

CHAPTER I

FINANCES OF THE LOCAL SELF GOVERNMENT INSTITUTIONS

1.1 Introduction

1.1.1 Consequent on the 73rd and 74th amendments of the Constitution of India, the State Legislature enacted the Kerala Panchayat Raj Act, 1994 (Act 13 of 1994) and the Kerala Municipality Act, 1994 (Act 20 of 1994). Government transferred responsibilities, institutions and schemes relating to matters enlisted in the Schedules of the respective Acts to the Panchayats and Municipalities, with effect from 2 October 1995. The Government also transferred the assets and liabilities along with the officials relating to the transferred institutions, but continued to pay the salary and allowances of the transferred officials.

1.2 Decentralised planning and people's participation

1.2.1 In order to give a meaningful direction to the process of decentralisation, Government decided (1997-98) that the Local Bodies should formulate and implement at least 35 to 40 *per cent* of the State's plan programmes within their areas of responsibilities. Accordingly, 'People's campaign for the formulation of Ninth Five Year Plan' was launched by the Government to identify local development problems and then prioritise and formulate projects for schemes.

1.2.2 The Government also transferred 35 to 40 *per cent* of the State's Annual Plan outlay from the year 1997-98. In 2002-03, the programme was renamed 'Kerala Development Plan'.

1.3 State Finance Commission

Government have not yet placed (December 2004) before the State Legislature the first part of the Report of the Second State Finance Commission (appointed in June 1999), submitted in January 2001. Meanwhile, the Third Finance Commission was constituted in September 2004.

1.4 Recommendations of the Eleventh Finance Commission

As recommended by the Eleventh Finance Commission, the State Government entrusted (October 2002) the audit of Local Bodies to the Comptroller and Auditor General of India under section 20 (1) of the Comptroller and Auditor General's (DPC) Act, 1971 for providing technical supervision of audit to the Director of Local Fund Audit. The State Government accepted (June 2003) the budget and accounts formats for Panchayat Raj Institutions prescribed by the Comptroller and Auditor General of India and they came into force with effect from 1 April 2004. The State Government has also accepted

(September 2003) the formats for Urban Local Bodies prescribed by the Comptroller and Auditor General of India.

1.5 Profile of the Local Self Government Institutions

1.5.1 As on 31 March 2004, there were 1215 Local Self Government Institutions (LSGIs) in the State. Rural and urban population of the State as per Census 2001 was 2.36 crore and 82.67 lakh, respectively. Details of the average area and population were as under:

Type of LSGIs	Number	Average area (Sq.km) *	Average population *
Grama Panchayats	991	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

* As per census 2001

1.6 Organisational structure

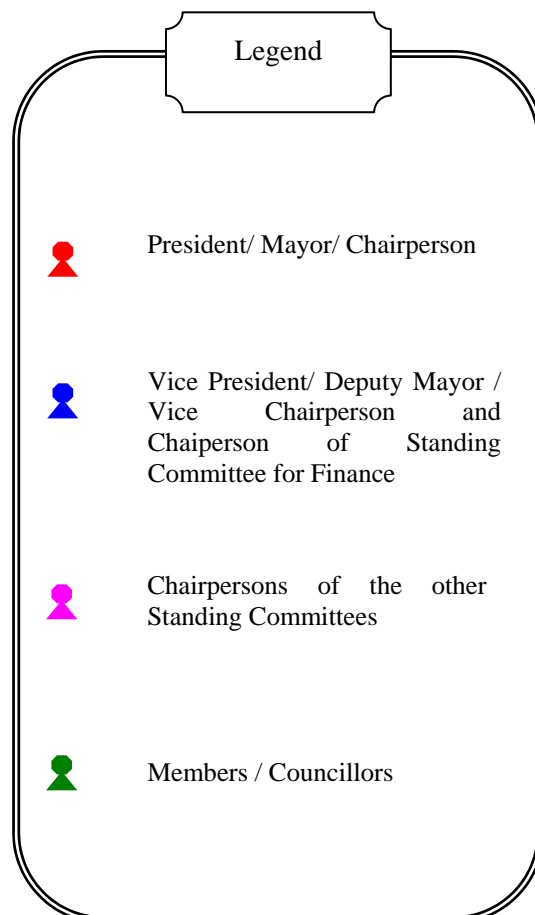
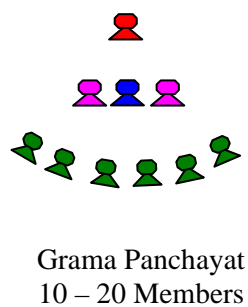
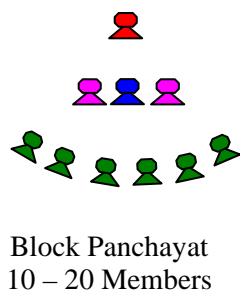
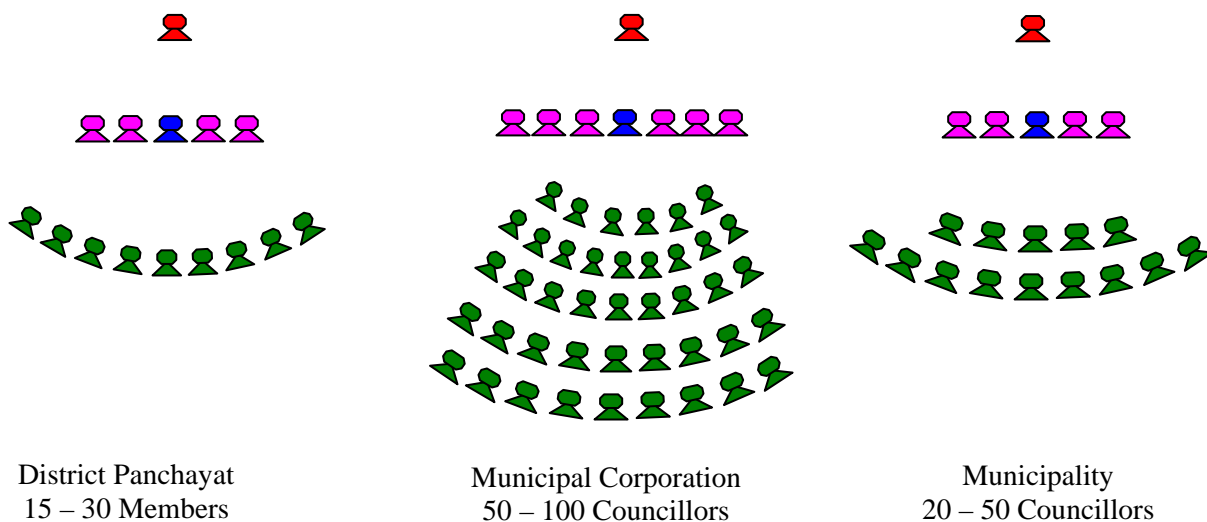
1.6.1 In the three-tier Panchayat Raj system in the State, each tier of Panchayat functions independently of each other.

1.6.2 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.

1.6.3 The President/ Chairperson/ Mayor is the ex-officio member of every Standing Committee and the Vice President/ Vice Chairperson/ Deputy Mayor is the ex-officio member and Chairperson of the Standing Committee for Finance. Each LSGI has a Secretary and supporting staff.

Diagram No. 1

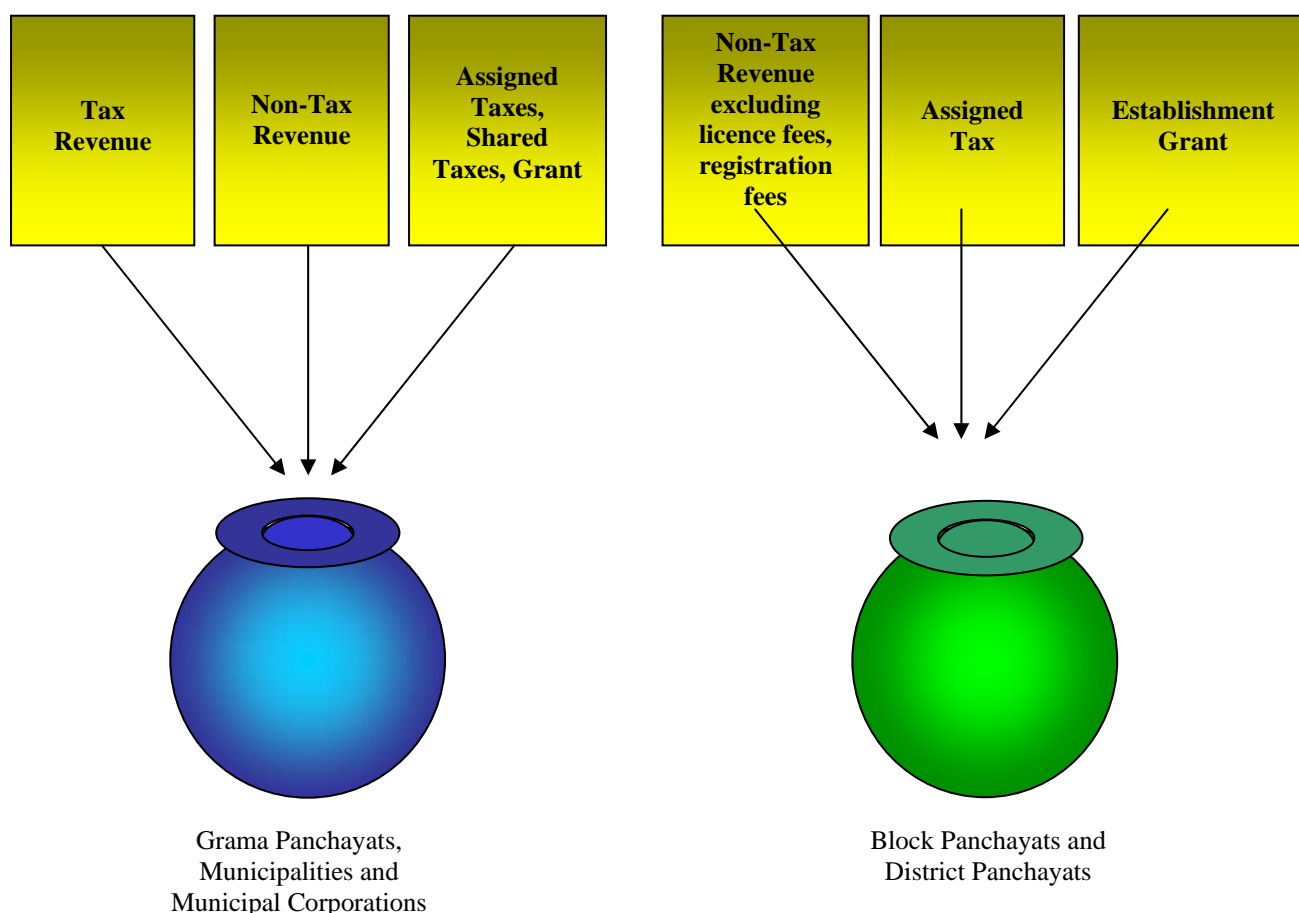
ORGANISATIONAL STRUCTURE OF LOCAL SELF GOVERNMENT INSTITUTIONS



1.7 Sources and utilisation of funds

1.7.1 The five sources of funds of LSGIs are (i) own fund, (ii) funds devolved upon them by the State Government for the decentralised planning and State Sponsored Schemes, (iii) Centrally Sponsored Scheme Funds, (iv) loans and (v) other sources. Flow of funds from the above sources has been shown in Diagrams 2, 3 and 4.

Diagram No.2
Sources of own funds of LSGIs



1.7.2 The 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

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

The correctness of these figures could not be authenticated in the absence of audited accounts.

1.8 Accounts

Non-presentation of Consolidated Accounts before the Legislative Assembly

1.8.1 A comprehensive picture of the finances of the LSGIs in the State is not available as the consolidated accounts of the LSGIs were not prepared as prescribed in the Acts. Every LSGI is required to submit to an officer authorized by Government in this behalf, an abstract of its annual report, showing receipts and payments under each head of account as certified by the Auditor, not later than the fifteenth day of the second month of the next financial year. The Acts prescribe that the authorised officer shall submit a consolidated report to Government forthwith and the Government shall cause the accounts together with the Audit Report to be laid before the Legislative Assembly.

1.8.2 The Government have not authorised till now an officer to consolidate the accounts of the LSGIs in terms of the provisions of the Acts. Consequently, consolidated annual accounts of the Panchayats and Municipalities have never been prepared and laid before the Legislative Assembly.

1.9 Arrears in submission of accounts

1.9.1 The accounts are in arrears from 1995-96 as shown below:

Year	Total number of LSGIs	Number of LSGIs whose accounts are in arrears *
1995-96	1214	223
1996-97	1214	143 #
1997-98	1214	236
1998-99	1214	336
1999-00	1214	361
2000-01	1215	492
2001-02	1215	638
2002-03	1215	937
2003-04	1215	1212
Total		4578

1.9.2 In spite of receiving the Eleventh Finance Commission grant of Rs 1.83 crore for the period 2000-01 to 2003-04 for maintenance of the accounts of the Grama Panchayats and Block Panchayats, the accounts are still heavily in arrears. Government have stated (December 2004) that they propose to update the accounts with the help of retired hands and performance audit teams.

* As on 31 March 2004

Some LSGIs submitted accounts without submitting accounts for previous years and they were audited by DLFA (Refer: Para 2.7.5 of Chapter II)

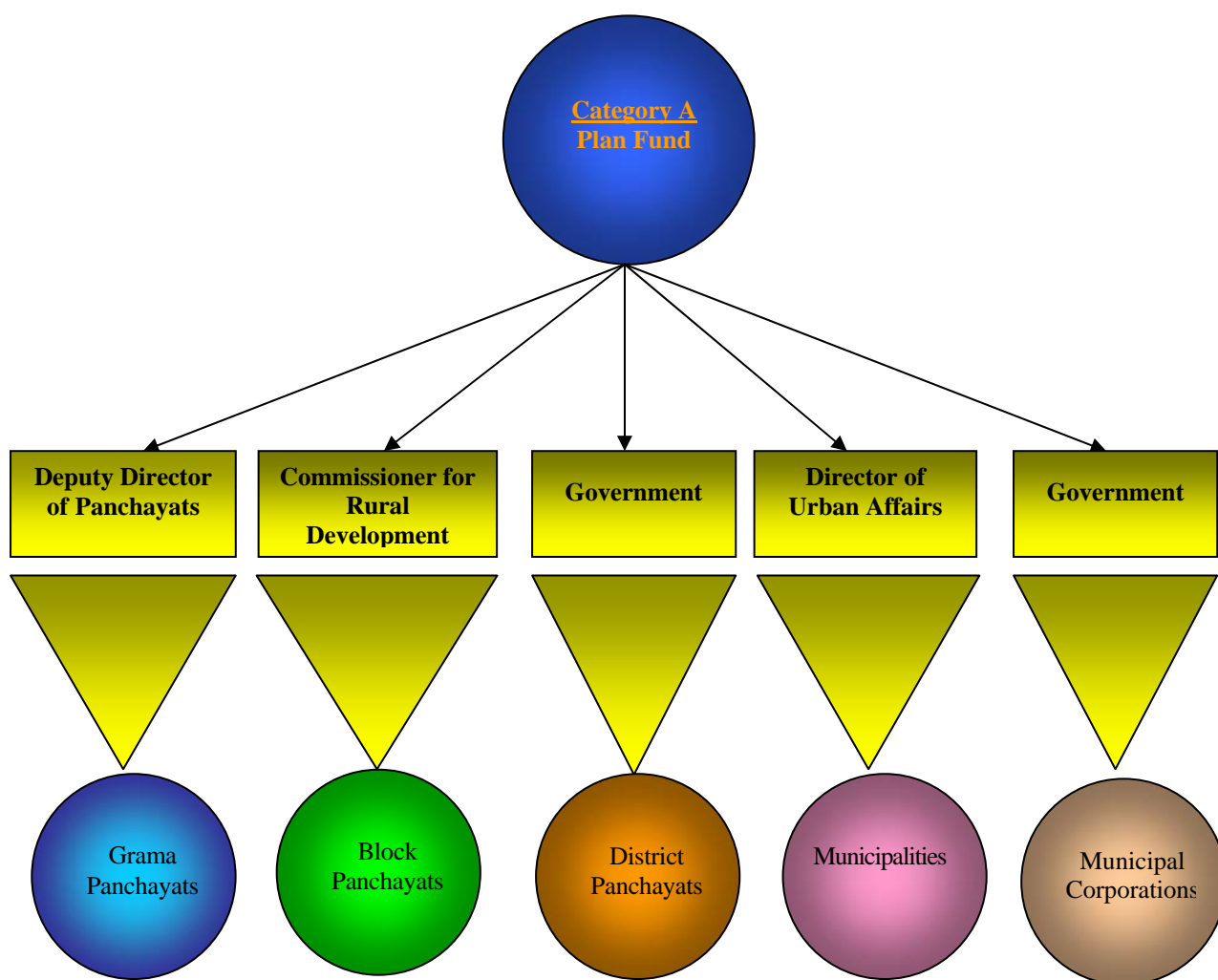
1.9.3 Government have not taken any effective action to support the LSGIs in updating their accounts. As a result, the statutory obligation to place the annual accounts before the Grama Sabha/Ward Sabha is not being observed by most of the LSGIs.

1.10 Funds devolved upon LSGIs for decentralised planning and State sponsored schemes

Category 'A' Funds

1.10.1 These are Plan Grants for schemes formulated by the LSGIs. Government makes allotment direct to the District Panchayats and the Municipal Corporations. The Director of Urban Affairs allots funds to the Municipalities. The Commissioner for Rural Development allots funds to the Block Panchayats while the Deputy Director of Panchayats makes allotments to the Grama Panchayats through the Deputy Director of Panchayats of each District.

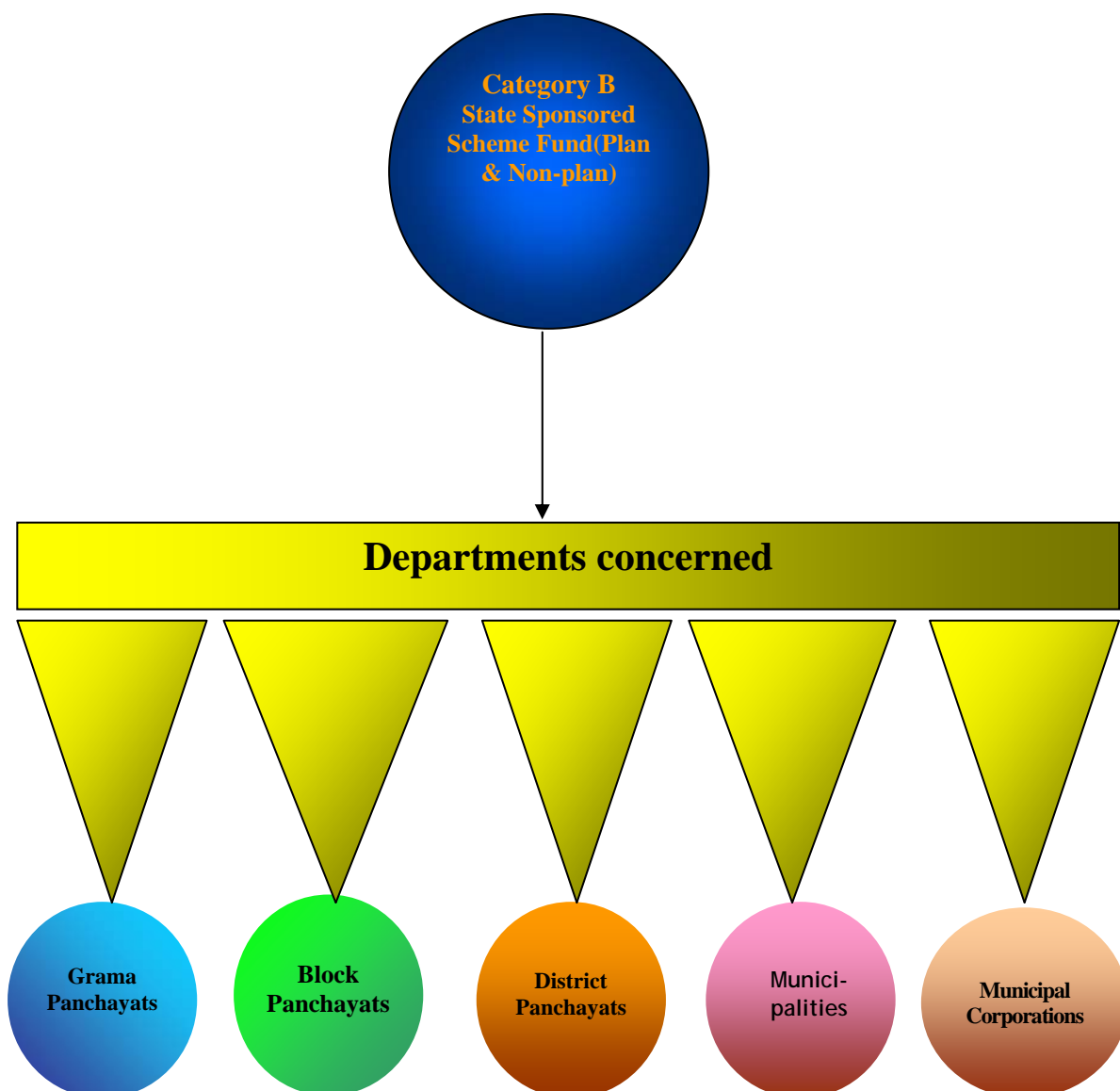
Diagram No. 3
Devolution of funds upon LSGIs -Category A funds



Category 'B' Funds

1.10.2 These include Plan Grants for State Sponsored Schemes, Non Plan Grants for the maintenance of the transferred institutions, assets and schemes and budgetary transfer of Centrally Sponsored Schemes. The District Officers of the Departments concerned allot Category 'B' Funds excluding Centrally Sponsored Scheme funds to each LSGI of the District.

Diagram No.4
Devolution of funds upon LSGIs – Category B Funds



1.11 Extent of devolution of funds

1.11.1 During the period 1997-98 to 2003-04, against a budget provision of Rs 10207.01 crore, the State Government devolved upon the LSGIs a total amount of Rs 8741.87 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 the *Appendix-I*.

(Rupees in crore)

Type of LSGIs	Budget provisions			Amount disbursed		
	Plan	Non-plan	Total	Plan	Non –plan	Total
Grama Panchayats	4414.76	996.03	5410.79	3792.73	1093.88	4886.61
Block Panchayats	1566.05	113.52	1679.57	1155.49	118.49	1273.98
District Panchayats	1208.96	388.00	1596.96	968.61	358.97	1327.58
Municipalities	710.00	279.76	989.76	628.15	172.72	800.87
Municipal Corporations	458.74	71.19	529.93	400.41	52.42	452.83
Total	8358.51	1848.50	10207.01	6945.39	1796.48	8741.87

1.11.2 In July 2003, Government closed the ‘General/Plan’ Personal Deposit Accounts of the LSGIs and credited back to Government account in reduction of expenditure for the year 2003-04, a total amount of Rs 581.20 crore relating to previous years remaining unutilised in those accounts. The under-utilisation of funds by the LSGIs resulted in the short achievement of the social objectives to that extent.

1.12 Reasons for under-utilisation

1.12.1 The Economic Review, 2003 states (Para 22.6 and 22.7) that the strategy of decentralisation adopted in Kerala was the ‘big bang’ approach – functions, powers and resources being transferred at one go. The Review also states that traditional wisdom calls for capacity building of local Governments and then giving power to them in degrees to match the improvement in capacity. The Review continues to state that Kerala followed the ‘reversals’ – of giving responsibility and then building capacity, of giving powers and then creating procedures and systems, of giving funds and then setting up umpiring systems.

1.12.2 The above statements reveal that the capacity building of the LSGIs was in the rudimentary stages and the LSGIs were not fully equipped to handle the transfer of large scale funds to the extent of thirty five to forty *per cent* of the State’s Annual Plan Outlay. Under-utilisation of funds received was an unavoidable fall out.

1.12.3 There were delays on the part of the Government in issuing the guidelines for plan formulation. Instead of issuing the guidelines well in advance of the beginning of the financial year, the Government issued them between April – November only, except for the year 2003-04. The formulation of Annual Plans and obtaining approval of the District Planning Committee was consequently delayed and the LSGIs did not get one full year for the implementation of Annual Plans except during the year 2003-04.

1.12.4 Delay in release of Plan Grants by Government was another contributing factor for the under-utilisation of funds. The scheduled release was quarterly during the years 1997-98 to 2002-03 and monthly during the year 2003-04. However, during the seven year period from 1997-98 to 2003-2004, the Government adhered to the schedule only during August 2003

to January 2004 resulting in delays ranging from 1 to 6 months in release of plan grants (Appendix II).

1.13 Outstanding advances

1.13.1 Test check of the records of 159 LSGIs revealed that advances paid to various implementing agencies like Kerala State Electricity Board, Kerala State Housing Board and Kerala Water Authority, etc., and mobilisation advances paid to convenors of beneficiary committees during 1997-98 to 2002-03 were treated as expenditure. As of 31 March 2004, Rs 43.99 crore was outstanding towards advances as per details below.

Sl. No	Recipients of advance	Period of advance payment	Amount (Rs in crore)
1.	Kerala State Electricity Board	1997-98 to 2002-03	14.07
2.	Kerala State Housing Board	"	12.46
3.	Kerala Water Authority	"	9.96
4.	Nirmithi Kendra	"	1.36
5.	COSTFORD*	"	0.83
6.	ANERT#	"	0.07
7.	Ground Water Department	1998-99 to 2002-03	0.33
8.	Convenors of beneficiary committees	1997-98 to 2002-03	4.91
Total			43.99

1.13.2 Non adjustment of advances for a long period is fraught with the risks of misutilisation/misappropriation of funds.

1.14 Centrally Sponsored Scheme Funds

1.14.1 District Rural Development Agencies, Director of Urban Affairs and Kudumbashree (the State Poverty Eradication Mission) disbursed funds to LSGIs for implementing Centrally Sponsored Schemes.

1.14.2 The Central and State shares distributed to the LSGIs and their utilisation during the period 1997-98 to 2003-04 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	66.55	460.17	137.21	663.93	606.91	57.02	91.41
2. Director of Urban Affairs	Municipal bodies	-	19.42	10.88	30.30	30.30	-	100.00
3. Kudumbashree (The State Poverty Eradication Mission)	Municipal bodies	-	135.33	55.62	190.95	135.42	55.53	70.92
Total		66.55	614.92	203.71	885.18	772.63	112.55	87.29

The details are given in Appendix -III

* Centre of Science and Technology for Rural Development

Agency for Non-conventional Energy and Rural Technology

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

1.15 Outstanding Loans

1.15.1 As on 31 March 2004, loans of Rs 274.18 crore availed by LSGIs from various sources were outstanding as per details below:

Sl.No.	Source of Loan	Category of LSGI					Total
		GP ¹	BP ²	DP ³	Municipality	Municipal Corporation	
1.	Government	-	-	2.00	25.83	50.85	78.68
2.	Government Guarantee	-	-	-	0.03	0.39	0.42
3.	Financail Institutions	30.33	-	120.15	33.40	11.20	195.08
	Total	30.33	-	122.15	59.26	62.44	274.18

1.15.2 In the absence of detailed accounts proper utilisation of loans, the trend of repayment and the amount of interest paid/payable etc could not be ascertained.

1.16 Other sources

1.16.1 LSGIs also receive donations, voluntary contributions and beneficiary contributions. In the absence of consolidated accounts, the details of receipts from other sources and expenditure therefrom were not available.

1.17 Budgeting

1.17.1 Panchayats are required to incorporate in their budgets, detailed estimates of income and expenditure. Due to non-formulation of annual plan in time, the LSGIs could not incorporate estimates of receipt and expenditure relating to Plan schemes in their budget. This resulted in LSGIs incurring plan expenditure without budget approval which was indicative of poor budgetary control and lack of accountability.

1.18 Asset accounting

1.18.1 With effect from 2 October 1995, the Government had transferred assets and liabilities of the institutions relating to the transferred subjects to the LSGIs in the process of decentralisation. The transferred institutions included Krishi Bhavan, Health Centres, Government Dispensaries, Hospitals, Schools and Agricultural Farms having considerable assets in the form of land, buildings and movable properties. Government had 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 had not been

¹ Grama Panchayat, ² Block Panchayat, ³District Panchayat

incorporated in the asset registers of the LSGIs and formal transfer in the revenue records had not been made. Government have stated that the assets transferred had not been valued so far. Government also stated that the ownership of the assets had not been formally transferred so that the assets could not be alienated by LSGIs.

1.18.2 The LSGIs had spent Rs 552.82 crore during 2002-03 and 2003-04 on creation of capital assets the correctness of which was certified by DLFA. The details of assets created were not available for want of recipient wise details of amount received and expenditure incurred. Test-check of records during supplementary audit revealed other improprieties in the maintenance of the Register of immovable properties.

1.18.3 In the absence of identification and valuation of assets and 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.

1.19 Deficiencies in Acts and Rules

1.19.1 Audit pointed out in March, 2004, the necessity for incorporating amendments to the Kerala Panchayat Raj Act, 1994 and Kerala Municipality Act, 1994 respectively to bring about greater clarity in the accounting and audit arrangements and procedures. The amendments were intended to prescribe the date of preparation of the Annual Financial Statements and its submission to Audit, to incorporate the Scheme of Technical Guidance and Supervision of the Comptroller and Auditor General of India, to prescribe the issue of Audit Certificate by Auditors on completion of audit, to prescribe the presentation of the Annual Financial Statements in the Grama Sabhas/ Ward Sabhas and to prescribe the due date for submission of accounts to the authorised officer.

1.19.2 The new formats for Budget and Accounts of Panchayat Raj Institutions prescribed by the Comptroller and Auditor General of India have become operational from 1 April 2004. The new formats for Urban Local Bodies prescribed by the Comptroller and Auditor General of India and accepted by Government in September 2003 have not come into force, pending adaptation by the State Government. Government have not framed so far the Rules and Manuals for Budgets and Accounts of the Panchayat Raj Institutions and Urban Local Bodies. Consequently, the Kerala Panchayat (Accounts) Rules, 1965, Kerala Municipalities (Accounts) Rules, 1963 and the Kerala Municipal Corporation (Accounts) Rules, 1967 which are at variance with the new formats continue to be in force.

1.19.3 Government response was awaited (November 2004).

1.20 Recommendations

- ❖ In a situation where 35 to 40 *per cent* of the State's Annual Plan Outlay is being devolved upon the LSGIs, consolidation of financial data based on audited financial statements assumes significance. Government should authorise an officer for this purpose as contemplated in the Act.
- ❖ Government should take adequate steps for the clearance of arrears in the accounts of the Panchayat Raj Institutions.
- ❖ The Government should issue plan formulation guidelines well before the beginning of the financial year to enable the LSGIs to incorporate approved plan expenditure in their budgets.
- ❖ In order to achieve the objectives of decentralised planning, which is a process through which solutions are attempted to be achieved for the problems identified by the Grama Sabhas / Ward Sabhas, full utilisation of plan grants received and other funds earmarked for Plan is necessary. For this purpose, Government have to ensure, prompt release of plan funds and capacity building of the LSGIs.
- ❖ The identification and valuation of the assets transferred by Government to the LSGIs and their proper accountal is a matter which calls for the immediate attention of the Government to ensure proper maintenance and safeguarding of assets.