

CHAPTER-III

3. DEVOLUTION OF FUNDS, FUNCTIONS AND FUNCTIONARIES TO ULBs

3.1 Introduction

Recent Government policies allow for greater community participation in planning and development of rural and urban areas adopting the policy of decentralization. Institutions of local governance are being encouraged to experiment and introduce new practices. An important initiative in this regard is the enactment of 74th constitutional amendment, which defined the formal process of decentralized governance in ULBs. Provisions relating to ULBs which constitute the third layer of governance of the federal structure were added as a new part to the constitution to build up these institutions as democratic and participatory with broad based activity. Articles 243 W of the constitution authorised the State legislatures to enact laws to endow the local bodies with powers and authority as may be necessary to enable them to function as institutions of self government and make provisions for devolutions of powers and responsibilities with respect to: -

- (i) Preparation of plans for economic development and social justice.
- (ii) Performance of functions and implementation of schemes as may be entrusted to them including those in relation to matters listed in the 12th schedule.

3.2 Audit coverage

The review covering a period of 5 years from 2003-04 to 2007-08 was conducted during the period from March 2008 to September 2008 with reference to records of selected 13 ULBs (Municipal Corporation-One, Municipality-Six and Notified Area Councils-Six) of eight districts. Evidences were gathered through questionnaires and study of files.

3.3 Constitution of ULBs

Urban Local Body is defined as an institution of self-government constituted under Article 243 Q of the constitution. In Orissa, the constitution of ULBs are of the following three types: -

1. Notified Area Council (NAC) constituted for the transitional areas i.e. the area in transition from rural to urban.
2. Municipal Council for smaller urban areas,
3. Municipal Corporation for larger urban areas.

There were 2 Municipal Corporations, 35 Municipalities and 66 NACs in the State. While the NACs and Municipalities were governed under Orissa Municipal Act 1950, the Municipal Corporations were governed by Orissa Municipal Corporation Act 2003.

3.4 Audit Findings

The audit findings are discussed in the succeeding paragraphs.

3.4.1 Amendment of the Act

Consequent to the 74th Constitutional Amendment Act 1992, the State Government, through legislation amended the provisions of the Orissa Municipal Act incorporating all the 18 functions of 12th schedule of Article 243W. Section 117 of the existing Orissa Municipality Act 1950, contains the list of functions where municipal funds could be applied and it was supplemented by an additional list of the left out functions under section 374A in 1994 through legislation (Orissa Act of 11 of 1994). The list of functions and duties assigned to the Municipal Corporations are incorporated in Section 24 & 25 of Orissa Municipal Corporation Act 2003.

3.4.2 State Finance Commission

Article 243 Y of the Constitution had made it mandatory for the State Government to constitute a Finance Commission within one year from the commencement of the constitutional amendment act and there after on expiry of every 5 years to review the financial condition of the ULBs and to make recommendations to the Governor for devolution of funds to the ULBs on the following aspects: -

- (i) The distribution of net proceeds of taxes, duties, and fees between the State and the ULBs.
- (ii) Taxes, duties fees, and tolls to be assigned and appropriated by the ULBs.
- (iii) Release of grant-in-aid to the ULBs from consolidated fund of the State.
- (iv) Measures needed to improve the financial conditions of the ULBs.

As the Constitutional Amendment Act 1992 came into effect on 20.04.1993, the constitution of the first State Finance commission (SFC) was due by 19.04.1994. But the State Government constituted the first Finance Commission (FC) on 21.09.1996 i.e. after a delay of more than two years. The State Government has so far constituted two (SFCs) on the following dates. The prescribed periodicity for constituting SFC was not maintained by the State.

Sl No. of the Finance Commission	Date of constitution	Date of submission of reports	Date of discussion in assembly
1st FC	21.09.1996	Not submitted	Does not arise
1st FC (Reconstituted)	24.08.1998	30.12.1998	09.07.1999
2 nd FC	05.06.2003	29.09.2004	11.08.2006

The 2nd FC in their report submitted to the Government in September 2004 had made the following recommendations: -

1. Resource mobilization of ULBs
2. Transfer of revenue earning sources to the ULBs
3. Devolution of funds to the extent of 10% of the average gross tax revenue of the State
4. To undertake the activities as per the activity mapping devolved by State Government.
5. Accountability of the developmental authorities like Water and Sewerage Board, Town Planning Organization, Public Health and Water Supply Department to be brought under the administrative control of the ULBs.

The 2nd FC was of the view that the ULBs were functioning as mere deliberative bodies bereft of the powers and authority to function as institutions of self-government. To make the devolution of powers and functions more meaningful, they had formulated an activity mapping depicting the various activities to the different levels of ULBs concerning 18 subjects of the 12th schedule. Most of the recommendations of the 2nd SFC were accepted in principle by the State Government. But, there was no centralized system of maintaining a data base at State level to track the actual transfer of funds and actions taken as per the SFC's recommendations.

3.5 Functioning of District Planning Committee

The State Government enacted Orissa District Planning Committee Act, 1998 for setting up of District Planning Committees to consolidate the plans prepared by the PRIs and ULBs in the district and also to prepare integrated draft development plan for the district as a whole. The Committee was also assigned the powers to review the implementation of the developmental programme by the LBs. Elected members of PRIs and ULBs in the district were to fill up 80 per cent

members of the committee and the rest 20 *per cent* were to be nominated by the Government. The Draft District Development Plan was required to be forwarded by the Chair Person of the DPCs to State Government for approval. Despite the formation of the DPCs since 2001-02, they were not yet made functional due to absence of technical support teams and secretariat support staff for monitoring and implementation of plans even after a decade of enactment of the Act. No consolidation of ULB plan and preparation of district draft development plan was done. However, Government (Planning and Coordination department) stated (May 2008) that 23 technical support institutions (TSI) were selected and assigned to different districts for preparation of district plans 2008-09 as per the directives of the Planning Commission and they were to report to Planning and Co-ordination Department (PCD) and district plan for the year 2008-09 was to be placed before DPCs by August 2008. Test check of units revealed that the ULBs formulated action plans for some individual schemes as a stand-alone process without having any linkage to the holistic development of the area. It lacked objectivity and vision for empowerment of LBs as envisaged in the Constitutional Amendment Act. Information on consolidated LB wise details of availability of resources including activity wise planning of own funds, GIA, special grants, GOI and State plan funds and position of assets and liabilities were not available either in ULBs concerned or centrally at district /State level.

3.6 Devolution of functions

To avoid overlapping of functions and its balanced distribution amongst the ULBs, an activity mapping concerning 18 items of 12th schedule of the Constitution as per details given (**Appendix-VI**) was evolved by the SFC along with the mechanism for inter tier co-ordination. The State Government had not so far acted on the recommendations of the SFC.

Test check of records of selected units revealed the position of actual activities done by them as follows in respect of the devolved functions.

Name of the ULBs	No of units test checked	No of functions done	No of functions partially done	No of functions not done at all
Corporation	01	13	-	05
Municipality	06	09 to 13	01	06 to 08
NAC	06	07 to 13	02	05 to 10

From the above it was evident that the major items of the devolved functions were yet to be performed by the ULBs.

3.7 Devolution of functionaries

Empowerment of the Local Bodies cannot be considered as meaningful unless the functionaries of the devolved functions along with the institutions are brought under their administrative control. As recommended by the 2nd FC, the State Government was to ensure the required administrative restructuring to make the institutions and functionaries of the devolved functions accountable to the Local Bodies. In compliance, the State Government in its Circular dated July 2003 had made the functionaries of the devolved functions accountable to the respective levels of PRIs but the same was not yet done in respect of the ULBs.

As regards the ULBs, most of the functions were done with the existing manpower without any staff being deployed by the concerned departments, except the function of maintenance of vital statistics and registration of birth and death which was done by the staff of the Health Department deployed in the ULBs.

3.7.1 Under utilization of the staff of octroi establishment

The collection of octroi tax by the ULBs was taken over by the Government in 1999 for which the ULBs became entitled for payment of compensation grant by the Government. The staff engaged by the ULBs were rendered surplus which were deployed in other identical activities related to collection of taxes. As, there was no increase in tax base of ULBs, the services of the surplus staff of the octroi

establishment remained grossly underutilized. As of 2005 the ULBs received compensation grant of Rs.118.05 crore per annum. The encroachment of Government on the activities of ULBs resulted in idle payment to the deployed staff while their services remained grossly under utilized.

3.7.2 Overlapping of functions done by line departments

As observed by the SFC, there was overlapping of functions of ULBs with other organizations like City Development Authority, Water and sewerage Boards & Town Planning organizations etc. There were also other areas of activities where the departments of government had also concurrent jurisdictions like Health, Education, Fire Services and maintenance of roads and bridges etc. There was every possibility of their working at cross purposes and existence of multiple organizations for rendering various civil services under different administrative controls was bound to be counter productive. They were not yet made accountable to the ULBs. No Government instructions were issued to make the other line departments accountable to the ULBs in respect of the functions devolved to them as per the provisions of the Acts.

3.8 Devolution of funds

Any local government exercising the powers of governance over a local area cannot administer, manage and develop the area without raising funds from its people. It is expedient on the part of any legislature giving birth to institutions of local government to provide it with matching provision conferring powers of generating funds to meet the expenses of governance. Consistent with the devolution of functions and responsibilities, the ULBs were to be provided with matching funds, broader tax and non tax revenue base for revenue generation, increased share of State revenue and higher flow of grant-in-aid from Government.

Scrutiny in audit revealed that in test checked ULBs, the transfer of functions was not accompanied by placement of matching funds by the State for efficient discharge of the functions thereby rendering transfer of functions meaningless.

3.8.1 Sources of Municipal Revenue

The ULBs depended upon the following internal and external sources for their revenue.

- (a) Internal sources: -
 - (i) Tax
 - (ii) Non-tax revenue
- (b) External sources: -
 - (i) Grant-in-aid from the Government
 - (ii) Transfer from Government towards share of taxes.

ULBs derived their taxation powers from Section 131 of Orissa Municipal Act 1950 and Section 192 of Orissa Municipal Corporation Act 2003.

Test check of selected ULBs revealed the position of revenue generated by them from internal sources against the total expenditure incurred as per details given in (**Appendix-VII**) from which it was evident that the ULBs were not able to mobilize their available potential resources to meet the expenses. The sources of revenue assigned to them were not enough to enable them to carry out the wide range of basic and obligatory functions and there was a complete mismatch between the increase in functions and resource generation causing fiscal imbalance. As recommended by the SFC, separate budget allocation was to be made for the Local bodies in respect of the devolved functions. But, it was noticed that the respective line departments had their independent budgets and funds were utilized by them without involvement of the ULBs.

3.8.2 Non-imposition of property tax by the Corporations

None of the two Municipal Corporations viz Cuttack and Bhubaneswar was able to levy property tax as per section 192 of Orissa Municipal Corporation Act 2003. Even after more than 5 years of implementation of the Municipal Corporation Act, they were not able to levy the property tax and continued to collect holding tax as per the existing Orissa Municipal Act 1950.

3.8.3 Non-revision of annual value of holdings by the ULBs

Section 131 of Orissa Municipal Act 1950 empowers the ULBs to impose holding tax, light tax, drainage tax and water tax etc. based on annual value of holdings. As per Section 146 of Orissa Municipal Act 1950, the ULBs are required to revise the annual value of the holdings at an interval of every 5 years. As revision of rate of taxes takes effect prospectively i.e. from the next quarter as per Section 147 of the act, the delay in revision leads to loss of revenue to the ULBs.

In test checked ULBs the annual value of holdings was not revised at the prescribed intervals as per the following details, which had entailed loss of revenue to them.

Name of the ULBs	Year in which last revision was made
NAC Chhatrapur	1989
Bhadrak Municipality	1996
NAC Sunabeda	1995
NAC Koraput	1996
NAC Bhawanipatna	1996

From above, it was evident that the annual value of the holdings basing on which the taxes are levied remained unchanged for periods ranging between 12 and 19 years. The reasons attributed by the ULBs for the delay was non-assessment of the annual value by the valuation wing of Housing & Urban Development (H & UD) department of Government of Orissa. In this connection, it was observed that dependence of ULBs on the government department for the revision of the annual value has led to the loss. No effective and appropriate steps were taken by the

ULBs to alter and amend the list wherever they considered necessary as per Section 147 of the Orissa Municipal Act, which authorised the Executive Officers of the ULBs to revise the rate of taxes during the interim periods. As observed by the Finance Commission, the performance of the ULBs for raising revenue was very dismal and the statutory avenues of raising revenue remained either unexplored or under explored because the elected Local bodies did not want to invite displeasure by increasing the rate of tax and levy of new tax during their tenure.

3.8.4 Low rate of collection of taxes

Besides the fact that the rate of tax remained unrevised for years together, the collection of tax was not made efficiently by the ULBs. The collection of arrear tax through issue of distress warrant as per Section 162 of Orissa Municipal Act was not effectively pursued. A test check of records revealed that the rate of collection of revenue was below 50% out of which in two cases the same was below 10%. The arrear demand of the test checked ULBs ranged between 19.71 and 92.30 *percent* of the total demand as per details given in (**Appendix-VIII**).

3.8.5 Weak tax base and insufficient transfer of funds

The major internal source of revenue of the ULBs was the property tax (holding tax), which was to be supplemented by other minor tax and non-tax revenue. The major elastic and buoyant taxes like VAT, Exercise duty and MV tax were collected by the State while the other sources which were stagnant and inelastic in nature were assigned to the local bodies. In 1999, the State Government had taken over the collection of entry tax from the domain of the ULBs, which was a major source of revenue.

The State Government however, released compensation grants to ULBs, as the collection of Entry tax was in the exclusive domain of the ULBs. The release of compensation grant to ULBs was made on the basis of figures available on

collection of Entry tax for the year 1998-99 with 10 *per cent* increase every year. As per the figures available in the SFC report, there was a mismatch between the amount of entry tax collected by Government and release of funds made to the ULBs in shape of compensation grants as per following details.

(Rupees in crore)

Year	Amount collected by Government	Amount released to ULBs as compensation grant
2003-04	300.00	115.50
2004-05	327.00	118.05

In test checked ULBs, the quantum of compensation grants received by them did not reveal any definite trend as per the following details. The principle recommended by the 2nd SFC to enhance it to 20 *per cent* was not so far been adopted by the State.

Sl.No.	Name of ULBs	2005-2006	2006-2007	2007-2008
1.	Chhatrapur NAC	023.28	036.25	-
2.	Gopalpur NAC	007.66	017.53	019.51
3.	Bhadrak Municipality	118.92	183.29	181.39
4.	Sunabeda NAC	078.14	122.24	148.34
5.	Koraput NAC	051.00	076.79	099.33
6.	Bhawanipatna Municipality	076.73	077.45	124.64

3.8.6 Maintenance of Uneconomical and oversized establishments

As per section 174 of Orissa Municipal Act 1950, the ULBs are authorised to incur expenditure on general office establishment, which should not exceed 5 *per cent* of their normal revenue income. In test checked ULBs, the expenditure incurred on general office establishment varied between 15.80 and 26.52 *per cent*, which was very much in the higher side and hence considered as uneconomical. The higher cost of establishment expenditure had reduced the availability of funds for developmental purposes.

Sl.No	Name of ULBs	Year	Per centage of establishment expenditure to revenue collection
1.	NAC Koraput	2005-06	24.25
		2006-07	18.42
2.	NAC Chhatrapur	2005-06	22.44
		2006-07	26.52
3.	NAC Gopalpur	2005-06	19.10
		2006-07	15.10

3.8.7 Poor revenue expenditure link

Given with the fact that the local bodies were incapable of raising adequate revenue, they showed syndromes of fiscal dependency on Government grants to carry out their normal functions. The critical factor for empowerment of local bodies which is the linkage between revenue earnings and expenditure incurred by them was very poor. Linkage of decisions to provide public utility services with the power to levy and collect user charges to ensure efficiency and accountability was missing. The principle adopted by Government to provide poor revenue base to local bodies and release of scheme based and purpose specific grants had reduced the efficiency of the local bodies and forced them to play the subservient role of Government agencies with higher level of financial dependence and low level of fiscal autonomy. As per information gathered from test-checked units, the flow of Untied funds to the local bodies was “ Nil”.

3.9 Monitoring, Evaluation and Internal Control

Local self-government in the sense of representative organisation of the community is a new philosophy and culture, which requires sustained effort to nurture and mature. Sincere and continuous efforts are necessary to inculcate, sustain and develop this culture. In order to build up the ULBs as effective organisations of self-government, government in power has to provide consistent

and continuous guidance undertaking regular monitoring activities, providing eternal vigilance, making inbuilt arrangements for midcourse corrections and taking up of regular performance evaluation. The performance of the ULBs in relation to the devolved functions was not evaluated at any time. No initiative was also taken by State Government to evaluate the performance on the basis of Devolution Index devised by the Ministry of Rural Development Department of Government of India. The High Level Committee constituted for monitoring of utilization of TFC grants did not deal with the above matter and DPCs constituted for that purpose remained non functional.

Further, for any organisation, internal audit as a part of internal control mechanism is an important mechanism for ensuring financial discipline. In this connection, Section 161 of the Orissa Municipal Corporation Act 2003 provided for creation of the post of Chief Auditor in the Municipal Corporations to conduct monthly examination and audit of the accounts of the Corporation and report the findings thereon to the Standing Committee on Taxation, Finance and Accounts. The Chief Auditor was required to perform his duty independently being only accountable to the above committee. It was noticed in audit the post of Chief Auditor was not created in CMC while; the same became non-functional in BMC, as the relevant records were not produced to him for examination.

3.10 Conclusion and recommendations

Unutilized balances of Rs.106.37 crore constituted 46.37 *per cent* of total funds available with 19 test checked ULBs. Receipt & Payment accounts were not maintained in formats prescribed in National Municipal Accounts Manual for want of State Manual. Database on finances was not prepared. Cases of idle investments in purchase of land were noticed in major ULBs of Cuttack, Bhubaneswar and Puri. The loss of revenue for idling of funds, irregular/inadmissible expenditure in violation of rules, wasteful expenditure in procurement of stores and non-remittance of statutory deductions to Government

indicated that internal control mechanisms are not adequate to ensure proper financial management.

It was more than fifteen years since the 74th constitutional Amendment Act which came in to existence in the year 1993. Yet, there was considerable ambiguity about the role the ULBs had to play in the overall governance system of the State. The State Government lacked effectiveness in making the DPCs functional and it showed no sincerity in acting upon the recommendations of the SFC. The ULBs were not devolved with all the relevant functions and funds with functional autonomy to carry out the devolved functions, which was the implicit requirement of the act. As a result, they were forced to play the subservient role of government agencies for implementations of the different government sponsored developmental schemes. The autonomy given to them in the matter of taxation and use of natural resources were not prudently and efficiently managed by them. The generation of income from internal resources was abysmally low for which the ULBs in their style of functioning fostered a sense of dependence on government grants to carry out their basic functions. Maintenance of luxurious and oversized establishments coupled with low rate of collection of revenue with mounting of arrears had under scored their achievements as institutions of self-government. It can be stated in brief that the ULBs were not able to live up to the expectations as envisioned in the act and they were yet to develop the capacity and attitude to discharge the functions independently with their internally generated income. The objectivity and vision behind the constitutional amendment act remained grossly un-achieved. In view of the findings as explained in previous chapters, the Government should ensure that: -

Recommendation: -

- Continuous monitoring and evaluation of performance of the ULBs are made;
- Accounts should be made upto date;
- Funds are utilized timely and unspent balances refunded promptly;
- Data base on finances are maintained in all levels of ULBs;
- Statutory deductions are remitted to Government accounts timely;

- Schemes are implemented as per Guidelines;
- Adequate control exists to prevent loss of fund, wasteful expenditure etc;
- Works are completed in time;
- Assignment of adequate resource generation powers to local bodies and enhancement of their collection efficiency;
- Ensure appropriate administrative restructuring of the Departments of devolved functions and bring them under administrative control of ULBs;
- Increase in share of State revenue and grant in aid to ULBs;
- Adequate flow of untied fund;
- Devolvement of financial and administrative powers.

Bhubaneswar
The 1st day of December 2008

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