

Audit of Local Bodies—A Collaborative Approach

In early nineties, when Government launched its famous liberalisation programme of economic management, another landmark legislation was enacted. This was of an entirely different nature viz. empowering the rural and urban local governments. The two momentous amendments to the Constitution viz. 73 and 74 Amendment Acts 1992 that did this have been rightly hailed as epoch making and a vital piece of legislation that resulted in creation of 'institutions of self-governance'.

The Constitution mandated the Government to do this by inserting a direction in Article 40 of the Constitution, which said, 'The State shall take steps to organise Village Panchayats and endow them with such powers and authority as may be necessary to enable them to function as units of self-government'. Even after several attempts towards such an empowerment, the progress in this direction was not satisfactory for a variety of reasons. Eventually, a beginning was made in Rajiv Gandhi's tenure as Prime Minister to bring in a comprehensive legislation to empower these bodies and make these real units of self-governance. That was in 1986—the fruits of this fallen legislation, however, came in 1992 in Narasimha Rao's time when the Parliament passed the historic 73rd and 74th Constitutional amendment bills pertaining to PRIs and ULBs respectively—the Presidential assent was given on 20 April 1993. These amendments inserted Part IX and IX A in the Constitution. Part IX concerns panchayats containing Articles 243 to 243 O and Part IX A containing Articles 243-P to 243-ZG, relates to municipalities.

Since Local Government Institutions in both urban and rural areas are State Subjects, Union cannot enact laws on them. By these amendments to Constitution, Union gave a framework of scheme which is essentially to be implemented by States by making suitable laws or amending their own existing laws 'to bring them in conformity with the provisions of 73rd and 74th Constitutional Amendment Acts'. The States soon followed with their respective back up legislations in line with the Central Act. Main features of this amended law are already outlined in Chapter-2.

The changes that were expected to come with this new Act were formidable in empowering these local bodies, specially the rural, and giving these a far greater role than ever before. As many as 29 subjects listed in Schedule-XI were on the transfer list from Government line departments to the PRIs for their budgeting and execution and 18 subjects in Schedule-XII to municipalities. In a way, this would take away, a huge portfolio of existing fund allocations from State Government line agencies to the local bodies. In practice, the transfer of functions and funds varies from State to State. From data available in Annex, it will be seen that only Karnataka has transferred to PRIs all the 29 functions along with funds for these functions. Other States that show a good picture in this regard are Kerala, Sikkim, Rajasthan and Maharashtra. In 8 other States and Union Territories (Madhya Pradesh, Chhatisgarh, Orissa, Rajasthan, Tamil Nadu, West Bengal and Daman and Diu) although a large number of functions have been transferred to PRIs, corresponding quantum of funds have not been given—these vary from funds for none to 15 functions only. Overall, in most States funds transfer is still not very encouraging and the real independence of PRIs and ULBs is still far away. The Eleventh Finance Commission Report stated that a study done by National Institute of Rural Development (NIRD) (commissioned by them) revealed that 73rd amendment had not significantly altered the functional domain of panchayats at various tiers, and only a few States 'have been serious in vesting the panchayats with necessary powers, funds and staff to enable them to perform the functions assigned to them under the Statute'.

In nutshell, these changes meant that:

- ❖ PRIs and ULBs became institutions of self-governance.
- ❖ They were to be the institutions of planning for their economic growth.

- ❖ These were to be the main agents for implementing State and Centrally Sponsored Schemes.

INITIAL INITIATIVES TAKEN BY C&AG

The issues that were likely to be thrown up by such changes as were to come, were clearly seen by the then C&AG, V.K. Shunglu. The relevant question that concerned Audit Department was that with so much devolution of funds to these bodies what was the audit and accountability system? These were not defined clearly in the Act. The Act (Articles 243 J and 243 Z) dealing with the provision for the maintenance of accounts and audit of local bodies merely said 'The Legislature of a State may, by law, make provisions with respect to the maintenance of accounts by the Panchayats/ Municipalities and the auditing of such accounts'. The pertinent issues were: Is the existing system for audit and accountability mechanism sufficient? To whom are the PRIs accountable? And what about the standardisation of accounting formats and accounts keeping?

C&AG discussed these issues with his top management team at the HQrs Office, during Senior Officers Meetings. He then decided to have these issues discussed in a wider forum. For this purpose, he convened a high level Seminar on 'Accountability of Local Bodies and PRIs' at the National Academy of Audit and Accounts, Shimla (NAAA) where, besides the senior officers of the Department, other participants included P.R. Das Gupta, Secretary, Rural Development, Sudhir Krishna, Member Secretary, Eleventh Finance Commission, Nirmala Buch, former Chief Secretary, Madhya Pradesh and S.C. Anand, President, Institute of Public Auditors of India (IPAI). This seminar was preceded by a Round Table Conference on 'Accountability of Panchayats and DRDAs' (held in August 1999) organised by the IPAI—an autonomous organisation under the aegis of C&AG in collaboration with the Ministry of Rural Development—where C&AG, the Secretary, Rural Development, Additional Secretary and Joint Secretary, Rural Development as well as some concerned Secretaries from States and experts from Institutions like National Rural Development Institute, Hyderabad, Indian Institute of Public Administration (IIPA) and officers of the Department participated. This Seminar as well as Shimla Seminar dealt with, amongst others, issues of audit and accountability of PRIs. The C&AG also submitted a Memorandum to the Eleventh Finance Commission

giving his views, amongst others, on the audit and accountability of local bodies consequent upon the 73rd and 74th constitutional amendments.

It would be obvious from these facts that a lot of spade work on information sharing amongst the key stakeholders had been facilitated by C&AG to make them aware of the issues concerning accountability of these bodies and also generate a broad framework of agreement on the accountability and other issues of PRIs. The general recommendations in these forums were:

- ❖ Need for prescribing accounting standards and accounts formats for local government accounts to ensure a degree of uniformity
- ❖ Laying down auditing standards
- ❖ Auditing arrangements
- ❖ Formal system for follow-up of audit findings

Surely, these things in some way facilitated Ministry of Rural Development, Finance Ministry and Eleventh Finance Commission's task.

ELEVENTH FINANCE COMMISSION'S RECOMMENDATIONS

It was the Eleventh Finance Commission's recommendation that set in motion a series of actions towards audit and accountability of rural and urban local governments. Eleventh Finance Commission, as part of their terms of reference, were required to suggest measures to augment the Consolidated Fund of the States to enable them to supplement the resources of the local bodies. In their Report dealing with accounts and audit¹ the Finance Commission, amongst other things, recommended that (a) the C&AG should be entrusted with the responsibility of exercising control and supervision over proper maintenance of accounts and their audit for all the three tiers/ levels of Panchayats and Urban Local Bodies, (b) the Director, Local Fund Audit or any other agency made responsible for the audit of the accounts of local bodies, should work under the technical guidance and supervision (TGS) of the C&AG in the same manner as the Chief Electoral Officers of the States operate under the control and supervision of the Central Election Commission, (c) the C&AG should prescribe the format for the preparation of budget and for keeping of accounts for the local bodies. These formats should be amenable to

computerisation in a network environment, (d) the C&AG may lay down qualifications and experience of the agency for accounts maintenance work, who could be contracted for this work, (e) audit of accounts of the local bodies be entrusted to the C&AG who may get it done through his own staff or by engaging outside agencies; an amount of half a per cent of the total expenditure incurred by the local bodies should be placed at the disposal of the C&AG for this purpose, (f) the report of the C&AG relating to audit of accounts of Panchayats and Municipalities should be placed before a Committee of State Legislature constituted on the same lines as a Public Accounts Committee.

In making these recommendations, the Finance Commission was prompted by the great concern it had over the prevailing state of affairs in these bodies as far as upkeep of accounts and their audit was concerned. Despite a Director, Local Fund Audit (or any equivalent authority) in position in most of the states to carry out audit of local bodies, and maintenance of accounts, there was widespread deficiency in accounts keeping as well as in the audit of the local bodies. To a large extent, the reason was that the local bodies had shortage of staff, but more important, the staff did not have requisite skills for maintaining accounts. There was no credible database on the finances of local bodies, and in addition, the accounting formats of PRIs were such, as were difficult to maintain. There was an urgent necessity for substantial technical skill upgrading among local fund auditors. The independence of the local fund auditors was also suspect and their report hardly ever elicited response from the auditee organisations or the government in most of the States.

COMPTROLLER AND AUDITOR GENERAL'S ROLE

In the above background, the Eleventh Finance Commission's recommendations were a very timely step towards establishing accountability and audit mechanism of local bodies.

The Ministry of Finance (Department of Expenditure) issued Guidelines for the utilisation of local bodies grants recommended by the Eleventh Finance Commission (2000-01 to 2004-05) in June 2001. The guidelines suggested that to give effect to the recommendations of the Eleventh Finance Commission regarding TGS, State Governments should send a request to C&AG under Section 20(1) of C&AG's (DPC) Act, 1971. Among other things, the guidelines also provided (i) C&AG shall lay down the

qualifications and experience for the agency or the person who should be contracted for maintenance of accounts by local bodies particularly village level panchayats and in some cases intermediate level Panchayats that do not have trained accounts staff. Such agency or person may be registered by the Director, Local Fund Audit (DLFA). A group of local bodies may be entrusted to an agency/ person for upkeep of accounts on payment of remuneration as may be fixed by the C&AG in consultation with the State Government, (ii) DLFA or his equivalent authority may do the supervision over the quality of work of such agency or person under the directions of the C&AG, (iii) DLFA or any other agency made responsible for the audit of accounts of the local bodies shall work under the technical supervision and advice of the C&AG, (iv) Guidelines also prescribe that the format for preparation of budget and for keeping accounts of the local bodies shall be as prescribed by the C&AG. The Guidelines were shown to C&AG office at draft stage.

MANDATE OF C&AG ON AUDIT OF LOCAL BODIES

In all the states, barring West Bengal, Bihar and Jharkhand, Audit of Local Fund is conducted by Director, Local Fund Audit (or a similar authority by any other designation). In the 3 States mentioned above C&AG has been conducting the audit of Local Bodies including Panchayati Raj Institutions and ULBs as Local Fund Auditor before the enactment of Constitutional amendments relating to Local bodies. In all these States, the Audit of these institutions is entrusted to C&AG (to concerned State AG) in terms of the relevant State Act. Of these, in the case of West Bengal, it is a very old history. Local Audit Department was first created in 1880 to audit the accounts of municipalities and other local funds by an officer of Finance Department styled as Examiner of Local Accounts attached to the office of Accountant General. Gradually local audit of the accounts of all local funds and similar other non-governmental institutions as also certain government institutions in Bengal was entrusted to him. Under the Reforms of 1921, audit of local bodies became a provincial subject. The Government of Bengal decided that control of Local Audit Department would remain with the Auditor General. The Examiner of Local Accounts in West Bengal under AG (Receipt, Works and Local Audit) will Audit Panchayati Raj Institutions and Urban Local Bodies and in case of Panchayati Raj Institutions, Accountant General has

conducted cent percent audit of accounts of Gram Panchayat from 2002–03 onwards under West Bengal Panchayat Act 1973.

C&AG's mandate for audit of Local Bodies flows basically from the CAG's DPC Act 1971, and he has been conducting the audit of receipts and expenditure of those local bodies both rural and urban, which are substantially financed from Union or State revenues under Section 14 of the Act *ibid*.

The first two tiers of Panchayat institutions in Karnataka-Zilla Parishads and Taluk Panchayats—have been entrusted to the C&AG in terms of Section 19 (3) of the DPC Act.

Entrustment of TGS over the local bodies audit and accounts, including technical support to the DLFA, in most states is under the provisions of section 20 (1) of the DPC Act which states that the C&AG may be requested by the President or the Governor of a State or the Administrator of a Union territory having a legislative assembly, to undertake the audit of the accounts of a body or authority on such terms and conditions as may be agreed upon between him and the concerned government.

C&AG'S ACTION PLAN—TECHNICAL GUIDANCE AND SUPERVISION (TGS)

In a minute recorded by the C&AG on 3 May 2001, he desired that with the possibility of Panchayat Audit being entrusted to the Department, the existing responsibility in this related area must be of appropriate quality and delivered on time. He further directed that the necessary resources if not available in the audit offices may be made available from the accounts offices. Soon thereafter, C&AG set about to restructure and revamp the Local Bodies Audit, hitherto not considered important enough. But now with TGS in the offing, this was needed. As an initial step towards such restructuring, C&AG set up a Local Bodies Audit Wing under the charge of newly created post of Deputy C&AG in December 2001. This wing became the nodal wing for all activities relating to Local Bodies audit which included policy formulation and strategy, processing of audit reports, consolidation of Inspection Reports, HR issues etc. Continuing with administrative restructuring the present C&AG V.N Kaul created 17 new field audit offices in July 2004 to exclusively deal with Local Bodies Audit. The personnel for these offices have been drawn from existing manpower in AG (A&E) and AG (Audit) offices on deputation basis. The administrative structure is therefore now well established. The

one point that still remains somewhat unsolved concerns staffing of these offices, while a committee, as elaborated elsewhere, is going into this issue, it needs to be said that greater demands on TGS for example checking the release and utilisation of funds by states following the Twelfth Finance Commission's recommendations, have meant increased work load.

In their first communication on the subject Dr. E.A.S. Sarma, Secretary, Department of Economic Affairs requested the C&AG vide his D.O. letter of 4 August 2000 while sending a copy of the Report of the Eleventh Finance Commission alongwith Memorandum detailing the action taken by the Government on the recommendations of the Commission to suggest 'an Action Plan for operationalizing the recommendations of the Finance Commission within a given time frame considered reasonable by you'. In the Memorandum, the Government made it clear that the recommendation of the Commission relating to the grants-in-aid for financing local bodies was accepted subject to the caveat '(i) measures to strengthen accounts and audit of local bodies recommended by the Eleventh Finance Commission have been accepted in principle. The details will be worked out in consultation with the C&AG, (ii) Earmarking of funds for maintenance of accounts, within the overall recommended level of grants, may be increased to the extent necessary in consultation with the C&AG'.

The initial thinking in the Department was that in order to fulfil the requirements suggested by the Eleventh Finance Commission and accepted by the Government of India regarding the format for maintenance of accounts as per the C&AG's prescription and regarding audit of these bodies, a suitable amendment to the relevant State Act would be required providing that C&AG shall conduct the audit by employing his staff and associating the staff of Examiner, Local Fund Audit or that of Panchayati Raj Audit as the case may be. The State Government's staff would work under the technical guidance and supervision of C&AG. The Director General (Audit) addressed Joint Secretary (Budget) in August 2000 to consider taking up the matter with the Ministry of Rural Development as well as Urban development as a follow-up to the Government's decision contained in the Memorandum to the action taken note on Eleventh Finance Commission's recommendation dated 11 August 2000. D. Swarup, Joint Secretary (Budget) promptly replied to this letter on 16 August 2000 advising the Department that there was no conflict between the recommendations of the EFC to entrust the audit of the local

bodies to the C&AG and the Constitutional provisions. He added that section 14, 15 and 20 of the C&AG's (DPC) Act, 1971 adequately cover the audit of Government financed bodies or authorities. He mentioned, therefore, that it was not Central Government's intention to deprive the States from its statutory control of accounts/ audit of local bodies. The Ministry's, in principle, approval of the EFC's recommendations should be presumed to mean a role for the C&AG under the C&AG's (DPC) Act, 1971 and State laws.

This set at rest the issue of any amendment. Addl. Dy. Comptroller and Auditor General² addressed Joint Secretary (Budget) in February 2001 in response to his D.O. of 16 August 2000 intimating him that C&AG office had, in the meantime, done the home work regarding assessment of staff needed for the audit of local bodies in the new system. The C&AG was prepared to take up the new challenge provided a request was received from concerned State or Union Territory under Section 20 of the C&AG's DPC Act, 1971. The idea was to pool the manpower resources of Accountants General and Director, Local Fund Audit (DLFA) so that a single and effective audit arrangement could be established to cover all the rural and urban local bodies. The letter requested the Government to suggest to State Governments/ Union Territories accordingly.

In response, the Government issued, in June 2001, Guidelines for the Utilisation of Local Bodies Grants which mentioned inter alia about C&AG arranging the training in audit through his training institute or training centre without charging any training fees; C&AG also agreed to waive audit fees in case either a suitable amendment in the Act entrusting audit to him was inserted by the State Government or a request under Section 20(1) of C&AG's (DPC) Act, 1971 was made for at least a period of 5 years or more. These guidelines were seen by the Headquarters at draft stage.

DAI (Local Bodies) acted fast on all these things. The format of accounts of Panchayati Raj Institutions was drafted in coordination between the Accounts Wing and the Commercial Audit Wing and after a series of discussions of the draft format between Addl. Dy. Comptroller and Auditor General (Report States), Addl. Dy. Comptroller and Auditor General (Accounts, Entitlement and Complaints), and the concerned Principal Director, the format was approved. The account and budget format prescribed by the C&AG has several advantages:

- ❖ The format is based on a modified cash basis. It has a few statements on demands, collections and assets appended to the accounts that address critical aspects. The formats also take care of all activities that are listed in the Eleventh Schedule to the Constitution and depict funds transferred to the Local Bodies under various programmes and the schemes.
- ❖ The format has been kept simple so that it can be maintained easily by limited expertise of staff that are generally available in PRIs.
- ❖ The accounts and the budget formats are synchronised and linked with classification codes on the same pattern as for Union and State Accounts. This will facilitate computerisation and building up of data base for effective monitoring. Subsequently in 2006–07 the format was further simplified and the latest simplification does away with the synchronisation in all cases, on grounds of ‘ease of use and understandability of accounts and codes to the users.’ Nevertheless the one to one correlation i.e, synchronisation, is achievable through computerised mapping, without having to burden the individual users with a complicated accounting structure.

IMPLEMENTATION OF THE TGS

TGS to the Director, Local Fund Accounts (DLFA) includes assistance in auditing standards, audit planning, improved audit methodology and professional training to the auditors of the DLFA by the C&AG’s institution. In a letter to all the Principal Accountants General/ Accountants General (Audit) in May 2002, the Principal Director (LB) from HQrs listed out the scope of technical control and supervision by C&AG (produced as a document in this Book). How much of this is in reality operational in the states which have accepted the TGS will differ from State to State. The DLFA (by whatever name it is known) continues to be the Principal Auditor of the Local Bodies and he works under the administrative control of State Government while receiving technical guidance and support/ supervision in audit matters from Accountant General. The AG also has the authority to carry out supplementary audit through the Local Fund Audit Department mainly to ensure proper certification of accounts.

The various components of TGS seem to have been implemented and these have performed creditably as can be seen from details below:

- (i) Entrustment of TGS for proper maintenance of accounts and audit to C&AG: As of now 19 States have entrusted TGS to C&AG while 3 States have partially entrusted such TGS to C&AG. Only 2 States (Arunachal Pradesh and Punjab) are yet to entrust such audit/ TGS to C&AG. Of the three States that have agreed to partial entrustment of TGS, Chhatisgarh has opted for only technical guidance, there is no audit mandate under TGS. In Haryana, also only technical guidance is being provided under TGS by the AG. Tamil Nadu, while entrusting TGS, withheld any powers to AG to audit Gram Panchayat.
- (ii) Documents prescribed by the C&AG for providing TGS: Documentation was one of the most problem areas in Local Self Government Audit specially in case of rural bodies. The Eleventh Finance Commission had commented on this very strongly stating that 'In many States the formats and procedures for maintenance of accounts by these bodies prescribed decades ago, are continued without making any improvements to take into account the manifold increase in their powers, resources and responsibilities'. One of the first tasks on which C&AG embarked immediately after the decision of TGS, was documentation preparation and preparation of manuals. C&AG in quick succession produced following documents:
- ❖ Auditing Standards for PRIs and ULBs
 - ❖ Guidelines for Certification audit of accounts –PRIs
 - ❖ Manual of Audit for PRIs
 - ❖ Audit training modules for ZPs, PSs and GPs
 - ❖ List of Codes for functions and activities of PRIs
 - ❖ Budget and Accounts formats for PRIs
 - ❖ Training Module on PRI accounts and budget—in 2 parts theory and practical.
- (iii) 21 States have so far accepted the accounting and budget formats as prescribed by the C&AG for the PRIs with some modifications. Three States (Arunachal Pradesh, Goa and Sikkim) are still in dialogue with the C&AG.
- (iv) Regarding the adoption of data based format, 10 States have accepted the format while 14 States are still in dialogue with the C&AG on this issue. C&AG has identified 'lack of information about finances and accounts or any institutional mechanism for collating and managing such

data in respect of local bodies at the State level', as a big handicap in efforts to create a (networked) data base on finances of PRIs.

While providing Technical Guidance and Support to the DLFA, C&AG's audit was expected to reflect qualitatively higher concerns for cost, efficiency or performance in respect of the schemes that the Panchayats manage. In contrast to the DLFA's concerns, which are generally legalistic and focus more on observance of financial rules or government orders, C&AG's audit, by way of a supplementary check of the work of DLFA, would essentially focus on performance issues and utilisation of funds in general, subversion of internal controls in the local bodies leading to fraud, corruption, misappropriation and mismanagement of funds. C&AG's Reports also suggest strengthening internal controls and best accounting practices and systems as also capacity building within these institutions.

SEPARATE OFFICES OF LOCAL BODIES AUDIT AND ACCOUNTS

In view of the fact that with every passing year, more and more States are transferring increased number of functions to the PRIs along with funds thereby increasing the audit and accounting responsibilities, a separate office, independent budget and dedicated staff was needed for this work. The question as to what organisational structure Local Bodies Audit would have and from where the staff would come was addressed at length by an HR Committee constituted in January 2004 by the C&AG under the chairmanship of DAI for 'a fundamental review of the organisational structure of the Department to see if any changes were required in order to fulfil the objectives of the Perspective Plan.' Amongst the 5 areas identified by the Committee in the context of Perspective Plan, where organisational changes would be required to fulfil the goals set out one area was audit of Local Bodies. The Committee concerned itself basically with the organisational structure for the Local Bodies audit and how to meet the staff requirements for that.

Based on Committees recommendations, the C&AG decided in March 2004 to create a separate office/ unit of Local Bodies Audit & Accounts headed by a Sr. DAG (Local Bodies, Audit and Accounts). The staff for these offices would be drawn from both Audit and A&E offices on deputation basis. Administratively and

technically these offices would be under the control of senior most Pr.AG/ AG at the station. Accordingly, as already stated 17 offices were created in various states in the above fashion.

NATIONAL MUNICIPAL ACCOUNTS MANUAL

A Task Force of accounting format for Urban Local Bodies was constituted by the C&AG of India in February 2002 with representative from Ministry of Urban Development, State Governments of Maharashtra, Tamil Nadu and Karnataka besides officers from the office of the C&AG of India. Deputy Comptroller and Auditor General (Accounts and Local Bodies) headed the task force. Task Force finalised its Report in December 2002 recommending accrual accounting system for municipalities. Based on the report of the Task Force, Ministry of Urban Development, Government of India brought out National Municipal Accounts Manual (NMAM) in December 2004 in association with C&AG of India. This document details the accounting policies, procedures and guidelines designed to ensure correct, complete and timely recording of municipal transactions and produce accurate and relevant financial reports. The Manual has been adopted by nearly all the states, who are now engaged in customising and adopting NMAM suitably to meet their specific requirements.

TRAINING

C&AG took special steps to impart training to the staff of Director Local Fund Audit as also Urban Local Bodies since it was recognised that capacity gaps were a major constraint in proper accounts keeping as well as effective auditing. The C&AG took initiatives in this direction as a component of his TGS model and over the period of about 4 years beginning 2002–03 organised training programmes to the concerned staff in PRI and ULB accounts and audit. Specifically speaking, in the early phase, C&AG organised training programme on maintenance of accounts of PRI through the agency of IPAI³ which was chosen as a Nodal agency for training for the audit and account staff of PRIs. Eventually, when the C&AG had prescribed budget and accounts formats for the PRIs, (IPAI was involved in their preparation) the training of PRI functionaries was formulated for execution in two segments. In the first phase there was training for trainers—in this training programme a core group of PRI functionaries were trained. These trainers were assigned the task of training the remaining personnel

at the district and block level. The conduct of training for trainers of PRIs in the various states was entrusted to the IPAI in April 2002, who conducted the training in the States of Jharkhand, Orissa, Uttarakhand, Gujarat, Assam, Chhattisgarh, Himachal Pradesh, Uttar Pradesh and Haryana and around 1100 trainers were trained. The process is ongoing. While the cost of the first phase of training was borne by the C&AG, the State Government bears the cost of Phase-II training, for which funding assistance is given by the Central Government to State Governments. C&AG also assists training efforts in states by providing training material and experts.

The training manual based on National Municipal Accounts Manual is under finalisation by a consultant under the aegis of National Institute of Urban Affairs. The Local Bodies Wing of C&AG is extending technical support and advice where required. The training for the staff of ULBs was largely conducted by National Institute of Urban affairs which is an autonomous body under the Ministry of Urban Development and has 16 branches all over the country. RTIs and RTCs would also be involved in training the State government staff and C&AG's staff.

The current focus of C&AG is on improving audit skills of the staff of DLFA in different States. In line with this thinking, training in PRI and ULB audit is planned in large number of States. C&AG is also organising refresher courses in audit and accounts on specific requests from State Governments. In fact the refresher courses in 12 States have already been organised by the C&AG for training in audit and accounting matters. This is because the trained staff of local bodies are still not very comfortable in organising the in-house training programmes on PRI accounts and, therefore, AG offices have continued to assist them in terms of experts and training material.

Regional Training Institute, Kolkata (which is designated as a 'centre of excellence' in local bodies audit) has developed a number of Audit Training Modules which are further customised by individual offices and these have been very helpful in providing a structured training programme on various aspects of PRI and ULB functioning. These modules have information on various aspects like finances, accounts, statutory basis of audit and practical guidance to audit of various schemes executed by local bodies including critical areas like works and contracts and also new areas like social audit, gender perspective, etc.

C&AG'S AUDIT REPORT ON LOCAL BODIES

The Eleventh Finance Commission, inter-alia, recommended that the Report of the C&AG relating to audit of accounts of panchayats and municipalities should be placed before a Committee of State Legislature, constituted on the same lines as the Public Accounts Committee (PAC). Prior to the enactment of 74th constitutional amendment, the results of C&AG's audit of the accounts of PRIs and ULBs were included in his Audit Report (Civil) of the concerned State Government as a Chapter which was discussed in the PAC in the usual manner.

It was decided by C&AG in July 2001 that a separate volume of Audit Report on Zilla Parishad/Panchayati Raj Institutions may be prepared by Principal Accountant General/Accountant General, Karnataka, Maharashtra, Bihar, West Bengal and Tamil Nadu. The report was to comprise three Chapters—Chapter-I on Financial Management in Zilla Parishad and Panchayat Institutions; Chapter-II would contain reviews, if any, on a selected topic (a model review published in report of West Bengal for the year ended 31 March 1998 was enclosed for guidance); and Chapter-III to contain individual audit paragraphs. Subsequently on the basis of discussions held on 24 July 2001 on the subject with the concerned Pr.AG/ AG it was decided that in the case of Karnataka, Maharashtra and West Bengal, this report would cover results of audit of Zilla Parishad and Taluka level panchayats. In the case of Bihar material for 4 Zilla Parishads was to be included and for Gram Panchayat only test audit of 100 Gram panchayats was to be done. In the case of Tamil Nadu the Audit Report was to cover results of Taluka Panchayat audit because Zilla Parishads did not execute any schemes or programmes by themselves in Tamil Nadu. Headquarters also intimated the money value of the paras for the 3 levels namely, Village panchayats (Rs.1 lakh or more), Taluk panchayats (Rs.5 lakh or more) and Zilla Parishads (Rs.10 lakh onwards).

In August 2002, the question of signature on the Audit Reports was carefully examined by Headquarters. Currently, separate Audit Report on Local Bodies is brought out by Accountants General of Karnataka, Kerala and Tamil Nadu for submission to respective State Legislatures. All these reports are countersigned by the C&AG and they are all bilingual. While AG, Rajasthan also prepared a report for his State on Local Bodies for the year 2004-05, duly countersigned by the C&AG, due to some legal objections

raised by the State Government, the report could not be placed in the Legislature so far. A final decision on the issue of placement is still to be taken. Accountants General, Andhra Pradesh and Maharashtra have prepared audit report for the year 2005-06 which is under process and these would also be placed in the State Legislature after countersignature of C&AG.

As regards discussions on these reports by the Legislative Committees, in both Tamil Nadu and Karnataka the State PAC discusses them; in Kerala, there is a separate Committee of Legislature called Committee on Local Self Government Institution which discusses the report; in Rajasthan also a Committee of the House has been constituted to deal with the C&AG's Report on Local Bodies. Separate Committees of Legislatures to examine the Report of DLFA is already in position in Gujarat.

In respect of eight States namely, West Bengal, Bihar, Assam, Orissa, Madhya Pradesh, Gujarat, Himachal Pradesh and Uttar Pradesh, the report prepared on the audit of Local Bodies by the concerned Accountants General/Examiners of Local Accounts is called Consolidated Technical Inspection Report. This is signed by Accountant General only and is submitted to State Government Finance Secretary who takes the follow up action on the report. All the reports mentioned above contain audit findings under TGS and also under section 14. However, where a separate audit report is not presented to the Legislature, important audit findings under section 14 are included in the State Civil Audit Report. In Maharashtra, there exists a Committee of Legislature to deal with the Report of States Local Fund Auditor. Who will deal with C&AG's Report when, as is likely, it is presented this year (2007) remains to be seen?

The C&AG is of firm view that there should be separate volume of audit report in respect of Local Bodies Audit. For achieving this objective, apart from other things, with the augmentation of staff, and more experience of TGS system, it is to be expected that separate volumes of audit reports would be produced by all the Accountants General.

In the coming years, when the system gets stabilised it would be possible to understand what kind of institutional mechanism will be in place to follow up of the report of the C&AG on Local Bodies.

RELEASE AND UTILIZATION OF FUNDS RECOMMENDED
BY TWELFTH FINANCE COMMISSION

Based on the recommendations of the Twelfth Finance Commission, Ministry of Finance issued Guidelines for utilisation of Local Bodies Grants, according to which, C&AG would provide assurance to Central Government on the releases and utilisation of these grants devolved by Central Government. For this purpose, C&AG would examine the timely release of funds from the Consolidated Funds of the State to the Local bodies to ascertain whether these releases have been timely or were delayed. When instructions to this effect were received, a meeting was held with the Secretary, Department of Panchayati Raj in September 2005, wherein it was decided that the C&AG shall work out the modalities to examine timely releases of funds to the PRIs/ ULBs. Similarly, C&AG was also to check about the utilization of funds to ascertain whether these had been used for the purpose for which they were sanctioned.

Necessary instructions on these lines were to be issued by Ministry of Finance, Government of India to the State Governments.

In this connection C&AG office issued following modalities in November 2005⁴

- ❖ Since Government of India would release the grants in July and January each year, Pr. Finance Secretaries of State Governments should provide certificates of release to Pr. AG/ AG by 31 August for first instalment and by 31 January for second instalment
- ❖ For utilisation of Grants, Pr. Financial Secretaries should provide certificate of utilisation by 30 April each year. Pr. AG/ AG would give necessary assurance to Central Government by October/ November each year. The release of second instalment in January would depend on this utilisation certificate.

The functions that were required to be performed by the C&AG needed a specific authority since this was an additional work. It also needed a separate entrustment under Section 20(1) of C&AG's DPC Act by State Governments. Pending this, the C&AG asked Principal Accountants General/ Accountants General to proceed with the work on the lines indicated in his modalities.

As is usually the practice, the C&AG's audit certificate on the audit of TFC grants was to be as a 'sole auditor' and he could not delegate this work to anybody else. A calendar for issue of audit

certificate was also prescribed according to which the Pr.AG/ AG shall issue audit certificate latest by October/ November.

The Headquarters instructions of November 2005 contemplated that the Pr.AG/AG of the State concerned would verify the correctness of the State Government certificate of utilization by adopting a risk based audit of transactions to enable him to give a reasonable assurance about the receipts of money into the accounts of PRIs, ULBs and the use thereof. In checking the utilisation of grants the AG would go as per the broad areas identified by the Twelfth Finance Commission in so far as use of grants in these areas is concerned. Guidelines also have laid emphasis on checking the utilisation in 'thrust areas'. The rule of the thumb is that if overall pattern of expenditure is within the priority areas then Audit should be satisfied.

This additional function assigned to the C&AG, though very important in nature, does have implications on staffing.

Another requirement, in the whole process was about timely intimation by the Government of India of the details of the amount released to the State Government Budget and a certificate from the State Government to the State Pr. AG/ AG in a prescribed format giving the details of release of funds by two prescribed dates namely 1 December and 31 January for the year 2005–06. Similarly, for utilization State Governments would provide a certificate by 31 October to the Pr.AG because the release of the next instalment in January would depend on this certificate. These provisions were for the year 2005–06 only. For subsequent years, the system as mentioned in earlier paragraphs was prescribed both for release and for utilization of funds as mentioned above.

In the above task, the C&AG's organization was tested very clearly because dimension of the work involved was stupendous — there are over five lakh village Panchayats (including 6795 taluk Panchayats and 531 Zilla Panchayats). Similarly there are 3723 ULBs. Working out a suitable model for their audit and issue of audit certificate along with application of funds to the purposes for which these were released posed some challenge to the department. While for the year 2005–06 and 2006–07, State Accountants General have been able to carry out this job well within the time frame, many of them have informed Headquarter that suitable augmentation of PRIs/ ULB audit staff would be necessary to cope with this additional work load. Currently, the Headquarters is examining the entire staffing pattern of the Sr.DAG (LB) offices.

The induction of C&AG's organisation into the TGS Scheme was a difficult task to be achieved despite the recommendations of the Eleventh Finance Commission and the backing of Ministry of Finance. Since, under the Constitution local bodies are listed in the State list, there is practically no power with the Centre to effectively do much in this regard. Given the sensitivity and reluctance of the State Governments to let anyone enter into their areas of operation, it should be considered remarkable that most of the States agreed to the TGS and C&AG's new role on audit and accounting matters.

While it looks that a workable collaboration has been established, it is too early to say how successful it is. TGS, as it is operationalized now, is different from what the Eleventh Finance Commission had proposed. At best, the C&AG is an external advisor without any authority to enforce his systems and procedures, more as a matter of conscious choice, which was influenced by the reluctance of the State Government to accept the expression supervision. TGS, therefore, now really means Technical Guidance and Support. As far as 'Supervisory' role of TGS is concerned, it is not really operational. The corroborative approach, however, has established a new system of what can be called 'participatory approach to accountability'. In such a case, all the three parties i.e. C&AG, Director, Local Fund Audit and the Civil Societies have joined together to explore the results of their respective oversight functions and improve local bodies functioning. This should be considered as a development of great importance.

There is no evaluation so far as regards the effectiveness of the new arrangements of audit of PRIs based on TGS. The eventual question also is has C&AG's new role as a guide and advisor improved accountability of local governments and resulted in qualitatively better audit outputs? How much progress has been made in satisfactory accounting system is yet another question? Added to this is the question perennial to all Audit Reports, namely, the question of follow up and action taken on the audit outputs. In other words, whether the new framework has produced better accountability, better resource utilisation and better accounting records, are the questions that need some answers.

ISSUES FOR THE FUTURE

The Local Bodies Audit Wing of the C&AG's Office have identified certain issues for the future in the context of audit of PRIs and Urban Local Bodies.

Issues in urban local governance in so far as they affect C&AG's Audit, relate to paradigm shift in municipal governance with the introduction of accrual based accounting. This will throw up a challenge to audit in areas like assets valuation and accounting, cost of services, etc. and would call for corresponding capacity building in audit. Similarly, with more and more public-private partnerships model in the execution of urban infrastructure programmes, new issues of Municipal Bonds, rationalization of property tax, issues of user charges and e-governance have been thrown up. Besides these new areas, audit would continue to address issues of urban poverty, unemployment, public health, slum development, sanitation and primary education.

As for the issues of rural local governance, the primary focus will be on 'issues of governance at the grass root level' and programmes of rural unemployment, public health and sanitation, drinking water, roads, education, women empowerment, creation of community assets and housing. Audit will have to come up with a system to comment on quality of democratic decentralization. Similarly, on devolution of funds and its uses, it would need a different kind of approach. One can visualize auditors acting as facilitators in fostering a culture of accountability in PRIs. All this could be done through capacity building, sharing of knowledge, ideas and experiences. The concern of government audit would be to strengthen the overall accountability framework.

In the context of devolution of power and authority to PRIs for implementation of TGS, C&AG is of the firm view that 'Without putting in place a system of commensurate accountability for desired performance it might turn out to be a futile attempt'. He, therefore, strongly recommended to Ministry of Finance 'for developing a strong and effective system of internal audit and control for PRIs that clearly defines their duties and clear responsibility and accountability chain and centres'. He also advocated building a strong social audit system for measuring the impact of various programmes implemented by PRIs or ULBs.

The TGS offers a unique picture of collaborative audit approach in the field of Local Bodies. It is still evolving. On the success of this model hinges the success of new accountability framework

for PRIs and Urban Local Bodies. TGS also implies looking beyond the traditional moors of audit—it should look beyond paper audit and extend a helping hand to the civil society, which is people's voice in the conduct of social audit of PRIs and ULBs. How exactly this can be done is something to think about?

C&AG'S DISCUSSION WITH ADMINISTRATIVE REFORMS COMMISSION

Administrative Reform Commission held discussions with the C&AG on 7 June 2007 where C&AG apprised the Commission of the progress made in the TGS arrangement regarding Local Bodies and conveyed his views to the Commission on some of the issues like strengthening the TGS arrangement, auditing arrangements for the Urban Local Bodies on the lines of Government companies under the Companies Act and regarding discussion of Audit reports where he was of the view that public interest would be better served if reports of the C&AG on Local Bodies were discussed by a separate committee of State Legislature on the same lines as the PAC. This was also in line with the recommendation made by the Finance Commission. C&AG also touched upon the important subject of poor documentation and record management in Local Self Government Institutions as well as arrears in accounts in many of them.

SOCIAL AUDIT AND LOCAL BODIES (PRIs)

C&AG has made a strong pitch for the role of social audit in accountability mechanism of Local Bodies Audit. He has voiced this in several forums. In his suggestions to Ministry of Finance regarding TOR for the Task Force proposed to be set up by Ministry of Finance, C&AG made a special mention of issues relating to the social audit of Centrally Sponsored Schemes (CSS) through the involvement of civil society. C&AG's note also impressed upon the fact that developing social audit 'is very essential' to improve the PRI mechanism, increase accountability and transparency as CSS, delivered through Panchayats and Gram Sabhas, automatically builds in decentralised participation of the community and user groups.

SOME IMPORTANT PARAGRAPHS

Some important audit paragraphs on Local Bodies Audit are summarised below:

Solid Waste Management by Municipalities and Corporations: Report of the C&AG for the year ended 31 March 2005 (ULBs—Government of Tamil Nadu) was a kind of Performance Audit on a subject of immense importance from environmental angle and functioning of the municipalities and corporations concerned on this score. The findings revealed that only two municipalities out of 151 in Tamil Nadu have established waste processing and disposal facilities. Out of 102 municipalities (after excluding 49 Grade III municipalities), five did not have any land for dumping solid waste and 36 had inadequate land for this purpose. More disturbing news was on the disposal of bio- medical waste by government for reclassification and private health care units—none of 313 government hospitals and nearly 85 per cent of 2,255 private health care units had obtained any authorisation for the disposal of bio-medical waste from Tamil Nadu Pollution Control Board as required under the relevant rules. An interesting point emerged in this audit was that after privatisation of the work regarding garbage collection by Corporation of Chennai the quantity of garbage cleared by a private agency in specified zones indicated that the quantity of the garbage cleared was inexplicably higher by 21 to 66 per cent compared to waste generated and cleared in other comparable zones resulting in excess expenditure of Rs.37.07 crore during the year 2001–02. Bio-medical Waste Management as would be clear from the above was in shambles. Only 2,382 kgs out of 57,461.50 kgs of bio-medical waste generated per day in the State were treated and disposed.

Audit Report gave a set of recommendations at the end of the Report that included concerted action for setting up waste disposal facilities, house-to-house collection of waste, modernisation of garbage collection and privatisation of conservancy operations to the extent envisaged.

The subject of Solid Waste Management by Municipal Corporation had also been discussed in his Report for the year ended 31 March 2004 (LSGI) Government of Kerala, where the audit noted same deficiencies as in the case of Tamil Nadu regarding collection segregation and removal of waste. None of the Municipal corporations had evolved adequate system for these functions. In three Municipal Corporations, the sweepers employed

were far below the required norms. Even in cities like Thiruvananthapuram, Thrissur and Kozhikode Municipal Corporations the solid waste power plants installed were not working regularly. The review thus concluded that sufficient number of bins were not provided for primary segregation and collection resulting in non-removal of full quantity of such waste. Worse, whatever waste was removed was not fully treated. Amongst the recommendations made by audit were ensuring an adequate system for primary collection and clearance of waste daily, providing coloured bins to ensure segregation of wastes at source into biodegradable, recyclable, hazardous, etc.

Ineffective implementation of Desert Development Programme: The Desert Development Programme (DDP) was implemented in the State from April 1995 in 22 blocks having hot and arid zones with low rainfall and depleting ground water table. The main objectives of DDP were development of land in these blocks and improving social and economic condition of poor. Audit test—checked (January–May 2003) the implementation of DDP in 10 taluks, covering the period 1995–2003. Implementation of Desert Development Programme was deficient as there was non-receipt of Government assistance of Rs. 78.91 crore and available funds were not fully utilised. Only 50 per cent of the projects under first Batch commenced in 1995–96 was completed and completion of projects in other Batches was delayed. There were instances of improper selection of watersheds (costing Rs. 5.48 crore) and irregular/doubtful expenditure /non/sub-standard execution of works (Rs. 6.03 crore) Internal controls, monitoring and follow up and evaluation were inadequate.

(Paragraph 2.3 of Audit Report for the year ended 31 March 2003, Government of Karnataka)

Misappropriation of funds in the Taluk Panchayat, Malur by presenting fraudulent claims: Audit scrutiny of records (2001–03) of Executive Officer (EO), Taluk Panchayat (TP), Malur in Kolar District disclosed that the EO misappropriated funds aggregating Rs. 1.74 crore by preferring fraudulent claims of works/supply bills in violation of Codal provisions. Sub-Treasury Officer (STO), Malur facilitated misappropriation by passing such fraudulent bills without exercising proper checks as prescribed in Codes and Manuals.

Audit scrutiny disclosed that Chief Accounts Officer Zilla Panchayat, Kolar did not object to the excess expenditure over

budget allocation and diversion of funds from one scheme to another. Most of the bills contained alterations/over writings / interpolations, supporting vouchers attached to the bills did not match with the total of bills, same bills were preferred more than once quoting the budget allocation more or less equal to the bill amount and checks were issued in favour of subordinate staff from scheme accounts.

Out of misappropriation of Rs. 1.74 crore, Rs. 70.37 lakh related to interpolated /tempered supply bills not supported by requisite certificate. Rs. 37.74 lakh was drawn on bills for which no material had been received , Rs. 33.88 lakh was drawn on work bills not supported by measurement books and many bills were tampered by altering without attestation. Government replied that socruse notices had been issued to officials responsible for the irregularities A Deputy Secretary was kept under suspension pending departmental enquiry.

(Paragraph 2.6, Report on Zilla Panchayats for the year ended 31 March 2004—Government of Karnataka)

ANNEX

Summary of Devolution of Funds and Functions to PRIs by States

Sl. No.	States/UTs	Functions devolved	Functions for which funds are devolved
1.	Andhra Pradesh	17	5
2.	Arunachal Pradesh	0	0
3.	Assam	29	0
4.	Bihar	25	8
5.	Jharkhand	0	0
6.	Goa	6	6
7.	Gujarat	15	15
8.	Haryana	16	0
9.	Himachal Pradesh	26	2
10.	Karnataka	29	29
11.	Kerala	26	26
12.	Madhya Pradesh	23	10
13.	Chhattisgrah	29	10
14.	Maharashtra	18	18
15.	Manipur	22	0
16.	Orissa	25	9
17.	Punjab	7	0
18.	Rajasthan	29	18
19.	Sikkim	24	24
20.	Tamil Nadu	29	0
21.	Tripura	12	0
22.	Uttar Pradesh	12	4
23.	Uttaranchal	11	0
24.	West Bengal	29	12
25.	Andaman & Nicobar	6	6
26.	Chandigarh	0	0
27.	Dadra & Nagar Haveli	3	0
28.	Daman & Diu	9	5
29.	NCT Delhi		
30.	Pondicherry	0	0
31.	Lakshadweep	6	0

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NOTES: CHAPTER-14

¹ The Finance Commission has discussed the auditing and accounting issues in para 8.19 of the then Report

² K.N. Khandelwal

³ Institute of Public Auditors of India

⁴ Letter No. 424/LB/PRI/4-2002 dated 14 November 2005

LIST OF KEY EVENTS

20 April 1993	President gave his assent to 73rd and 74th amendments to the Constitution relating to rural and urban local bodies.
3 July 1998	President constituted XIth Finance Commission to give recommendations on specified aspects of Centre-State fiscal relations during 2004–05.
7 July 2000	Commission submitted its Report covering all aspects of its original mandate. C&AG was made responsible for exercising control and supervision over the maintenance of accounts and audit for all the tiers/levels of Panchayats and Urban Local Bodies. Government accepted the recommendations.
4 August 2000	Secretary, Ministry of Finance, Department of Economic Affairs, New Delhi requested C&AG to suggest an action plan for operationalising the recommendations of the Commission.
16 August 2000	Joint Secretary (Budget), Department of Economic Affairs, New Delhi intimated Director General (Audit) that C&AG's (DPC) Act covers the audit of Local Bodies.
13 February 2001	ADAI wrote to Joint Secretary (Budget) stating that C&AG can undertake Technical Guidance and Supervision provided a request from State/Union Territory is received under Section 20 of C&AG's (DPC) Act, 1971.
8 June 2001	Ministry of Finance sent Guidelines for utilisation of Local Bodies Grants recommended by the XIth Finance Commission (2000–01 to 2004–05).
19 July 2001	ADAI addressed State Accountants General intimating that the Department would finalise auditing standards and provide training to staff of State Governments. Model accounts format for panchayat institutions was to be sent separately.
11 July 2001	Decision to bring out a separate Audit Report on working of Zilla Parishads and other Panchayati Raj Institutions.
20 July 2002	Following documents were issued by C&AG : (i) Auditing Standards for Panchayati Raj Institutions and Urban Local Bodies. (ii) Guidelines for Certification Audit of Accounts of Panchayati Raj Institutions.
16 October 2002	Following documents were issued by C&AG : (i) List of Codes for Functions, Programmes and Activities of Panchayati Raj Institutions.

- (ii) Model Budget Format for Panchayati Raj Institutions.
 - (iii) Model Receipts and Payments Account Format of Zilla Parishad.
 - (iv) Model Receipt and Payments Account Format of Block Panchayat/Village Panchayat.
- 31 December 2002 Manual of Instructions for Audit of Panchayati Raj Institutions was issued by C&AG.
- December 2004 National Municipal Accounts Manual detailing the accounting policies, procedures and guidelines was launched.
- November 2005 Director, Local Bodies approached Ministry of Finance for issue of instructions to Chief Secretaries/Principal Finance Secretaries of States to provide certificates and related information regarding release of grants recommended by XIIth Finance Commission to state Accountants General.

DOCUMENTS

1

D.O. No. 10 (17)-B(S)/2000
Ministry of Finance
Department of Economic Affairs
4th August, 2000
Dear Sh. Shunglu,

Kindly refer to our brief discussion regarding the recommendations of the Eleventh Finance Commission (EFC) relating to the maintenance of accounts and audit of local bodies. EFC has proposed that C&AG may be entrusted with the responsibility of exercising control and supervision over the accounts and audit of these bodies.

I am sending herewith a copy of the Report of the Commission along with an Explanatory Memorandum detailing the action taken by the Government on the recommendations of the Commission. Both these documents have been laid on the Table of both the Houses of Parliament on 27th July, 2000.

I would request you to suggest an action plan for operationalizing the recommendations of the Finance Commission within a given time-frame considered reasonable by you.

With regards,

Yours sincerely,
Sd/-
(E.A. S. Sarma)

Encl: as above
Shri V.K. Shunglu,
Comptroller & Auditor General of
India, 10, Bahadur Shah Zafar Marg,
New Delhi.

2

D.O. No. 502-Audit-II/68
Date: 11 August 2000

Dear Shri Dhirendra Swarup,

I am enclosing a copy of the letter received from Joint Secretary, Ministry of Rural Development asking for our comments on a private bill moved by Mr. Priya Ranjan Dasmunsi, Member of Parliament. The proposal from the Hon'ble M.P. is to amend Article 243-J to provide for audit of Panchayat accounts by the C&AG of India. The letter from the Joint Secretary, Rural Development states that the Ministry has decided to oppose the introduction of this bill. This letter was received on 28 July (Copy enclosed).

In the meantime, it is seen that the Department of Economic Affairs has come out with an explanatory memorandum to the Action Taken on the Eleventh Finance Commission's recommendations on 27 July 2000. According to para 9 of this memo, Govt. has accepted the recommendations of the

Commission regarding the measures proposed for strengthening the arrangements for maintenance of accounts and audit of local bodies including Panchayats.

We have brought this development to the notice of Department of Rural Development through the letter addressed to Ms. Sudha Pillai, Joint Secretary (Copy enclosed) and have also suggested that suitable constitutional amendment may be proposed by them in consultation with us.

For municipal bodies, similar amendments will be needed in Article 243-Z of the Constitution. You may kindly consider taking up the matter with the Ministries of Rural Development as well as Urban Development as a follow up to the Govt.'s decision contained in the explanatory memo.

Yours sincerely,
SD/-
(J. Manadal)

Shri. Dhirendra Swarup,
Joint Secretary (Budget),
Deptt. of Economic Affairs,
Ministry of Finance, North Block,
New Delhi-1

3

D.O. No. F.10 (7)-B(S)/2000
Ministry of Finance,
Department of Economic Affairs
Date: 16 August 2000

Dear Sh. Mandal,

Kindly, refer to your D.O. letter No. 502-Audit II/68-2000 dt. 11.8.2000 regarding audit of local bodies.

2. Under Article 243-J and 243-Z, State Legislatures are empowered to regulate by law the accounts/audit of Panchayats/Municipalities . Eleventh Finance Commission (EFC) has recommended that C&AG should exercise control and supervision in this regard. The recommendation has been accepted in principle.

3. Government's in-principle decision to the recommendations concerning strengthening of accounts and audit of panchayats and the municipalities should be interpreted in the context in which the Commission has made the recommendations. In the memorandum submitted to EFC, the Ministry of Rural Development had stressed the need for a proper system of maintenance of accounts and their audit, under the supervision and control of the Comptroller and Auditor General of India (vide para 8.4 of the EFC's Report). Further, the Commission had taken cognizance (vide para 8.19 of the EFC's Report) of Articles 243J and 243Z of the Constitution under which States are authorised to make provisions by way of legislation for maintenance of accounts by the panchayats and the municipalities and for the audit of such accounts. The Commission did not, however, specifically recommend any change in Articles 243J and 243Z of the Constitution. The Commission has noted that most States' legislation do make general provisions for these purposes, but detailed

guidelines or rules have not been laid down, in several cases. In many States, the formats and procedures for maintenance of accounts by these bodies prescribed decades ago, are continued without making any improvements to take into account the manifold increase in their powers, resources and responsibilities. As regards audit, in many States, the legislation leaves it to the State Government to prescribe the authority. In the Commission's view this area—of accounts and audit—needs to be set right under the close supervision of the C&AG and supported by specific earmarking of funds from the grants recommended by the Commission. This also conforms to the submissions of the Ministry of Rural Development to the Commission.

4. There is no conflict between the recommendations of the EFC in this matter and the Constitutional provisions requiring any legal/constitutional amendment. Sections 14, 15 and 20 of the C&AG's (DPC) Act adequately cover the audit of Government financed bodies or authorities. Exercise of control and supervision by C&AG would essentially involve setting up of standards, advice on systems and procedures and perhaps a super-imposed test audit under the DPC Act without transgressing the provisions of any State law. It is not Central Government's intention to deprive the States from statutory control of accounts/audit of local bodies. In principle approval should be presumed to mean a role for the C&AG's under the DPC Act and State laws. Questions of inter-law conflict, if any could be addressed as and when they arise.

With regards,

Yours sincerely,
Sd/-
(D. Swarup)

Shri J. Mandal
Director General (Audit),
O/o the C&AG of India
New Delhi.
Copy to:
Mrs. Sudha Pillai,
Joint Secretary,
M/o Rural Development
New Delhi.

Sd/-
(D. Swarup)

4

D.O. No. 199-II/73-2000
Date: 13 February, 2001

Dear Shri Swarup,

Kindly, refer to your D.O. No. F.10 (17)-B(S)/2000 dated 16th August 2000 regarding audit of local bodies. In the meantime, this office has developed a standard format for keeping accounts of the village level and intermediate level Panchayats in Zilla Parishads as recommended by the Eleventh Finance Commission. These formats have been devised taking care that they will be amenable to computerisation in a network environment. Once the Ministry of

Rural Development agrees with this format after a pilot experiment in two or three Panchayats, the Ministry plans to suggest its adoption throughout the country during 2001–02.

After ascertaining the arrangements of audit of Panchayats in various states, it is gathered that almost each state has a Director of Panchayat Audit with significant staff. However, as already noticed by the Finance Commission, the area of accounts as well as audit of Panchayats, Municipal local bodies needs to be set right, under the close supervision of the C&AG and for this purpose the Commission has recommended that the state audit agency should work under the technical and administrative supervision of the C&AG. C&AG may also get the audit done through his own staff.

It is noticed that presently the calibre of staff of Director, Panchayat audit is not upto the required level nor is the audit conducted in a regular manner. A lot of upgradation of their skill through training and standardisation of accounts and audit procedures will be needed particularly so in view of the expected increase in the flow of funds to the Panchayats and Municipalities.

We have made a rough assessment that we can associate our staff and officers to the required degree for the function of technical supervision as well as in the conduct of audit of the local bodies and no extra staff will be required excepting a few senior level officers to take care of training, framing guidelines, high quality supervision where needed, editing and pursuance of reports. We are, therefore, prepared to exercise this function of audit of local bodies if any request is received from any State or Union Territory under Section 20 of the C&AG's (DPC) Act 1971. In fact, by pooling the man power and resources of the Accountant General and the Director Local Fund Audit, a single and effective audit arrangement can be established to cover all the rural and urban local bodies

It is presumed that the states while making such request will place their Director of Panchayat Audit/Director, Local Fund Audit under the suprintendence and technical supervision of the C&AG as recommended by the Finance Commission.

Govt. of India may like to suggest to the State Govts./Union Territories accordingly.

In the meantime, it is understood informally from a few State Govts. that they may undertake suitable amendments in their Local Fund Audit Acts entrusting audit on a regular basis to C&AG alongwith directing the Examiner Local Fund/Director, Panchayat Audit to work under the technical guidance of C&AG. Whenever any such development takes place, we would keep you suitably informed.

Yours sincerely,
Sd/-
(K.N. Khandelwal)

Shri D. Swarup
Joint Secretary (Budget),
Deptt. Of Economic Affairs,
R.No. 168-B, North Block,
New Delhi-1

5

D.O. No. 220/Local Bodies/PRI/ULB

Date: 2 May 2002

R.N. Ghosh
Principal Director (LB)

Dear

Please refer to D.O. letter No. 48/Local Bodies/PRI/51-2001 (Vol.II) dated 28.02.2001 from Shri K.N. Khandelwal, Dy. C&AG (LB) regarding entrustment of audit of Panchayati Raj Institutions (PRIs) and Urban Local Bodies (ULBs) to C&AG of India.

In terms of para 6.4 of the guidelines for grant to Local Bodies issued by the Ministry of Finance, Government of India in June, 2001, the C&AG is to be entrusted with the responsibilities of technical control/guidance and supervision (TGS) over the audit and accounts matter of PRIs/ULBs.

The scope of technical control and supervision by C&AG would be broadly as under:

- ❖ The audit methodology and procedures for audit of ULBs/PRIs by Director/Examiner Local Fund shall be as per the audit guidelines/standards prescribed by the C&AG.
- ❖ The nature, extent and scope of audit including form and contents of the report of Director/Examiner Local Fund shall as per the guidelines laid down by the AG.
- ❖ Training programmes for staff of Director/Examiner Local Fund at all levels would be finalised and imparted by an agency approved by the C&AG. The course contents would include, inter-alia, audit procedures, certification of accounts, audit standards etc. Similar help will be extended for account staff of PRIs including VLWs/Secretaries of Panchayats.
- ❖ Staff of Director/Examiner Local Funds would continue to work under the administrative control of the state government and state government will pay their salaries.
- ❖ Accountant General would monitor quality and timeliness in preparation of accounts and their audit.
- ❖ The Director/Examiner Local Fund would prepare the audit plan in consultation with the AG to include selection/rotation of units, number of units to be test checked by AG (say 20%), audit party composition and deployment. The AG would approve the audit plan.
- ❖ The reports of test check conducted by AG would be sent to Head of the concerned Local body and to the Director (LFA)/similar statutory authority for follow up on action taken with the Local Bodies. The Director (LFA)/similar statutory authority would pursue settlement/action taken on the audit paras raised by AG in the same manner as he would pursue his own reports.
- ❖ The composition of audit parties of Director/Examiner Local Fund would be in accordance with the guidelines issued by the AG.
- ❖ Officials of the AG shall supervise some of the audit parties of Director/Examiner Local Fund as decided by AG.

- ❖ The Director/Examiner, Local Fund shall submit such returns/reports in such form as may be prescribed by the AG to have an effective check/monitoring of the audit functions.
- ❖ The Director/Examiner Local Fund shall develop in consultation with AG a system of internal controls in his/her organisation.
- ❖ AG would supervise proper certification of accounts with reference to initial records like—cash book, assets register, bank accounts etc.
- ❖ The inspection reports, their vetting, issue and follow up action would be as per the guidelines issued by the AG. A copy of the IRs of the first tier (ZP/MC) of Local Bodies would be submitted to the AG. In case of other 2 lower tiers, the AG would decide which IRs would be sent to him based on the criteria of monetary value of expenditure/budget/any other suitable criteria.
- ❖ Irrespective of money value or any other criteria, serious irregularities noticed during audit particularly those related to system defects, serious violation/deviation from rules, embezzlements, frauds etc. shall be intimated to the AG demi-officially by the Director/Examiner Local Fund, alongwith necessary supporting documents as when they come to notice.
- ❖ Finalisation of reports would be as per the guidelines issued by AG.

During discussion with the State Government officials, you may also like to emphasize on the advantages of technical supervision and guidance of the C&AG, some of which could be:

- ❖ The State government would get an independent and fair opinion on the correctness of accounts of local bodies.
- ❖ There would be no additional financial burden on the state government.
- ❖ The staff of AG would supplement the audit by Director/Examiner local fund to ensure quality and timeliness of accounts and audit.
- ❖ It would improve the credibility of the accounts and audit of local bodies, especially if the local bodies approach the open market or International lending agencies for grants/loans.
- ❖ The training programmes and supervision by C&AG would help in capacity building and expertise of the Examiner local fund staff and the accounting staff in the local bodies.

The above points for TGS are illustrative and these may be added to/modified after discussions with the State Government. The final blueprint for TGS by C&AG would have to be finalised by you keeping in view the local requirement and in consultation with the State Government.

I would request you to follow up closely with the State Government for entrustment of audit/TGS of PRIs/ULBs to C&AG of India.

Yours sincerely,
Sd
(R.N. Ghosh)

To
All PAsG/AsG.

GLOSSARY OF ABBREVIATIONS

CSS	Centrally Sponsored Schemes
DLFA	Director, Local Fund Audit
DRDA	District Rural Development Agency
EFC	Eleventh Finance Commission
GP	Gram Panchayat
HR	Human Resources
IIPA	Indian Institute of Public Administration
IPAI	Institute of Public Auditors of India
NIRD	National Institute of Rural Development
NMAM	National Municipal Accounts Manual
PRIs	Panchayati Raj Institutions
PS	Panchayat Samiti
TFC	Twelfth Finance Commission
ULBs	Urban Local Bodies
VLC	Voucher Level Computerisation
ZP	Zilla Parishad.