

CHAPTER-1

INTRODUCTORY

1.01 General

The provisions in this manual are intended to assist and guide the staff engaged in the conduct of audit of Panchayati Raj Institutions (PRIs) and Urban Local Bodies (ULBs), which are required to perform certain specified services of public utility or to execute certain programmes and policies of the Government, essentially out of financial assistance from the Government (Central as well as State). Such bodies and institutions include Zila Panchayats, Kshetra Panchayats and Gram Panchayats which perform development works and services in rural areas and Nagar Nigams, Nagar Palika Parishads and Nagar Panchayats which are responsible to provide the basic services of health, Sanitation, water supply, waste management and street lighting to the people residing under their territorial control.

1.02 Authority for the audit of Local Bodies(LBs)

The basic authority for the audit of the local bodies is derived from Article 149 of the Constitution of India, which, inter-alia, provides that the Comptroller and Auditor General shall perform such duties and exercise such powers in relation to the accounts of any authority or body, as may be prescribed by, or under any law made by Parliament or the State Legislatures. The audit of the accounts of these bodies is conducted under the provisions of sections 20 of the Comptroller and Auditor General's (Duties, Powers and Conditions of service) Act, 1971, amended in 1984 to ensure that these bodies are properly held accountable for the public funds placed at their disposal and they do achieve the objectives with which they are set up or programmes entrusted to them. The provisions of section 18 of the Act, empowering the Comptroller and Auditor General to inspect any office of accounts; to call for accounts records and any other information relevant for the conduct of audit, are also applicable to the audit of the local bodies conducted under the above mentioned section of the Act.

1.03 Recommendations of the 14th Finance Commission to LBs

Panchayati Raj Institutions and Urban Local Bodies were accorded constitutional status by 73rd and 74th constitutional Amendment Acts 1992 which came into force with effect from 24.04.1993 and 01.06.1993 respectively. The 14th Finance Commission (FFC) made the following recommendations in respect of Accounts and Audit of PRIs and ULBs which were accepted by Government of India.

- 1 The local bodies should be required to spend the grants only on the basic services within the functions assigned to them under relevant legislations.(para9.56)
- 2 The books of accounts prepared by the local bodies should distinctly capture income on account of own taxes and non-taxes, assigned taxes, devolution and grants from the State, grants from the Finance Commission (FC) and grants for any agency functions assigned

- by the Union and State Governments. In addition to the above, it also recommended that the technical guidance and support arrangements by the CAG should be continued and the State should take action to facilitate local bodies to compile accounts and have them audited in time.(para9.61)
- 3 Distribution of grants to the States should be made using 2011 population data with weight of 90 *per cent* and area with weight of 10 *per cent*. The grant to each State will be divided into two parts, viz, a grant to duly constituted gram panchayats and a grant to duly constituted municipalities on the basis of urban and rural population of that State using the data of Census 2011.(para9.64)
- 4 Grants are recommended in two parts-a basic grant and a performance grant for duly constituted gram panchayats and municipalities. In the case of gram panchayats, 90 *per cent* of the grant will be the basic grant and 10 *per cent* will be the performance grant. In the case of municipalities, the division between basic and performance grant will be on 80:20 basis. The shares of the States for these grants are set out in Annex9.1(para9.70)
- 5 The grants should go to gram panchayats, which are directly responsible for the delivery of basic services, without any share for other levels. It is expected that the State Governments will take care of the needs of the other levels. The earmarked basic grants for gram panchayats will be distributed among them, using the formula prescribed by the respective State Finance Commissions (SFCs) for the distribution of resources. Similarly, the basic grant for urban local bodies will be divided into tier-wise shares and distributed across each tier, namely the municipal corporations, municipalities (the tier II urban local bodies) and the Nagar Panchayats (the tier III local bodies) using the formula given by the respective SFCs. The State Government should apply the distribution formula of the most recent SFC whose recommendations have been accepted. (para9.72)
- 6 In case the SFC formula is not available, then the share of each gram panchayat as specified above should be distributed across the entities using 2011 population with a weight of 90 *per cent* and area with a weight of 10 *per cent*. In the case of urban local bodies, the share of each of the three tiers will be determined on the basis of population of 2011 with a weight of 90 *per cent* and area with a weight of 10 *per cent*, and then distributed among the entities in each tier in proportion to the population of 2011 and area in the ratio of 90:10. (para9.73)
- 7 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. In addition,the ULBs will have to measure and publish service level benchmarks for basic services. These performance grants will be disbursed from the second year of the award period i.e. 2016-17 onwards,so as to enable sufficient time to State Governments and the local bodies to put in place a scheme and mechanism for implementation. (para9.75)
- 8 To be eligible for performance grants, the gram panchayats will have to submit audited annual accounts that relate to a year not earlier than two years preceding the year in which the gram panchayat seeks to claim the performance grant. It will also have to show

- an increase in the own revenues over the preceding year as reflected in the audited accounts. To illustrate, the audited accounts required for performance grants in 2016-17 will be for the year 2014-15. (para9.76).
- 9 It may be better that the detailed procedure for disbursement of the performance grant to gram panchayats based on revenue improvement be designed by the State Governments concerned, keeping in view the two conditions given above. The operational criterion including the quantum of incentive to be given, is left to the discretion of the State Governments. In case some amount of the performance grant remains after disbursement to the eligible gram panchayats, this undisbursed amount should be distributed on an equitable basis among all the eligible gram panchayats. Scheme for disbursement of the performance grant will be notified by the State Government latest by March 2016, in order to enable the preparation of the eligibility list of local bodies entitled to them. The concerned Ministries of the Union Government will also be informed in order to facilitate release of the installment of performance grants. (para9.77).
- 10 A detailed procedure for the disbursement of the performance grant to ULBs would have to be designed by the State Governments concerned, subject to certain eligibility criteria. To be eligible, the ULB will have to submit audited annual accounts that relate to a year not earlier than two years preceding the year in which it seeks to claim the performance grant. It will also have to show an increase in own revenues over the preceding year, as reflected in these audited accounts. In addition, it must publish the service level benchmarks relating to basic urban services each year for the period of the award and make it publically available. The service level benchmarks of the Ministry of Urban Development may be used for this purpose. The improvement in revenues will be determined on the basis of these audited accounts and on no other basis for computing the increase in own revenues in a particular year, the proceeds from octroi and entry tax must be excluded. In case some amount of the performance grant remains after disbursement to the eligible urban local bodies, the undisbursed amount should be distributed on an equitable basis among all the eligible urban local bodies that had fulfilled the conditions for getting the performance grant. (para9.78).
- 11 These guidelines for the disbursement of the rural and urban performance grants will remain in force for the period of FFC award. The Union Government accept the detailed procedure prepared by the state which incorporates broad guidelines of FFC without imposing any further conditions. (para9.79).
- 12 No further conditions or directions other than those indicated by FFC should be imposed either by the Union or the State Government for the release of funds. (para9.80).
- 13 The recommended grant shall be released in two installments each year in June and October. This will enable timely flows to local bodies during the year enabling them to plan and execute the works better. 50 *per cent* of the basic grant for the year be released to the state as the first installment of the year. The remaining basic grant and the full performance grant for the year may be released as the second installment for the year.

- The States should release the grants to the gram panchayat and municipalities within fifteen days of it being credited to their account by the Union Government. In case of delay, the state government must release the installment with interest paid from its own funds. (para9.81).
- 14 Stern action should be ensured if irregularities in the application of funds are noticed or pointed out. (para9.82).
- 15 The State Government should strengthen SFCs. This would involve timely constitution. Proper administrative support and adequate resources for smooth functioning and timely placement of the SFC report With action taken notes before State legislature. (para9.84).
- 16 Existing rules be reviewed and amplified to facilitate the levy of property tax and the granting of exemptions be minimised. The assessment of properties may be done every four or five years and the urban local bodies should introduce the system of self-assessment. Action be taken by the States to share information regarding property tax among the municipalities, State and Union Government. (para9.90).
- 17 The levy of vacant land tax by peri-urban¹ panchayats be considered. In addition, a part of land conversion charges can be shared by State Government with municipalities and panchayats. (para9.91).
- 18 The States should review the position and prepare a clear framework of rules for the levy of betterment tax. (para9.92).
- 19 States may like to consider steps to empower local bodies to impose advertisement tax and improve own revenues from this sources. (para9.93).
- 20 States review the structure of entertainment tax and take action to increase its scope to cover more and newer forms of entertainment. (para9.94).
- 21 The ceiling of professions tax be raised from Rs. 2,500 to 12,000 per annum. Article 276(2) of the Constitution may be amended to increase the limits on the imposition of professions tax by States. The amendment may also vest the power to impose limits on Parliament with the caveat that the limits should adhere to the Finance Commission's recommendations and the Union Government should prescribe a uniform limit for all States. (para9.97).
- 22 State Governments take action to assign productive local assets to the panchayats, put in place enabling rules for collection and institute systems so that they can obtain the best returns while leasing or renting common resources. (para9.98).
- 23 The ULBs rationalise their service charges in a way that they are able to at least recover the operation and maintenance costs from the beneficiaries. (para9.99).
- 24 We are of the view that mining puts a burden on the local environment and infrastructure, and therefore, it is appropriate that some of the income from royalties be shared with the local body in whose jurisdiction the mining is done. This would help the local body ameliorate the effects of mining on the local population. (para9.101).

¹ It can be described as the landscape interface between town and country, or also as the rural-urban transition zone where rural and urban uses mix and often clash.

- 25 The Union and State Governments examine in depth the issue of properly compensating local bodies for the civic services provided by them to government properties and take necessary action, including enacting suitable legislation, in this regard. (para9.102).
- 26 The local bodies and States explore the issuance of municipal bonds as a source of finance with suitable support from the Union Government. The States may allow the larger municipal corporations to directly approach the markets while an intermediary could be set up to assist medium and small municipalities who may not have the capacity to access the markets directly. (para9.107).
- 27 The Union Government may consider a larger, sustained and more effective direct intervention for the upgradation of administration as well as development of the areas covered under the proviso to Article 275 (1) and excluded from the consideration of Finance Commissions in the Terms of Reference, in order to bring such areas on par with other areas. (para9.110)

Recommendations of 14th Finance Commission in brief and relevance to CAG

Re. no.	Recommendation in brief	Remark
1.	Grants to be spent only on basic services	May be useful while auditing for diversion of grants to non basic services
2.	What should books of accounts contain (in brief) TGS arrangements with CAG should continue State to take action to facilitate LBs to compile accounts and have them audited in time	Discussed separately
3.	Criteria for distribution of grants	-
4.	Total size and per capita grants to PRIs/ULBs	-
5.	Basic and performance grants and its ratios 90:10 for PRIs and 80:20 for ULBs	-
6.	For PRIs, grants only for GPs (not for other two tiers):for ULBs for all tiers; Distribution using latest SFC formula	State Govt. to fund other two tiers of PRIs. In case state diverts GP grants to other tiers, audit could point that out.
7.	In case SFC formula is not available, based on 90%-2011 population and 10% area	May be reported in case there is no SFC and formula used is inappropriate.
8.	Purpose/criterion of performance grants(PG) (two for PRIs and three for ULBs) only from second year onwards	-
9.	Detailing of how PG for condition relating to submission of accounts will operate, provides two years gap for preparing accounts starting with those of 2014-15	-
10.	States to design and notify scheme of disbursement of PG for PRIs by March 2016 and also inform and Ministries:	As conditions relating to submission of accounts have been fairly detailed by FC itself. Major portion of scheme will be on revenue improvement: undistributed grants be given to eligible LBs. We (field offices) need to be aware that schemes notified by states do not dilute basic conditions of 14 th FC.LB wing at HQs may coordinate at GoI Ministries level.
11.	States to detail scheme of disbursement of PG for ULBs	There are three conditions of disbursement of PG for ULBs: 1. Audited Accounts should be submitted. 2. To show an increase in its own revenues.

		3. Municipalities must measure and publish the service level bench mark relating to basic urban services.
12.	If schemes formalized by states broadly incorporate conditions of 14 th FC. Central government not to impose additional condition	The schemes for disbursement of grants will be sent to the Ministries and they are expected to examine if these contain all necessary conditionalities of 14 th FC. In case Ministry of PanchayatiRaj(MoPR)/Ministry of Urban Development(MoUD) are willing, we can associate (LB wing at HQs) while scrutinizing schemes sent by the states.
13.	No further conditionalities either by state or central government	-
14.	Release of grants in two installments (July and October each year; funds to be transferred to LBs within 15 days otherwise interest from states own funds	Release of grants to LBs could be seen at the time of audit and delays could be commented in LB reports
15.	Stern action to be ensured if irregularities in the application of funds are noticed or pointed out.	Although specific actions are not defined for irregularities, this gives sufficient message and important role for us as oversight mechanism. We can use this and quote whenever irregularities are pointed out by us in our LB reports. Logically the irregularities and possible actions may be part of the states scheme for distribution of grant.
16.	State government to strengthen SFC	-
17.	Review of existing rules to facilitate levy of property tax	-
18.	Levy of vacant land tax by peri-urban panchayats	-
19.	States to review and prepare clear framework of rules for levy of betterment tax	-
20.	Advertisement tax	-
21.	Entertainment tax	-
22.	Raising ceiling of professional tax from Rs 2500 to Rs 12,000	-
23.	Assignment of productive local assets to panchayats	-
24.	ULBs to rationalize service charges to recover O&M costs	-
25.	Sharing of royalties of mining with local bodies	-

26.	Compensate LBs for services used by government properties	-
27.	Explore Municipal Bonds	-
28.	Excluded	-

Working of TGS mechanism relating to interaction with the Primary Auditor

Audit planning & issue of certification and maintenance of accounts of PRI/ULBs	<ol style="list-style-type: none"> 1. Audit plans for the State are not being sent to AG office. 2. Audit plans are being sent late and thus becomes irrelevant for us. 3. Audit plans received are to be vetted by AG office with respect to required frequency of audit as specified in rules. 4. Shortfalls, if any, in the actual execution of the Audit plans are to be highlighted. 5. System of monitoring of implementation of audit plans by the Primary Auditor needs to be seen. 6. Use of risk assessment and/or grading of LBs for audit planning. 7. Possibility of working out a coordinated audit plan (AG Office and Director of Audit) with a view to provide better assurance to stakeholders. 8. Examination of audit plan from timeliness specified in rules regarding certification of LB accounts. 9. Coordination in selection of auditable unit by Local Audit Department and AG office so the overlapping of units and topic of Primary Auditor may be avoided.
Audit methodology and procedure	<ol style="list-style-type: none"> 1. Adequacy of rules and regulation regarding audit methodology is to be evaluated. 2. Check whether audit methodologies adopted by the Primary auditor are as per rules and regulations. 3. In case of inadequacy recommend guidelines for audit to the primary auditor.
Copies of Inspection Reports	<ol style="list-style-type: none"> 1. Inspection report copies are not being sent by the Primary auditor. 2. Selection of inspection reports to be called for from the Primary auditor should be on systematic basis. 3. Inspection reports are to be evaluated for their deficiencies along with recommendations for improvements and subsequent follow up.
Return by Primary auditor	<ol style="list-style-type: none"> 1. Analyse weaknesses in internal control mechanism of the Primary auditor and prescribed appropriate returns for its better performance. 2. Based on assessed weaknesses in functioning of the primary auditor, returns regarding planning and execution of audit, serious irregularities, status of receipt of accounts for certification, timely finalization of audit reports (individual IR and state level report), progress of audit of a scheme, etc., may be recommended. 3. Regular interaction with the Primary auditor should be arranged.
Test check Reports	<ol style="list-style-type: none"> 1. Whether the primary auditor is picking up good aspects of our

to be sent to primary auditor	reports or not.
Reporting of serious irregularities	1. Serious irregularities are not being reported by the primary auditor this should be followed by us.
System of internal control	1. Examine the adequacy and effectiveness of internal controls of the primary auditor and recommend suggestions for improvements wherever necessary.
Training and capacity building	1. Identification of capacity gaps in manpower of primary auditor is to be done. 2. Raining or workshop with primary auditor is to be held.

1.04 Scope of audit

The audit is responsible to examine the books of accounts of local bodies to ensure that the final accounts are drawn up and exhibit a true and fair view of the working and the state of affairs of the body. Most of the bodies have little income of their own and depend on Government to a considerable extent for financial assistance in the shape of grants, loans, etc. In all such cases, the audit has to go beyond certification of annual accounts to probe into aspects relating to efficiency, performance, propriety etc., with regard to the utilisation of the resources made available to them by Government. Here the audit of transactions of Government will also have to be carried out in relation to release of such assistance and watch exercised by Government over utilisation, return of loans etc.

1.05 Code of conduct

The audit of the local bodies by the Indian Audit and Accounts Department is conducted under powers vested in the Comptroller and Auditor General of India, as delegated by him to the officers of his department and it is important to note that it is not permissible to make independent enquires of the tax payer or the general public, unless such a course, is expressly authorised by statutory provisions of executive orders.

1.06 Matters dealt with to be kept confidential.

The inspecting staff should carefully note that matters, with which they have to deal during the course of audit of local bodies, are kept confidential. The results of audit inspection of the accounts are also not to be made public before the Audit Report incorporating the results is placed before the Parliament or the State Legislature as the case may be.

1.07 Disclaimer-Regarding inclusion of disclaimer in Part-1 of Inspection Report

All Inspection Reports forwarded by the field parties to headquarters shall include the following disclaimer statement on the top of Part-I of the Audit Inspection Report as per para 2.3 of order of the C & A.G. of India circular no. 629 LC/III-2005 dated 7th October 2005 on the subject Right to Information Act, 2005- Disclosure of “the Information

regarding- “The Inspection Report has been prepared on the basis of information furnished and made available by..... (Name of auditee entity) The office of Dy. Accountant General (Local Bodies) Uttarakhand, Dehradun disclaims any responsibility for any misinformation and/or non- information on the part of auditee”
The head of the auditee Unit as also the Inspecting Officer/ party in-charge of the audit party should invariably sign the disclaimer.

Section 20(1) of CAG’s (DPC) Act 1971 is produced below for the guidance of field staff so engaged in audit of above units.
