	-	-	0.13	23.37	68.89	92.39
2.	Government Guarantee	-	-	119.89	0.03	0.15	120.07
3.	Financial Institutions	21.46	-	116.45	34.76	9.82	182.49
	<b>Total</b>	<b>21.46</b>	<b>-</b>	<b>236.47</b>	<b>58.16</b>	<b>78.86</b>	<b>394.95</b>

\* Not available.

<sup>@</sup> HUDCO – Housing and Urban Development Corporation.<sup>§</sup> KURDFC – Kerala Urban and Rural Development Finance Corporation Limited.<sup>£</sup> Source: Finance Accounts and information collected from Financial Institutions.<sup>1</sup> Grama Panchayat, <sup>2</sup> Block Panchayat, <sup>3</sup> District Panchayat

In the absence of consolidated accounts, there is no assurance regarding the total loan availed from the financial institutions during the financial year, the loans outstanding at the end of the year, the proper utilisation of loans and the trend of repayment.

### Other Sources

**1.7.20** The receipts from other sources are beneficiary contributions, voluntary contributions, contributions in kind etc. These are kept in the own fund account but are utilised for the specified purposes. In the absence of consolidated accounts, information on the funds received under this category is not available.

## 1.8 Overall finances of the LSGIs – missing picture

**1.8.1** The inevitable consequence of the weak financial reporting is the missing picture regarding the overall finances of the LSGIs in Kerala. In an attempt to present an overall picture of the finances of the LSGIs for the year 2004-05, even though fraught with the risk of non-reliability in the absence of audited accounts, audit requested the LSGIs in the State in July 2005, to furnish information in a specially devised format. However, only 10 per cent of the LSGIs responded. The available information, showing the total receipts of LSGIs under various sources during year 2004-05 was Rs.2909.71 crore is presented below.

Type of LSGI	Own Fund (E)		Devolved Funds: Plan Fund (A) and State Sponsored Fund (B)	General Purpose Grant (C)	Maintenance Grant (C)	Centrally Sponsored Scheme funds received through DRDA, DUA and SPEM (D)		Funds for drought/ flood relief, literacy programmes, Balika Samridhi Yojana etc. (D)	Loans (D)	Other Sources (F)	Total of the available figures
	Tax revenue	Non - Tax revenue				Central share	State Share				
Grama Panchayats	123.18	102.83	868.30	#	#	#	#	*	0.20	*	*
Block Panchayats	Nil	*	189.34	#	#	#	#	*	Nil	*	*
District Panchayats	Nil	*	154.84	#	#	#	#	*	Nil	*	*
<b>Total for Panchayats</b>	<b>123.18</b>	<b>102.83</b>	<b>1212.48</b>	<b>151.53</b>	<b>132.19</b>	<b>244.55</b>	<b>81.86</b>	<b>*</b>	<b>0.20</b>	<b>*</b>	<b>2048.82</b>
Municipalities	86.17	57.79	125.04	#	#	#	#	*	7.64	*	*
Municipal Corporations	93.85	58.09	79.15	#	#	#	#	*	16.54	*	*
<b>Total for Municipalities and Corporations</b>	<b>180.02</b>	<b>115.88</b>	<b>204.19</b>	<b>40.52</b>	<b>42.24</b>	<b>179.03</b>	<b>74.83</b>	<b>*</b>	<b>24.18</b>	<b>*</b>	<b>860.89</b>
<b>Grand Total</b>	<b>303.20</b>	<b>218.71</b>	<b>1416.67</b>	<b>192.05</b>	<b>174.43</b>	<b>423.58</b>	<b>156.69</b>	<b>*</b>	<b>24.38</b>	<b>*</b>	<b>2909.71</b>

The sources of information for the above figures are as follows.

- Own fund: The figures submitted to the Twelfth Finance Commission by the Government of Kerala. In the absence of figures for the year 2004-05, the figures for 2002-03 are adopted.

# Split up not available.

\* Not available

- Devolved funds, General Purpose Grant and Maintenance Grant: extracted from Finance Accounts 2004-05.
- Centrally Sponsored Scheme Funds received through DRDA, DUA and SPEM: Information furnished by CRD,DUA and SPEM
- Loans: Extracted from Finance Accounts 2004-05 and information collected from Kerala Urban and Rural Development Finance Corporation Limited and Housing and Urban Development Corporation Limited (HUDCO). Details of loans, if any, availed from any other sources are not available.

**1.8.2** Good financial reporting is a key element of good financial management. The final accounts should be derived from routine management accounting information and their production should be a natural extension of normal monthly management reporting. From the above table, it is clear that reliable and relatively current figures are available only for devolved funds, General Purpose Grant, Maintenance Grant and Centrally Sponsored Scheme funds received through DRDA, DUA and SPEM. For the figures under the other four distinct sources of funds, there is no assurance regarding completeness and accuracy. As long as the system of consolidation of accounts is not properly provided for as envisaged in the regulatory legislation, there would always remain uncertainty regarding the correctness of figures. This would naturally impact the quality of oversight provided by the State Government and the successive Finance Commissions.

**1.8.3** LSGIs are required to incorporate in their budgets, detailed estimates of receipts and payments. However, due to the non-formulation of annual plan in time, the LSGIs could not incorporate estimates of receipts and payments relating to Plan schemes in their budgets. This resulted in LSGIs incurring plan expenditure without budget approval which was indicative of poor budgetary control and lack of accountability. The position continued to be the same in 2004 - 05 even though the deficiency was pointed out in the report for the year ended 31 March 2004. A detailed comment regarding this aspect appears in the Performance Review on Plan Formulation appearing in Chapter III.

## **1.9 Outstanding advances**

**1.9.1** Test check of the records of 116 LSGIs revealed that advances paid to various implementing agencies like Kerala State Electricity Board, Kerala State Housing Board, Kerala Water Authority etc. and mobilisation advances paid to convenors of beneficiary committees during 1997-98 to 2003-04 were treated as expenditure. As of 31 March 2005, Rs.49.71<sup>#</sup> crore was outstanding towards advances as detailed below.

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<sup>#</sup> Source : Local audit reports of LSGIs.

(Rs in crore)			
Sl. No	Recipients of advance	Period of advance payment	Amount
1.	Kerala State Electricity Board	1997-98 to 2003-04	15.85
2.	Kerala State Housing Board	"	8.93
3.	Kerala Water Authority	"	9.16
4.	Nirmithi Kendra	"	1.35
5.	COSTFORD*	"	0.73
6.	ANERT <sup>δ</sup>	"	0.09
7.	Convenors of beneficiary committees	"	5.27
8.	Others <sup>§*</sup>	"	8.33
<b>Total</b>			<b>49.71</b>

**1.9.2** Despite having been pointed out the risks of non-adjustment of outstanding advances in the previous report (2003-04), there is no significant change in the earlier position.

### **1.10 Diversion of Plan Grants for payment of Audit Fee**

**1.10.1** Government ordered in January 2004 that the arrears of Audit Fee due to Government relating to the audit conducted by the DLFA from various LSGIs should be adjusted from the monthly instalments of Plan Grants released to them. While releasing the Plan Grant of Rs.28.20 crore earmarked for Block Panchayats, the CRD deducted Rs.1.92 crore towards audit fee of Block Panchayats.

**1.10.2** Diversion of Plan Funds granted by Legislature specifically for approved Plan Schemes, was a violation of Art 266 (3) of the Constitution.

### **1.11 State Finance Commission**

**1.11.1** Government placed (March 2005) before the State Legislature the first part of the Report of the Second State Finance Commission (appointed in June 1999), submitted in January 2001. Government have partially accepted the recommendations of the Report and implemented recommendations for separate Budget provisions towards Maintenance Grant and General Purpose Grant. The Third State Finance Commission which came into being in September 2004 submitted its report in November 2005.

### **1.12 Twelfth Finance Commission Grants**

**1.12.1** The share of Kerala State under the Twelfth Finance Commission (TFC) Grants payable during the period 2005-2010 is Rs.985 crore for PRIs and Rs.149 crore for ULBs. PRIs are to utilise the funds for schemes of water supply and sanitation and ULBs for solid waste management. The States have to mandatorily transfer the grants released by the Centre to the PRIs and ULBs within 15 days of the same being credited to the State's Accounts. In case of delayed transfer to PRIs/ULBs beyond the specified period of 15 days, the State Government shall transfer to PRIs/ULBs interest at bank rate along with the delayed transfer of grants. The CAG is to audit the release and use of the

\* Centre for Science and Technology for Rural Development

<sup>δ</sup> Agency for Non-conventional Energy and Rural Technology

<sup>§\*</sup> Kerala Agro Industries Corporation Limited, Harbour Engineering Dept, Command Area Development Authority, Ground Water Dept, etc.

local bodies grants within the time and for the purposes mentioned by the TFC.

**1.12.2** In response to a communication, the State Government furnished (January 2006) a copy of the certificate forwarded by the State Finance Secretary to Government of India. The particulars of receipts and release of funds according to the above certificate are given below.

(Rs in crore)

Sl No	Allocation and release	PRIs		ULBs		Total	
		Date	Amount	Date	Amount	Date	Amount
1	Local Bodies Grant received from Centre	26.8.05	98.50	26.8.05	14.90	26.8.05	113.40
2	Total allocation of grants	April 2005 to November 2005	964.34	April 2005 to November 2005	174.32	April 2005 to November 2005	1138.66
3	Matching contribution if any, provided by State Government.	*	865.84	*	159.42	*	1025.26
4	Grants released to Local Bodies	April 2005 to November 2005	964.34	April 2005 to November 2005	174.32	April 2005 to November 2005	1138.66

**1.12.3** The State Government have stated that as recommended by the Second Finance Commission, Government have to release funds to LSGIs in the form of bulk grants. According to the State Government, separate allotments for different purposes cannot be made by them to the LSGIs and the funds received from Government of India as Local Bodies Grants cannot be allotted separately under different heads as indicated. However, Government issued circular instruction in January 2006, that the PRIs should give priority to spending on operation and maintenance of water supply and sanitation and ULBs should utilise at least 50 *per cent* of TFC award on solid waste management.

**1.12.4** The procedure for release of TFC grants to the LSGIs decided by the State Government is at variance from the procedure prescribed by the Central Government.

### 1.13 Recommendations

- Determined efforts are called for to improve the unsatisfactory position of financial reporting in LSGIs. The State Government should take strong initiatives in this area. As a first step the State Government may transfer to the Panchayats the Eleventh Finance Commission Grants received for maintenance of accounts and permit the LSGIs to utilise their own funds for updation of their accounts.
- As a consequence of inadequate financial reporting, there is a near complete absence of reliable information about the overall finances of LSGIs in the State. An authorised officer supported by suitable infrastructure should be put in place without further delay to consolidate the accounts of the LSGIs for presentation before the Legislative Assembly as envisaged in Section 215 of the KPR Act, 1994 and Section 295 of KM Act, 1994.

\* These columns were left blank in the Certificate forwarded by State Finance Secretary.