

## CHAPTER 1

### An Overview of the Functioning, Accountability Mechanism and Financial Reporting

#### 1.1 Introduction

The Seventy Fourth Constitutional Amendment Act, 1992 paved the way for decentralisation of powers and devolution of more functions and funds to Urban Local Bodies (ULBs) for enabling them to function as institutions of self-governance. Consequently, more diversified responsibilities were devolved through three-tier structures, namely, *Nagar Nigam*<sup>1</sup> (NN), *Nagar Palika Parishad*<sup>2</sup> (NPP) and *Nagar Panchayat*<sup>3</sup> (NP). To incorporate the provisions of the Seventy Fourth Constitutional Amendment, the legislature of Uttar Pradesh enacted (1994) the Uttar Pradesh Urban Local Self Government Laws (Amendment) Act, 1994.

Subsequently, the existing Uttar Pradesh Municipalities Act, 1916 and Uttar Pradesh Municipal Corporation Act, 1959 were amended to enable the State Government to devolve funds, functions and functionaries to the grass-root level. The objective was to make ULBs self-reliant and to provide better civic facilities to the people of the areas under their jurisdictions.

Accordingly, the elected bodies at each level of ULBs were established with regular elections of ULBs in every five years.

##### 1.1.1 State Profile

Uttar Pradesh is the fifth largest State in the country in terms of size and spans with an area of 2.41 lakh square kilometres. There were 636 ULBs in the State, governed by elected members of the boards with normally five years tenure. The last election to these ULBs was held in 2012. The profile of ULBs as compared to national value is given in **Table 1**.

**Table 1: Important statistics of the State**

Sl. No.	Indicator	Unit	State Value	National Value
1	Urban population	<i>Per cent</i>	22.28	31.16
2	Number of ULBs	Number	636	3,842
3	Number of NNs	Number	14	139
4	Number of NPPs	Number	198	1,595
5	Number of NPs	Number	424	2,108
6	Gender Ratio (Urban)	Females per 1000 Males	894	929
7	Literacy (Urban)	<i>Per cent</i>	75.14	84.11

(Source: Census Report 2011 and Thirteenth Finance Commission Report)

<sup>1</sup> Represents larger urban area.

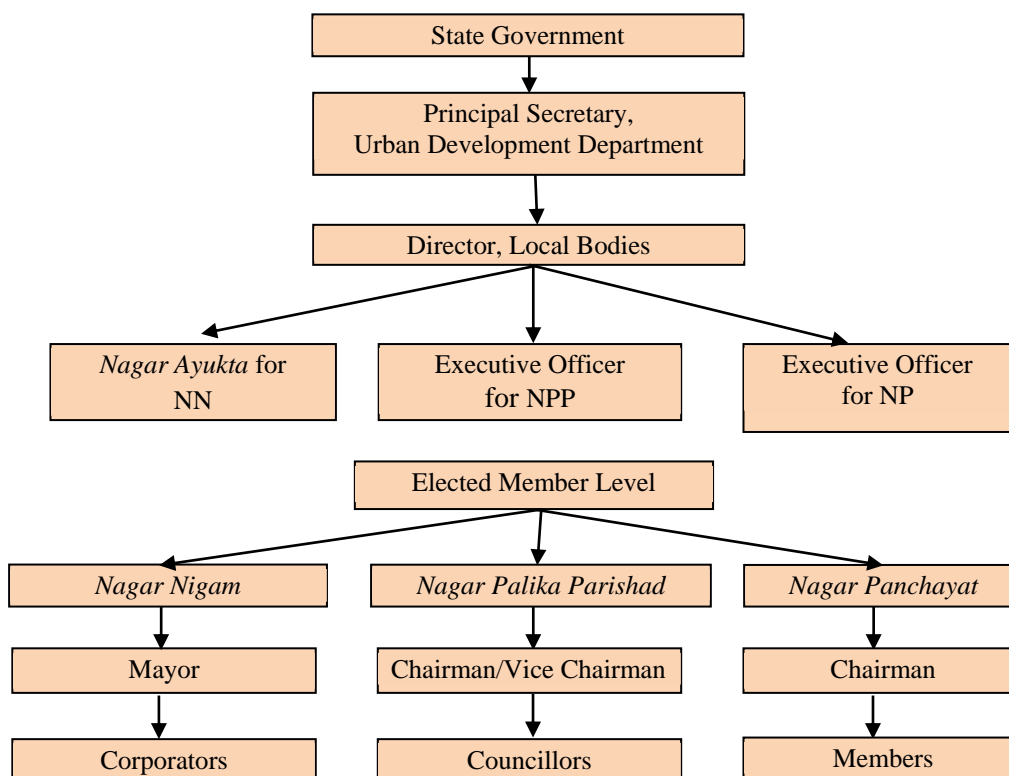
<sup>2</sup> Represents smaller urban area.

<sup>3</sup> Represents transitional area.

## 1.2 Organisational set up of ULBs

The organogram of the ULBs at the Government and Elected representative level of the State is given in **Chart 1**.

**Chart 1: Organisational structure of ULBs**



(Source: Director, Local Bodies, Lucknow)

While the Mayor heads the NN, Chairman heads NPP and NP. The elected representatives exercise their powers and discharge duties through the committees of elected members. *Nagar Ayukta* in case of NN and Executive Officer in case of NPP and NP are the administrative heads, responsible for execution of works and utilisation of funds. At the Government level the Director, Local Bodies is the head of respective bodies, under overall control of Principal Secretary, Urban Development Department (UDD).

## 1.3 Functioning of ULBs

The Seventy Fourth Constitutional Amendment Act, 1992, envisaged devolution of 18 functions (**Appendix 1.1**), listed in the 12<sup>th</sup> Schedule of the Constitution, to the ULBs. As of March 2016, eight functions were being performed exclusively by ULBs (**Appendix 1.2**); five functions were being shared between ULBs and other Government agencies (**Appendix 1.3**) and five functions were being performed by Government departments/agencies (**Appendix 1.4**).

Thus, the Government devolved only 13 functions<sup>4</sup> to ULBs as against 18 functions envisaged in the Constitution. This partial devolution of funds,

<sup>4</sup> Inclusive of five functions that were being shared between ULBs and other Government agencies.

functions and functionaries restricted the activities of ULBs and also affected their active participation in poverty alleviation and planning for economic and social development of the urban areas as envisaged in the Constitution.

## **1.4 Formation of various Committees**

### **1.4.1 Standing Committees in ULBs**

As per the provisions of Sections 88 to 105 of Uttar Pradesh Municipal Corporation Act, 1959 and Sections 104 to 112 of Uttar Pradesh Municipalities Act, 1916, a number of standing committees were required to be formed to carry out the business of ULBs. However, information regarding the number of committees formed and their functional status has not been furnished by Government, though called for (July 2016).

### **1.4.2 District Planning Committees**

Article 243 ZD of the Constitution of India (Constitution) inserted vide 74<sup>th</sup> Constitutional Amendment Act in 1993 states that “There shall be constituted in every State at the district level a District Planning Committee (DPC) to consolidate the plans prepared by the *Panchayats* and the Municipalities in the district and to prepare a draft development plan for the district as a whole”.

In pursuance with the above amendment, the Government of Uttar Pradesh enacted the Uttar Pradesh DPC Act, 1999 (July 1999). The Act provides that there shall be constituted a DPC in each district to prepare District Development Plan (DDP) for whole of the district integrating the plans prepared by ULBs and allocate funds to sectors and sub-sectors within outlines of the DDP.

Director, Local Bodies, Lucknow stated (July 2016) that the DPCs were constituted and functional.

## **1.5 Audit Arrangement**

### **1.5.1 Primary Auditor**

The Director, Local Fund Audit (DLFA) is the primary auditor and empowered to conduct the audit of ULBs as per Uttar Pradesh Local Fund Audit Act, 1984. Out of 636 ULBs in the State, the audit of accounts of 570 ULBs was conducted by DLFA during 2015-16.

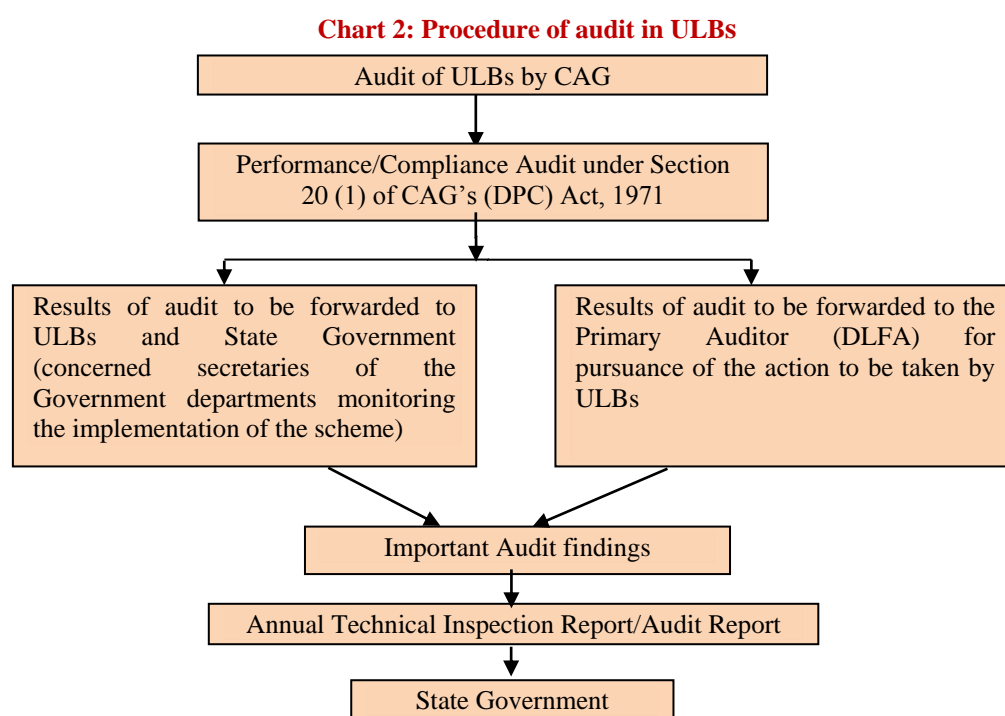
As per Section 8(3) of the Act, DLFA is to prepare a consolidated audit report of accounts and forward to the State Government every year for laying it in each house of the State Legislature. However, such reports were placed, up to 2010-11 only. In reply (July 2016), DLFA stated that the report for the year 2011-12 was prepared and sent to government for its laying before the state legislature and reports for the years 2012-16 were under process. State Government has constituted Local Fund Audit Compliance Committee to discuss the audit reports prepared by DLFA in legislature. The reports from 1999-11 have been discussed.

The reply, however, does not indicate reasons as to why the Audit Reports were not prepared in time for the years 2012-16.

### 1.5.2 Audit by the Comptroller and Auditor General of India

Thirteenth Finance Commission recommended continuance of entrustment of Technical Guidance and Support (TGS) of ULBs in the State. It provided for an additional component of Performance Grant which was linked to the condition of laying of the CAG's Annual Technical Inspection Report (ATIR) for Local bodies in the State Legislature. CAG's certificate was to demonstrate compliance to that condition. As per the entrustment letter (October 2011), the CAG or his representative will have the right to report to State Legislature the result of audit at his discretion. Also, the CAG is to decide the scope, manner and extent of conducting audit.

The TGS for the audit of ULBs to Local Fund Auditors/DLFA is given by the CAG under Section 20 (1) of CAG's (DPC) Act, 1971. The results of audit/audit reports are sent to State Government, Director, Local Bodies and DLFA for compliance and pursuance of action. Procedure of audit of ULBs is depicted in **Chart 2**:



Though the entrustment letter (October 2011) provides for the laying of the audit reports in the State Legislature, the ATIRs for the period 2004-05 to 2013-14 and the CAG audit report for the period 2014-15 has not been laid in the State Legislature as of March 2017.

### 1.6 Response to Audit observations

To check that expenditure was as per rules, procedures and purposes for which it was carried out, compliance audit by the CAG was conducted during 2011-16; the details of outstanding compliance audit objections with money value are depicted in **Table 2**.

**Table 2: Details of outstanding compliance audit objections as on 31 March 2016**

Year	No. of Inspection Reports (IRs)	No. of Paras in IRs	Amount involved (₹ in crore)	No. of Paras settled	No. of outstanding Paras	Money value of outstanding Paras (₹ in crore)
2011-12	43	194	297.29	Nil	194	297.29
2012-13	88	480	3,832.23		480	3,832.23
2013-14	131	756	4,107.19		756	4,107.19
2014-15	121	730	2,701.09		730	2,701.09
2015-16	116 <sup>5</sup>	627	1,836.25		627	1,836.25

(Source: Register of Audit Inspection Reports)

It may be seen from **Table 2** that the 756 audit observations (value: ₹ 4,107.19 crore) relating to 2013-14, 730 audit observations (value: ₹ 2,701.09 crore) relating to 2014-15 and 627 audit observations (value: ₹ 1,836.25 crore) relating to 2015-16 were communicated to the heads of offices of the ULBs and the DLFA. However, no audit observations were settled up to March 2016.

## **Accountability Mechanism and Financial Reporting**

### **Accountability Mechanism**

#### **1.7 Property Tax Board**

Property Tax Board (PTB) was to be constituted to see the various aspects relating to proper levy and realisation of property tax. Though PTB was constituted in March 2011, it remained ineffective as the basic purpose of constituting PTB, viz. streamlining the process of levy and realisation of property tax, was not fulfilled.

The Director Local Bodies in its reply (July 2016) stated that property Tax Board was constituted for the year 2016-17. Audit findings in this regard have been specified in the paragraph 3.1.4.1 of this Report.

#### **1.8 Service Level Benchmark**

In accordance with Para 6.4.10 of the Thirteenth Finance Commission guidelines, the State Government was to notify, by the end of succeeding fiscal year, that all Municipalities and Municipal Corporations in the State may propose a specified minimum level of the service for each of the four service sectors viz. water supply, sewerage disposal, solid waste management and storm water drainage, for improvement in service delivery.

The Director, Local Bodies stated (August 2016) that notification (May 2015) for issuance of service level bench mark for *Nagar Nigams* and *Nagar Palika Parishads* was issued. But, no direction was issued to *Nagar Panchayats* in this regard. The status of achievement of standards against the target in the test checked ULBs *w.r.t.* the four key service sectors are given in the **Appendix 1.5**.

<sup>5</sup> Out of 116 Inspection Reports, NNs: Seven; NPPs:40; NPs:69.

## 1.9 Fire-hazard Response

All municipal corporations having population of more than one million (2001 census) were to set up a Fire-hazard Response and Mitigation Plan for their respective jurisdictions. However the Fire-hazard Response and Mitigation Plan were not set up in any of the test checked ULBs (*Appendix 1.5*).

## 1.10 Submission of Utilisation Certificates

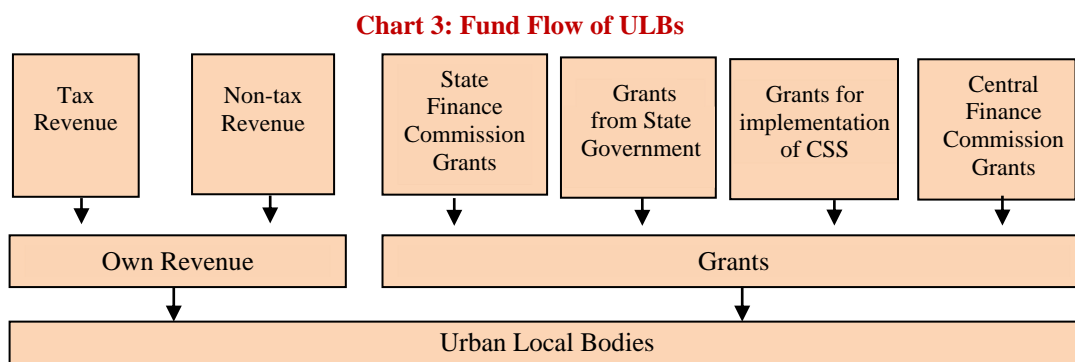
The State Government was to submit Utilisation Certificates (UCs) in respect of grants received from GoI for expenditure incurred through local bodies as per General Financial Rule.

Audit observed that UCs provided by GoUP to GoI were only on the basis of grants released to ULBs and no certificates regarding its utilisation has been taken from the ULBs.

## 1.11 Financial reporting

### 1.11.1 Source of funds

The resource base of ULBs consists of own receipts, State Finance Commission (SFC) grants, Central Finance Commission (CFC) grants, State Government grants and grants for implementation of Centrally Sponsored Schemes (CSS) for maintenance and development purposes. The fund flow chart of ULBs is given in **Chart 3**.



(Source: Director, Local Bodies, Lucknow)

#### 1.11.1.1 Flow of revenue

With the constitution of Eleventh Finance Commission, ULBs were brought within the purview of Finance Commission for the first time. The objective was to augment Consolidated Fund of the state to enable the State Government to supplement resources of ULBs. Accordingly, the successive Finance Commissions recommended release of grants to the State Government, who was also to further release grants to ULBs. Together, the sources of revenues for ULBs comprised:

- Grants assigned under Twelfth/Thirteenth/Fourteenth Finance Commissions;

- Funds from Centrally Sponsored Schemes;
- Devolution of 7.5 per cent of net proceeds of total tax revenue of the State Government under recommendations of the Third SFC;
- Funds from departments for functions transferred to ULBs; and
- Revenue earned by ULBs out of their own resources *i.e.* taxes, rent, fee *etc.*

The position of gross receipts and expenditure of ULBs during 2011-16 is given in **Table 3**.

**Table 3: Receipt and expenditure of ULBs during 2011-16**

(₹ in crore)

Sl. No.	Year	Source of revenue			Total receipts	Expenditure		
		Own Revenue (tax+ non-tax)	Transfers from 13 <sup>th</sup> /14 <sup>th</sup> CFC	Devolution (SFC)		Revenue	Capital	Total
1	2011-12	1,089.19	517.51	3,354.37	4,961.07	4,207.63	2,457.61	6,665.24
2	2012-13	1,307.02	756.49	3,993.98	6,057.49	5,049.15	2,949.13	7,998.28
3	2013-14	1,269.11	760.01	6,160.69	8,189.81	NA	NA	NA
4	2014-15	1,413.69	821.98	6,948.17	9,183.84	NA	NA	NA
5	2015-16	1,483.07	983.60	5,462.43	7,929.1	NA	NA	NA
<b>Total</b>		<b>6,562.08</b>	<b>3,839.59</b>	<b>25,919.64</b>	<b>36,321.31</b>			

(Source: Director, Local Bodies, Lucknow) (NA- Not made available by Director, Local Bodies, Lucknow).

Government did not give any reason for not furnishing expenditure figures for 2013-16. Details of actual funds utilised from previous years and the closing balance at the end of each year were also not provided to Audit. Own revenue and grants from CFC showed an increasing trend, while SFC grants increased substantially during 2013-15 before suffering significant decrease in 2015-16. Throughout 2011-16, own revenue remained between 14 and 18 per cent of the total receipts.

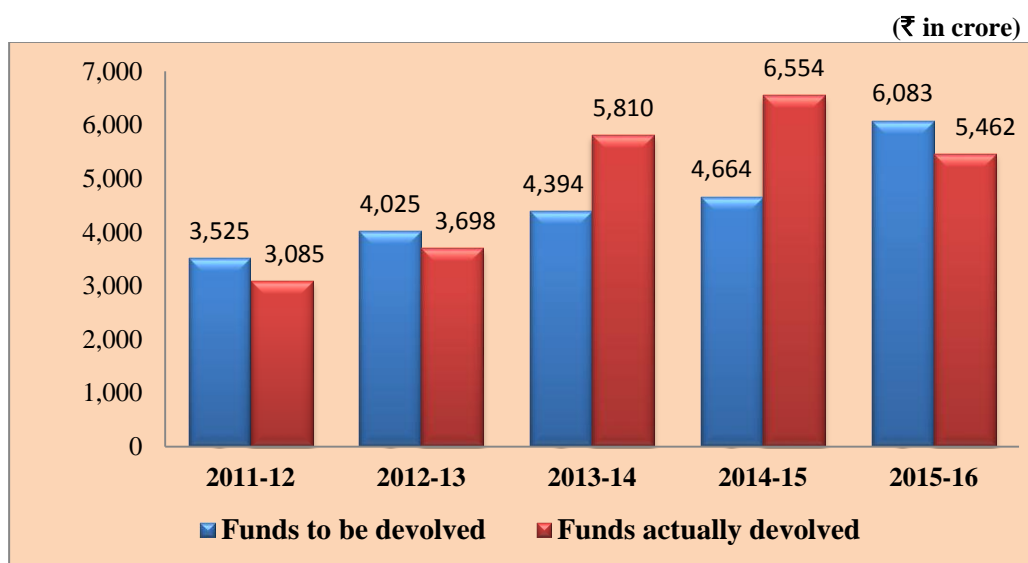
It is important to be mentioned that the figures under Central and State Finance Commission grants provided to Audit by the Urban Development Department (Directorate of UDD) have substantial differences in the years 2011-12 to 2015-16 (**Appendix 1.6**) compared to the figures reported now by the Department of Finance GoUP both in respect of CFC and SFC. This indicated poor monitoring and control of the Government over accounting of the funds devolved under CFC and SFC grants to ULBs.

Government should examine and carry out early reconciliation of these figures to ensure that there is no misappropriation and or diversion of grants of CFC and SFC.

### **1.11.2 Recommendation of State Finance Commission**

Third and Fourth SFCs recommended that 7.5 per cent of the total tax revenue of the State Government should be devolved to ULBs. The devolution of funds during 2011-16 is given in **Chart 4**.

**Chart 4: Devolution of SFC grants vis-à-vis net Tax Revenue**



(Source: Director, Local Bodies, Lucknow)

As seen from **Chart 4**, actual devolution of funds was erratic as it was significantly higher than the recommended value during 2013-15, while being lowered during 2011-13 and 2015-16.

### 1.11.3 Recommendations of Central Finance Commission

The sanction and release of CFC grant in the state for ULBs during the period 2011-16 is given in **Table 4**.

**Table 4: Details of sanction and release of CFC grants**

(₹ in crore)

Sl. No.	Financial Year	General Basic Grant		General Performance Grant		Total		Less (-)/ More (+) to total sanction
		Sanctioned	Released	Sanctioned	Released	Sanctioned	Released	
1	2011-12	318.83	344.60	109.02	172.91	427.85	517.51	(+) 89.66
2	2012-13	372.61	391.47	255.72	365.01	628.33	756.48	(+) 128.15
3	2013-14	441.50	451.62	301.63	308.39	743.13	760.01	(+) 16.88
4	2014-15	451.55	493.63	292.92	328.35	744.47	821.98	(+) 77.51
5	2015-16	983.60	983.60	-	-	983.60	983.60	-

(Source: Director, Local Bodies, Lucknow)

It may be seen from the **Table 4** that CFC grants released for ULBs during 2011-15 were higher than the grants sanctioned due to receipt of additional performance grant. In this regard, the Director, Local Bodies stated (July 2016) that this was due to release of additional CFC grants of States which did not perform and fulfilled the nine conditions of the 13<sup>th</sup> Finance Commission.

However, several important conditions *viz.* Maintenance of accounts on double entry system, Placement of audit report to state legislature, Constitution of Property Tax Board, Evaluation of performance on State Level Benchmarks and setting up of Fire-hazard Response and Mitigation plan were not fulfilled by GoUP as discussed in preceding paragraphs.



### 1.11.3.1 Interest paid due to delay transferred to ULBs

According to the recommendation of the CFC, the States should release the grants to the Municipalities within five days of its being credited to their account by Union government. In case of delay, the State government must release the instalment along with interest at the Bank Rate of the Reserve Bank of India. In 2015-16 the State Government transferred the funds to ULBs with a delay of three days, resulting in an avoidable interest payment of ₹ 33.35 lakh.

Director, Local Bodies, Lucknow stated (August 2016) that the delay was made at the government level in issuance of financial sanction.

### 1.11.4 Expenditure under major Centrally Sponsored Schemes (CSS)

JNNURM was the major CSS being implemented in ULBs. The GoI launched (December 2005) JNNURM with the objective of encouraging the reforms and fast-tracking development of major cities with specific focus on efficiency in urban infrastructure and service delivery mechanisms, community participation and accountability of ULBs. The Director, Local Bodies/State Nodal Agency was responsible for the monitoring of the JNNURM Scheme. Expenditure in ULBs during 2011-16 under this scheme is given in **Table 5**.

**Table 5: Expenditure under JNNURM**

(₹ in crore)

Sl. No.	Year	Allotment	Expenditure
1.	2011-12	1,512.43	1,512.43
2.	2012-13	1,279.38	1,279.38
3.	2013-14	1,107.75	1,107.75
4.	2014-15	299.10	299.10
5.	2015-16	126.48	126.48
<b>Total</b>		<b>4,325.14</b>	<b>4,325.14</b>

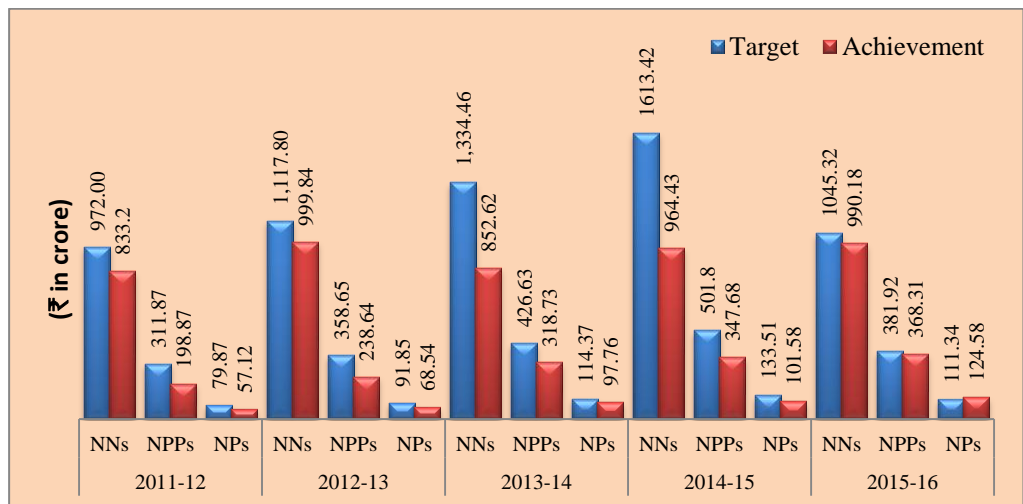
(Source: Director, Local Bodies, Lucknow)

It may be seen from **Table 5** that entire funds allotted were utilised by the ULBs during 2011-16. Director, Local Bodies, Lucknow intimated that the funds released to ULBs were treated as final expenditure. Apart from this ₹ 320.81 crore was allotted (2015-16) for Atal Mission for Rejuvenation and Urban Transformation (AMRUT) Scheme. However, expenditure actually made at the level of ULBs was not ascertained by the government.

### 1.11.5 Revenue realised from own resources

ULBs were required to generate revenues by collecting taxes, rent, fees *etc.*, to meet establishment and recurring expenditure. Position of target fixed by the Government for revenue realisation and achievement there against during 2011-16 for the ULBs in the state is given in **Chart 5** and **Appendix 1.7**

**Chart 5: Revenue realised from own resources**



(Source: Director, Local Bodies, Lucknow)

It may be seen from the above chart that the targets were consistently not achieved. Further, it was noticed that the targets for the year 2015-16 were reduced from that of previous year and even the reduced targets were not achieved in NNs and NPPs during 2015-16. The matter has been reported to the government.

The details in this regard have been specified in chapter 3.1 of this Report.

### **1.11.6 Maintenance of records of ULBs**

Audit noticed that the test checked ULBs did not at all maintain the following records:

- road register which indicate history of roads constructed/maintained;
- contractor ledger which incorporates payments made time to time to the contractor;
- contract bond register which depicts details of bonds executed;
- work register which disclosed details of the works and payments made their against;
- PF register & broadsheet which shows amount of credits and debits of the incumbents;
- grant registers which showed grants sanctioned and received;
- log book indicate status of running of vehicle; and
- asset register indicate details of assets in the ULBs.

It was also noticed that apart from not maintaining the above records certain other records were also maintained only partially, the details of which are given in **Appendix 1.5**

### **1.11.7 Maintenance of Accounts of ULBs**

In terms of the Eleventh Finance Commission recommendations, Government of India (GoI), Ministry of Urban Development in consultation with the CAG, developed (November 2004) the National Municipal Accounts Manual (NMAM), for maintenance of accounts on accrual basis. The implementation of accrual based Double Entry Accounting System (DEAS) by the ULBs would increase transparency and accountability in utilisation of public funds by ULBs.

However, it was noticed that even after a lapse of more than 12 years, ULBs did not adopt NMAM (August 2016).

It was noticed in 21 test-checked ULBs (NNs:2, NPPs:8, NPs:11) that accrual based accounts on DEAS were not prepared in 17 ULBs and partially prepared in four ULBs. Further, quality and reliability criteria of the records could not be ascertained (*Appendix 1.5*).

In reply, for not implementation of NMAM and Annual Accounts on DEAS, Director, Local Bodies, Lucknow stated (July 2016) that the Uttar Pradesh Municipal Account Rules 2012 have been prepared and forwarded to GoUP for their approval.

### **1.12 Conclusion**

Laying of the audit report in State Legislature and formation of a committee for its discussion was mandated in Thirteenth Finance Commission recommendations. These are yet to be followed by the State Government.

Government devolved only 13 functions<sup>6</sup> to ULBs against 18 functions as envisaged in the Constitution which restricted the activities of ULBs and also affected their active participation in poverty alleviation and planning for economic and social development of the urban areas.

Compliance to audit observations pertaining to previous years was not sent by State Government which resulted that the audit observations were not settled.

The targets fixed by the Government for realisation of revenue were not achieved by the ULBs, indicating their large dependency on government grants.

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<sup>6</sup> Inclusive of five functions that were being shared between ULBs and other Government agencies