CHAPTER IV

DEVOLUTION OF FINANCIAL RESOURCES

Robustness of Urban Local Bodies (ULBs) gets reflected in the state of their finances and in their capacity to look after their own needs. Devolution to take effect in its true sense in the context of ULBs would require them to be endowed with financial resources commensurate with their requirements. As fiscal autonomy is one of the core elements of decentralisation, effective decentralisation would imply not just availability of adequate financial resources (either self-generated or transferred), but also the power to make financial decisions. Funds available to ULBs in Kerala include own revenues (tax and non-tax), grants from the Centre and State and loans. This Chapter attempts to study the efficacy of financial devolution facilitated by 74th CAA and the State legislations, through observations pertaining to overview of finances and analysis of receipts of ULBs.

4.1 Finances of Urban Local Bodies

Article 243X of the Constitution provided for constitution of Funds for crediting all moneys received, by or on behalf of the Municipalities and for their withdrawal, as well as for grants-in-aid to the Municipalities from the Consolidated Fund of the State. Article 243Y mandated constitution of State Finance Commissions to review the financial position of the Municipalities and to make recommendations on the principles governing the grants-in-aid to the Municipalities from the Consolidated Fund of the State and the measures needed to improve the financial position of the Municipalities. The KM Act, 1994 also reiterated through its provisions, measures to strengthen local finance.

The Kerala Municipality (Manner of Inspection and Audit System) Rules, 1997 envisage that every Municipality has to submit Annual Financial Statements for audit to the primary auditor within four months after the completion of the financial year, i.e., before 31st day of July to the Auditor authorised to conduct the audit of the accounts of that Municipality. It was noticed that during the period from 2017-18 to 2020-21, all the 93 ULBs had submitted their Annual Financial Statements for audit to the Statutory Auditor, Kerala State Audit Department.

Audit came across shortcomings in financial management of ULBs as discussed in following paragraphs, which if rectified, would facilitate higher level of financial autonomy and good governance thereby.

4.1.1 Unrealistic budget formulation

Sections 285 and 287 of the Kerala Municipality Act, 1994 make it mandatory for the urban local governments to prepare the annual budget before the beginning of each financial year. As per Section 285 of KM Act, the Secretary of ULB shall prepare and submit to the Standing Committee concerned, a budget containing a detailed estimate of receipts and expenditure for the ensuing year before the fifteenth day of January each year. The Standing Committee concerned, after considering the estimate and proposals of the Secretary of the ULB and the officials dealing with the respective subjects, shall submit the proposals to the Standing Committee for Finance. After considering these proposals, the Standing Committee for Finance shall prepare budget estimate of the receipts and expenditure of the Municipality for the next year. The budget estimate prepared by the Standing Committee for Finance shall be laid by its Chairman before the Municipality/Corporation Council for its approval before the end of the first-week of March. The Council shall finally pass the budget estimates before the beginning of the year to which it relates and submit copies to the Government.

Audit noted that the LSGIs did not prepare estimates on the basis of the trends in receipts and expenditure in previous years. Thus there was wide variation in figures of budget estimates and actuals. The budgeted figures would have been more realistic, if the LSGIs had relied upon the trends in receipts and expenditure in previous years.

Illustrative examples of preparation of unrealistic budget by four test-checked ULBs are shown in **Table 4.1:**

Table 4.1: Statement showing the details of unrealistic budget

Name of ULB	Year	Receipts (₹ in lakh)			Expenditure (₹ in lakh)		
		Budget	Actual	Percentage of actuals to budget	Budget	Actual	Percentage of actuals to budget
Wadakkanchery Municipality	2015-16	3882.11	755.69	*19.47*	3951.27	820.89	*20.78*
	2016-17	9239.04	2132.47	*23.08*	8733.22	1835.20	*21.01*
	2017-18	10748.54	3487.55	*32.45*	10665.85	3118.81	*29.24*
	2018-19	30819.41	4234.26	*13.74*	29242.48	3692.87	*12.63*
	2019-20	20709.59	3562.65	*17.20*	19680.51	2668.07	*13.56*
Kalpetta Municipality	2015-16	12947.63	3081.15	*23.80*	12873.68	2379.92	*18.49*
	2016-17	16785.61	1896.43	*11.30*	16720.61	2713.70	*16.23*
	2017-18	19126.67	3498.14	*18.29*	19073.54	3293.88	*17.27*
	2018-19	4444.19	3353.67	*75.46*	4401.59	2887.23	*65.60*
	2019-20	9012.92	3622.75	*40.20*	8957.61	3567.42	*39.83*
Thiruvananthapuram Corporation	2015-16	80568.96	25803.70	*32.03*	68620.91	26001.81	*37.89*
	2016-17	57454.09	39661.63	*69.03*	48626.69	27492.26	*56.54*
	2017-18	68994.75	41952.69	*60.81*	60049.23	28566.44	*47.57*
	2018-19	84304.17	58442.97	*69.32*	72873.87	54476.21	*74.75*
	2019-20	92205.35	55445.56	*60.13*	95867.91	39486.44	*41.19*
Kochi Corporation	2015-16	88154.17	42132.93	*47.79*	84188.00	32506.76	*38.61*
	2016-17	88355.99	41367.63	*46.82*	84095.02	30762.67	*36.58*
	2017-18	85416.69	54334.06	*63.61*	82229.92	43546.86	*52.96*
	2018-19	91747.57	65762.97	*71.68*	88898.97	50134.74	*56.40*
	2019-20	98756.95	57885.27	*58.61*	94518.59	52133.98	*55.16*

(Source: Details furnished by test-checked ULBs)

The percentage of actual receipts to the budget figures during the period 2015-16 to 2019-20 ranged from 13.74 to 32.45 *per cent* in Wadakkanchery Municipality; 11.30 to 75.46 *per cent* in Kalpetta Municipality; 32.03 to 69.32 *per cent* in Thiruvananthapuram Corporation and 46.82 to 71.68 *per cent* in Kochi Corporation. On the other hand, the expenditure was over estimated by

12.63 to 29.24 *per cent* in Wadakkanchery Municipality; 16.23 to 65.60 *per cent* in Kalpetta Municipality; 37.89 to 74.75 *per cent* in Thiruvananthapuram Corporation and 36.58 to 56.40 *per cent* in Kochi Corporation during the same period. The above trends raise concern about the realistic nature of the budgets of these ULBs, which makes them ineligible to qualify as instruments of financial control and expenditure management.

The trends in receipts and expenditure in previous financial years are to be taken into account while formulating budget estimates of a financial year. Budget estimates are to be made realistic by analysing reasons for persistent savings, if any, for effecting correction. Consistent significant variations between budgeted and actual figures in test-checked ULBs during the five-year period is indicative of the low priority assigned by the ULBs towards planned formulation of budget. ULBs need to exercise due care in their budgeting processes, as the budget of the Municipality does not require approval by the State Government in the light of decentralisation. The Report of the Committee for Evaluation of Decentralised Planning and Development had pointed out (March 2009) the failure of all Local Government Institutions to use budget as an instrument of financial control.

Reply of the Government is awaited (December 2021).

4.1.2 Expenditure of Urban Local Bodies

The expenditure of ULBs can be categorised into five, *viz.*, Human Resource expenses, General expenses, Operations and Maintenance, Interest and Finance charges and Programme expenses. The details of expenditure incurred by 93 ULBs in the State as well as by test-checked 21 ULBs during the period 2015-16 to 2019-20 are shown in **Tables 4.2 and 4.3** respectively.

Table 4.2: Expenditure incurred by ULBs in the State

(₹ in crore)

Year	Human Resource Expenses	General expenses	Operation and Maintenance	Interest and Finance charges	Programme expenses, expenses out of Grants	Total Expenditure
2015-16	107.45 (9.68%)	39.93 (3.60%)	118.13 (10.64%)	9.12 (0.82%)	835.44 (75.26%)	1110.07
2016-17	145.77 (13.02%)	44.84 (4.01%)	125.34 (11.20%)	6.98 (0.62%)	796.66 (71.16%)	1119.59
2017-18	201.76 (11.05%)	60.54 (3.32%)	140.31 (7.68%)	13.84 (0.76%)	1409.39 (77.19%)	1825.84
2018-19	212.27 (8.51%)	64.95 (2.60%)	249.70 (10.01%)	10.39 (0.42%)	1958.42 (78.47%)	2495.73
2019-20	197.76 (8.75%)	44.23 (1.96%)	207.83 (9.20%)	13.68 (0.61%)	1796.07 (79.49%)	2259.57
Total	**865.01 (9.82%)**	**254.49 (2.89%)**	**841.31 (9.55%)**	**54.01 (0.61%)**	**6795.98 (77.13%)**	**8810.80**

(Source: Figures furnished by IKM)

Table 4.3: Expenditure incurred by selected ULBs

(₹ in crore)

Year	Human Resource Expenses	General expenses	Operation and Maintenance	Interest and Finance charges	Programme expenses, expenses out of Grants	Total Expenditure
2015-16	43.54 (9.79%)	13.63 (3.07%)	58.81 (13.23%)	5.53 (1.24%)	323.09 (72.67%)	444.60
2016-17	52.41 (12.10%)	12.35 (2.85%)	56.63 (13.07%)	2.57 (0.59%)	309.17 (71.38%)	433.13
2017-18	74.60 (12.08%)	20.62 (3.34%)	60.79 (9.85%)	2.95 (0.48%)	458.47 (74.25%)	617.43
2018-19	71.66 (7.62%)	30.93 (3.29%)	127.83 (13.60%)	3.89 (0.41%)	705.76 (75.08%)	940.07
2019-20	64.47 (8.42%)	13.23 (1.73%)	74.95 (9.79%)	2.65 (0.35%)	610.59 (79.72%)	765.89
Total	**306.68 (9.58%)**	**90.76 (2.84%)**	**379.01 (11.84%)**	**17.59 (0.55%)**	**2407.08 (75.19%)**	**3201.12**

(Source: Figures furnished by IKM)

The major share of expenditure by ULBs in the State, ranging from 71.16 *per cent* to 79.49 *per cent* of the total expenditure is seen incurred for Programme expenses, expenses out of grants, etc., which is reflective of the high priority given to project implementation by ULBs. Sufficient share of funds are to be allotted to Operation and Maintenance (O&M) expenses also, to facilitate the pace of delivery of mandatory civic functions like disposal of solid and liquid waste, vector control, establishment of slaughter houses, maintenance of burial grounds, provision of public toilets, etc.

The Fifth SFC observed that the laxity on the part of Local Governments towards civic functions has created serious problems relating to public health, sanitation and environment in the State. Hence, the approach of the Commission was to assign top priority to these functions and devolve sufficient funds for the purpose.

4.1.3 Analysis of financial data of Urban Local Bodies

The following ratios were considered by Audit to establish the fiscal autonomy of ULBs.

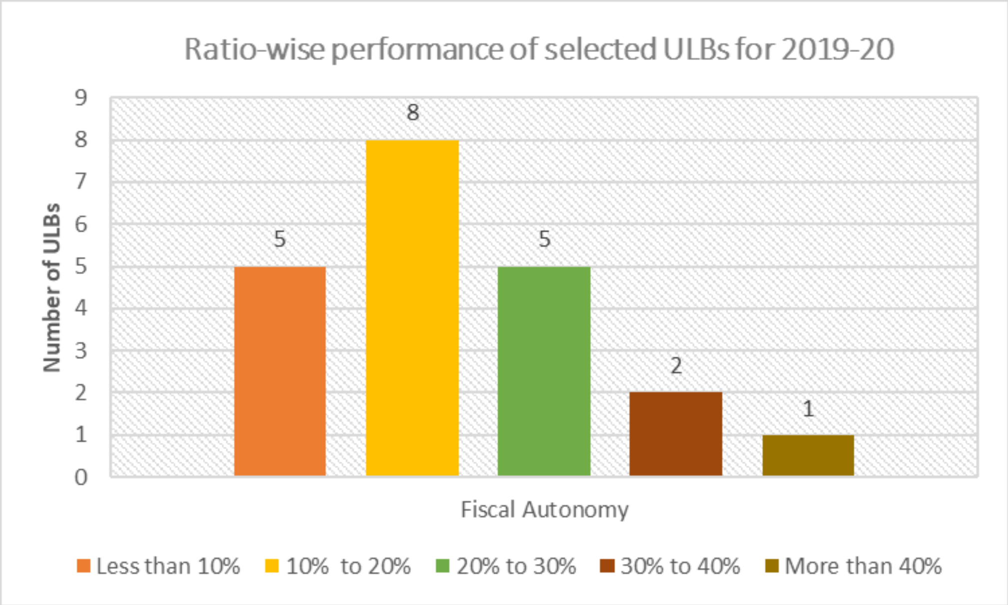
- Local fiscal autonomy: This is the share of own revenue to the total revenue of the ULB.
- Local dependency on fiscal transfer: This is the share of Central Finance Commission (CFC) and State Finance Commission (SFC) grants to the total fiscal revenue of the ULB.

Local fiscal autonomy and local dependency on fiscal transfer are inversely related to each other. The higher the fiscal autonomy, lesser is the dependency on fiscal transfer. On scrutiny of the data for the year 2019-20, it was observed that the ratio of own revenue to total revenue was higher than 40 *per cent* in one

ULB[32] only (out of test-checked 21 ULBs). In two ULBs the ratio was in the range of 30-40 *per cent.* This is indicative of the urgent need to effectively tap the potential sources of revenue to ULBs, to facilitate self-reliance in local finances.

The trend in fiscal autonomy in the test-checked 21 ULBs during the year 2019-20, is depicted in the **Chart 4.1**:

Chart 4.1: Local Fiscal Autonomy



4.1.4 Extent of utilisation of funds

A comparison of the total expenditure with total revenue for the period 2015-16 to 2019-20 showed that expenditure incurred by 93 ULBs in the State ranged from 35.78 to 57.67 *per cent*, and that of selected ULBs from 32.71 *per cent* to 53.54 *per cent* of total revenue as shown in **Tables 4.4 and 4.5** respectively.

Table 4.4: Extent of utilisation of funds by ULBs in the State

(₹ in crore)

Year	Revenue	Expenditure	Percentage of Expenditure out of revenue
2015-16	2169.86	1110.07	51.16
2016-17	3129.30	1119.59	35.78
2017-18	3166.06	1825.84	57.67
2018-19	4447.56	2495.73	56.11
2019-20	4210.47	2259.57	53.67
Total	**17123.25**	**8810.80**	**51.46**

(Source: Data furnished by IKM)

[32] Aluva Municipality

Table 4.5: Extent of utilisation of funds by test-checked ULBs

(₹ in crore)

Year	Revenue	Expenditure	Percentage of Expenditure out of Revenue
2015-16	1002.57	444.60	44.35
2016-17	1324.25	433.13	32.71
2017-18	1264.02	617.43	48.85
2018-19	1755.74	940.07	53.54
2019-20	1759.69	765.89	43.52
Total	**7106.27**	**3201.12**	**45.05**

(Source: Data furnished by IKM)

The figures of expenditure incurred by ULBs in the State and test-checked ULBs in the five year period 2015-2020 recorded a total percentage of 51.46 and 45.05 respectively. Higher expenditure would symbolise active intervention of ULBs to bring all weaker sections of society under social security net and to impart quality services in health and education sectors. It was noticed that the ULBs in the State could not incur appreciable trends in expenditure during the audit period (2015-2020), which may hamper positive outcomes in priority sectors.

4.1.5 Non-preparation of Budget Manual

Sections 285 to Section 293 of KM Act, 1994 stipulate the procedure for preparation of budget in ULBs. The power to make rules by Government in matters relating to the estimate of receipts and expenditure is provided in Section 565 of KM Act.

Fourth SFC had recommended (March 2011) that the Budget Rules may be thoroughly recast with adequate provisions for participatory planning and budgeting and that the Rules should incorporate provisions for transparency and ensure integrity and sanctity of budget, especially in relation to forecasting of revenues and estimating expenditure. The Budget Rules needed to be amplified in considerable detail in a simple manner with enough number of illustrations and issued in the form of a Budget Manual which would detail procedures for re-appropriation and enable appropriation control. Though Government in its Action Taken Report (2011-12) accepted the above recommendations and assured necessary action, Budget Manual for Local Bodies has not been formulated in the State till date. Non formulation of Budget Manual may facilitate laxity in adherence to financial norms and unrealistic estimation of receipts and expenditure by Local Governments. The recommendations discussed above, if implemented, would streamline the financial accounting of ULBs and enable a reliable financial reporting system for Local Governance.

4.2 Receipts of Urban Local Bodies

Devolved functions can be carried out effectively by ULBs only when they are supported by sufficient financial resources. Financial resources are obtained through fiscal transfers facilitated by State Finance Commissions and compliance to State and Central Finance Commission recommendations as well as through increased access to own sources of revenue commensurate with expenditure requirements. Audit attempted to analyse the channels of receipts of ULBs as detailed below:

4.2.1 Sources of revenue of Urban Local Bodies

The chief sources of revenue of ULBs are grants devolved as per recommendations of SFC and own revenue comprising tax and non-tax revenue and other revenue[33]. The details of revenues of ULBs in the State during the period 2015-16 to 2019-20 are indicated in **Table 4.6:**

Table 4.6: Details of revenues of ULBs during the period 2015-16 to 2019-20

(₹ in crore)

Year	Finance Commission Grants		Own Revenue	Other Revenue	Total Revenue	Percentage of own revenue to total revenue
	Development Fund	Maintenance and General Purpose Fund				
2015-16	1000.77	595.81	791.73	582.44	2970.75	26.65
2016-17	1439.05	719.93	938.37	2289.63	5386.97	17.42
2017-18	1688.28	784.65	1008.54	1716.33	5197.80	19.40
2018-19	1850.56	935.55	1149.05	2538.87	6474.03	17.75
2019-20	1837.16	870.55	1080.08	1595.27	5383.06	20.06

(Source: Details of FC Grants from SFC Cell, Own revenue figures from IKM and figures of Other revenue from VLC cell, AG (A&E)/various offices)

The share of own revenue to total revenue of ULBs ranged from 17.42 to 26.65 *per cent* during the period 2015-16 to 2019-20. This is indicative of the urgent need for enhancing the own revenue of ULBs.

4.2.2 Fiscal transfers to Urban Local Bodies

Significant quantum of funds is made available to ULBs through fiscal transfers by the Central and State Governments. These include Finance Commission grants[34], central share of Centrally Sponsored Schemes and lumpsum grants[35] provided in the Budget for schemes/ functions transferred to ULBs.

The fiscal transfers from Government formed the major portion of the revenue (ranging from 73.35 to 82.58 *per cent*) of ULBs in the State during the period 2015-16 to 2019-20.

A. State Finance Commission grants

The major share of financial resources of ULBs comprised grants recommended by SFC. The details of funds due as per the orders of the State Government and funds actually released to ULBs during the period 2015-16 to 2019-20 are given in **Table 4.7**:

[33] Funds to transferred institutions and Centrally Sponsored Schemes.

[34] Including Central Finance Commission grant, Development Fund, Maintenance Fund and General Purpose Fund.

[35] Against separate sub heads of account under the Minor head '191-Assistance to Municipal Corporations, 192-Assistance to Municipalities/Municipal Councils', under the functional Major and Sub Major heads of the Departments concerned.

Table 4.7: Details of grants due and released under SFC during 2015-16 to 2019-20

(₹ in crore)

Year	SFC allocation as accepted by State	Actual allocation in Budget-Appendix IV	Actual release from Finance Department GoK	Short (-) / Excess (+)release	% of short (-) / Excess (+)release
2015-16 (4th SFC)	1438.07	1438.07	1939.04	(+)500.97	(+) 34.84
2016-17 (5th SFC)	2250.33	2250.33	2222.50	(-) 27.83	(-) 1.24
2017-18	2306.16	2306.16	2473.00	(+)166.84	(+) 7.23
2018-19	2554.85	2554.85	2786.13	(+)231.28	(+) 9.05
2019-20	2827.72	2827.72	2707.71	(-) 120.01	(-) 4.24

(Source: Data furnished by SFC Cell)

The funds released to ULBs under SFC was short of the mandated devolution by 1.24 *per cent* and 4.24 *per cent* during 2016-17 and 2019-20 respectively. However, fund distribution in the remaining three years was marked by excess release varying from 7.23 *per cent* (2017-18) to 34.84 *per cent* (2015-16). This suggests the prominent share of contribution facilitated by State Finance Commissions to the finances of Local Bodies.

B. Central Finance Commission grants

Article 280(3)(c) of the Constitution mandates the Central Finance Commission (CFC) to recommend measures to augment the Consolidated Fund of a State to supplement the resources of Municipalities based on the recommendations of the respective SFCs. The 14th CFC recommended providing of Basic grant and Performance grant to ULBs. The details of 14th CFC grants received by ULBs in the State during the audit period are shown in **Table 4.8**:

Table 4.8: Details of Fourteenth CFC grants received by ULBs in the State during 2015-20

(₹ in crore)

Year	General Basic Grants			Performance Grants		
	Allocation by GoI	Release by GoI to State	Release from State to ULBs	Allocation by GoI	Release by GoI to State	Release from State to ULBs
2015-16	351.66	351.66	316.49	0.00	0.00	0.00
2016-17	486.94	486.94	510.84	143.71	143.71	143.71
2017-18	562.61	562.61	562.61	162.63	162.63	193.82
2018-19	650.84	650.84	650.84	184.69	0.00	184.69
2019-20	879.42	879.42	879.42	241.83	0.00	0.00
Total	**2931.47**	**2931.47**	**2920.20**	**732.86**	**306.34**	**522.22**

(Source: Data furnished by SFC Cell)

(i) The 14th Finance Commission recommended a total allocation of ₹2931.47 crore under Basic grants[36] and ₹732.86 crore under Performance grants[37] for the period 2015-20. Out of the Basic Grants allotted for the period, the State Government released ₹2920.20 crore to the ULBs. Against the Performance Grants of ₹306.34 crore released by GoI, the State Government released ₹522.22 crore, which was in excess of the amount received[38] from GoI. As per the 14th Finance Commission Performance Grant Scheme, if the ULB has an overall score of 60 or more from three criteria *i.e.*, Audit of annual accounts (weightage 10), Increase in own revenue sources (weightage 40) and Publishing of Service Level Benchmarks (weightage 50), it qualifies for receiving the Performance Grants.

The list of ULBs eligible for Performance Grants was forwarded (November 2018) to the Ministry of Housing and Urban Affairs (MoHUA) by GoK alongwith Utilisation Certificates for 2016-17 and 2017-18. The MoHUA recommended[39] for release of Performance Grants for Kerala for the years 2018-19 and 2019-20 and the matter is pending with the Ministry of Finance, GoI. Though GoK requested (October 2020) to expedite the release of these funds, no favourable action was seen initiated. The Additional Chief Secretary (Finance), GoK stated that no reply has been received from MoHUA in response to the above request till February 2022.

As the underlying objective of the grant is to initiate action at the grassroots level for compilation of data on local bodies' receipts and expenditure for the stakeholders to have access to reliable information for decision making, non-receipt of this grant may adversely impact upon the quality of service delivery by LSGIs.

(ii) During 2014-15, GoK released ₹166.39 crore of Thirteenth FC grant for the year in advance, anticipating that the funds will be received from GoI either in the same year or in the next year. However, GoI did not release second instalment for the year 2014-15 as the term of Thirteenth FC was over by 2014-15. Paragraph 17 of Fourteenth Central Finance Commission guidelines stipulates that there should not be any deductions at source from the grant due to the local bodies. Contrary to this, GoK adjusted the excess amount (March 2016) released on account of Thirteenth Finance Commission Grant relating to the year 2014-15 amounting to ₹166.39 crore from the Development Fund grant in 2015-16, in violation of guidelines. Out of this, an amount of ₹20.44 crore relates to 21 test-checked ULBs,

[36] Basic grant is intended to be used to improve the status of basic civic services including water supply, sanitation including septage management, sewerage and solid waste management, storm water drainage, maintenance of community assets, maintenance of roads, footpaths and street-lighting, and burial and cremation grounds

[37] Performance grant is provided to address the following issues: (i) making available reliable data on local bodies' receipt and expenditure through audited accounts; and (ii) improvement in own revenues.

[38] Due to formation of new Municipalities and consequent transfer of funds of upgraded Panchayats

[39] The National Institute of Urban Affairs (NIUA) vide e-mail dated: 17 March 2020 has informed GoK that Performance Grant for ULBs in Kerala has been recommended for the years 2018-19 and 2019-20 and that the matter is pending with MoF.

which would have remained at the disposal of these ULBs for fruitful utilisation in project implementation.

Reply of the Government is awaited (December 2021).

4.2.3 Change in system of drawal of funds by Local Bodies

The Local Self-Governments followed the practice of drawing funds for utilisation from the Consolidated Fund through contingent bills[40] until 12 April 2006. As per this system, funds allotted to ULBs remaining unutilised at the end of the financial year would lapse. The Third SFC recommended (November 2005) fiscal freedom for LSGIs by introducing a system to avoid lapse of funds on 31 March of every financial year and to remove difficulties such as treasury restrictions/ways and means clearance from Finance Department. Government accepted the recommendation and the new system was introduced from 2006-07 onwards, wherein the grant devolved to each ULB was to be deposited in three public accounts[41] in the treasury for development fund, maintenance fund and general purpose fund.

This system was dispensed[42] with in March 2015 and Government re-introduced the system of drawal from Consolidated Fund through contingent bills, under which the allotment for a financial year would be issued by the Finance Department in three instalments on or before 25th of March, July and November every year. The bills submitted at treasuries at the end of March every year were to be shifted to treasury queue as per orders[43] issued by the State Government. The queued bills were intended to be cleared in the subsequent financial year. As per details furnished by Information Kerala Mission (IKM), the bills which were presented well in advance before the month of March i.e., as early as in the month of June in previous year, were also kept in queue at treasury. Consequently, the test-checked ULBs could not utilise ₹447.74 crore out of SFC grants during the period 2017-18 to 2019-20.

Further, the allotment not drawn as on 31 March every year was to be provided to LSGIs through Additional authorization/Supplementary Demand for Grants, based on the consolidated figures furnished by the Director of Treasuries. However, scrutiny of the Government orders permitting additional authorisation to enable drawal of bills kept in queue during previous year revealed that the amount was being authorised from the fund allotment to ULBs for the current year. Thus, the amount devolved in a particular year remaining unutilised at the end of the year was not made available to the ULBs for utilisation in the subsequent year.

Reversal of the fund flow system proposed to avoid lapse of funds and treasury restrictions, which was recommended by SFC, accepted by Government and adopted by LSGIs, to the system prevalent earlier, without assessing the possible bottlenecks in effective fund utilisation resulted in non-utilisation of ₹447.74 crore by test-checked ULBs.

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[40] from the Major heads 3604 and 3054
[41] Major Head 8448
[42] vide GO (P) No. 119/2015/Fin dated 21 March 2015 and GO (P) No. 419/2015/Fin dtd.19 September 2015 (for KLGSDP and CFC Grants)
[43] March 2018, March 2019, March 2020

The ACS, LSGD stated in response (November 2021) that the queue bill system was adopted to incentivise the Local Governments and prompt them to push up their annual expenditure, to address the gap between actual expenditure incurred and budgetary allocation. It would compensate for the amount authorised through budget which could not be utilised and resultant lapse of funds, through additional authorisation.

The response does not explain why the additional authorisation was being made out of the funds allotted for the next year and not over and above the allocation for the next year. Further, resort to Government orders as an instrument to bypass or overturn an accepted recommendation of the Finance Commission is contrary to the spirit of devolution.

4.2.4 Payment of pension from Own Fund/ General Purpose Grant

Kerala Municipality (Employees Death-Cum-Retirement Benefit) Rules, 1996 envisage that 15 *per cent* of the total monthly emoluments of each employee shall be remitted to the Central Pension Fund (CPF) as pension contribution by the ULB. Each ULB is to contribute amount equivalent to 15 *per cent* of total monthly emoluments of each of its employees every month to the CPF, which was administered by the Director of Urban Affairs (DUA). The amount so contributed was to take care of the payment of Death-Cum-Retirement Benefit (DCRB) to the employees, thus absolving the ULB of any liability to pay DCRB at a later stage. The major advantage of this system was that the liability for the payment of DCRB of an employee could be apportioned among the ULBs in proportion to the length of his service in each ULB.

As per request of DUA, Government transfer credited funds to the account of CPF, prior to 2016, to release pension allotment to the ULBs. In March 2016, Government permitted ULBs to utilise General Purpose Fund for payment of pensionary and other benefits, on condition that additional fund will not be sanctioned for the purpose. Audit noticed that though DUA maintains the CPF, there is no mechanism to monitor timely collection and transfer of pension contribution to DUA by ULBs. As a result, the payment of pension to the retiring employees of ULBs could not be assured from the CPF. Information furnished by 14[44] out of 21 test checked ULBs pointed out that the funds for DCRB were sourced from the Own fund/ General Purpose Fund of ULBs during the audit period. Audit also observed that as of March 2020, ₹542.81 crore remained to be paid to 75 ULBs out of CPF in the whole State.

The Director of Urban Affairs replied (August 2021) to Audit that due to lack of sufficient amount in CPF, Government issued permission to grant pension and pensionary benefits from General Purpose Fund of Municipalities. The pensionary benefits of employees in ULBs were since then, being sanctioned to the employees from the General Purpose Fund. Audit observes that permitting utilisation of General Purpose Funds for payment of pensionary benefits without any other long term solution to the issue would not be a preferred situation. This would limit the scope of utilisation of funds at the disposal of ULBs for development purposes and thereby deprive them of their financial autonomy.

[44] Aluva, Irinjalakkuda, Cherpulassery, Kalpetta, Mattannur, Kozhikode Corporation, Thiruvananthapuram Corporation, Kochi Corporation, Kayamkulam, Thiruvalla, Pathanamthitta, Nileshwar, Panoor, Ottappalam

While accepting the audit observation that the CPF was not being supplied with the funds required, ACS, LSGD stated in the Exit Conference (November 2021) that the ULBs had to take care of their employees' pension benefits and generate resources and maintain them for the purpose.

4.2.5 Own Revenues of ULBs

The Fifth State Finance Commission reported that own tax revenue and non-tax revenue of ULBs in Kerala constitute only 30.30 *per cent* of their total receipts indicating that ULBs are dependent to a large extent on the Government for resources. Audit noted that the tax and non-tax revenue of Kochi Corporation was only ₹108.92 crore and ₹23.95 crore respectively for the year 2019-20, compared to the corresponding figures of ₹50323.14 crore and ₹12265.22 crore for the State as a whole.

The constraints/deficiencies observed in realisation of own revenue in the test-checked ULBs are discussed below:

4.2.5.1 Property tax

Undermining fiscal autonomy through Government control on property tax

- The Council of the Municipality shall levy property tax on every building within the Municipality. The shift in basis of taxation from Annual Rental Value (ARV) of the buildings to plinth area was introduced through an amendment to Section 233 of the KM Act with effect from 07 October 2009. As per Kerala Municipality (Property Tax, Service Cess and Surcharge) Rules, 2011, assessment of property tax on Plinth area basis was to be made applicable for new buildings from 14 January 2011 and for existing buildings (assessed on annual value basis) from 01 April 2011. The buildings were classified under ten categories and minimum and maximum rates fixed for each category. The date of coming into effect of plinth area method of assessment for existing buildings was extended by Government initially upto 01 April 2013 (in March 2013), and further till 01 April 2016 (in March 2019). Consequently, the existing method and rate of assessment for existing buildings on 14 January 2011 continued to be in effect. Continued extension of date of effect of revised basis and rates of assessment resulted in denial of potential revenue to the ULBs.

- Audit noticed that out of 21 test checked ULBs which have furnished information, property tax is still being levied (2021) on the basis of ARV on buildings existing as on 14 January 2011, in 14 ULBs. State-wide assessment of buildings for revised property tax has not been completed in 45 out of 93 ULBs. Audit observes that despite the amendment to the Act changing the basis of tax calculations to plinth area basis w.e.f. 07 October 2009, the intent of the legislators could not be given effect to for a long time, on account of the time taken by Government to frame the Rules (2011) and due to extensions permitted. The inaction of the State in this regard would undermine effective fiscal autonomy in the hands of ULBs.

- The increase in annual property tax on plinth area basis of Residential buildings assessed before 14 January 2011 was to be limited to 60 *per cent* of tax levied on ARV basis. However, the above order was kept in abeyance for more than two years and the modified order was issued in March 2013. The increase in Annual property tax assessed was to be in the range of 25 *per cent* to 60 *per cent* for residential buildings and 25 *per cent* to 150 *per cent* for commercial buildings. Government provided (April 2015) for continuing the levy of taxes for existing residential buildings of plinth area upto 2000 sq.ft. and limited the increase in Annual tax for residential buildings above 2000 sq.ft. to 25 *per cent* of tax. Also, the increase in annual tax of Commercial/Industrial use buildings assessed on ARV basis before 14 January 2011, if reassessed on plinth area basis was to be limited to 100 *per cent*. The above order exempted all dwelling houses with plinth area upto 660 sq.ft. from property tax w.e.f. 2015-16.

The Fifth SFC observed that above action of Government in having modified the limit of enhancement of property tax fixed as per Kerala Municipal Rules, 2011 through an Executive order was undesirable and would not stand before law. Further, SFC recommended that Kerala Municipality (Property Tax, Service Cess and Surcharge) Rules, 2011 as amended in 2013, have to be enforced by revoking the Government order dated 27 April 2015. Government was silent on this part while furnishing (February 2018) Action Taken Report on the recommendations of SFC.

- As per Section 233 of KM Act, the maximum and minimum rates of basic property tax fixed by the Government and the rates of basic property tax determined by the Council shall have effect for five years from the date on which they came into force. Thereafter, before the expiry of the period of five years, the Government and the ULBs shall revise the rates of basic property tax as well as the limits of rates, so as to be in effect for the next five years. It was noted that though plinth area based tax rates came into force on 14 January 2011 for new assessees, and the rates of taxes had to be revised after five years in 2016, rate revision did not happen even after a period of ten years (March 2021). Since Government failed to revise the maximum and minimum rates of basic property tax, the ULBs could not revise the rates of property tax.

Audit observed that Geographic Information System (GIS) mapping for identifying buildings for levy of property tax was not implemented in any of the test-checked ULBs. Government directed (December 2013) that no schemes relating to GIS were to be taken up and no expenditure in this regard incurred by Local Self Government Institutions. Consequently, no GIS system has been developed by the State for assessment of Property Tax in ULBs, which deprives the ULBs of a sound and updated database to facilitate effective extraction of tax revenue (March 2021). The above action of the Government has effectively blocked one of the potential ways of improving the property tax base for Municipalities. The ACS, LSGD informed (November 2021) that the capability to utilize GIS for identifying buildings for levying property tax has been developed recently only and is in its nascent stages across the country. Government of Kerala is conducting experiments to improve the system.

Government replied (December 2021) that action was afoot to strengthen the collection of own source revenues.

Property Tax Board

The Thirteenth Finance Commission mandated constitution of a Property Tax Board on the lines of West Bengal Valuation Board, which was constituted in the year 1980. Accordingly, Government issued (February 2011) orders for constituting a Property Tax Board with one chairperson and three members. The Board was to take action to ensure imposition and collection of property tax on all taxable properties, share expertise on valuation and arrange training in this regard to the staff of ULBs. It was to assist all Municipalities and Municipal Corporations in the State to put in place an independent and transparent procedure for assessing property tax, by enumerating all properties within the jurisdiction of ULBs and offering suggestions for a suitable basis for assessment and valuation of properties and periodic revisions.

However, LSGD intimated Audit that the Board was not constituted in the State. Setting up of Property Tax Board would have been a positive step towards enhanced collection and timely revision of property tax.

4.2.5.2 Profession Tax

Kerala Municipality (Profession Tax) Rules, 2005 provide for the levy and realization of Profession Tax. The Fifth State Finance Commission recommended that a proper database of all categories of professionals, traders and businessmen, employees and workers in the unorganized sector and self-employed persons should be prepared and assessed for profession tax. This database was to be updated from time to time. All commercial institutions/ enterprises which have been issued licences under D & O licence[45] rules and employees were also to be assessed for profession tax. It was further suggested that a survey on professionals practising within the jurisdiction of Local Governments concerned be made with the help of Ward Members/Councillors so as to bring them into the net of profession tax. Though the recommendation was accepted by Government, it was not implemented. Due to non-implementation of the recommendation, the tax base of profession tax w.r.t ULBs could not be widened.

As per Section 447 of KM Act, licence is to be issued for all trades included in prescribed laws. The licence for functioning of all type of trades /establishments in the ULB area is issued by Health wing of ULB which maintains a traders' list. A separate register is to be maintained in Revenue section in the ULB for entering the details relating to levy and collection of profession tax of traders/ shops/ establishments in its jurisdiction. A sample check of traders' lists for profession tax in Revenue section in ULBs and traders' list for D&O licence in Health wing in ULBs revealed that profession tax was not being levied and collected from all traders to whom licence was issued by Health wing. The traders' list maintained in Health wing was not being shared with Revenue section, which indicates lack of concerted action among the sections in the ULBs to ensure collection of profession tax from all licensed business establishments.

Government replied (December 2021), that action would be taken to strengthen the collection of own source revenues.

[45] Dangerous and Offensive Trade Licence

4.2.5.3 Advertisement Tax

Advertisement Tax, being an item in the State List[46] of the Constitution, was subsumed (July 2017) with the introduction of Goods and Services Tax (GST). Consequently, vide Kerala Goods and Services Act 2017, Section 271[47] of KM Act was omitted. Thus, the Municipalities/ Corporations lost a prominent source of revenue. This has not been compensated by assigning or sharing the revenues earned by the Government from advertisements. As per Section 272, in case of an advertisement liable to Advertisement tax, the Secretary of ULB shall grant permission for the advertisement for the period to which the payment of tax relates and no fee shall be charged in respect of such permission. Section 567 (32)[48] of KM Act empowers the Council to make bye-laws to provide for the prohibition and regulation of advertisements in public streets or parks. Among the test-checked ULBs, Nedumangad Municipality and Thiruvananthapuram Corporation stated that they were levying licence fee for advertisements in their jurisdiction, consequent to the discontinuance of Advertisement tax. But such fees were not being collected in most other Municipalities in the absence of clarification from the Government as to the permissibility of such levy.

4.2.5.4 Entertainment Tax

Entertainment and Amusement Tax[49], except when levied by the Local Bodies, was subsumed[50] in GST from 01 July 2017. Government, however, issued orders on 24 June 2017 stopping the collection of Entertainment tax by Local Bodies from July 2017.

Levy of Entertainment Tax by Local Bodies was re-introduced from 10 June 2019. Thus, Entertainment tax could not be collected as revenue by ULBs during the period from 01 July 2017 to 10 June 2019. For compensating the loss in this regard, Government sanctioned (October 2018) ₹83.72 crore as compensation to ULBs for the period 2017-18. However, no compensation was paid for the period from April 2018 to May 2019, which resulted in loss of revenue to ULBs. Audit observed that on account of an incorrect Government order which had the effect of curtailing the fiscal autonomy of the Municipalities, own revenue of the Municipalities was adversely impacted.

The Sixth SFC in its first Report (December 2020), while acknowledging that the Government action in stopping collection of Entertainment tax and Advertisement tax has caused loss to Local Governments of around ₹100 crore per year, had recommended that since Government is collecting GST, this cumulative loss since 2017-18 may be made good in four half yearly instalments starting from 01 April 2021. This was not seen complied with (November 2021).

In the Exit Conference (November 2021), ACS, LSGD assured that the recommendations of Sixth SFC to make good the cumulative loss in collection

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[46] Entry 55 in List II of 7th Schedule

[47] Every person who erects, exhibits, fixes or retains in a municipal area any advertisement, shall pay a tax as the Council with the approval of the Government, by resolution determine.

[48] Power of Council to make bye-laws

[49] Section 3 of Kerala Local Authorities Entertainment Tax Act, 1961

[50] vide Section 17(b) of the 101th Amendment of the Constitution Act, 2016 dated 08 September 2016

of Entertainment tax and Advertisement tax would be considered by Government.

4.2.5.5 Show Tax

The KM Act envisages that Show tax may be levied by the Municipal Council as determined by resolution, on all shows within the Municipal area. The Council can impose the said tax every two years after making a fixed percentage of enhancement. Further, no Show tax is to be levied in respect of any show for which no entertainment tax is leviable.

The Fifth SFC recommended that the existing minimum rate of Show tax which varied from rupees five to ₹50 need be raised by 100 *per cent*. The recommendation though accepted by Government, was not implemented. Tax rate fixed as on 24 March 1999 was not revised even after a period of twenty-one years. Audit also observed that Show Tax was also not levied during the period of discontinuance of levy of Entertainment Tax from 01 July 2017 to 10 June 2019, and is yet to be compensated.

4.2.5.6 Licences for Dangerous and Offensive trades and other trades

The Municipal Council shall, within thirty days from the date of receipt of the application, either grant a licence for the use of a place for conducting a dangerous or offensive trade or refuse to grant it. Audit observed that the time period for implementing the Kerala Municipality (Issue of Licence to Dangerous and Offensive Trades, other Trades and Factories) Rules, 2011[51] was continually extended through a series of Government orders[52] issued during the period from January 2011 till January 2017[53]. Thus, the licence fees continued to be levied at rates which prevailed before the commencement of the Rules, thereby depriving the ULBs of a potential source of revenue during the period 2011 to 2018.

Audit also noted that Government issued orders in October 2020, further curtailing the Councils of ULBs of their levying power, by replacing the condition stipulated for levy "as per rates fixed by the Council subject to the minimum rate specified in Schedule III" with "as per rate specified in Schedule III".

The ACS, LSGD accepted the observation stating (November 2021) that GoK fixed the rates of licence fee for issue of D&O licence, thereby curtailing the levying power of ULBs, and that the minimum rates remained to be low.

4.2.5.7 Income from other sources

Audit also observed that there was inadequacy in generation of income from non-tax sources of income.

- *Rent from commercial establishments*
  A Municipality may construct commercial or other buildings and let them out to the public on licence and may charge such fees as it may fix,

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[51] With effect from 30 October 2020, this licence has been renamed as Licence for factories, trade, entrepreneurial initiatives and other services.

[52] Twelve Government orders issued from 25 January 2011 to 10 January 2017.

[53] vide Notification dated 30 October 2020, Government amended the Kerala Municipality (Issue of Licence to Dangerous and Offensive Trades, other Trades and Factories) Rules, 2011, incorporating revised rates of licences

for the use and occupation of the building, under the KM Act. However, extent of contribution of this source of income to the Own revenue of test-checked ULBs was not satisfactory. Scrutiny of records in 21 test-checked ULBs revealed that rent amounting to ₹4.11 crore was in arrears as at the end of March 2020, underlining the immediate need to spruce up collection of eligible rent from the buildings constructed by the ULBs themselves.

- *Building permit fees*

  Schedule II of Kerala Municipality Building Rules (KMBR)1999 which provides for the permit fee to be collected by Local Bodies was revised in June 2010, enhancing permit fee. KMBR 1999 was subsequently revised in November 2019. However, the Schedule of Rates for permit fee fixed in 2010 remained the same.

- *Penalties*

  Section 538 of KM Act deals with all costs, damages, penalties, compensation, charges, fees (other than school fees), expenses, rents, contributions and other sums due to the Municipality to be recovered. The penalty to be charged w.e.f. 24 March 1999 is provided in Fourth Schedule and Fifth Schedule of KM Act. The rates of penalty to be charged have not been revised even after a period of 22 years.

There is an urgent need for Government to review and enhance the rates of above items to strengthen own revenue resources of ULBs.

Government replied (December 2021), that action would be taken to strengthen the collection of own source revenues.

4.2.6 Inadequate reliance on application software

Information Kerala Mission (IKM) is entrusted with the responsibility for development of software for various activities in ULBs. The Technical Support and Infrastructure Management Division of IKM provides support to ULBs by appointing Technical Assistants. The services of Technical Assistants include handholding in the operation of the application software and support for data entry of local databases. Sanchaya is the revenue and licence system software developed by IKM for the computerisation of Revenue System in local governments. The software handles property tax, profession tax, rent on Land and building, licence for Dangerous and Offensive Trades, Prevention of Food Adulteration, Advertisement tax, etc. The software also provides facility for e-Filing of property tax self-assessment, e-Filing of profession tax details, e-payment system, generation of Demand-Collection-Balance (DCB) statements, etc. The software was developed in 2010-11 and was made functional during 2016-17 in all ULBs.

As per Government order of March 2019, data entry on property tax in Sanchaya database was to be completed by September 2019. The Director of Urban Affairs confirmed to Audit that as on date (March/April 2021) only 48 out of 93 ULBs in the State were using the finalised database. Out of the test checked ULBs, only seven ULBs[54] recorded entries in the property tax database.

[54] Thiruvananthapuram Corporation and Nedumangad, Pathanamthitta, Thiruvalla, Kattappana, Mattannur, Nileshwar Municipalities

Database on D & O Module was made functional by four[55] ULBs only. Nine and eight test-checked ULBs offered the facility for printing ownership certificates and licences respectively, directly to public. Audit also observed that separate modules as described in the Administrative Report of IKM, for utility payment services such as hall booking, ambulance, vehicles, crematorium, etc., were not seen incorporated in Sanchaya Software. The facilities other than Property Tax and D&O licence were not functional in Sanchaya Software in test checked ULBs. Thus, despite Technical Assistants from IKM posted in all ULBs, the extent of applicability of the software in generating DCB statement by ULBs is restricted to property tax alone, even after a lapse of ten years since its inception.

As a positive step towards improving the efficiency of tax collection in ULBs, it is essential that Demand, collection and balance needs to be monitored regularly through the effective functioning of application software in all Municipalities.

[55] Ponnani, Nedumangad, Kattappana Municipalities and Thiruvananthapuram Corporation