

**PART – I URBAN LOCAL BODIES**

**CHAPTER – I**

**OVERVIEW ON FINANCES OF THE URBAN LOCAL BODIES  
INCLUDING THE ACCOUNTING PROCEDURES**

**1.1 Introduction**

Article 243 (W) of the Constitution of India envisages that the State Government may, by law, endow the municipalities with such powers and authority as may be necessary to enable them to function as institutions of self Government and such law may contain provisions for devolution of powers and responsibilities upon municipalities.

After the 74<sup>th</sup> Constitution Amendment, the Urban Bodies (ULBs) were made full fledged and vibrant institutions of Local Self Government by vesting them with clearly defined functions and responsibilities. Accordingly, the State Government reorganized (1993) these institutions into three tier system of ULBs namely Municipal Corporations for a larger urban area, Municipal Councils for smaller urban area and Nagar Panchayats for a transitional area.

At present, there are 14 Municipal Corporations, 87 Municipal Councils and 237 Nagar Panchayats. The last elections for the ULBs were held during 2005-06.

**1.2 Administrative arrangements**

The over all administration of ULBs is vested with the Principal Secretary to Government of Madhya Pradesh, Urban Administrative and Development Department (UADD) at Government level. The organisational structure of the Department is given in **Appendix -I**.

**1.3 Accounting arrangements**

**1.3.1** Consequent upon adoption of the budget and accounts format prescribed by the Task Force constituted by Comptroller & Auditor General of India (CAG) which inter alia suggested adoption of accrual based accounting by ULBs, the UADD published Madhya Pradesh Municipal Accounts Manual (MPMAM) in July 2007. However, as per orders of the UADD (July 2007) the accrual system of accounting was to be implemented with effect from April 2008 in 14 Municipal Corporations only. The above system was yet to be implemented in the remaining ULBs.

**1.3.2** As per the decisions taken in the National Seminar organized September 2003 by the Ministry of Urban Development, GoI, a Steering Committee was to be formed in all the States to see the implementation of budget and accounting formats as suggested by the CAG's Task Force. Even after regular correspondence, the committee was not formed so far (October 2008).

**1.3.3** Government of India (GOI) forwarded (September 2004) extracts of section 93 to 96 of Model Municipal Law (MML) along with CAG's suggestions thereon for adoption by State Government. Commissioner (UADD) stated in the meeting (November 2008) that some progress in this regard has been made and assured to appraise audit accordingly.

#### **1.3.4 Database on finances of ULBs**

The Second State Finance Commission (SFC) recommended (December 2003) the need for building up database in respect of municipal finances. This recommendation was accepted by the State Government (March 2005). The database need to be collected, compiled and maintained in standard formats prescribed by CAG. UADD agreed (June 2004) in principle to adopt the formats of database. In compliance it was stated (March 2009) that the data base on finances are being maintained in standard formats in Nagar Nigam and action will be taken to maintain the database in other ULBs also.

### **1.4 Audit arrangements**

**1.4.1** As per recommendations of the Eleventh Finance Commission (EFC), audit of accounts of Urban Local Bodies was entrusted to Commissioner Local Fund Audit (CLFA) under the Technical Guidance and Supervision (TGS) of Comptroller & Auditor General (C&AG) of India by the State Government in November 2001. Accordingly, the office of the Senior Deputy Accountant General, (Local Body Accounts and Audit) is conducting audit of ULBs under TGS module. 55 ULBs including six Municipal Corporations were test checked by audit during 2007-08.

#### **1.4.2 Approval of audit plans of Commissioner Local Fund Audit**

The CLFA was required to prepare the audit plan in consultation with the Principal Accountant General (PAG) as a part of the TGS arrangement. However, in spite of request to the Government (February - November 2008), the audit plans of CLFA were never got approved from the PAG. The CLFA has furnished the list of units proposed to be audited during 2009-10 to this office without getting it approved from PAG.

#### **1.4.3 Constitution of State Legislature Committee**

The Eleventh Finance Commission (EFC) recommended that the report of CAG relating to audit of accounts of ULBs was to be placed before Committee of the State Legislature (SLC) constituted on the same lines as Public Accounts Committee. In spite of request to Government by PAG (up to November 2008), Committee was not constituted (May 2009). Principal Secretary (FD) stated in the meeting (November 2008) that action will be taken after studying the procedure adopted in other states.

#### **1.4.4 Internal Audit System**

According to para 7.2 of the recommendations submitted (July 1996) by the First SFC and decision of the Finance Department (FD), an Internal Audit System was to be set up to ensure the accountability of ULBs. Such provision for creation of internal audit department was also mentioned in para 2.2.1 of MPMAM. However Directorate UADD (February 2009) stated that apart from the arrangement of pre-audit in 50 ULBs units, there was no system of internal audit in other ULBs.

#### **1.5 Source of revenue**

There were mainly two sources of revenue for local bodies (i) Government grants and (ii) own revenues. Own revenue resources of ULBs comprise of tax and non-tax revenues realised by them. Government grants comprise of funds released by the State Government and Government of India (GOI) on the recommendation of SFC, Eleventh & Twelfth Finance Commission (TFC) and State and GoI share for implementation of various schemes. The ULBs also obtain loans for implementation of various schemes relating to urban development.

#### **1.6 Receipts and expenditure**

**1.6.1** Funds (Share of tax revenue of the state, schemes funds & grants etc.) allocated to ULBs by the State Government through budget including GOI's share of the schemes & grants recommended by TFC were as under:-

**(Rs. in crore)**

Sl. No.	Year	Total Grant (Budget Provisions)	Actual Expenditure			Excess (+)/ Saving (-)
			Revenue	Capital	Total	
1.	2005-06	1266.87	1158.12	19.45	1177.57	(-) 89.30
2.	2006-07	1891.90	1614.57	28.81	1643.38	(-) 248.52
3.	2007-08	2333.38	1695.40	305.55	2000.95	(-) 332.43

The above figures indicate that the budget provisions increased by 84 per cent in ULB sector during the year 2007-08 as compared to the year 2005-06 but the ULBs could not spend the amount, resulting in saving during 2005-06 to 2007-08. Details of receipts of ULBs from their own sources and loans & expenditure was not available with Directorate, UADD. The Commissioner, (UADD) stated (March 2009) that the same would be collected and furnished to audit. However the position of State and Central grant, own revenue realized and classification of expenditure into capital and revenue heads of the test checked ULBs (Bhopal, Indore and Khandwa) has been mentioned in the **Appendix-II.**

#### **1.6.2 State Finance Commission (SFC)**

FD accepted (March 2005) the recommendation of second SFC for devolution of 1.07 per cent of 90 per cent of state own tax revenue to ULBs. The grants actually released to ULBs through state budget during 2005-06 to 2007-08 were as given below:-

(Rs. in crore)

Year	Amount of own tax revenue of the State		Amount of share of State own tax revenue to be allocated as per prescribed percentage (i.e. 1.07%)	Amount of share of State own tax revenue released to ULBs	Short fall (with percentage)
	Total	Net (After deduction of 10%)			
1	3	4	5	6	7
2005-06	9115	8203.50	87.77	83.14	4.63 (5)
2006-07	10473	9425.70	100.85	87.77	13.08 (13)
2007-08	12018	10816.20	115.73	100.86	14.87 (13)

As these funds were meant to cover the works relating to basic services and development of slum areas in ULBs, the shortfall in release of funds during 2005-08 resulted in less availability of funds with ULBs for the purpose envisaged by SFC.

### 1.6.3 Submission of Utilisation Certificates (UCs)

Directorate UADD circular (December 2004) stipulated that grants should not be released before obtaining UCs of previous years. Audit scrutiny (March 2009) of records relating to the release of SFC grants by the Directorate UADD Bhopal revealed that grant were released without obtaining UCs of previous years from ULBs during the period 2005-08. During test-check of records of MC Bhopal, Indore and Khandwa it was noticed that UCs for SFC grants amounting to Rs. 20.14 crore<sup>1</sup> released during 2005-06 to 2007-08 were not sent to Directorate. On being pointed out, the Commissioner UADD stated (March 2009) that orders have been issued for submission of UCs regularly. It was whoever observed that the test checked ULBs did not submit UCs to the Commissioner UADD till May 2009.

### 1.7 Position of outstanding loans

The position of outstanding loans of all ULBs was not available with the Directorate UADD. Scrutiny (March 2009) of records in MC Bhopal, Indore and Khandwa revealed that principal amount of Rs. 230.93 crore and Rs. 4.07 crore interest thereon was due for repayment (March 2008) against the outstanding loans. The position of outstanding loans and interest in test checked districts were as under:-

(Rs. in lakh)

Sl. No.	Name of ULB	Balance as on 1.4.06	Fresh loan during 07-08	Repayment during 07-08		Outstanding Principal as on 31 March 2008.
				Principal	As Interest	
1.	Bhopal	3458.72	500	448.82	406.78	3509.90
2.	Khandwa	156.61	--	2.92	0.46	153.69
3.	Indore	10227.00	11000	1797.96	--	19429.04
	<b>Total</b>	<b>13842.33</b>	<b>11500</b>	<b>2249.70</b>	<b>407.24</b>	<b>23092.63</b>

<sup>1</sup> Bhopal 6.06 crore, Indore 10.26 crore and Khawanda 3.82 crore.

### 1.8 Position of outstanding audit paragraphs

The position of outstanding audit paragraphs of ULBs included in the Inspection Reports (IRs) of the CLFA and AGs Inspection Reports are as under:-

#### (A) Outstanding audit paragraphs of CLFA

(As on 31 March 2008)

Sl. No.	Financial Year	ULB			
		Total No. of outstanding audit paragraphs	Addition	No. of paragraphs settled	No. of paragraphs Outstanding
1.	2005-06	177438	6666	5839	178265
2.	2006-07	178265	8227	13066	173426
3.	2007-08	173426	6471	8890	171007

#### (B) Outstanding audit paragraphs of AGs Inspection Reports.

(As on 31 March 2008)

Sl. No.	Financial Year	ULB			
		Total No. of outstanding audit paragraphs	Addition	No. of paragraphs settled	No. of paragraphs Outstanding
1.	2005-06	1440	1110	42	2508
2.	2006-07	2508	601	0	3109
3.	2007-08	3109	514	0	3623

These outstanding paragraphs require active pursuance by CLFA for early settlement.

### 1.9 Bank-reconciliation statement not prepared

Rules 97-98 of Madhya Pradesh Nagar Palika Lekha Niyam 1971, provides that the reconciliation of any difference between the balances of cash book and bank accounts is required to be conducted every month. However, it was noticed that the difference of cash balance of Rs. 2.92 crore between Cashbook and Bank statement at the close of the year (2006 to 2007) was not reconciled by 20<sup>2</sup> ULBs. Due to non-reconciliation of cash balance, possibility of embezzlement of funds could not be ruled out. The authenticity of cash balance of ULBs in the cashbook also remained doubtful in the absence of reconciliation with bank statement.

### 1.10 Non-recovery of advances from individuals

Temporary advances were paid to Staff/officials for making petty payments. Madhya Pradesh Finance Department orders (2001) provides that the temporary advances should be adjusted or recovered at the earliest but in no case later than 3 months of payment of advance or last month (March) of financial year. In case of non-adjustment/recovery penal interest @ of interest payable by Banks on fixed deposits shall also be recovered. Audit of 21 Nagar

<sup>2</sup> Nagar Nigam Satna, Nagar Palikas Dhanpuri, Khargoan, Umaria, Pasan, Junnardev, Dhar, Deori, Mandideep, Nepa Nagar and Nagar Panchayats Lakhnadoan, Tarana, Barghat, Chandia, Khujner, Thandla, Bheraghat, Bamhri Banjar, Mandleswar, Kasrawad.

Nigam/ Nagar Palika/ Nagar Panchayat revealed that a sum of Rs. 309 lakh paid to officials/ staff for various purposes were outstanding against them for the last one to 5 years as shown in **Appendix -III**. Lack of effective action to recover/ adjust the old outstanding advances may lead to loss with the passage of time.

### **1.11 Diversion of funds**

Central Government / State Government released funds in the form of grants-in-aid for development of urban areas which were to be spent exclusively on the projects for which these were sanctioned. Diversion of funds from one scheme to another was not permissible without prior approval of the Central/ State Government.

Scrutiny of records revealed irregular diversion of funds amounting to Rs.1.80 crore by 10 ULBs during 2001-07 for the purposes not covered under the schemes or for routine municipal activities as shown in **Appendix -IV**.

### **1.12 Non utilisation of government grant**

Centrally Sponsored Schemes such as Conversion of dry latrines, Mid-day-meal, Integrated Development of Small and Medium Towns (IDSMT), Tenth, Eleventh and Twelfth Finance Commission etc. and State Plan Schemes were being implemented through ULB's during 2001-07.

Scrutiny of records revealed that grants of Rs. 5.57crore released to 9 ULB's for specific purposes as mentioned in **Appendix – V**, were lying unspent for a period ranging from one year to eight years This deprived the public from intended benefits.

### **1.13 Non recovery of taxes**

Urban Local Bodies (ULBs) earn revenue from their own resources through taxes, rent, fees, issue of licenses etc. In (21) test checked Nagar Nigam/Nagar Palika/Nagar Panchayat, demand for tax amounting to Rs. 36.37 crore was raised for the year 2001-08, out of which only Rs. 12.49 crore (34 percent) was recovered during the period. As of March, a sum of Rs. 23.88 crore (66 percent) as shown in **Appendix –VI** was outstanding against the taxpayers, although the ULBs had powers under section 165 of Madhya Pradesh Municipalities Act, 1961 to approach a Magistrate to seek orders for recovery by distress and sale of any movable property of attachment and sale of immovable property belonging to defaulters, they failed to utilise these power to recover the outstanding taxes.

Non exercise of available powers ULBs resulted in non-recovery of outstanding taxes and resource crunch and subsequent hindrance in development works.

#### **1.14 Non depositing of amount in Provident Fund Accounts**

Rule 102 (4) of M.P. Nagar Palika Lekha Niyam 1971 provides that the deduction of P.F. subscription will be credited in P.F. Account. Government of Madhya Pradesh, Department of Local Bodies further directed (February 1998) all the Commissioners / Chief Municipal Officers that Provident Fund (PF) subscriptions was required to be credited to the fund account of the employees. However it was noticed that three Nagar Palikas and three Nagar Panchayats did not deposit provident fund subscription of Rs. 52.06 lakh in the fund account of the employees during 2001-07 which resulted not only in loss of interest on provident fund account but also put additional burden on the ULBs as shown in **Appendix –VII**.

#### **1.15 Non-creation of Reserve Fund of ULB's**

Sub rule 3 (3) of Madhya Pradesh Nagar Palika Budget Rules, 1962 provides that every Nagar Palika is required to create a reserve fund account (Sanchit Nidhi) by depositing five per cent of net income every year, so that it may be used in special circumstances in the interest of the ULB.

Scrutiny of records of twenty one Nagar Panchayat/ Nagar Palika/Nagar Nigam revealed that a sum of Rs. 5.65 crore was not deposited in the reserve fund account from their net income during 2001-08 as shown in **Appendix-VIII**, resulting in continued financial crisis.

#### **1.16 Non recovery of rent and premium of shops**

Shops were constructed at various places by the ULBs to increase the revenue by way of premium and monthly rent of these shops.

Test check of records of four Nagar Palika and twelve Nagar Panchayat revealed that the premium of shops amounting to Rs. 0.91 crore and rent of shops amounting to Rs. 1.23 crore was not recovered by these ULBs for the last two to six year despite powers available to ULBs under section 165 of Madhya Pradesh Municipalities Act, 1961 for taking restraint action against defaulters. Detail are shown in **Appendix - IX**.

Non exercise of powers vested in ULBs under section 165 of Madhya Pradesh Municipalities Act, 1961 has resulted in loss of revenue of Rs. 2.14 crore.

#### **1.17 Non deduction of Labour Welfare Cess**

An Act to provide for levy and collection of a cess on the cost of construction and to augmenting the resources of the Building and other construction workers Welfare Boards, constituted under the Building and other construction workers (Regulation of employment and condition of service) was enacted by Parliament in 1996. According to the provisions of Section 3 (2) of M.P. Bhawan and Sannirman Karmkar Kalyan (Regulation of employment and service condition), Rules 2002 (framed under Section 40 of the Act of 1996), labour welfare cess at the rate of one percent of the construction cost was to be deducted from the bill of the construction works done by the contractor and sent to Madhya Pradesh Bhawan and Sannirman Karmkar Kalyan Mandal, Madhya Pradesh, Bhopal.

Test check of records of two Nagar Nigams, two Nagar Palikas and two Nagar Panchayat revealed that during the year 2001-07, the cess of Rs. 6.44 lakh was not deducted from the contractor's bill and Rs. 2.89 lakh deducted from the contractor bills by the Nagar Palika Nepa Nagar was not sent to Kalyan Mandal Bhopal. Thus the beneficiaries were unlawfully deprived of the benefits, provided by the Act as details shown in the **Appendix-X**.

#### **1.18 Irregular procurement of material**

In order to ensure the quality and competitive rates, Madhya Pradesh Store Purchase Rules and notification issued by the Government (April 1978 and December 1997) provide that the purchases must be made from M.P. Laghu Udyog Nigam (LUN) or through open tenders after obtaining no objection certificate from LUN.

Test check of records of one Nagar Nigam, six Nagar Palika and eight Nagar Panchayat revealed that the purchases amounting to Rs. 1.88 crore as shown in **Appendix - XI** were made from local market ignoring the quality and competitive rates of rates without inviting tender and also without obtaining no objection certificate from LUN.

#### **1.19 Non-realization of loan amount and contribution from the beneficiaries under Total Sanitation Campaign.**

In pursuance of the Centrally Sponsored Scheme of Total Sanitation Campaign, Government of Madhya Pradesh decided (1982-83) to convert the dry latrines into pour flush latrines. The programme was to be implemented from grants from GOI (50 percent), loan from HUDCO (45 percent) and contribution from beneficiaries (5 percent).

As per orders of the State Government, the repayment of HUDCO loan was to be made from the Octroi compensation fund by the Directorate Urban Administration and Development. Subsequently the recovery of loan and contribution from beneficiaries was to be collected by the ULBs.

Test check of records of five Nagar Palika and nine Nagar Panchayat revealed that an amount of Rs. 1.11 crore on account of repayment of loan and contribution from 8519 beneficiaries was not recovered as shown in **Appendix-XII**. Agreements were also not executed between the beneficiaries and the Nagar Panchayats to enforce recovery of contribution from beneficiaries.

#### **1.20 Conclusion**

Budget and accounts in the format, prescribed by the CAG, were not maintained in all the three tiers of ULBs. Database in the formats prescribed by the CAG on finances of ULBs is yet to be developed. The provisions of MML along with suggestion of CAG on section 93 to 96 of MML have not yet been incorporated in the concerned Acts. The information regarding receipts and expenditure of all ULBs was not being maintained by the Directorate UADD. Approval of PAG on audit plan was not obtained by the CLFA. The Steering Committee and State Legislature Committee were not yet formed.



## **1.21 Recommendations**

Steps to maintain budget and accounts in the formats prescribed by C&AG of India should be taken immediately. Similarly, the provisions of section 93 to 96 of MML with suggestions of C&AG are needed to be incorporated in Municipal Corporation/ Municipality Acts. Arrangements for maintenance of information of receipts and expenditure of all ULBs at state level should be made. The steps to obtain approval of annual audit plan of CLFA from PAG are required to be taken.

Effective monitoring from Directorate on following items is essential.

- (i) Unutilized grants
- (ii) Recovery of out standing advances.
- (iii) Regular deposit of the Provident Fund (PF) subscription in the PF account of employees.
- (iv) Regular transfer of the prescribed percentage of income in Reserve Fund Account by ULBs.
- (v) Regular reconciliation of Cash Book with Bank Pass Book balances; and
- (vi) Speedy settlement of outstanding audit objections.