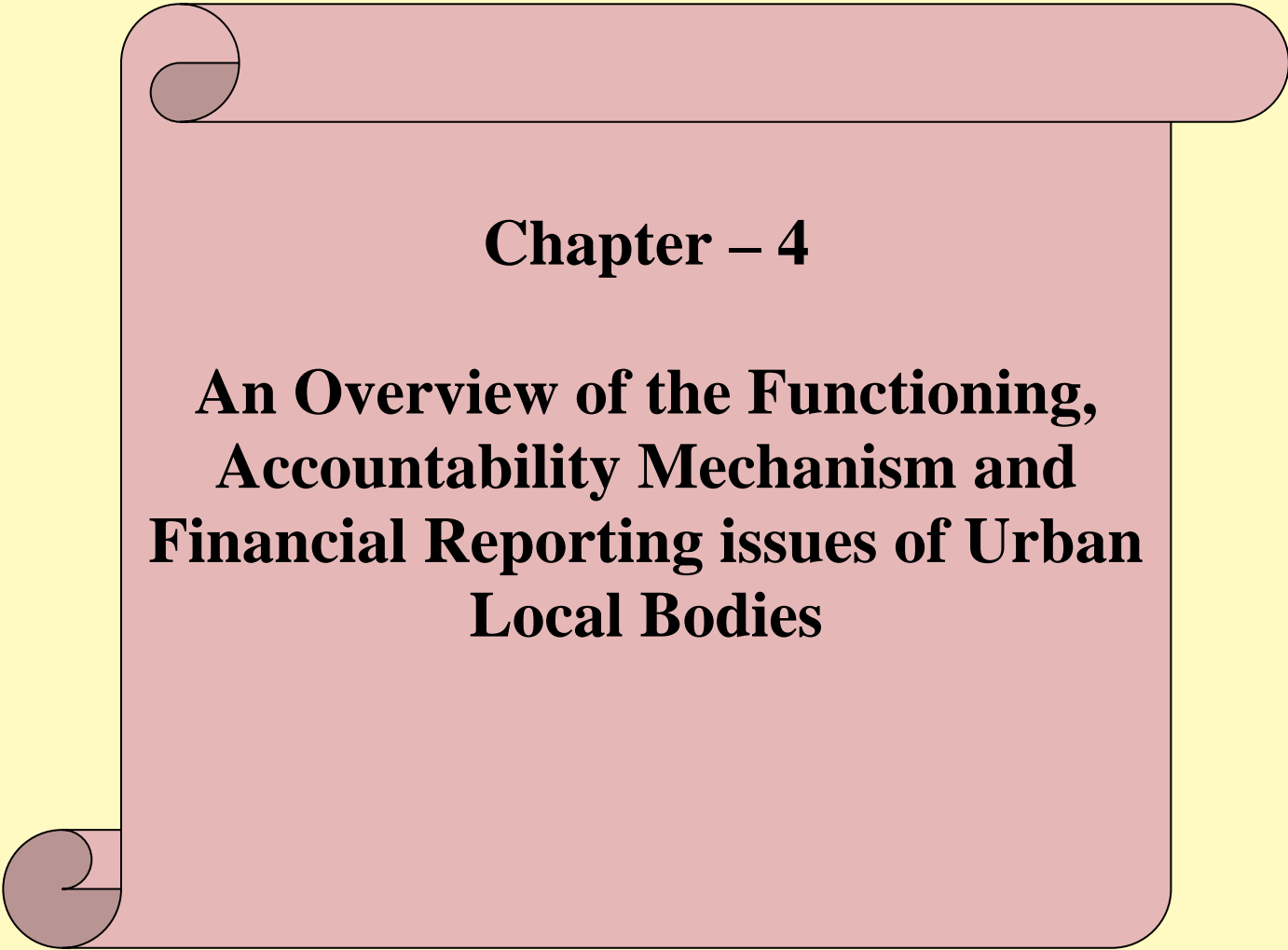




Part - B
Urban Local Bodies



Chapter – 4

**An Overview of the Functioning,
Accountability Mechanism and
Financial Reporting issues of Urban
Local Bodies**

Chapter – 4

AN OVERVIEW OF THE FUNCTIONING, ACCOUNTABILITY MECHANISM AND FINANCIAL REPORTING ISSUES OF URBAN LOCAL BODIES

An overview of the functioning of the Urban Local Bodies (ULBs) in the State

4.1 Introduction

The 74th Constitutional amendment gave constitutional status to Urban Local Bodies (ULBs) and established a system of uniform structure, regular election and regular flow of funds through Finance Commission etc. As a follow up, the States are required to entrust these bodies with powers, functions and responsibilities so as to enable them to function as institutions of Self-Government.

Article 243Q of the Constitution envisages that there shall be constituted in every State, Municipal Corporation for large urban areas; Municipal Councils for smaller urban areas; and Nagar Panchayats (or whatever name called) for areas in transition from a rural to an urban area. Further, Article 243W states that the Legislature of a State 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.

There are 16 Municipal Corporations, 98 Municipal Councils and 264 Nagar Parishads in the State as of March 2015. The basic demographic information relating to the State of Madhya Pradesh vis-a-vis National average is given below:

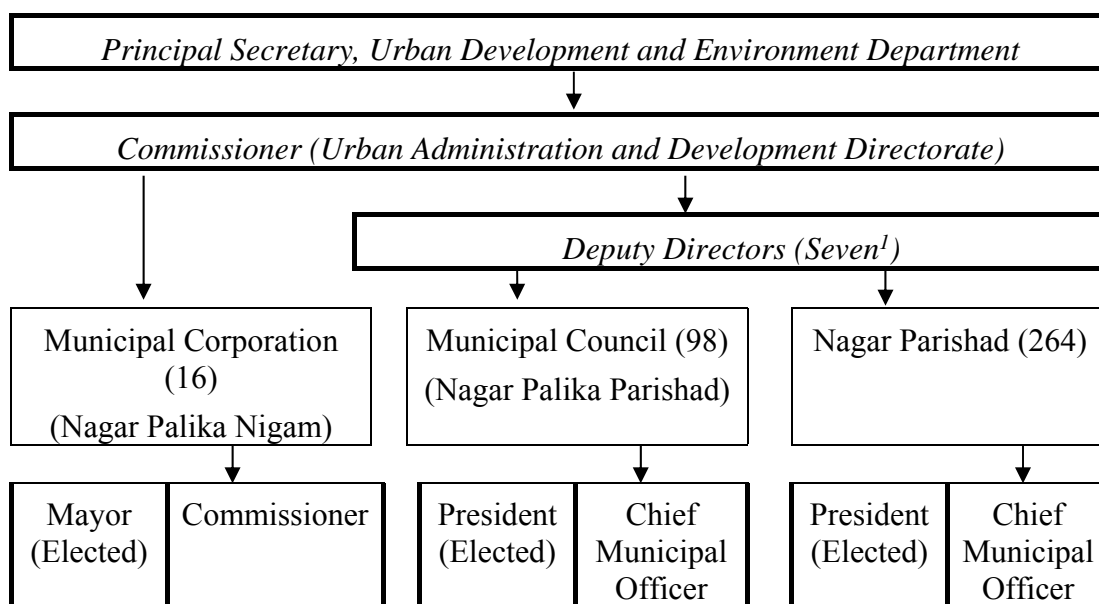
Particulars	Unit	Madhya Pradesh	All India
Population	crore	7.26	121.02
Share in country's population	<i>per cent</i>	6	-
Urban population	crore	2	37.70
Share of urban population	<i>per cent</i>	27.63	31.16
Literacy rate	<i>per cent</i>	69.32	74.04
Sex ratio (females per thousand males)	ratio	931/1000	940/1000

(Source: Census data 2011)

4.2 Organisational set up of ULBs

All the ULBs are empowered to discharge the functions devolved under the provisions of Madhya Pradesh Municipal Corporation Act, 1956 and Madhya Pradesh Municipalities Act, 1961, subject to monitoring powers vested in State authorities provided therein. At the Government level, Urban Development and Environment Department (UDED) is the administrative Department for ULBs. The organisational set up of governance of ULBs is as under:

Organisational Chart of ULBs



4.3 Functioning of ULBs

The State Government devolved all 18 functions, enshrined in Twelfth schedule of the Constitution, to ULBs as detailed in (Appendix-4.1). However, Urban Administration and Development Directorate (UADD) informed (September 2015) that the funds and functionaries were yet to be transferred to ULBs.

4.4 Audit arrangement

The State Government has appointed (November 2001) Director, Local Fund Audit (DLFA) for audit of accounts of ULBs and who shall work under the technical guidance and support (TGS) of the Comptroller and Auditor General (C&AG) of India. As per the standard terms and conditions of TGS, C&AG of India has the right to conduct such test check of the accounts and to comment on and supplement the report of the Statutory Auditor, as he may deem fit. Further, the C&AG of India or his representative has the right to report to State Legislature, the result of audit at his discretion.

Madhya Pradesh State Legislative Assembly has constituted (March 2015) Local Bodies and Panchayatiraj Accounts Committee (LBPAC) for examination of Appropriation Accounts of local bodies in the State. LBPAC is also responsible for examination of reports of C&AG laid on the table of the Legislative Assembly.

● Technical Guidance and Support provided by Indian Audit and Accounts Department

Section 152 of Regulations on Audit and Accounts, 2007 envisages the following arrangements regarding technical guidance and support to ULBs:

¹ Bhopal, Gwalior, Indore, Jabalpur, Rewa, Sagar and Ujjain

- Local Fund Auditor would prepare an annual audit plan for audit of ULBs and forward it to the Accountant General (Audit) of the State.
- The audit methodology and procedure for audit of ULBs by the Local Fund Auditor would be as per various Acts and Statutes enacted by the State and guidelines prescribed by the C&AG.
- Copies of inspection reports in respect of selected local bodies shall be forwarded by the Local Fund Auditor to the Accountant General (Audit) for advice on system improvements.

The Annual Audit Plan for 2013-14 was prepared by DLFA, which was forwarded to the Accountant General (Audit). DLFA followed the methodology and procedure as suggested by the AG (General and Social Sectors Audit), Madhya Pradesh from time to time. Inspection reports were forwarded to the AG (G&SSA) Madhya Pradesh for vetting.

• **Audit Report on Local Bodies**

Para 10.121 of the recommendations of Thirteenth Finance Commission (ThFC) envisages that Annual Technical Inspection Report of C&AG as well as the Annual Report of DLFA should be placed before the State Legislature. Accordingly, amendments were made (January 2012) in the Madhya Pradesh Municipal Corporation Act, 1956 and Madhya Pradesh Municipalities Act, 1961, which lays down that the Annual Audit report of DLFA on Local Bodies along with the Annual Technical Inspection Report of the C&AG of India shall be submitted to the Governor, who shall cause the reports to be laid on the table of the Legislative Assembly.

Annual Technical Inspection Report (ATIR) for the year 2013-14 was forwarded to State Government in May 2015. The status of laying ATIR on the table of the Legislative Assembly was awaited (December 2015), despite reminders (July 2015 and December 2015). State Government informed (July 2015) that the audit report of DLFA was awaited.

4.5 Response to audit observations

For providing technical guidance and supervision under TGS arrangement, Inspection Reports (IRs) of Accountant General (G&SSA), Madhya Pradesh were sent to DLFA. As per TGS arrangements, DLFA was to follow up compliance with the audit paragraphs of IRs. However, 2,984 paragraphs in 662 IRs, including 805 paragraphs in 67 IRs issued during 2014-15, were pending for settlement as of March 2015, as detailed in **Table 4.1**:

Table - 4.1: Status of outstanding Inspection Reports and Paragraphs

Sl. No.	Year	Opening balance and addition during the year				Settled during the year		Closing balance	
		OB IRs	Addition IRs	OB Paras	Addition paras	No of IRs	No of Paras	No of IRs	No of Paras
1	Up to 2010-11	451	Nil	2,764	Nil	5	96	446	2,668
2	2011-12	446	84	2,668	597	2	139	528	3,126
3	2012-13	528	59	3,126	448	2	143	585	3,431
4	2013-14	585	69	3,431	682	4	301	650	3,812
5	2014-15	650	67	3,812	805	55	1,633	662	2,984

(Source: Monthly Arrear Reports compiled by the AG (G&SSA), Madhya Pradesh)

Financial reporting issues

4.6 Sources of funds

As per provisions of Section 105 of MP Municipalities Act, 1961 and Section 87 of MP Municipal Corporation Act, 1956, there are mainly two sources of revenue for ULBs, viz. Government grants and own revenue. The Government grants include:

- grants assigned under the Thirteenth Finance Commission of India; and
- devolution of one *per cent* of divisible tax revenue² of the State Government as per recommendations of the Third State Finance Commission (SFC). Devolution of Grants as per recommendation of the Third SFC during 2014-15 was as under:

The Third State Finance Commission (SFC) recommended (accepted by State Government in February 2010) that one *per cent* of divisible tax revenue of the State Government should be devolved to ULBs. During the year 2014-15, the devolution of SFC grants by the Finance Department to ULBs is shown in **Table 4.2** below:

Table - 4.2: Devolution of funds to ULBs

(₹ in crore)

Year	Divisible funds of State Government	Funds were to be devolved	Funds actually devolved	Excess devolved
1	2	3	4	(4-3)
2014-15	25,678.61	256.79	270.47	13.68

(Source: Information provided by Finance Department and UADD)

It can be seen from **Table 4.2** that there was excess devolutions of ₹ 13.68 crore to ULBs during 2014-15. Reasons for excess release of fund to ULBs were not intimated (December 2015) by Finance Department.

4.7 Budgetary allocation and expenditure of ULBs

Funds (share of tax revenue of the State and grants for implementation of schemes) allocated to ULBs by the State Government through State budget during last five years were as follows:

Table – 4.3: Statement showing receipt and expenditure of ULBs

(₹ in crore)

Year	Grants in aid			Actual Expenditure			Unspent balance	Percentage of savings
	Revenue	Capital	Total	Revenue	Capital	Total		
2010-11	3,577.21	323.15	3,900.36	2,983.60	202.64	3,186.24	714.12	18
2011-12	4,148.30	208.00	4,356.30	3,743.23	152.54	3,895.77	460.53	11
2012-13	5,271.89	215.09	5,486.98	4,879.63	138.50	5,018.13	468.85	09
2013-14	6,547.97	124.21	6,672.18	5,435.55	53.18	5,488.73	1,183.45	18
2014-15	6,718.54	33.27	6,751.81	5,281.52	12.63	5,294.15	1,457.66	22
Total	26,263.91	903.72	27,167.63	22,323.53	559.49	22,883.02	4,284.61	

(Source: Appropriation Account -Grant No. 22, 53, 68 and 75)

² Divisible Fund = total tax revenue of previous year - ten *per cent* of expenditure for collection of taxes - assigned revenue to PRIs and ULBs.

As evident from **Table 4.3**, the grant allocation increased by 73 per cent for ULBs during the year 2014-15 as compared to the year 2010-11. However, ULBs could not spend the entire grant allocation and savings ranged from nine to 22 per cent during the period 2010-15 mainly due to considerable unspent balances in the Revenue Head.

4.8 Accounting arrangement

4.8.1 Maintenance of Accounts in formats prescribed by C&AG

On recommendation of the Eleventh Finance Commission, Comptroller & Auditor General (C&AG) of India constituted a Task Force to recommend budget and accounting formats for ULBs. The Task Force constituted by C&AG, suggested the adoption of National Municipal Accounting Manual (NMAM) for accrual basis accounting by ULBs. The Urban Development and Environment Department (UDED), Government of Madhya Pradesh (GoMP), published (July, 2007) Madhya Pradesh Municipal Accounting Manual (MPMAM), as suggested in NMAM, for adoption of accrual basis accounting system by ULBs from 1 April 2008.

We noted that UDED issued an order (July 2010) to implement MPMAM in all ULBs of State. However, it was implemented only in 100 ULBs³ out of 378 ULBs of the State. Thus, only 26 per cent of ULBs could implement MPMAM as of June 2015.

Further, we audited 91 ULBs⁴ (**Appendix 4.2**) during the year 2014-15. Out of these 21 ULBs⁵ prepared their budget and accounts as per MPMAM and remaining 70 ULBs prepared their accounts as per the existing accounting rules of Madhya Pradesh Municipal Corporation, Act 1956 and Municipal Council Act, 1961.

On this being pointed out (September 2015), UADD stated that budget and accounts were prepared in 31 ULBs out of test checked 91 ULBs as per MPMAM. The Commissioner UADD also stated that MPMAM was under progress for adoption in 53 ULBs.

The reply of UADD is not acceptable as only 21 ULBs out of 91 test checked ULBs had reported preparation of their accounts on the basis of MPMAM.

4.8.2 Annual Budget of ULBs

As per Section 98 of Madhya Pradesh Municipal Corporation Act, 1956 and Section 116 of Madhya Pradesh Municipal Council Act, 1961, every ULB shall prepare budget estimates covering all receipts and expenditure and send the same to the State Government.

We observed that out of 91 test-checked ULBs, only 74 ULBs prepared their budget estimates, four ULBs⁶ sent their budget estimate to State Government

³ 14 out of 16 Municipal Corporations, 41 out of 98 Municipal Councils and 45 out of 264 Nagar Parishads

⁴ Eight Municipal Corporations, 35 Municipal Councils and 48 Nagar Parishads

⁵ Municipal Corporations: Bhopal, Burhanpur, Dewas, Gwalior, Jabalpur, Khandwa, Ratlam and Ujjain; Municipal Councils: Agar, Anuppur, Chaurai, Dabra, Harda, Kotma, Sanawad and Seoni; Nagar Parishads: Churhat, Dahi, Harrai, Kolaras and Lanji

⁶ Municipal Council: Kotma Nagar Parishads: Dikken, Khategaon and Kolaras.

as envisaged in the Act. Remaining 17 ULBs did not furnish relevant information/records. Thus, 70 test-checked ULBs did not send their budget estimates to State Government, which was contrary to provisions of the respective Acts.

4.9 Non-preparation of bank reconciliation statement

Madhya Pradesh Municipal Accounting Rules prescribe for reconciliation of any difference between the balances of cash book and bank accounts on monthly basis.

During test check of records of 91 ULBs, we found that 30 ULBs did not prepare bank reconciliation. There were unreconciled differences in the closing balances of cash books and bank books of these 30 ULBs as of March 2014, as detailed in (Appendix-4.3). Further, 56 ULBs⁷ did not produce relevant information/records. Non-reconciliation of differences was fraught with the risk of misuse of funds.

The Commissioner/CMO of respective Municipal Corporation, Municipal Council and Nagar Parishad stated (2014-15) that the bank reconciliation of difference between the balances of cash book and bank accounts would be carried out.

4.10 Non-realisation of tax revenue/non-tax revenue

As per Section 87 of MP Municipal Corporation Act, 1956 and Section 105 of MP Municipalities Act, 1961, the source of own revenue of ULBs are through taxes, rent, fees, issue of licenses etc. In case of non-receipt of the tax and non-tax revenue, the Municipal Corporations are required to take necessary action for recovery as envisaged in section 173 to 183 of the MP Municipal Corporation Act, 1956.

We observed that tax revenue of ₹ 131.81 crore imposed up to March 2014 in 77 ULBs out of test checked 91 ULBs, remained unrealised. Remaining 14 ULBs did not furnish information to Audit. The amount included ₹ 117.11 crore on account of property tax, composite tax, education and development cess, market fees and show tax imposed in 77 ULBs (Appendix-4.4) and ₹ 14.70 crore on account of rent and premium imposed by 32 ULBs as shown in (Appendix-4.5).

Similarly, non-tax revenue (water charges, license fees, land and building rent etc.) amounting to ₹ 178.16 crore remained unrealised in 78 ULBs (Appendix-4.6). Remaining 13 ULBs did not furnish information to Audit.

The Commissioner/CMO of respective Municipal Corporation, Municipal Council and Nagar Parishad stated (2014-15) that effort would be made to recover unrealised revenues of ULBs.

However, no action was taken by these ULBs under Sections 173 to 183 of the Act *ibid* to recover the dues.

⁷ Municipal Corporation: 4 Municipal Council: 25 Nagar Parishads: 27

4.11 Non-adjustment of temporary advances

Rule 112 (2) of the MP Municipal Accounts Rules, 1971 stipulates that no advance shall be drawn unless expenditure is likely to be incurred within one month. The CMO/Accounts Officer of Municipalities would review unadjusted advance quarterly and submit before Finance Committee/Standing Committee of ULBs.

During test check of records of 91 ULBs, we found that temporary advances of ₹ 2.97 crore provided by 34 ULBs to individuals/agencies remained outstanding as on 31 March 2014. Details are given in (Appendix-4.7). The oldest outstanding amount of ₹ 0.48 lakh pertained to January 1962, i.e. more than 53 years. In 24 ULBs no temporary advance was outstanding, whereas remaining 33 ULBs did not furnish the relevant information to Audit.

The Commissioner/CMO of the concerned ULBs stated (2014-15) that instructions for recovery and adjustment of outstanding advances had been issued.

4.12 Release and utilisation of Thirteenth Finance Commission Grants

Thirteenth Finance Commission (ThFC) grants-in-aid were released to the State mainly in two forms, viz., General Basic Grant and Special Area Basic grant. In addition, the performance related grants (General Performance Grant and Special Area Performance grant) were also released to the State from 2011-12 onwards on fulfillment of conditions imposed for its release. As per ThFC recommendations, allocations among various Urban Local Bodies (ULBs) within the State were to be made by the respective States. The position of grants released to Madhya Pradesh and thereafter transfer of the same to ULBs are as shown in the Table 4.4.

Table-4.4: Entitlement and Release of ThFC grant during 2010-11 to 2014-15

(₹ in crore)

Types of Grants under ThFC	Entitlement of State for ULBs	Grant released by GoI	Short(-) release by GoI	Grant released to ULBs by State Government
General Basic Grant (GBG)	976.81	864.93	(-) 111.88	864.93
General Performance Grant (GPG)	517.15	195.09	(-) 322.06	195.09
Special Area Basic Grant(SABG)	19.74	17.33	(-) 2.41	17.33
Special Area Performance Grant (SAPG)	13.81	11.68	(-) 2.13	11.68
Total	1,527.51	1,089.03	(-) 438.48	1,089.03

(Source: Information provided by the Finance Department and UADD)

It is evident from above that Government of India (GoI) released ₹ 1,089.03 crore of ThFC grants for ULBs against the entitlement of ₹ 1,527.51 crore of the State during 2010-15. Thus, there was short release of ₹ 438.48 crore ThFC grants to State.

4.12.1 Fulfillment of conditions by State Government to draw GPG

The State was eligible to draw its allocation of General Performance Grant, if it complies with certain conditions prescribed in para 10.161 of ThFC guidelines. The status of compliance with the conditions by State is as under:

Conditions	Action taken by the State Government
ULBs, having elected body were eligible to receive GPG.	Election for ULBs was held in 2015.
Release of grants will be subject to submission of utilisation certificate for previous installment drawn.	Utilisation certificates were submitted in prescribed format by UADD on time, on the basis of funds released to ULBs.
The State should implement in all ULBs an accounting framework suggested in the National Municipal Accounts Manual (NMAM).	UDED, Government of Madhya Pradesh issued an order (July 2010) to implement MPMAM in all ULBs of State, but it was implemented only in 100 ULBs out of 378 ULBs of the State, which consist only 26 per cent. Despite non fulfillment of this condition, GPG was released to all ULBs of State.
To put in place an audit system for ULBs, the Annual Technical Inspection Report of the C&AG as well as the Annual Report of the Director of Local Fund Audit, must be placed before the State legislature.	MP Municipal Corporation Act, 1956, and MP Municipal Council Act, 1961, were amended in January 2012. According to amendment the Annual Audit report of DLFA on ULBs along with the ATIR of the C&AG of India shall be submitted to the Governor, for laying in Legislative Assembly. However, the ATIR of 2013-14 was not placed before State Legislature (December 2015).
To put in place a system of independent local body ombudsmen who will look into complaints of corruption and mal-administration against the functionaries of local bodies.	The M.P. <i>Lokayukt Avam Up-Lokayukt Adhiniyam</i> , 1981, was in force and all functionaries of Local Bodies are covered under the Jurisdiction of this Act.
To put in place a system of transfer of funds through e-banking in all ULBs.	All ThFC grants were transferred to ULBs through e-banking by UADD.
To constitute State Finance Commission (SFC) as per Article 243 I(2) of the Constitution.	The relevant legislation was already in force and fourth State Finance Commission was constituted.
Constitution of State Property Tax Board for suggesting reform in tax collection by the ULBs.	The State Government constituted the Board in March 2011 to reform existing tax collection system in MP by ULBs. The last meeting of Board was held in May 2014 and discussion was made regarding reform of tax collection system in ULBs. ULBs were collecting taxes at the prevailing rates.

4.12.2 Delay in release of ThFC grant to ULBs

As per para 4.2 of ThFC guidelines, ThFC grants were to be transferred to Urban Local Bodies (ULBs) within ten days of receipt from the Central Government. In case of any delay, the State Government would release the grant with interest, at the bank rate of RBI, this would be applicable from the second installment of 2010-11 onwards.

We observed that ThFC grants were not transferred to ULBs within the time limit envisaged in guidelines. Finance Department (FD) of State sanctioned ₹ 0.66 lakh as interest for delay in release of ThFC grant to ULBs.

We further observed that ThFC grants of ₹ 404.39 crore were released to ULBs during 2011-15 with the delay⁸ ranging between eight to 198 days (**Appendix-4.8**). Keeping in view the interest rate of nine *per cent* adopted by FD for payment of interest on delayed release of ThFC grants, interest payable to ULBs worked out to ₹ 2.08 crore. Thus, there was short release of ₹ 2.07 crore⁹ towards interest payable to ULBs for delayed release of ThFC grants.

The matter was referred to Commissioner, UADD, reply awaited (December 2015).

⁸ After excluding ten days within which ThFC grants were to be released.

⁹ Due interest for release to ULBs by FD (₹ 208 lakh-₹ 0.66 lakh)= ₹ 207.34 lakh i.e. ₹ 2.07 crore

