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India
Public Financial Management and Accountability in Panchayati Raj Institutions (Rural Local Governments)

Synthesis Study

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CURRENCY EQUIVALENTS

Currency Unit	=	Indian Rupee (Rs.)
US$1	=	approx. Rs. 46
1 Crore	=	10 million
Rs. 1000 Crores	=	approx. US$217 million

FISCAL YEAR

April 1 – March 31

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LIST OF ACRONYMS

alphabetically listed

AG	Accountant General
AP	Andhra Pradesh
ANSIRD	Abdul Nazir Sab Institute of Rural Development
ATR	Action Taken Report
AWW	Anganwadi Workers
BC	Before Christ
BDO	Block Development Officer
BPL	Below Poverty Line
CAG	Comptroller & Auditor General
CARISMA	Computerization, Automation, Refinement of Integrated System of Management and Accounts
CBO	Community Based Organization
CEO	Chief Executive Officer
CHD	Centre for Human Development
CSS	Centrally Sponsored Scheme
CUTS	Consumer Unity & Trust Society
DFID	Department For International Development (UK)
DLFA	Director Local Fund Audit
DPC	District Planning Committees
DPC Act	Duties, Power and Conditions of Service Act 1971
DPEP	District Primary Education Programme
DPDA	District Panchayat Development Agencies
DRDA	District Rural Development Agencies
EFC	Eleventh Finance Commission
GOI	Government of India
GP	Gram Panchayat
GPMS	Gram Panchayat Management System
GRAMSAT	Village Satellite
GTZ	Gesellschaft für Technische Zusammenarbeit (German Agency for Technical Co-operation)
IA&AD	Indian Audit and Accounts Department
IFMAS	Integrated Fund Monitoring and Accounting System
IPAI	Institute of Public Auditors of India
IRDP	Integrated Rural Development Programme
IRM	Internal Revenue Mobilisation
ISS	Institute of Social Sciences
JGSY	Jawahar Gram Samridhi Yogana
JRY	Jawahar Rozgar Yogana
KP	Kshettra Parishad
KfW	Kreditanstalt fur Wiederaufbau
KSSP	Kerala Shastra Sahitya Parishad
LAD	Local Audit Department
LFA	Local Fund Audit
MKSS	Mazdoor Kisan Shakti Sangathan

MoPR	Ministry of Panchayati Raj
MoRD	Ministry of Rural Development
MP	Madhya Pradesh
MP-LADS	Member of Parliament - Local Area Development Scheme
MTFP	Medium Term Fiscal Plan
NASB	National Accounting Standards Board
NGO	Non Government Organization
NIC	National Informatics Centre
NIPFP	National Institute for Public Finance and Policy
NIRD	National Institute of Rural Development
O&M	Operation and Management
PAC	Public Accounts Committee
PAMIS	Panchayat Accounting & Monitoring Software
PESA	Panchayat (Extension to Scheduled Areas) Act 1996
PFMA	Public Financial Management and Accountability
PRI	Panchayati Raj Institution
PRIASOFT	Panchayati Raj Institution Accounting Software
PS	Panchayat Samiti
RCC	Roller Compacted Concrete
RLB	Rural Local Bodies
RTI	Regional Training Institutes
SC/ST	Schedule Caste/ Schedule Tribes
SFAA	State Financial Accountability Assessment
SFC	State Finance Commission
SGRY	Sampoorna Gramin Rozgar Yojna
TFC	Twelfth Finance Commission
TGS	Technical Guidance & Supervision
TP	Taluk Parishad
ULB	Urban Local Bodies
UP	Uttar Pradesh
UT	Union Territories
VO	Voluntary Organization
VTC	Voluntary Technical Corps
XIM	Xavier Institute of Management
ZP	Zilla Parishad

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ACKNOWLEDGEMENTS

This Synthesis Study was conducted during March and April of 2005. Priya Goel[1] and Manvinder Mamak led the study under the overall guidance of Robert Saum, P.K Subramanian and Ivor Beazley (SARFM) and with help from Vikesh Mehta of Grant Thornton. Hemant Chadha carried out the initial data gathering and assimilation.

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The report has been discussed with the Government of India but does not necessarily bear their approval for all its contents, especially where the Bank has stated its judgment / opinion / policy recommendations.

This Study builds on state-specific diagnostic work done by several consultants to the Bank over the preceding six months. It also derives from information published by the Planning Commission, the Ministry of Finance, Ministry of Rural Development and the recently-constituted Ministry of Panchayati Raj. The Bank also had access to similar state-specific studies undertaken by other donors such as DFID, GTZ and KfW.

The Synthesis also draws on State Financial Accountability Assessments and related Public Financial Management and Accountability Assessments at the Panchayati Raj Institutions level. These were conducted at Andhra Pradesh (by Ken Jones), Karnataka (by T.K. Balakrishnan), Uttar Pradesh (by Rajat Narula and Priya Goel), and Orissa (by Vinod Sahgal). The selection of focus states for the study is based on a request from the Department of Economic Affairs.

The Study benefited from a range of comments and suggestions provided by Barbara Kafka (SARSQ), T.K. Balakrishnan (OPCFM) and Vinod Sahgal (SARFM).

[1] For further information on the Synthesis Study contact Priya Goel at pgoel@worldbank.org

Executive Summary

Introduction

1. The 73rd Constitutional Amendment Act of 1992 heralded a new era in the democratization and decentralization of India. This law designated Panchayati Raj Institutions (PRIs) as the third tier of rural local government; PRIs are distinct from urban local bodies such as municipalities. PRIs exist in, and oversee, rural areas only. The Amendment provided for devolution of powers and responsibilities to different tiers of PRIs.

2. Since then, many states are in their second elective tenure. The process of empowering them has varied from state to state. These differences have a bearing on the extent to which the PRIs' financial management systems can assure that funds were used for the purposes for which they were intended.

3. PRIs need to have strong financial management systems to increase transparency, accountability, and management efficiency and to provide timely, reliable information to state governments. With the devolution of significant funds, along with functions and functionaries to PRIs, it is imperative that PRIs have in place an appropriate institutional framework for Public Financial Management and Accountability (PFMA) as well as systems and processes to effectively and efficiently discharge their responsibilities to the people.

Objectives and Scope of the Synthesis Study

4. Therefore, this Study has been designed to serve as a reference point for (i) mapping the PFMA arrangements currently in place; (ii) highlighting good practices that have emerged across States relative to PFMA; and (iii) summarizing issues that are most relevant to the Government of India, State Governments and the Bank when it comes to financing future projects through PRIs. This Synthesis also captures the recommendations of the Eleventh and Twelfth Finance Commissions, as well as the initiatives of the recently constituted Ministry of Panchayati Raj (MoPR). Inter alia, the MoPR has laid out a road map for enhancing the accountability of PRIs to their constituents.

5. Because devolution of powers has resulted in different models in the various states, this study has not attempted prescriptive solutions or standard models for implementation. Rather, this study offers input to the design of Bank interventions and activities relating to Decentralization; it is not in itself a Decentralization study.

6. This Study covers PRIs in six Indian states, including (i) Karnataka, Orissa and Uttar Pradesh where the Bank has carried out State Financial Accountability Assessments (SFAA); (ii) Rajasthan and West Bengal where several good practices have emerged at the urging of the state government and/ or the public at large; and (iii) Uttaranchal where the Bank has changed the design of existing projects, such as the Watershed Project to route funds through the PRIs as much as possible.

Approach and Methodology

7. For the purpose of this Study, PFMA arrangements, in context of PRIs, have been envisaged as constituting an ecosystem of regulations, practices and processes concerning all aspects of the financial management system and cycle.

8. Attention centered around the evolution of PFMA arrangements and PRI practices as documented in several studies in the public domain as well as PFM diagnostics in SFAAs carried out by the Bank. The methodology behind this Synthesis involved building on these studies and analyses in (i) discussions with Task Leaders, other Bank staff and consultants; (ii) the observance and gathering of information about innovative and good PFMA practices through field visits to Rajasthan, Orissa and West Bengal; and (iii) discussions with senior officials in the MoPR, Government of India (GoI), the Office of the Comptroller and Auditor General of India (CAG), and the Panchayati Raj Departments in the states visited.

Current PFMA Arrangements and Good Practices

Legal and Institutional Framework

9. The three tiers of PRIs obtained their legal status after the states enacted/ amended their own Panchayati Raj Acts [and related Rules] in conformity with the 73rd Constitutional Amendment in 1992. These laws provided for institutional mechanisms such as the holding of Gram Sabhas, the establishment of State and Central Finance Commissions, District Planning Committees and jurisdiction over 29 subjects specified in the Constitution. States also set up Panchayati Raj Departments as the administrative arm of PRIs in the state. These departments work closely with the Ministry of Rural Development at the GoI level. Historically, this body has dealt with Centrally Sponsored Schemes (CSS) and other PRI issues. The legal and institutional framework has thus far made PRIs function as extensions of the state and not as independent self-governing bodies in the true sense.

In 2004, a new Ministry of Panchayati Raj (MoPR) became the nodal agency to deal exclusively with policy matters relating to PRIs. Since then, the MoPR has held seven roundtables of Panchayati Raj Ministers of the States and has also developed an action plan, including several initiatives relating to PFMA to facilitate the implementation of reforms in a homogenous manner across the country.

Devolution of Powers

10. Accountability should be assessed in the context of power and authority. Some states, like Karnataka, have taken the lead in implementing the devolution of funds, functions and functionaries for all 29 subjects assigned to PRIs. They did so after undertaking a detailed activity mapping exercise whose guiding principle was to limit an activity to a specific level of government. Other states like MP, Rajasthan and UP have also made significant progress in achieving devolution of powers.

Planning, Budgeting and Monitoring

11. While the state Acts and Rules contain elaborate provisions for the preparation and approval of PRI budgets, there is a lack of information about the progress of projects at the village level. Financial information is unreliable and often delayed; moreover, the flow of funds is unpredictable from the higher tiers. As a result, budgeting in all three Panchayat tiers is top-down rather than bottom-up and demand driven. In addition, since budgeting is done in an unrealistic manner, there is no serious attempt to forecast revenues and expenditures. Budgets are pro forma,

they are prepared only to comply with statutory requirements; they are not used as a tool for financial control or long-term planning.

12. State legislation and executive orders have elaborate mechanisms for monitoring the physical and financial progress of public works at each PRI tier and accountability arrangements are well defined. However, these processes have little meaning in the absence of bottom-up planning. Furthermore, the states appear to undermine the independence and sustainability of PRIs by directly or indirectly controlling the funds to be transferred to them, their projects, and their operational flexibility in executing these projects.

13. Some states, such as Kerala, have changed this situation by creating a resource pool of approximately 10,000 experts called the Voluntary Technical Corps (VTC). The VTC vets and modifies projects prepared by the Panchayats. The VTC is an innovative people's campaign for decentralized planning; with the VTC, PRIs are empowered to prepare their plans in a transparent and participatory manner.

In West Bengal, legislative amendments have introduced Gram, Block and Zilla Sansads for planning, budgeting and selection of beneficiaries at the respective PRI tiers. The Gram Panchayats (GP) at the village level must act upon any recommendations of the Gram Sansad.

Similarly, the Karnataka Local Fund Authorities Fiscal Responsibility Act requires the preparation of a Medium-Term Fiscal Plan (MTFP). It mandates performance-linked budgets and a consultative budget as part of the preparation process.

Fund Flows

14. The flow of funds to the three tier Panchayats mainly consist of Plan assistance from the Central and State governments. However, the timing and amount of these funds varies considerably from one sate to another and is generally unpredictable. Although GPs have their own revenues from various [non buoyant] taxes and fees that they collect, these funds constitute an insignificant portion of their total revenues. For example, during 1998-99 to 2002-03, Panchayats in 23 states generated only 6.4% of their total revenues. What further complicates the situation is that these funds come through many different paths and banking arrangements.

15. As a result of the Government of Karnataka's efforts to standardize property tax rates in rural areas, tax collection have gone up substantially. This influx of revenue has added resources to the meager coffers of PRIs. In addition, since 2003-2004, the Government of Karnataka has earmarked funds for the GPs. The State Treasury credits these funds to the bank accounts maintained by the GPs in their respective villages. In doing so, the transfer time has shrunk to 12 days. The flow of funds is now more predictable and the potential for higher level PRIs to divert funds has subsided.

Internal Control and Internal Audit

16. In general, the Panchayati Raj Act and Rules of States provide for a tight set of internal controls on the use of PRI resources. However, these controls have not curbed the thousands of reported frauds and embezzlements at the PRI level. In order to achieve a strong control environment, there is a need to strengthen systems and administrative processes so that accountability and oversight are routine.

17. The SFAAs have documented that internal audit is either nonexistent or inadequate at the PRI level. West Bengal is an exception. A special cadre of internal auditors exist at all the three tiers of Panchayats. Equally important, this arrangement is recognized as a good practice. It ensures that internal audits take place. However, because the auditors represent the Panchayats and Rural Development, they are vulnerable to conflicts of interest and their independence is in doubt.

Accounting

18. The accounting practices adopted by the Panchayats, each of which is an accounting unit, do not reflect the financial resources entrusted to them. Their registers and books of accounts have not been upgraded to enable them to account for the increased and diversified flow of resources in the present decentralized system. There are no accounting standards or uniform accounting codes for Panchayats. Variation exists even within the same State. Furthermore, the accounts are often late and unreliable. In addition, the current accounting systems do not allow for an assessment of the cost of services, the tracking and record keeping of community infrastructure and other assets that the PRIs own.

19. However, the lack of reliability is changing as a result of a recommendation put forth by the Eleventh Finance Commission, namely it entrusted the Technical Guidance and Supervision (TGS) of PRI accounts to the CAG. Twenty two States have already complied with this requirement. To fulfill the TGS mandate, the CAG has prescribed accounting formats for PRIs, 16 in all, as well as auditing standards, guidelines for certification audit, a list of codes for programmes, functions and activities of PRIs. Eighteen states are in an advanced stage of implementing these formats; several others are modifying the formats in keeping with local requirements.

20. Orissa has initiated an E-Governance plan for PRIs to strengthen their accounting functions through Information Technology (IT) and inter-connectivity. Web-enabled state-wide databases will soon be in place to track the transfer of funds across the PRI tiers to show the balances available for each one, expenditures incurred in each CSS/ State scheme and to display online PRI accounts at the Block and State levels. West Bengal has undertaken a similar IT based initiatives for improving the accounting [including the introduction of double-entry bookkeeping] at the district and intermediate level PRIs.

External Reporting and Transparency

21. Organized financial reporting is scant in any of the three PRI tiers. Each PRI tier submits financial and physical performance reports to the next higher tier. But there is no consolidation of financials by the PRI at the intermediate or block levels. The frequency of reporting, the level of detail and quality of information contained in them varied significantly across the states and within the same state. An important component of vertical reporting is the utilization certificate of funds transferred from the Central or State Governments. However, expenditures reported back up the line are not verified for their genuineness or accuracy. This means that the utilization certificates that the implementing officers provide are taken at face value. It raises the possibility of differences between reported expenditures and expenditures incurred.

22. To improve accountability, the Central and State Governments have issued many directives that focus on enhancing transparency in the use of funds. One outcome has been to create a 'fourth tier' of institutions/ Community-Based Organizations (CBO) below the GP. The goal is to ensure more participation by people closest to project execution and to expect greater

accountability from them. The establishment of Ward Sabhas in Karnataka, Palli Sabhas in Orissa and Village Development Councils (VDC) in West Bengal are just a few examples.

23. Giving the electorate access to information and introducing social audits at the Gram Sabha level help to ensure transparency. Good practices worth mentioning are:

- Right to Information Act (pioneered in Rajasthan; now introduced in seven other States)
- The posting of GP accounts for public display (Karnataka, UP and Kerala amongst others)
- Televising Gram Sabha proceedings (Karnataka)
- Encouraging women to participate in the Panchayat through Vama Panchayats (Uttaranchal)
- Vaarta Boards at ward headquarters display daily information regarding the names of workers, material costs, etc (Kerala)
- Citizen's charter specifying responsibilities of each PRI tier (Andaman & Nicobar Islands)
- Jan Sunvai or public hearing (Rajasthan)
- Jamabandi or social audit (Karnataka)

External Audit

24. The statutory auditor of Panchayats in all three tiers is either the Local Fund Audit (LFA) or the CAG. Chartered accountants engaged by the District Rural Development Agency (DRDA) audit CSS funds. Although there are many audits, they tend to be late. West Bengal is an exception. Nearly all GPs there have been audited by the Examiner of Local Accounts (ELA), who is an officer attached to the office of the State Accountant General (AG).

25. Moreover, audit procedures are lacking or deficient. For example, PRI auditors are not required to verify assets. A typical audit of a GP's annual financial statements usually includes verifying the propriety of individual items. But the audit does not encompass the existence, completeness, valuation, presentation and disclosure of the financial statements. In addition, there is no mandate for PRIs to publishing their annual performance reports or their certified financial statements.

26. However, the TGS of the EFC has made recommendations to improve the accountability of PRIs; the CAG has prescribed an audit methodology and procedures for LFA. The TGS also expects the CAG to train for the LFA staff, to vet their programs and to approve their audit plans. There is also a provision for the CAG to follow up on audit findings; the AG is supposed to monitor whether the auditors meet their deadline.

27. To ensure the auditors' independence, the Twelfth Finance Commission recommended that officials of the Panchayati Raj Department should not be statutory auditors of the village Panchayats. Further, the CAG should audit accounts of the intermediate and district Panchayats. These recommendations should be taken seriously for the purpose of enhancing transparency and strengthening the audit function.

28. Follow up of audit reports does not occur in an organized manner at any level. Replies and clarifications to audit observations are not forthcoming in a timely way. As a result, the effectiveness of the audit declines. In addition, legislative committees do not scrutinize the Annual Report of the LFA Department.

Conclusion

The Government of India has a well-defined legal and institutional framework for rural local governments or PRIs. Nevertheless, there is considerable room for improvement in carrying out the spirit of the law. More than a decade after the 73rd Constitutional Amendment, PRIs are still evolving, some more rapidly than others. It is true that past studies have highlighted several weaknesses from a PFMA perspective. There is a need to strengthen the framework for accountability at PRI level, especially mechanisms to ensure adherence to basic financial controls, putting more trained accountants on the ground to match the increased levels of financial responsibility, enhancing transparency and public involvement and the value of states learning from each other's experience by sharing good practices.

It is however encouraging to note that the series of ongoing initiatives at the Centre and State levels have the potential for altering the accountability landscape. Furthermore, there are several success stories. All stakeholders, especially other states, need to take note of these initiatives and consider emulating them. The implementation of these initiatives would help mitigate fiduciary risk associated with a PRI project and inform the design of future Bank interventions.

This Synthesis attempts to highlight good practices in various aspects of the Financial Management Cycle in the context of issues and concerns raised in previous studies.

I. Background and Context

1. Traditionally in India, plans and programs for the rural population originated at the state level. This top-down approach imposed development priorities on rural communities and restricted the development of administrative institutions at rural local bodies [called Panchayati Raj Institutions (PRIs)[2] in India]. In the 1990s, there was a paradigm shift in the strategy for rural development. The Government of India [GoI] decided to decentralize financial and administrative powers to PRIs[3]. As a result, the administrative capacity of PRIs began to accommodate their new role. Administrative capacity included processes and institutions for Public Financial Accountability (PFMA) for monies that the PRIs had at their disposal. These PFMA processes are the focus of this study.

2. Since the 1990s, institutions and processes for PFMA at PRIs have been evolving rapidly. There is universal agreement that if PRIs are to effectively discharge their development responsibility, then they must exercise stewardship and control of the funds at their disposal. Therefore, PRI accounting systems are being upgraded in many states, despite the overwhelming pressures of decentralization. The CAG has issued directives, which set forth accounting forms and formats for PRIs at different levels. Public scrutiny of funds is being encouraged and some state governments; the CAG and NGOs are doing substantive work in this area. The CAG is strengthening the external assurance function by developing standard manuals for PRI audits. Civil Society organizations, active in some states, have succeeded in bringing about landmark legislation [Rajasthan – Right to Information Act] regarding PRI accountability. This study tries to capture all these efforts to improve accountability.

3. For the purposes of this study of PRIs, the PFMA may be compared to an ecosystem of regulations, practices and processes in the following areas of the financial management system and cycle:

(i) Legal and institutional framework
(ii) Devolution of funds, functions and functionaries
(iii) Planning and budgeting
(iv) Fund flows
(v) Budget execution and monitoring
(vi) Internal control and internal audit
(vii) Accounting
(viii) Asset management
(ix) External reporting and transparency
(x) External auditing

4. This study intends to map PFM arrangements and accountability in PRIs by synthesizing work done by the World Bank and other donors [like DFID, KfW and GTZ]. It covers project reports and studies as well as diagnostics conducted at the state level [such as the State Financial Accountability Assessments]. It also takes the following initiatives into account relative to PRI accountability: work undertaken by different state governments, the Planning Commission, the recently-constituted Ministry of Panchayati Raj (MoPR) at the GoI level, the Local Bodies wing of the Office of the Comptroller & Auditor General of India (CAG), NGOs and civil society

[2] Annual Report 2002-03, Government of India, Ministry of Rural Development.
[3] Annual Report 2002-03, Government of India, Ministry of Rural Development.

organizations. The authors also sought inputs from Bank staff and consultants who have worked with PRIs.

5. This study is relevant because of the substantial public expenditures PRIs incur. Several programs carried out by the Ministry of Rural Development, Government of India under `Central Assistance Programs' or `Centrally Sponsored Schemes' routinely provide funds to the three tiers of PRIs directly or through the state governments. In addition, state governments provide funds[4] through intergovernmental transfers; a substantial proportion[5] of State expenditures go to PRIs that way. The Bank also channels funds to PRIs by supporting six existing projects;[6] this support is consistent with its Country Assistance Strategy. Therefore, the Bank seeks to map a fiduciary framework for India's PRIs by using this study to document the baseline system and ongoing improvements. This study clearly identifies the strengths of the system as well as gaps that need to be addressed.

6. This synthesis study also documents GoI's own vision for PRIs embodied in recommendations of the Planning Commission Task Force on PRIs. This Task Force suggested that PRIs administer and carry out all future Externally Aided Projects entrusted to them. Furthermore, a recent order by the Government of Karnataka State [October 2004] made a similar stipulation, namely that World Bank or other Externally-Aided Projects should be implemented by PRIs only.

7. This study focuses on the following six states: Karnataka, Orissa, Rajasthan, Uttar Pradesh, Uttaranchal and West Bengal. The goal is to identify and highlight good practices amongst these PRIs. In addition, this report includes examples from other states, namely Kerala, Madhya Pradesh and Tamil Nadu.

Key objectives of this Study

8. The third tier of Government at the rural level has received more and more attention. The main objectives of the study are (i) to develop a better understanding of PFMA issues in PRIs by mapping existing processes; (ii) to identify good practices; and (iii) to synthesize knowledge gained from the SFAAs and other analytical work with experience gained from working with PRIs at the project level. This combined experience will inform the design of future Bank interventions with PRIs. It may also be of value to central, state and local governments that want to improve their own PFMA arrangements with PRIs.

9. Because devolution to PRIs has resulted in different models in the various states, this study does not attempt to put forth prescriptive solutions or implementation standards.

10. This study is not intended to be about fiscal decentralization. Nor does it cover issues of inclusion, the state of GP finances, efficiency in service delivery to the people, sector-specific

[4] A new scheme Sampoorna Grameen Rozgar Yojana, launched in September 2001 was implemented entirely through the three tiers of PRIs; the annual allocation for this scheme was Rs. 4,900 crores for the year 2002-03.

[5] In Karnataka, the total expenditure for rural local governments is equivalent to about 20 percent of State expenditures. Eighty percent of the budget of local governments comes to them through a complicated system of 428 state and central government conditional grants. In Kerala, 18% of the state expenditures take place at the local government level, with about 80% of the grants being for plan purposes and allocated as `general purpose' grants. The quantum and system of allocations may differ in each state and largely depends on the pace of fiscal decentralization reforms.

[6] These projects include: Karnataka Rural Water Supply and Sanitation II, Kerala Rural Water Supply & Sanitation Project fund implementation of rural water supply and sanitation schemes implemented by the Village Panchayats. In addition, several District Poverty Initiatives/Reduction Projects (DPIP/DPRP) exist in AP, MP, Rajasthan and Chattisgarh; they finance small community infrastructure public works by Village Panchayats. In total, these projects are valued at approximately US$ 500 million or more.

and capacity building; these are the subjects of other studies. Rather this study is about accounting, budgeting, internal controls and auditing; the intent is to document practices and to offer insight to the design of Bank interventions.

II. Legal and Institutional Framework

Evolution of Panchayati Raj in India

1. The following chart summarizes the evolution of the third tier of democratic self-governance in India from earliest times (BC) to today:

2. While self-governing village communities existed from earliest times, the following laws by the GOI substantially empowered the Panchayats:

(i) GOI Act of 1935 granted them the power to administer themselves, including the responsibility for criminal justice
(ii) The 73rd constitutional Amendment Act 1992 established a three-tier structure of local self - Governments in rural areas; the Act recommended that State Finance Commissions suggest measures to improve the finances of local bodies and it mandated regular elections for PRIs every five years.

3. The 73rd Amendment suggested reservations for Scheduled Castes (SCs), Scheduled Tribes (STs) and women for membership in Panchayats and for the post of chairperson. It also mandated that State Election Commissions hold PRI elections at all levels. Moreover, it added an Eleventh Schedule to the Constitution, which gave PRIs jurisdiction over 29 subjects.

4. Subsequently in 1996, the Panchayat Extension to Scheduled Areas Act (PESA) extended Panchayats to tribal areas in nine states[7]. This Act empowered tribal communities and ensured their inclusion in decision-making.

5. One of the initiatives of the 73rd amendment was granting legal status to Gram Sabhas at the GP level. The intent was to improve accountability and participatory development. Most State legislation made Gram Sabhas responsible for supervising and monitoring the operation of Gram Panchayats, examining their accounts and audits and participating in the planning process.

6. The 73rd Amendment recommended setting up SFCs to make suggestions about sharing/distributing and assigning taxes, duties, tolls and duties between the States and PRIs and grants-in-aid from the states' Consolidated Fund to the Panchayats.

7. This Amendment also expanded the domain of the Central Finance Commission. The Finance Commission was asked to suggest measures to augment the States' Consolidated Fund with additional grants to supplement the Panchayats' resources.

8. A discussion on the institutional framework of PRIs would not be complete without mentioning the Ministry of Panchayati Raj (MoPR) which was set up on May 24, 2004 to oversee all matters concerning rural local bodies.

9. MoPR has made many initiatives regarding PRIs, particularly the PFMA. Chief among them were the Round Table Conferences by Ministers-in-Charge of Panchayati Raj of all the States and Union Territories in India. Seven of these round tables occurred between July and December 2004; 150 resolutions relating to various aspects of PRIs were either adopted or recommended for joint acceptance by the Centre and the States. Among the more important resolutions dealt with PRIs' effective devolution of funds, functions and functionaries, the empowerment of the marginalized, the holding of regular elections, the improvement of accounting and audits, and capacity building in PRIs to discharge their responsibilities as rural local governments.

10. It is pertinent to add that the Ministry has commenced monitoring the progress of the States against these action points; the first status review occurred in New Delhi on April 11, 2005.

The Way Ahead on Legal and Institutional Framework

11. It is important that Central and State Governments recognize that Constitutionally different levels of PRIs were meant to be lateral bodies. The three tiers were not envisaged as a hierarchical structure for purposes of functions, fund flows or accountability. Now that considerable thought and effort is being given to orientation of PRIs as rural local governments, GoI and State Governments could orient legislation and institutions towards creating a regime of equals rather than the more traditional vertical arrangements that have existed historically where responsibility was conferred from one level to another rather than being shared between partners.

[7] AP, Chattisgarh, Gujarat, Himachal Pradesh, Jharkhand, Maharashtra, MP, Orissa and Rajasthan.

III. Devolution of Powers

1. Article 243-G of the Constitution establishes the legal basis for the empowerment of Panchayats. It mandates State Governments to endow Panchayats with such powers and authority as may be necessary to govern them. This provision gives State legislatures discretionary power to strengthen the finances of the Panchayats by: (a) giving them certain revenue powers, (b) sharing State revenues with them and (c) supporting them with grants-in-aid.

2. The devolution of powers to PRIs was to take three forms (referred to as the three "F"s), viz. functions, functionaries and finances/funds. States like Karnataka, Kerala, Maharashtra, MP, Orissa, Rajasthan, Sikkim, Tamil Nadu, Tripura, UP and West Bengal have issued detailed instructions and placed departmental officials with them. As of December 2001, the status of devolution among PRIs in the focus States appears in Table 1:

Table 1

State	No. Of Depts./ Subjects transferred to Panchayats		
	Fund	**Function**	**Functionary**
Karnataka*	29	29	29
Orissa[8]*	0	11	11
Rajasthan*	18	29	18
UP	12	13	09
Uttaranchal	12	13	09
West Bengal	12	29	12

Source: Report of Planning Commission Task Force * denotes latest position based on field visits

In addition to Karnataka, Sikkim and Pondicherry have devolved to the PRIs all three Fs associated with all the 29 subjects. The State Governments of MP, UP and Rajasthan have claimed that they have also made considerable progress in this direction. Some of those recent initiatives are described in the next few boxes.

Box 2: Developments in Panchayati Raj in Karnataka – BELUR DECLARATION

A proclamation known as the Belur declaration occurred on January 2004. It said: ***"What needs to be done at a particular level needs to be done at that level only."***

The GoK committed to devolving funds and officials to strengthen the Panchayats' capacity to handle the expanded mandate. To facilitate this activity mapping would be undertaken and capacity enhancement measures like strengthening GP administration to integrate village level revenue functions with GP administration, creating an Ombudsman for every district to ensure accountability, and strengthening the technical and financial management capabilities of GP was promised.

PRIs, in turn, committed to maintaining the highest level of integrity and transparency in all public expenditures. They also agreed to incorporate in their operations such best practises as conducting a minimum of two Ward Sabhas and two Gram Sabhas each year, selecting only beneficiaries that qualify

[8] Chapter 4 of the Report of the Second SFC in Orissa states that the devolution of subjects is limited to (i) accountability to the ZP/ PS or the GP as the case may be (ii) visits to some of the Government offices/ institutions by the head of the concerned PRI (iii) transmission of reports about performance of certain officers and (iv) sanction of casual leave to the heads of few such offices. This report has recommended that the State take up the further devolution of powers and make it more meaningful.

for various schemes, enhancing reserves through tax reform and higher rates of tax collection, and creating and maintaining income-generating assets as well as fulfilling the aspirations of the people.

Government Orders

The State Government carried out Activity Mapping that specifies the role of each PRI tier within their purview. In October of 2004, Government Orders transferred several State Sector Schemes to the District Sector and rationalized the District Sector Schemes. This regrouping resulted in a decline in the total number of schemes from 654 to 335. A total of 176 State Sector Schemes, representing an outlay of Rs. 1,887 crores, have gone to the three PRIs. Approximately Rs. 800 crores went to Zilla and Gram Panchayats; another Rs. 200 crores went to Taluk Panchayats.

3. The Madhya Pradesh Government has recently amended its Panchayati Raj Act to allow Standing Committees to strengthen the devolution process to GPs. The duties and responsibilities of the Gram Panchayat are clearly defined. However, the Standing Committees are to help supplement the institutional framework available to GPs regarding the three F's.

Similarly, the Government of Uttar Pradesh has adopted measures to enhance the effectiveness of the devolution process across the three tiers of PRIs. See the Box below:

Box 3: Recent Initiatives Taken By Government Of Uttar Pradesh For Empowerment Of PRIs (Source: Abstract From The Report Of The Planning Commission Working Group)

To sustain decentralization and encourage people's participation, the State Government has devolved many functions and powers to the Panchayats.

New Responsibilities Assigned to Gram Panchayats:

- Identify beneficiaries and disburse pensions and scholarships. Funds for public works, maintenance of assets, and the payment of salaries and honorarium to teachers and GP Vikas Adhikaris.
- Transfer four percent of the State's total tax revenues to the Gram Panchayats. This step resulted in an unprecedented increase in funds from Rs. 20 crore in 1996-97 to Rs. 328 crore in 1999-2000. In addition, funds from the rural development schemes and the Tenth Finance Commission Award have gone to the Gram Panchayats.
- Gram Panchayats now collect irrigation taxes from the State Tube-wells and impose surcharges on land revenue.
- To improve transparency, the villagers may obtain a copy of any Gram Panchayat document for a nominal fee.
- Gram Panchyats must hold a minimum of one meeting each month.
- In the case of Women Pradhans, husbands/male relatives are not allowed to attend these meetings as proxies for the women.
- The works of the Gram Panchayats will proceed through six committees, namely Planning and Development, Education, Construction Work, Health/ Welfare, Administration and Water Management.

Responsibilities Handed Over to Kshettra Panchayats:

- The local bodies will receive 10 percent of the State's tax receipts.
- The six Subject Committees previously mentioned will execute all public works.

Empowerment of Zilla Panchayats:

- Instead of the District Magistrate, the Chief of the ZP will be the Chairman of the (DRDA).
- The governing body of DRDA now comprises the Chairpersons of the six Standing Committees of the Zilla Panchayat and 50 percent of the Pramukhs.

- A separate officer, with the title of Chief, will be in charge of developing work implemented by the DRDA/ Zilla Panchayat. This Chief Officer will replace the District Magistrate.

Box 4: Recent Initiatives taken by the Rajasthan Government

In August 2004, the State Government convened a high-level Ministerial Committee. This committee consisted of the following ministers: Home, Education, Food & Civil Supplies, Social Development and the Minister for Panchayati Raj and Rural Development to move devolution forward. Since then and March of 2005, this committee has met eight times. Recently, this same committee has visited other States such as Karnataka.

The Way Ahead on Devolution of Powers

4. The preceding examples show how the states are complying with the spirit of the Constitutional amendments. These are positive steps in improving the sustainability and authority of PRIs and therefore their accountability. Going forward, it is important to understand that the extent to which devolution has unfolded is the consequence of the direct relationship between responsibility and authority and this is what is expected to inform the course of future devolution also. In addition, there are many states [such as Orissa and West Bengal] where devolution has happened in principle but not in practice and in going forward, it would be essential that practice follows principle.

IV. Planning and Budgeting

1. Bottom-up planning is imperative to effective development, efficient service delivery and sound accountability. Article 2430-ZD of the Constitutional Amendment Act (1992) provides for District Planning Committees (DPCs) to consolidate the plans prepared by individual Panchayats in the district and to prepare a draft development plan for the district as a whole[9]. The intent behind this arrangement was to link strategic planning with budgeting and physical targets with expenditures. The planning provision exists in the Panchayati Raj Act and in the Rules of States; they relate to the preparation and approval of PRI budgets.

2. As a practical matter, however, the amount of untied funds the PRIs receive is very low. Most development work occurs with tied funds from the central GOI. So, planning continues to be top down. Budgeting is an exercise in extrapolation based on figures from the previous year plus an inflation factor. Because the timing of transfer of funds is unknown, PRIs are unable to rely on these funds for important initiatives. Although the SFC mandated that PRIs receive untied funds, the Twelfth Finance Commission (TFC) commented "...very few states honoured their commitment for release of additional resources."

3. Nevertheless, some states have made incremental progress in planning. Kerala is one example, specifically the Voluntary Technical Corps (VTC). VTC consists of about 10,000 experts whose mandate is to vet and revise projects prepared by the Panchayats. Similarly, other States need to identify voluntary groups and institutions that could provide services, training and support for programmes at the local level. The Planning Commission has recommended Kerala as a model for other States to emulate. Details of the Kerala Model appear in Box 5.

Box 5: People's Planning Campaign in Kerala as per the Report of the Working Group on Decentralized Planning and PRIs

The People's Planning Campaign has a method for participatory planning at the local level. The basis for this methodology goes back to an experiment carried out in Kalliassery Panchayat of Kannur District in the early 90s and later modified for large-scale applications. The key features of this methodology appear below.

1. **Needs Identification**: The needs of rural communities are identified through Gram Sabha meetings. These semi-structured meetings have plenary and sub-group sessions dealing with specific developmental issues. The decisions are documented in the minutes and shared with the Panchayats.

2. **Situation Analysis**: Thereafter, the demands of the Gram Sabha go into a Development Report. This report describes the status of each sector of development. It contains a problem analysis and a direction for future development. This analysis occurs once; the Reports will be revised before the next five-year plan.

3. **Strategy Setting**: Based on feedback from the Gram Sabha and the Development Report, a one-day seminar takes place at the PRI level. Participants include experts, elected officials, representatives nominated by Gram Sabhas, and members of the public. The seminars suggest priorities and general strategies for projects for a given year.

[9] According to the Report of the Working Group on Decentralized Planning and PRIs , Ministry of Rural Development, November 2001, only 11 States, namely Haryana (only in four Districts), Karnataka (in 18 out of 27 districts), Kerala, Madhya Pradesh, Manipur (in two out of four districts), Rajasthan, Sikkim, Tamil Nadu, Tripura, Uttar Pradesh and West Bengal had constituted DPCs.

4. **Projects**: The ideas that came out of these three stages include projects at the PRI level. Each PRI has about 12 Task Forces dealing with different sectors of development. An elected official heads each Task Force. The Vice Chairman of the Task Force is usually a non-government expert. Project plans outline objectives, describe the benefits, explain the funding and execution of it.

5. **Plan Finalization**: The respective PRI finalizes its plan for the year and submits it to the DPCs through the Expert Committees. The Panchayat is free to take up any project, regardless of cost, but subject to available resources and sector limits.

6. **Plan Vetting**: The Expert Committee at the Block or the District level evaluates the projects for their technical viability and their conformity with government guidelines for costing and planning. Next the committee forwards them to the DPC. They cannot change priorities or projects; they can only ask for adjustments.

7. **Plan Approval**: The DPC gives formal approval to the plans, and then the PRI can start implementation. The DPC cannot change a PRI's priorities. Administrative approval for implementation is given by the PRI. Every PRI has unlimited administrative powers, restricted only by its financial resources.

Facilitating the Campaign are approximately 650 Key Resource Persons at the State level, about 10,000 District Resource Persons and about 100,000 Local Resource Persons (100 per Village Panchayat). Each of them receives basic training.

4. Similarly, NGOs, such as the Consumer Unity and Trust Society (CUTS) in Rajasthan, have shown that bottom-up needs assessment is feasible through careful micro-planning at the village level and with the blessings of the Gram Panchayat (see Box 6).

5. Another important step in bottom-up budgeting occurred in West Bengal. The West Bengal Panchayat (Amendment) Act of 1992 provided for the establishment of Gram Sansads. These are legal entities below the level of the GP; they take an active interest in planning, budgeting and selecting beneficiaries (Details in Box 7). Subsequently, West Bengal has made even more progress in bottom-up budgeting. In 2003, an amendment to this Act made it obligatory for GPs to act upon any recommendations of the Gram Sansad. The recent amendment envisages a Block and a Zilla Sansad that is similar to the Gram Sansad.

6. On the issue of budgeting, a reference to the Karnataka Local Fund Authorities Fiscal Responsibility Act, 2003[10] is warranted. This statute establishes an overarching legal framework for fiscal and financial management in a wide range of entities including PRIs. This act requires the preparation of a Medium-term Fiscal Plan (MTFP) that outlines the mission and goals of the entity, its medium-term fiscal objectives and performance indicators. Annual budgets must be in line with the MTFP. The act also stipulates financial management principles that govern those entities, including those applicable to budgeting, accounting, and auditing and fiscal transparency. Mandated features include performance-linked budgets and a consultative budget preparation process. Implementing this act is a major priority that will also require significant effort, given capacity constraints. The act applies to the various entities upon notification by the State Government.

[10] This paragraph is a reproduction of paragraph 3.22 of the Karnataka SFAA Report.

7. In preparation for the Bank's funding of the Karnataka Panchayat and Service Delivery Project, the Government of Karnataka drew up a new set of Accounting Rules applicable to Gram Panchayats. The FM Assessment Report for the proposed project states that a fiduciary framework would be established to implement new planning guidelines (MTFP) in all GPs. The goal is to prepare a plan at the beginning of every year that shows the use of Block Grants under the project.

The Way Ahead on Planning and Budgeting

8. For planning to be meaningful, the process needs to include local people and to identify what they want. The community should drive the plan, as was true of the CUTS micro plans. The scant amount of untied funds makes the grassroots ineffective. If the state governments were committed to a timetable of devolution of unrestricted grants to the villages, that planning would help rural communities. Even tied funding that villages receive from centrally-sponsored schemes does not follow a time table, nor is there any assurance of their receipt. Even when funds for particular centrally sponsored schemes (CSS) are received, the selection of beneficiaries and sites for installation of village assets has already been done centrally. The GPs do not have a say in what, where or whom the schemes should benefit. To link plans with budgets and physical progress, the CSS methodology should be more consultative. The Gram Sansads in West Bengal have initiated an exercise in participatory planning that could be a model for other states. Similarly, Karnataka's planning guidelines are also a step in the right direction.

V. Fund Flows

1. PRIs receive funds mainly from external sources in addition to raising their own income from the levy of taxes (primarily at the village level). Taxes levied by village bodies are usually buildings and land, on the registration and mutation of properties, water supply, entertainment, vehicles, advertisements, market fees and fees on transport operators, etc. These taxes are relatively non buoyant and ineffective for the PRIs to use as resources. Compounding the problem is their low collection rate. As a result, PRIs tend to have a low fiscal base. Statistical evidence from 1990-91 to 1997-98 shows that the internal revenue mobilization (IRM) for Panchayats from 23 states constituted only 4.17% of the total revenue of those States. From 1998-99 to 2002-03 IRM increased to 6.40% of total state revenue. But in 1997-98 IRM accounted for only 0.04% of the states' GDP compared to an expenditure of 1.38% by the GDP.

2. The other main external funding sources for PRIs are (i) funds from the State's Consolidated Fund to carry out State functions as per SFC recommendations; (ii) tied funds from line departments at the State level when financial devolution has taken place; (iii) tied funds from the Central Government for the execution of CSS; (iv) tied funds received directly from the Centre/ State under the MP-LADS and MLA-LADS schemes for identified and approved public works and (v) grants-in-aid as from the Finance Commission award (the most recent was the Twelfth Finance Commission – TFC).

3. Typically State government grants, most of them tied except for SFC devolutions, account for 80% or more of the Panchayats' total resources. See the Table 2 overleaf. This table summarizes the statewide revenue devoted to IRM and assigned or devolved by the six States that are the subject of this study for all levels of PRIs during the past 5 years[11]. In all the 6-states, IRM represents a very small percentage of total revenue. A detailed tabulation appears in Annex I.

4. Because their own resources are low, Panchayats have to rely on funding from the states and the GoI. As previously mentioned, based on SFC recommendations, the only untied funding available devolves from the states. The TFC mentions that most states have reneged on their SFC commitments totally or in part. Where states have transferred untied funds to PRIs, there have been delays and partial payments. In many instances, state governments operate Personal Deposit or Personal Ledger Accounts and document the transfer of funds in these accounts. But in fact there is no corresponding transfer of these funds. Consequently, PRIs are unable to rely on the untied funds that they receive to satisfy expenditures such as staff salaries or the salaries of elected representatives, minor maintenance works like Panchayat buildings, etc. Until the transfer of funds actually happens, the Panchayats must depend on their own revenue or untied funds.

Table 2

State	Item	1998-99	1999-00	2000-01	2001-02	2002-03
Karnataka	Own Revenue as % of Total Revenue	1.53	1.31	1.42	1.20	1.38
	Assignment/Devolution/Grants in aid as % of Total Revenue	98.47	98.69	98.58	98.80	98.62
	Other Revenue as % of Total Revenue	0	0	0	0	0
	Total Revenue (%)	100	100	100	100	100
	Total Revenue (Rs. Crore)	**3,370.57**	**4,378.79**	**4,717.97**	**4,373.51**	**4,303.03**
Orissa	Own Revenue as % of Total Revenue	5.40	3.97	7.82	6.48	2.93

[11] This information has been collated from Annexure 8.8 referred to in para 8.25 of the Report of the Twelfth Finance Commission.

State	Item	1998-99	1999-00	2000-01	2001-02	2002-03
	Assignment/Devolution/Grants in aid as % of Total Revenue	94.60	96.03	92.18	93.52	97.07
	Other Revenue as % of Total Revenue	0	0	0	0	0
	Total Revenue (%)	100	100	100	100	100
	Total Revenue (Rs. Crore)	**170.79**	**218.31**	**115.91**	**135.90**	**182.33**
Rajasthan	Own Revenue as % of Total Revenue	2.09	2.18	2.25	2.06	2.08
	Assignment/Devolution/Grants in aid as % of Total Revenue	62.24	65.54	62.99	64.87	63.29
	Other Revenue as % of Total Revenue	35.67	32.28	34.76	33.07	34.63
	Total Revenue (%)	100	100	100	100	100
	Total Revenue (Rs. Crore)	**1,521.14**	**1,678.97**	**1,637.15**	**1,806.81**	**1,811.63**
Uttar Pradesh	Own Revenue as % of Total Revenue	11.50	10.61	9.60	9.24	10.14
	Assignment/Devolution/Grants in aid as % of Total Revenue	66.74	53.90	52.28	54.35	71.14
	Other Revenue as % of Total Revenue	21.77	35.49	38.11	36.41	18.73
	Total Revenue (%)	100	100	100	100	100
	Total Revenue (Rs. Crore)	**403.46**	**502.29**	**612.50**	**641.14**	**623.21**
Uttaranchal	Own Revenue as % of Total Revenue	7.02	8.42	15.15	21.01	9.94
	Assignment/Devolution/Grants in aid as % of Total Revenue	27.78	37.12	53.08	31.84	15.66
	Other Revenue as % of Total Revenue	65.19	54.46	31.77	47.10	74.41
	Total Revenue (%)	100	100	100	100	100
	Total Revenue (Rs. Crore)	**66.80**	**61.20**	**32.14**	**23.27**	**61.38**
West Bengal	Own Revenue as % of Total Revenue	16.89	10.36	5.26	7.30	17.64
	Assignment/Devolution/Grants in aid as % of Total Revenue	82.65	89.36	94.60	92.51	82.36
	Other Revenue as % of Total Revenue	0.47	0.28	0.14	0.19	0
	Total Revenue (%)	100	100	100	100	100
	Total Revenue (Rs. Crore)	**171.94**	**285.79**	**618.05**	**460.18**	**177.23**

5. PRIs, particularly GPs, get tied funds for public works from the states and GoI (on CSS). The physical flow of funds to PRIs and the associated timeframe for disbursement varies with the source of those funds, for example, CSS, State, Finance Commission or Line Department funds, how the funds will be used (salaries or public works), and the availability of banking arrangements. However, this can be said; the flow of funds is generally unpredictable. As a result, fiscally constrained Panchayats cannot rely on the tied grants promised to them.

6. It is also noteworthy that fund flow arrangements vary significantly across states. For example, in Rajasthan, funds intended for GPs usually flow from the State to the ZP and then to the intermediary level -PS before being transferred to the GP. In Rajasthan, SGRY, a CSS, is an exception to this rule. The Rural Development Cell of the ZP [formerly DRDA] transfers the GP's 50% share directly. In Orissa, on the other hand, the DRDA acts as the PRIs' banker and transfers the respective shares of funds to the three tiers of PRIs for CSS.

7. There are no statutory requirements or deadlines for the transfer of funds. In general, PRIs do not know how much money they will receive or when. The unpredictability undermines the Panchayats' ability to function. It also has an impact on accountability. Panchayat officials are seldom held to account for their use of funds. The chart below attempts to depict the multiplicity of fund flow routes across the three tiers of PRIs:

8. Despite many obstacles, some PRIs have developed good practices in the way they use the limited funds at their disposal. Karnataka is one example. According to the 2003-04 Annual Report of the Rural Development & Panchayat Raj Department, Government of Karnataka has conducted a survey of all rural households. The goal was to develop an accurate list of people on BPL living in the district, to identify CSS beneficiaries who were eligible for the program and those who were not. The starting point for the survey was the voter's registration list for each GP broken down by constituency. Questionnaires were limited to the number of registered voters. The survey was successful because the Panchayats owned it; it was their idea. There were also a few surprises. For example, in one constituency, the registered BPL population represented 113% of the total number of people living there. Afterward, the government was able to establish the correct number of rural beneficiaries and target the state schemes more efficiently.

9. The second example from Karnataka, documented in the same Annual Report mentioned previously, had to do with local taxation. Guidelines came out in May of 2003, which standardized the rules for collecting property taxes for all Gram Panchayats. Later, a process for evaluating taxes went into effect; it allowed people to participate in that process. Subsequently, two activities ensued. The first was a massive survey of each and every dwelling unit/ structure within the boundaries of the gram Panchayat. Second, the Annual Rateable Value (ARV) for levying property taxes was determined for each zone within each taluk. For example, houses or shops on land adjoining a state highway were far more valuable than any other area within the

same village. A committee at the taluk level supervised the physical survey (intermediate level). Members of the committee were either engineers or elected representatives of the GP. All dwelling units were categorized in three ways: (i) thatched; (ii) tiled; or (iii) RCC. Each category was further subdivided based on: (a) personal use or (b) commercial use. The Gram Panchayat could levy property taxes at a uniform rate up to a maximum of 10% of ARV.

Based on data for 176 taluks, the chief outcome of this exercise was an increase in the number of properties from 74.2 lakhs to 104.5 lakhs and a corresponding increase in the property tax collected from Rs. 37.86 crore to Rs. 86.25 crores.

10. As a result of initiatives by the Government of Karnataka to standardize property tax rates in rural areas, tax collection has gone up substantially and added much needed resources to the meager coffers of rural local bodies. The government of Karnataka is also an exception regarding funds transfer. Since 2003-04, the State Treasury credits the bank accounts of GPs in their respective villages. The availability of suitable banking arrangements has helped to facilitate this policy. The Department of Rural Development and Panchayati Raj has entered into Service Level Agreements with 18 banks. The State Government issues a single cheque from the "Repositor" bank account , then the funds get transferred by wire and are available to the GPs up to 12 days later. This process also prevents the potential diversion of funds at higher level PRIs. These simple initiatives have augmented the funds of rural local bodies, reduced the number of steps in the funds transfer process and given rural local bodies a measure of predictability. Other states could easily imitate Karnataka's initiatives.

The Way Ahead on Fund Flows

11. The flow of funds across the three tiers of PRIs should not be hierarchical, i.e. from ZP to TP to GP since each tier potentially becomes a bottleneck for the smooth and timely flow of funds to the next tier. Some States [such as Karnataka] have circumvented this route and demonstrated greater efficiency in fund flow. There has been a fair amount of debate about whether performance indicators should be introduced at the GP level in order to determine the quantum of funds that should be flowing to a particular GP. There are compelling arguments both for and against performance measurements or scorecards. While there are arguments that clearly lay out the points in favor of performance measurements, there are also arguments against such a system which point to the fact that GPs with better capacity will perform better, be rewarded and become stronger while the GPs with poorer capacity will languish. Since this is a philosophical debate, this Study has deliberately stayed away from this. However, notwithstanding this, some states have mentioned the need for performance based transfers as in Uttaranchal [the details of how this could be operationalized, as specified in the SFC Report are set out in Annex II] which may well create this system going forward. In addition, the Ministry of Panchayati Raj is considering setting up an Incentive Fund for states where aggregate levels of performance on key indicators are better.

VI. Budget Execution and Monitoring

1. As observed in earlier sections of this Report, bottom-up planning and budgeting by PRIs is still evolving. However, there has been a fair amount of progress in the monitoring and execution of public works at the local level. Elaborate mechanisms are in place to track physical progress and their corresponding expenditures across three tiers of the PRIs; accountability arrangements are well defined at each level. In its simplest form, the PS at the intermediate level controls the issuance of muster rolls to GPs. These muster rolls record attendance and document the payment of wages to workers on a project. They are numbered in advance, stamped for authentication, and valid for a seven-day period. Moreover, the number of names on each muster roll is limited. As a further check, the Junior Engineer of the PS corroborates this information.

2. In addition, at the State level, the Statistics Division of the Panchayati Raj/ Rural Development Department collates information on the financial and physical progress of public works based on monthly, quarterly and annual statements received from each district. Periodic meetings of the Accounts Officers of the ZPs and DRDAs at the State level supplement these reports and State officials visit PRIs on a random basis as well.

Box 9 shows the typical steps in the monitoring of public works projects across the PRI levels. The chart below shows the typical steps involved in the execution and parallel monitoring of development works which are executed at the GP level.

The Way Ahead on Budget Execution and Monitoring

3. Going forward, budget execution and monitoring will gain meaning if the budget represents an endorsement of the need for local development and is not simply an extrapolation of the previous year's numbers. Although the PRIs have procedures in place for these purposes, they have little meaning if budget and planning is top down rather than bottom up.

Furthermore, the states appear to be undermining the independence and sustainability of the PRIs by directly or indirectly controlling their funds, the projects they undertake and the lack of flexibility they have in executing them. Our conclusion is that monitoring and oversight of budget execution is relevant only if PRIs have the independence and the means to make their own decisions.

VII. Internal Control and Internal Audit

1. In general, the Panchayati Raj Acts and related Rules of most states have a tight set of internal controls for the use of resources, particularly those dealing with PRI funds. Key internal management controls are summarized in Box 10:

2. In practice, however, the SFAAs have documented that at the PRI level internal auditing is either non-existent or inadequate. It is pertinent to mention that since the early 1980's West Bengal has had a special cadre of internal auditors at all three-tiers of Panchayats;[12] the intent was to achieve accountability of PRIs for funds at their disposal. This arrangement is recognized as a best practice because it ensures that internal audits actually take place. However, this practice

[12] The Panchayat Audit and Accounts Officer conducts audits at the GP level. Meanwhile, the Sub-Divisional Audit and Accounts Officer and Parishad Audit and Accounts Officer, respectively conduct audits at the Panchayat Samiti and Zilla Parishad levels.

has also been criticized for conflicts of interest. Moreover, it compromises the independence of audit officers because they are officials of the Panchayats and Rural Development Department itself[13]. In certain states, such as Orissa, where DRDAs continue to coexist along with the ZPs, external CA firms empanelled with the CAG carry out these audits instead.

3. In addition to internal auditing, the controls within the PRIs' administrative processes need to be tightened. According to another Bank report, the Study Report on Accounting and Financial management Systems of Three Tier Panchayats in Kerala: "Panchayats at all three tiers do not implement internal controls in a diligent manner. The lack of reconciliation of local body accounts and Treasury books on a regular basis results in huge variances between book balances and the Panchayats' real balances. The frequent restrictions imposed on payments from the Treasury result in many Treasury checks not being honored. However, the Panchayats have already booked these checks as expenditures. This creates a mismatch between actual expenditures and book expenditures. Most of these checks tend to get revalidated, if the Treasury does not honor them within three months. This phenomenon of uncashed Treasury checks raises a control issue since the local body is not in a position to know the extent of its payment obligations on any specific day."

The Way Ahead on Internal Audit

4. It should be noted that we are not advocating a tight supervisory control by the state or any other oversight bodies. Rather we are suggesting that the PRIs should routinely structure their systems and procedures in a way that establishes accountability and oversight and to minimize fraud and embezzlement.

[13] In preparation for the DFID-funded SRD Programme, the Government of West Bengal is working on shifting the internal audit function out of the P&RD Department.

VIII. Accounting

1. PRIs at all levels are accounting units and that is mandated by Article 243J of the Constitution and reinforced by the states' PRI Acts and Rules.

2. Recently the Ministry of Finance and the EFC have vested the overarching responsibility for facilitating reliable accounts with the CAG of India. While the Ministry of Finance mandates that the CAG ensures proper accounting and auditing of funds related to centrally-sponsored schemes devolved to PRIs[14], the EFC recommended that the Technical Guidance and Supervision (TGS) of PRI accounts should be with the CAG as well.

3. Twenty two states have entrusted the TGS for rural local bodies to the CAG. To fulfil the TGS mandate, the CAG has prescribed accounting formats for PRIs, auditing standards, guidelines for certification audit, a list of codes for programmes, plus functions and activities.

4. With respect to accounting, the CAG has prescribed receipts and payment formats on a cash basis. These formats, 16 in total, provide for accompanying statements on demand and collections and assets that address critical aspects of accruals for PRIs. Similarly, cash-based budget formats are also prescribed.

5. The CAG's transaction classification system may be synchronised with the accounting codes of the Central and State governments; they also allow for major and minor headings. Several states have adopted the CAG's prescribed formats, subject to local variations. However, these same formats have been criticized as cumbersome and difficult to implement, particularly at the lowest tier of government because of their lack of capacity. The status of the adoption of CAG formats appears in Table 3.

Table 3

S. No.	Extent of Adoption[15]	States
1.	Formats adopted, printed and disseminated in local language; implementation commenced (6 States)	Bihar, Jharkhand, Karnataka, Kerala, Uttar Pradesh, Uttaranchal
2.	Modifications of State requirements agreed upon by the State AG and proposed for implementation in 2005-06 (12 States)	AP, Assam, Goa, Gujarat, Haryana, Himachal Pradesh, Maharashtra, MP, Orissa, Rajasthan, Tamil Nadu, Tripura
3.	Still in discussion with State AG (4 States)	Chattisgarh, Manipur, Punjab, West Bengal
4.	Little progress (2 States)	Arunachal Pradesh, Sikkim

6. In practice, accounts maintained by PRIs are inadequate in scope, timeliness and reliability. Accounting formats and accounting practices remain fragmented across states and PRI levels. Although Panchayats at all levels maintain cash accounts, district and intermediate level PRIs have greater capacity. Therefore, the quality and timeliness of their accounting is better than that of GPs.[16] The responsibility for maintaining accounts in higher level Panchayats lies with Accounts Officers. These officers come from a separate Subordinate Accounts Cadre of the State Administrative Service. At the GP level, accounting is the responsibility of the GP

[14] This mandate is only for the funds flowing to PRIs and not those flowing to the DRDAs.
[15] This status as of April 2005 is based on information provided by Director (Local Bodies) at the Office of the CAG.
[16] The situation in West Bengal seems to be different; the GP accounts fare better than the higher tier accounts based upon observations by the DFID team as part of their Post-design Strategic Study on Fiduciary Risk and Financial Management Issues of the SRD Program.

Secretaries or their equivalent. Usually these GP Secretaries are not trained in accounting, and yet, they are responsible for the maintenance of accounts for more than one GP. Consequently, the quality of their accounting suffers.

7. Accounts at the GP level tend to be simple, with limited diversity in the nature of transactions; the number of entries is low. Complexity increases, however, as one moves up the tiers, particularly at the district level where PRIs deal with more sources of funds [such as CSS, State, EFC, SFC, Line Departments]. The same complexity is true for the DRDAs which have legacy accounting systems.[17] PRIs do not adhere to any particular accounting standards. The accounting treatment accorded to various items of income and expenditures also varies across PRIs. In fact, the chart of accounts could vary across PRIs in the same State as well as across States. As a result, it is difficult to make any intra-state or inter-state comparison and analysis.

8. The lack of reliable financial information about the physical progress of public works projects, the existence and status of assets, and the cost of service delivery compound the lack of reality about budgets, the unpredictable flow of funds and the diffusion of accountability.

9. The Government of West Bengal has recently negotiated the implementation of the DFID-funded Strengthening Rural Decentralization (SRD) Programme. SRD plans several changes to the Accounts and Finance Rules, 2003. The goals are two: to introduce double-entry bookkeeping across the district and to intermediate level PRIs and to comply with the CAG's requirements. Similarly, in preparation for the Karnataka Panchayat and Service Delivery

[17] Detailed description of accounting procedures, books, and records maintained by DRDAs can be found in *Accounting Procedure for DRDAs/ Societies, 2001* issued by the MoRD.

Project[18] to be funded by the Bank, the Government of Karnataka has drawn up a new set of Accounting Rules applicable to Gram Panchayats. The Government proposes to implement these rules and at the same time enhance the GP's accounting capacity.

The Way Ahead on Accounting

10. These are constructive steps in the creation of reliable and timely accounts at the GP level; other states could emulate them. For these improvements to be sustainable, however, Gram Secretaries need to receive training and their numbers need to be commensurate with their responsibilities. With regards to the training to PRI accountants and auditors, there is evidence which points to the fact that CAG has done the first phase of training to trainers in 9 states for audit and the second stage of training to the lower tier accounts functionaries has been started in Bihar, Orissa, Kerala and Gujarat. In addition, if the public was aware that public officials are accountable for public monies, then they would demand better quality accounting and record keeping. Going forward, the states need to put in place structures and build human capacity to provide assurances that funds devolved to this level will be appropriately and comprehensively accounted for.

[18] the FM Assessment Report for the proposed project states that a fiduciary framework would be established to implement the new planning guidelines of Government of Karnataka (MTFP) in all GPs. A plan would be prepared at the beginning of every year to show how Block Grants would be used.

IX. Asset Management

1. The SFAA Synthesis study concluded "*all SFAAs point to asset management as a major weakness.*[19]" The same is true of PRIs. There are several reasons for this situation:

(i) The cash basis of accounting does not require the tracking of capital expenditures or the maintenance of detailed asset registers. Accounting Rules issued pursuant to the State Panchayat Acts [such as Rajasthan] require the maintenance of a Stock Register and a detailed log of vehicles owned by PRIs. However, PRIs do not follow these rules.
(ii) None of the reporting formats at any PRI level requires the disclosure of assets or community infrastructure. The only monitoring for public works projects is for centrally sponsored schemes. Reports to the Central Ministry of Rural Development are in aggregate numbers only by district and by type of project.
(iii) There is a lack of clarity on what constitutes an asset and who owns it. For example, streetlights, parks, storm water drains, etc. are not considered assets.
(iv) There is a fair amount of focus on budgets for new works, particularly works that are to be created from the funds of a particular scheme. Nevertheless, there is inadequate emphasis on safeguarding O&M's existing assets. PRIs' low-income base exacerbates the situation, so too does the unpredictability and the meager amount of unrestricted funds that they receive.
(v) Control on assets is weak; there is no verification of assets in annual audits. PRI external auditors are not required to carry out a physical verification of assets as part of their procedures.
(vi) There is no institutional mechanism to track assets. Despite the fact that the Panchayat leadership serves a five-year term, since there are no checks and balances to monitor creation, usage and maintenance of assets, there is no incentive for people in power to bring about better asset management.

2. Despite these weaknesses, some PRIs, particularly at the intermediate level, have taken the initiative to maintain asset records. These registers contain the location and cost details of all public works completed in that GP's jurisdiction. For example, Rajasthan's Panchayat Samiti Nimaheda in Zilla Chittorgarh is a showcase for accounting. Among other records, detailed asset registers exist for all GPs under this PS.

[19] Refer Page 13 of the SFAA Synthesis Report

The Way Ahead on Asset Management

3. Since PRI assets are created out of community resources, they should be properly inventorized, maintained and accounted for. The maintenance of simple asset registers is a basic tool for achieving this. It is pertinent to note that the accounting formats prescribed by the CAG (referred to in the section on Accounting) also include formats for maintenance of records of land, roads and building, etc. If implemented properly, these records would serve to establish a database of assets at the PRI level.

X. External Reporting and Transparency

1. The PRI Acts and Rules at the state level provide for the preparation of financial statements, such as the receipts and payments account. Reporting is entirely based on upward accountability. Each PRI tier submits financial and physical performance reports to the next higher tier on a monthly or quarterly basis, depending on the state. These reports are in addition to the PRIs' annual reports. The higher PRI tier, in turn, submits independent reports of its activities and flow of funds to the next tier. But there is no consolidation of financials at any level. Consequently, the extent of detail and the quality of information presented in the annual report varies significantly across states and within the same state.

In Rajasthan, the Panchayati Raj Department receives Quarterly Progress Reports (QPR) and Annual Progress Reports (APR) from all district and intermediate level PRIs; the QPRs and APRs from the GPs stay at the intermediate PS level. These are relatively simple statements that summarize each PRI's opening balances, receipts, expenditures and closing balances of each category of funds [such as CSS, State, EFC, SFC]. By comparison, in West Bengal, some districts publish a detailed annual report similar to annual reports by the Panchayats and Rural Development Department. These district reports give details about fund flows, activities, the status of audits, punitive action taken in response to complaints, progress in key CSS and State schemes, information about staff positions and computerization. In Maharashtra, the ZP accounts for the year ended March 31 are published in the Official Gazette by November 15th each year.

2. To strengthen accountability, the Central and State Governments have issued many directives to enhance transparency in the use of funds. However, at the local level, there is a lack of awareness among the rural population about large-scale release of funds by the Central Government and about various development and welfare schemes. Two fundamental tools which will help to improve this situation are giving the electorate a right to information and introducing social audits at the Gram Sabha level. Specific initiatives include:

- Introduction of the Right to Information Act by States,[20] such as Rajasthan, Karnataka and UP. This legislation grants every citizen the right to obtain copies of official documents by paying a small fee.
- Public display of GP accounts in many states (Karnataka, UP and Kerala amongst others)
- Televising the proceedings of the Belandur Gram Sabha near Chennai in Tamil Nadu, a positive step in transparency and accountability
- Encouraging women to participate in the Panchayat process; Vama Panchayats in Uttaranchal are an example.
- Kerala prescribes a daily public notice appears at the site of every public works project. This notice must list the names of workers and the wages they've earned, materials purchased with unit costs, quantities, transport charges and contingency expenses. The State Government has also required the construction of a large notice board, called the Vaarta Board, at the headquarters of every ward. These and other notices must be displayed or subsequent grants to the Panchayat are withheld.

[20] The following states have introduced the Right to Information legislation: Goa, Karnataka, Kerala, Madhya Pradesh, Maharashtra, Tamil Nadu and UP in addition to Rajasthan. A Right to Information Bill at the Centre, which applies only to the Central Government, is pending approval by Parliament.

- Citizen's charter in Andaman & Nicobar Islands specifies the responsibilities of each PRI tier towards its citizens. Citizens know what to expect from their rural local governments and can hold them accountable for non-performance.
- Jan Sunvai in Rajasthan (see Box 13)
- Jamabandi in Karnataka (see Box 14)
- A letter from the Union Minister in charge of Panchayati Raj congratulates Gram Panchayats on the devolution of powers. It assures them of funds and officials commensurate with their activities. The GoK published this letter in a Newsletter that was routinely issued to all Panchayats.(See Annex III)
- Some Panchayats like Howrah ZP in West Bengal routinely publish their accounts in a way that is available to the public. (See Annex IV)

Box -13: Jan Sunvai and the Right to Information campaign in Rajasthan[21]

The Mazdoor Kisan Shakti Sangathan (MKSS) is a peoples' organization that has used collective analysis and political action as a means of empowerment. MKSS pioneered the *jan sunvai* or public hearing for poor and exploited villagers to speak up and be heard. Public hearings demanding access to muster rolls, vouchers and records of bill payments of development projects at the Panchayat level have crystallized issues; they make tangible the abstract notion of transparency and the right to information. In public hearings, evidence of wrongdoing by Panchayat and village authorities, which auditors had overlooked, came before the community at large.

During the first public hearing in Kot Kirana (Pali district), muster rolls revealed that one-half of the names were fictitious. There were also several false bills. For example, records for a building at the site of the public hearing showed it to be complete. And yet, there were bills for doors, windows, roofing and finishing. Everyone at the hearing could see that not even the walls were in place. At another public hearing in Bhim's Rajsamand district on 7 December 1994, it was the same story. Bhairon Nath and Company had defrauded the block of Rs 37 lakh through false billing. And yet, government auditors had checked and cleared the company, but in fact, the company existed only on paper.

Today Rajasthan today has a Right to Information Act in place. Jan sunvais have been established to do a social audit of government's performance. Certain areas in Orissa now perform these audits and other parts of the country are planning to do likewise. The Rajasthan experiment culminated in social audits at the Panchayat level. There is no doubt about the practical impact these social audits have had in keeping a constant check on the government's performance and the ability of the people to demand accountability in the use of public funds.

3. In some states like Rajasthan social audits are mandatory. Reports indicate that Gram Sabha meetings have also been extremely effective in offering a public forum that serves the same purpose. The experience gained from the experiment on Jan Sunvais (Public Hearings) in Rajasthan [see Box 14] is instructive. The village movement for Jan Sunvais to fight corruption and mismanagement of funds has been quite effective.

Box 14: Recent Developments relating to Transparency and Social Accountability in Karnataka[22]

Jamabandi – is a form of social audit that now exists in Karnataka. The Executive Officer of the Taluk Panchayat appoints a senior officer to conduct a Jamabandi in the presence of all elected representatives from the respective Gram Panchayat and the public at large. The designated officer has to examine all activities undertaken by the Gram Panchayat during the previous year. If any member of the public wishes to examine pertinent records, he or she may do so and the Jamabandi will issue a report the next day.

[21] Aruna Roy, Nikhil Dey and Shanker Singh, Article, "*Demanding Accountability*"
[22] These changes came about in 2003 as a result of 47 amendments to the Karnataka Panchayati Raj Act. during 2003.

Ward Sabhas and Gram Sabhas – Ward Sabhas may forward various issues to the Gram Panchayat. The GP, in turn, may place the recommendations of all Ward Sabhas before the Gram Sabha. The Gram Sabhas have been statutorily empowered to make decisions on as many as 21 subjects. Gram Sabhas must conduct business four times a year and develop a specific agenda for each of them. Decisions by Gram Sabhas regarding the selection of beneficiaries are binding on all implementing agencies. Besides, Gram Sabhas may also generate proposals and determine the priority of all schemes and development programmes for implementation in the Panchayat area by the ZP or TP.

Karnataka Transparency Act and Right to Information Act - All PRIs are under the purview of these two Acts. The former requires the tendering of works over a specified limit; the latter gives the people the power to obtain copies of PRI official documents.

Disclosure of Assets and Liabilities - To ensure accountability, it is mandatory for elected members of ZP and TPs to furnish election expenses to the State Election Commission. Likewise, elected members of ZP and TP will have to submit details of their personal Assets and Liabilities annually or they will be disqualified. Several amendments to the Karnataka Panchayati Raj Act have transferred the Government's powers to the State Election Commission. These amendments set the Government apart from the PRI election process.

Ombudsman - The State has proposed an Ombudsman in each district. The Ombudsman would deal with complaints regarding mal-administration and corruption by the PRI. The Ombudsman will act as a fact finding and problem-solving body without the trappings of a court.

4. The Ministry of Rural Development (MoRD) has issued instructions which stipulate that the Gram Sabha should be empowered to conduct social audits of all public works and beneficiary-oriented programmes at the village level. These binding instructions also require that the Gram Sabha should award the completion certificate for all village level public works only after conducting social audit of the work in question. Most state governments have committed to this in principle, but they have yet to issue orders to put these social audits into operation.

Box 15: Other Good Practices in Institutionalising PFMA processes for External Reporting and Transparency

Rajasthan

The State Government recently announced the establishment of a Panchayati Raj Committee, modelled after the Public Accounts Committee, which would review the audit reports of PRIs. The leader of the opposition party in the State Assembly is likely to be the Chairperson of this body.

Orissa

To accelerate decentralization and participation beyond the Gram Sabha level, the Orissa Act provides for meetings of Palli Sabha. A Palli Sabha is made up of voters of a revenue village and presided over by Ward members. The GP convenes these meetings of the Palli Sabha. Palli Sabha makes decisions about the selection of beneficiaries, the preparation of these schemes, and the selection of Village Labour Leaders.

West Bengal

District Council

The "District Council for Panchayats" exists in each district; it includes the leader of the largest opposition party, the Additional Executive Officer of the ZP and other members elected by the ZP. The primary duties of the District Council are (i) to examine the accounts of the Panchayats within its jurisdiction and compare it *inter alia* to the budget they have approved as well as their annual reports and other books of accounts; (ii) to satisfy itself that money disbursed from these accounts was spent for the service or purpose it was allocated for; and (iii) to inject parliamentary democracy into village democratic institutions and build in an audit mechanism; the latter is consistent with the Public Accounts Committee.

Gram Unnayan Samiti (Village Development Council)
This is a new concept, which has yet to go into operation. However, the objective is to ensure active participation by the local people in carrying out an equitable distribution of benefits through rural development programs. The VDC will be accountable to the Gram Sansad.

The Way Ahead on External Reporting and Transparency

5. Going forward, it is important to increase the awareness of rural populations regarding the usage of public funds. People need to be familiar with the importance and procedures for social audits and their right to information and transparency. Adult-literacy programmes are one way to achieve that in places where they exist. NGOs and the local media may also be associated with this public education programme. It is only when the general public starts to hold public officials accountable that accountability takes hold.

XI. External Auditing

1. Sections 243 J through 243 Z of the Constitution mandates the annual audit of PRIs at all levels. According to State law, either the Director of Local Fund Audit or the CAG are nominated PRI auditors. Table 4 shows who holds the office of statutory Auditor to PRIs in different states.

Table 4

State	Audit arrangements[23]
Karnataka	Audit by CAG for first two tiers under section 19(3) of the DPC Act The Controller of State Accounts (Karnataka State Audit Department) audits the GPs
Kerala	Audit by Examiner of LFA DRDA Audit under section 14 of DPC Act
Maharashtra	Chief Auditor, Local Fund Account Maharashtra Also under Section 14 of CAG's Act where applicable
Orissa	Director Local Fund Audit for first two tiers of PRIs Test audit by State AG
Rajasthan	Director Local Fund Audit for all three tiers of PRIs Test audit by State AG
Tamilnadu	Director Local Fund Audit for first two tiers of PRIs GP audited by Deputy Block Development Officer Accounts monitored by Assistant Director of Rural Development (Audit) at the District level Audit of Zilla Parishad also u/s 14 of DPC Act
Uttar Pradesh	Audit by Director LFA and Chief Audit Officer, Cooperative Societies and Panchayats Audit of Zilla Parishad u/s 14 of DPC Act. All external auditing of PRIs comes under the CAG and staffed by the AG and Panchayati Raj Department[24]
Uttaranchal	Audit of ZPs, KPs and GPs conducted by Director, Treasury cum State Internal Auditor
West Bengal	Audit conducted by Examiner, Local Fund Accounts of IA&AD In addition audit of Zilla Parishad under section 14 of DPC Act

Source: Director – Local Bodies, CAG of India, April 2005

2. In addition to being appointed statutory PRI auditors in the states of West Bengal, Bihar and Jharkhand, the CAG has discretionary powers to audit PRIs based on the CAG Duties, Powers and Conditions of Service Act (DPC Act). In West Bengal, the auditing of PRIs comes under the Examiner of Local Accounts (ELA). This officer is part of the Finance Department and attached to the State AG.[25]

3. Pursuant to the TGS recommendations, described in the Accounting section, the CAG has prescribed an audit methodology and procedures for Local Fund Audit in the absence of statutory

[23] Note that of the States mentioned in this table, in the States of Kerala, Maharashtra, Tamil Nadu and Uttaranchal, the State AG also carried out a test audit of PRI accounts
[24] As stated in Chapter F of the UP SFAA.
[25] The ELA has completed 125 years of service.

auditors. The TGS also calls upon the CAG to train LFA staff, to vet programs and agencies that conduct programs where the CGA does not do the training, and to approve the LFA's audit plans. TGS guidelines require a follow up of audit findings. The AG is supposed to monitor the quality and timeliness of the audit.

4. While there are provisions for improving PRI audits, few improvements have taken place. In practice, PRI audits are a formality as many audit years are pending[26] and audit follow up is limited. PRI audits only address requirements for reporting audit findings to state governments. Originally the system was supposed to build in provisions for disallowance and punitive surcharges. However, that did not work out due to drawn-out recovery proceedings. As a result, PRI audits have no teeth.[27] Audits of ZPs and intermediate Panchayats are timelier than those of GPs in most states - with the exception of West Bengal. In West Bengal, 3,300 GPs out of 3,353 GPs were audited for the year 2003-2004. During transaction audits by CAG and the Ministry of Rural Development, DRDA accounts were found lacking in accuracy and scope.

5. Amongst the chief weaknesses of PRI audits is the lack of a mandate to publish annual performance reports or certified financial statements of PRIs. Moreover, the auditors never hear the public directly since their work is confined to a review of records. There is no statutory mandate to verify assets. The number of staff is inadequate to the task and qualified staff are lacking. As a result, the quality of the audit suffers.

6. Going forward, it is essential to strengthen the audit function, to build the capacity of auditors, to ensure a regular follow up of audit findings, to provide for publication of audit reports and to reinstate punitive measures for fraud and defalcation.

7. LFA statutory auditors should be independent of state governments. Auditing standards and certification guidelines should be revised to suit local contexts. Based on the recommendations of the Twelfth Finance Commission, officials of the Panchayati Raj Department should not be statutory auditors of the village Panchayats.[28] Accounts of the intermediate and district Panchayats should be audited by the CAG[29] to enhance transparency and strengthen the audit function.

8. To ensure that PRI accounts accurately present financial position, the CAG has prescribed *'Guidelines for Certification Audit of PRIs' as* part of the TGS. During the test check performed by the State AG, it should be determined whether the DLFA has followed the guidelines and the certification has been done properly. That would improve the quality of work by the primary auditors and inject greater accountability.

The Way Ahead on External Audits

9. Some of the resolutions adopted by the VIth MoPR Round Tables (in Box 18 below) sum up the Government's views on the future of PRI audits. These resolutions address what the

[26] For example, there are nearly 4,000 audit years pending at the GP level in Rajasthan. Further, in the case of completed audits, approximately one million LFA audit paras are outstanding. In Karnataka, for the year 2002-03, audits of 500 GPs are pending and for the year 2003-04, all GPs are pending audit. In Uttaranchal, for the year 2002-03, , audits of 1,000 GPs, 93 KPs and 12 ZPs are pending.

[27] For example, in the State of Bihar between 1991 and 2002, , the Examiner LAD issued 1,116 surcharge notices totaling Rs. 4.62 crores. Similarly, during the same period, the LAD in Jharkhand issued 397 notices totaling Rs. 2.31 crs. However, the surcharge has failed as a deterrent to delinquent officials due to abysmally poor recoveries, which were less than 10 %.

[28] In Tamil Nadu, the Deputy Block Development Officer is in charge of PRI audits even though he is a functionary under the state government directly responsible for implementing development programmes.

[29] This recommendation appears in para 8.19. It summarizes best practices recommended by the National Institute of Rural Development (NIRD). The NIRD was commissioned to study the innovations/ best practices adopted by different states to augment PRI resources.

Government [at the Centre and the States] and the office of the CAG consider key to enhancing the quality of PRI audits. Some of these improvements appear in the preceding paragraphs; others are summarized in Box 18.

Box 18: The Future of PRI Accountability suggested by the MoPR's VIth Round Table

Since PRIs are regarded the third tier of government, the following actions should be considered to strengthen their accountability:

1. To ensure the audit is efficient and does what it is supposed to do, there should be standards for these audits and input from the PRIs. The focus of these standards should be fund management and tracking, not the flow of funds. These standards should be elementary, simple and comprehensible to elected representatives, and should focus on:

    a. When transactions should be examined;
    b. What should be monitored;
    c. How transactions should be documented; and
    d. How they should be disclosed

    For auditing to be effective, a National Accounting Standards Board (NASB) should be established for local government accounts. This Board should complement the establishment of audit commissions or similar regulatory bodies at the State level.

2. A system of internal audit should be set up.
3. Public Accounts Committees (PACs) specific to PRIs should also be set up. Alternatively, PRI accounts should be submitted to PR Committees of the State Legislatures. State level committees to settle audit paras is also an option; Andhra Pradesh is one example.
4. PRI staffing capacity and their audit offices should be expanded, staffing constraints removed.
5. Social audits and other social accountability mechanisms should be encouraged. These mechanisms should exist not only at the GP level but also at higher levels. There also needs to be adequate provision for follow up and public disclosure of audit findings.
6. Those states, which have not yet adopted the Technical Support Guidelines of the CAG, should consider doing so.

XII. Some Cross-Cutting Issues

Issue	Comments
1. Maze of CSS and State- sponsored schemes tend to confuse accountability	• Routing the flow of funds to PRIs and banking arrangements vary according to the source of funds and their purpose. These aspects also vary across states. For example, CSS funds typically move from MoRD to DRDA accounts, then to the three respective tiers of PRIs, based on a pre-determined formula. In the SGRY, the formula is 20% ZP: 30% PS: 50% GP. That particular scheme offers a treasury route, and in some cases, a commercial bank route. In Rajasthan, the ZP receives these funds directly. Then they move sequentially to the PS and next to the GP. • The total number of CSS and state schemes runs into several hundred. Many of them require the maintenance of separate bank accounts at the GP level [eg. SGRY, PMGSY, IAY] and the submission of separate audited utilization certificates (UC). • In a sense, these UCs are issued and audited in isolation of entity accounts; they are often submitted on a provisional basis, particularly at year-end, to comply with requirements for drawing the second installment under the CSS even though expenditures may not have been incurred. • Because there are so many sources of funds, fund flow routes, banking arrangements, and uses of funds as well as varying requirements by different Central/ State schemes, accountability arrangements are compromised and complex. This state of affairs adversely affects fiduciary assurance obtained from FM [refer the chart in Section VI for details]. • The example quoted from the CAG report in the Orissa SFAA and reproduced here is a case in point. This chart shows that only 38% of expenditures [of the expenditure test checked] by SGSY in Orissa were incurred for the programme; the balance was irregular in one way or another. • In 2004, the Government of Karnataka issued a series of Orders to rationalize the number of schemes and to ensure the direct transfer of funds to the appropriate PRI tier that will carry it out. When fully implemented, these practices will enhance the level of assurance from the PRIs' FM arrangements.

Issue	Comments
2. Externally-Aided projects have tended to ring-fence FM arrangements by establishing parallel bodies	*"In the Externally Aided Projects (EAP) the involvement of `community` and `participation of people`, where included in its design, is conceptualized through engagement of NGOs funded through the project. Thus, the entire apparatus of PRIs elected democratically by the people having a Constitutional mandate about their existence and legitimacy about powers they should exercise in respect of certain subjects lies unused. The EAPs do not trust them and are therefore deprived of vast space, support and cooperation which otherwise could have been available for the benefit of the projects. Even the involvement of NGOs funded through the project is not brought within the ambit of transparency and accountability to the community through appropriate linkages with the PRIs.*[30]. • The Central and state governments have expressed concern about the benefits of the PFM practice of bypassing PRIs when it comes to EAPs [including Bank projects such as DPEP/ DPIP] • The Government of Karnataka issued an Order in October 2004 whereby PRIs would implement all future EAPs within their own jurisdiction. • The Bank and other donors accept this position; DFID's SRD project in West Bengal and the Bank's Service Delivery Project in Karnataka are examples of working through PRIs. In those cases, state government have agreed to address the donors' specific action points concerning fiduciary assurance and those which promote the best PFM practices at the PRI level.
3. Steps initiated by some states to set up databases to create and track information for upward reporting	• The EFC had set aside Rs. 200 crores to set up a computerized database of Panchayat finances at the district, state and Central Government levels. Allocations come from the state and were based on the number of urban and local bodies. This database was to have satellite connectivity and is to be a reliable source of data for PRI revenues and expenditures. The CAG established the formats for data collection. This initiative stems from the state's own e-Governance initiatives and the need to comply with the CAGs new accounting and budget formats (refer to point 4 below). Some states have made significant progress in this area. Key steps have been to provide computer hardware to the PRIs, satellite connectivity at the State level and customized accounting/ MIS software. These databases enhance accountability by facilitating (i) tracking the flow of funds across all PRI tiers in real time (ii) compiling actual project expenditures (iii) monitoring the physical progress of development works, and (iv) setting up a citizen's section on the website so the public can check on the status of funds transferred to their villages and lodge e-mail/ voice complaints • Orissa has been fairly successful in its pilot run of Priasoft, Ruralsoft and PAMIS • West Bengal is implementing IFMAS and GPMS for accounting plus service delivery software such as CCMS and COSA • The Rajasthan Government has recently approved the CARISMA project, which has similar elements of hardware, software, and inter-connectivity.

[30] Abstract from Chapter 5 of the Report of the Task Force on PRIs, December 2001.

Issue	Comments
4. Initiatives taken by the CAG aim to achieve harmony among accounting, financial reporting and auditing across the country	• Pursuant to the recommendations of the EFC in 2001, the CAG has undertaken several initiatives aimed to standardize and improve the PFMA arrangements of PRIs: - 22 states have entrusted to the CAG technical guidance and supervision (TGS) functions account maintenance and auditing all three PRI tiers of PRIs-CAG has approved the parameters in five states for engaging outside agencies to clear arrears in the preparation of accounts - To achieve uniformity, 16 accounts and budget formats are in place for receipts and payments with appendices for assets created, accrued income/ expenditures, etc. 18 states have accepted the formats with some modifications. - Nine states have conducted the first phase of train-the-trainer programs to upgrade the skills of the local fund audit department.
5. Current accounting practices are cash book centric; they track transfers of funds and aggregate expenditures only.	• PRIs follow the cash basis of accounting which centers around the maintenance of a cashbook and bank records. In some cases, separate bank accounts exist for individual schemes, such as SGRY expenditures. However, in the absence of double entry, accrual accounting, there is limited information about the assets created, settlement of advances, and the compilation of expenditures on an activity-by-activity basis. • As such, current FM arrangements make it difficult to calculate the cost of services. • West Bengal is somewhat different. IFMAS and GPMS are based on a double-entry system of accounts; ledgers are based on a set of master account codes defined and modified at the sub-account level. From a PFMA perspective, this software has useful features such as daily bank reconciliations.
Lack of PRI Capacity	• PRIs, particularly GPs, are severely constrained by limited capacity to meet their mandate as rural local governments. Consequently, they must fulfill their accountability obligations with inadequate staff and staff that are insufficiently trained. For example, in Uttaranchal, one Secretary is allocated to five or six GPs. It is the responsibility of this person to maintain the account books. A Bank study documented that the GP Secretaries take their account books with them in their bags. In their absence, even routine activities like writing cheques get delayed. • The executive management structure of GPs fails to ensure that trained staff are in place and that all positions are filled. Traditionally, GPs do not hold elected representatives accountable for explaining the use of public funds to their constituents. The chart in Annex V shows the typical administrative arrangements for GPs.

XIII. In Conclusion

In conclusion, it is appropriate to acknowledge that while PRI accountability systems have many weaknesses that need to be corrected, incremental steps to improve systems and processes are being taken. GoI's Round tables, CAG (TGS), successive Finance Commissions as well as civil society representatives have made a case for improvements in accounting, strengthening the audit function, building capacity of PRI accountants and auditors and bringing about a culture of transparency. The other constituents of PFMA like internal control, asset management, budget preparation, execution and management also require attention.

Some key action steps that evolving PFMA systems in PRIs should consider including are set out below:

1. Devolution in principle should be followed by practical steps for the devolution of funds, functions and functionaries. This has not been done in many states (amongst which are West Bengal and Orissa which are covered in this study). In addition, the framework for devolution should take account of the fact that the three tiers of PRIs were constitutionally meant to be lateral bodies and not hierarchical ones. This is especially pertinent to the route of funds flows that is used by most state governments where funds flow hierarchically from one level of PRI to another creating incentives for bottlenecking of funds for 'release money'. This study documents some good practice examples where funds are being transferred directly to all tiers of PRIs from state governments. This practice could be emulated by other states. GoI is also considering the use of commercial banks for transfers across different levels of PRIs for Centrally Sponsored Schemes going forward. Homogeneity in policy and practice across the Centre and States on this would make for speedy transfers, better cash management and economies of scale (viz lower banking charges and lower transaction costs).

2. The budgeting and budget execution functions are dependent on the quantum and timeliness of funds flowing to PRIs. In evaluating budgeting and budget execution, we should draw a distinction between the three tiers of PRIs. The District and Intermediary PRIs are mandated tasks that are usually extensions of the functions of the state government and the flow of funds to these levels is relatively smooth. In addition, since these two tiers normally do not carry out development works directly and so, they are not severely affected by funds flow problems. Since the mandate for development is with the village panchayats and their own revenues are low, they are dependent on funds flowing down from the state and central government. The timing and the quantum of these funds varies by source and intended usage (as was shown by the Chart on Page 20). In addition, as funds are mostly transferred hierarchically from one tier of government to the next, this results in bottlenecks and delays. Therefore, the budgeting exercise done by village panchayats is an exercise in extrapolation while budget execution tends to be a cash management exercise. Going forward, it is important to ensure that timely transfers are made directly to the level that they are meant for. This would help the village panchayats plan their expenditures and monitor budgets and they could then be held to account for works or services that they have committed to undertake in a particular period.

3. Since timely, accurate and reliable financial reports are the basis of accountability to civil society for usage of public funds, the accounting function in the context of PRIs needs attention. While the requirements for maintenance of accurate and timely accounts are

set out in the PRI Acts and Rules, practices across different levels of PRIs and across different states vary. While at the District and Intermediate levels, there is often good accounting capacity, the village level panchayats often have little capacity and inadequate guidance regarding the preparation of accounts. There have been movements to strengthen this function with the CAG having introduced accounting formats and both the TFC and EFC having stressed the requirements for accurate and timely accounts. However, much remains to be done, to strengthen accounting capacity at the village level, to ensure that the Gram Secretaries who are responsible for accounting are trained and that the formats used for accounting are appropriate to the transactions at that level. It is pertinent to note that some states like Karnataka and West Bengal are considering switching from the cash basis to accrual basis of accounting at the village level. While this is a good initiative, there should be careful consideration of whether this is supported by capacity at that level. In addition, the nodal and guidance providing bodies like the CAG should consider these movements and work to ensure that there is homogeneity in accounting across particular levels of PRIs throughout the country. The accounting function should also take account of the need to maintain, depreciate and provide for assets, particularly at the GP level.

4. A vibrant control environment is important to a well functioning PFMA system. As stated in Section VIII, there are comprehensive rules and regulations with respect to the controls that should be in place but practices are weak. While there cannot be a prescription for good internal controls, certain practices like strong internal audit and mechanisms of social accountability reinforce the control framework. So, state governments and PRIs should work to ensure that people are aware of their rights and demand accountability from elected representatives and that internal audit is a useful exercise which helps the systems and processes within PRIs to function appropriately.

5. The external audit function serves the role of independent scrutiny and attestation and therefore could serve as an important means of assurance. Amongst the main weaknesses of PRI audit are the poor quality of audits, no mandate to publish audited accounts or certified financial statements, no statutory mandate to verify assets and lack of technical capacity in audit staff. The CAG has taken steps to strengthen the process and quality of audits through its TGS mandate. But the capacity of LF Auditors remains weak, their processes are archaic and the backlogs in audit make the function lose much of its validity as an assurance function. The training of all audit staff (both those belonging to AG offices and LFA) are imperative to improve the quality of audits and audited accounts. The "Terms of Reference" or the mandates of the auditors at all levels should be revisited to include the function for attesting financial statements, verifying assets and making it mandatory for the audited accounts to be published.

The actions laid out in the preceding paragraphs are some of the very basic steps that could be taken to bring about an improvement in PFMA systems of PRI institutions to enable them to handle their responsibilities as rural local governments. The eventual destination for PRIs is best enunciated in the words of Mahatma Gandhi, ***"The Panchayat shall have all the authority and jurisdiction required. Panchayats will be the legislature, judiciary and executive combined to operate for its year of office. There is perfect democracy based upon individual freedom. The individual is the architect of his own government. My idea of village swaraj is that it is a complete republic....."***

ANNEX I

REVENUES & EXPENDITURES OF PRIs IN THE FOCUS STATES[31]

(Rs. Crore)

State	Item	1998-99	1999-00	2000-01	2001-02	2002-03
Karnataka	Revenue					
	Own Tax	51.61	57.27	66.83	52.36	59.46
	Own Non-tax	0.00	0.00	0.00	0.00	0.00
	Total Own Revenue	51.61	57.27	66.83	52.36	59.46
	Assignment+Devolution	3,318.96	4,321.52	4,651.13	4,321.15	4,243.57
	Grants-in-aid	0.00	0.00	0.00	0.00	0.00
	Others	0.00	0.00	0.00	0.00	0.00
	Total Other Revenue	3,318.96	4,321.52	4,651.13	4,321.15	4,243.57
	Total Revenue	**3370.57**	**4,378.79**	**4,717.97**	**4,373.51**	**4,303.03**
	Expenditures					
	Revenue Expenditures	2,519.42	3,634.34	4,041.57	3,666.88	3,525.80
	Capital Expenditures	570.48	543.67	480.89	535.55	570.08
	Total Expenditures	**3,089.89**	**4,178.00**	**4,522.57**	**4,202.43**	**4,095.89**
Orissa	Revenue					
	Own Tax	0.48	0.45	0.48	0.48	0.21
	Own Non-tax	8.75	8.21	8.58	8.33	5.30
	Total Own Revenue	9.23	8.66	9.06	8.81	5.51
	Assignment+Devolution	75.62	56.49	64.99	65.19	82.07
	Grants-in-aid	85.94	153.16	41.86	61.90	100.26
	Others	0.00	0.00	0.00	0.00	0.00
	Total Other Revenue	161.56	209.65	106.85	127.10	182.33
	Total Revenue	**170.79**	**218.31**	**115.91**	**135.90**	**187.84**
	Expenditures					
	Revenue Expenditures	120.79	100.81	115.91	135.90	135.51
	Capital Expenditures	50.00	117.50	0.00	0.00	46.82
	Total Expenditures	**170.79**	**218.31**	**115.91**	**135.90**	**182.33**
Rajasthan	Revenue					
	Own Tax	3.04	4.70	4.75	4.79	4.84
	Own Non-tax	28.77	31.92	32.15	32.35	32.84
	Total Own Revenue	31.81	36.62	36.89	37.14	37.68
	Assignment+Devolution	59.50	77.67	81.24	92.51	93.87
	Grants-in-aid	887.20	1,022.70	949.93	1,079.62	1,052.66
	Others	542.64	541.98	569.08	597.54	627.42
	Total Other Revenue	1,489.34	1,642.35	1,600.26	1,769.67	1,773.94
	Total Revenue	**1,521.14**	**1,678.97**	**1,637.15**	**1,806.81**	**1,811.63**
	Expenditures	638.59	827.60	896.11	923.52	996.73
	Revenue Expenditures	700.55	753.50	669.23	707.85	739.96
	Capital Expenditures	**1,339.14**	**1,581.10**	**1,565.34**	**1,631.38**	**1,736.69**

[31] This information has been collated from Annexure 8.8 referred to in para 8.25 of the Report of the Twelfth Finance Commission. It may be noted that the purpose of this table is not to establish inter-state comparisons. This table is presented to give the reader a flavor of the break up of the quantum of Panchayat finances in every state as per GoI's latest available data when this report was written.

State	Item	1998-99	1999-00	2000-01	2001-02	2002-03
	Total Expenditures					
UP	Revenue					
	Own Tax	9.43	11.51	11.68	10.87	11.02
	Own Non-tax	36.95	41.79	47.15	48.39	52.15
	Total Own Revenue	46.38	53.30	58.83	59.26	63.17
	Assignment+Devolution	253.90	270.58	319.08	348.04	382.24
	Grants-in-aid	15.35	0.14	1.16	0.41	61.09
	Others	87.83	178.27	233.43	233.43	116.71
	Total Other Revenue	357.08	448.99	553.67	581.88	560.04
	Total Revenue	**403.46**	**502.29**	**612.50**	**641.14**	**623.21**
	Expenditures					
	Revenue Expenditures	72.56	74.49	99.10	78.35	64.76
	Capital Expenditures	327.40	506.22	518.98	354.97	530.04
	Total Expenditures	**399.96**	**580.71**	**618.08**	**433.32**	**594.80**
Uttaranchal	Revenue					
	Own Tax	0.74	0.79	0.84	0.88	0.92
	Own Non-tax	3.95	4.36	4.03	4.02	5.18
	Total Own Revenue	4.69	5.15	4.87	4.89	6.10
	Assignment+Devolution	15.61	20.93	15.81	6.37	6.37
	Grants-in-aid	2.95	1.79	1.25	1.04	3.24
	Others	43.55	33.33	10.21	10.96	45.67
	Total Other Revenue	62.11	56.05	27.27	18.38	55.28
	Total Revenue	**66.80**	**61.20**	**32.14**	**23.27**	**61.38**
	Expenditure					
	Revenue Expenditures	33.31	39.37	18.42	31.93	9.70
	Capital Expenditures	20.67	23.39	12.71	14.73	20.12
	Total Expenditures	**53.98**	**62.76**	**31.30**	**46.66**	**29.82**
West Bengal	Revenue					
	Own Tax	6.82	6.86	9.00	9.57	9.87
	Own Non-tax	22.22	22.76	23.53	24.04	21.39
	Total Own Revenue	29.04	29.62	32.53	33.61	31.27
	Assignment+Devolution	4.15	0.40	5.02	12.74	0.00
	Grants-in-aid	137.95	254.97	579.65	412.95	145.96
	Others	0.80	0.80	0.84	0.88	0.00
	Total Other Revenue	142.90	256.17	585.51	426.58	145.96
	Total Revenue	**171.94**	**285.79**	**618.05**	**460.18**	**177.23**
	Expenditures					
	Revenue Expenditures	171.94	285.79	618.05	460.18	177.23
	Capital Expenditures	0.00	0.00	0.00	0.00	0.00
	Total Expenditures	**171.94**	**285.79**	**618.05**	**460.18**	**177.23**

Note: It is interesting that in some states total expenditures are exactly the same as the reported total revenue [Orissa and West Bengal].

ANNEX II

ILLUSTRATION OF INCENTIVE BASED TRANSFER OF FUNDS PURSUANT TO SFC RECOMMENDATIONS (UTTARANCHAL)

Each SFC prescribes a separate formula or basis for the devolution of funds to the PRIs taking into consideration the funds available for devolution in the State and the specific circumstances of the State concerned. For example, in Uttaranchal, the Report of the First SFC specifies the following Devolution Scheme:

Gram Panchayats

(i) All GP would be classified into only 5 classes based on the distance of the headquarters of their respective blocks from the nearest railhead.

(ii) The devolution would be made in rounded per capita terms.

(iii) The per capita entitlement of the GPs would remain unchanged as long as the State's gross tax revenues trends from year to year remained within a range of 25%. The GPs entitlement would change in multiples of 25% at a time, and such a change would materialize only in the year following a cumulative change in State revenues by +/- 25%.

(iv) The quantum of amount devolved would be calculated at a rate varying from Rs. 30 – 90 per capita, based on 2001 Census, varying according to the 5 classes.

Kshettra Panchayats

The SFC has recommended an annual grant-in-aid of Rs. 3 lakhs each per annum to those KPs with Census 2001 population up to 50,000 (45 in number) and a grant-in-aid of Rs. 5 lakhs each to those KPs which have more than 50,000 population (50 in number).

Zilla Panchayats

The SFC has recommended that all ZPs should be classified into 5 classes similar to the classes for GPs based on the distance from the nearest railhead. The devolution would be made in rounded per capita terms which would remain unchanged as long as State gross tax revenues trends from year to year remained within a range of 25%. The entitlement would change in multiples of 25% at a time, and such a change would materialize only in the year, following a cumulative change of State revenues by +/- 25%.

But rapidly, within two years, a responsibility has to be cast on the ZPs to substantially raise their own resources. Thus, while recommending devolution, the Commission also recommends that in a year, initially 70% of entitled amount be released to each ZP; the release of the remaining 30% must be linked to the financial and democratic good performance of each ZP to be judged, as per the following criteria:

Financial performance: Four sets of indicators would be adopted as follows

(i) C&P Tax, as per norms adopted for the resource forecasts

(ii) Non-tax revenues to achieve a minimum growth rate of 5% per annum

(iii) Clearance of tax and non-tax arrears

(iv) Closing the shortfall between present level of own resource generation and Rs.10 per capita within two years, i.e. 2002-03 and 2003-04.

The entitlement to the release of 15% for financial performance would be determined by a State Level Monitoring Committee chaired by the Finance Secretary to Government.

Democratic good performance: Progress towards more democratic and efficient working of the institution (15%), as judged by

(i) Frequency and quality of proceedings of formal meetings of the ZP, and its Committees
(ii) Financial record-keeping, budget quality and clarity of content, timely decisions, and particularly adherence to approval processes for incurring expenditure
(iii) Grading achieved in audit reports, and timely placement of reports before the ZP for discussion and reply.

The entitlement to the release of 15% for institutional/democratic performance will be determined by the Commissioner of the Division, whose findings would be sent to the State Level Monitoring Committee for the release of these funds.

In the case of non-performing ZPs, 30% of the amount due for transfer will be withheld and kept separately in an account to be released in the year in which the performance level reaches the desired norms.

ANNEX III

LETTER FROM UNION PANCHYATI RAJ MINISTER CONGRATULATING PANCHAYATS ON THE DEVLOUTION OF POWERS TO THEM IN KARANATAKA

ಕರ್ನಾಟಕ ವಿಕಾಸ

ಡಿಸೆಂಬರ್ ೨೦೦೪

D.O. No. ...M.(PR)/VIP/2004

मणि शंकर अय्यर
MANI SHANKAR AIYAR

मंत्री
पेट्रोलियम एवं प्राकृतिक गैस और
पंचायती राज
भारत सरकार
नई दिल्ली-110 001
Minister
Petroleum & Natural Gas and
Panchayati Raj
Government of India
New Delhi 110 001

17 November 2004

You are aware of the Union Government's commitment to a time-bound programme for effective devolution to Panchayat Raj institutions keeping in mind the true letter and spirit of the 73rd amendment of the Constitution. You would recall that the Honourable Prime Minister, while addressing the Chief Minister's Conference on poverty Alleviation and Rural prosperity through panchayati raj at New Delhi on 29-6-2004 exhorted the Chief Ministers to play a visionary role in the empowerment of the Panchayati Raj Institutions (PRIs). I was touched and impressed by your forthright speech on that occasion and was assured that devolution to PRIs in Karnataka is in safe hands under your able and farsighted leadership.

In my opinion, the trigger for true devolution is role clarity, which can only be brought out by a clear activity mapping between three tiers of PRIs, which clearly states out their roles and responsibilities with respect to functions devoted to them. I was happy to note in the Round Table Conference that karnataka happens to be the only State that has taken steps to issue an activity mapping framework in accordance with the framework circulated by the GOI. However, activity mapping is only the trigger for further changes. In order to bring true meaning to activity mapping, schemes will have to be transferred to the PRIs. Heads of accounts and line items in the budget will have also to stand transferred to the appropriate PR tier.

I am now given to understand that Karnataka has in mid-october 2004 passed a far-reaching order that has effectively operationalised the activity mapping that was issued by it last year. I am deeply impressed by the fact that Karnataka has completed this task by transferring almost 176 schemes, which total to around Rs. 1887.23 crores of funds from the State Sector to the District Sector. To my mind, there can be no greater action than this, which displays your total commitment to panchayati raj.

I would like to place on record my heartfelt congratulations for taking this step. Karnataka has always led the country in innovations and today you again stand before the entire nation as an example for effective devolution. I intend to use the example of Karnataka to all other states to show that indeed such far-reaching steps are desirable and possible.

I Thank you once again.

Yours sincerely

Shri Dharam Singh
Chief Minister
Government Of Karnataka
Vidhana Soudha
Bangalore.

201-ए शास्त्री भवन, नई दिल्ली-110 001 दूरभाष : 011-2338 14 62, 2338 66 22 फैक्स : 011-2338 61 18
201-A Shastri Bhawan, New Delhi-110 001 Tele : 011-2338 14 62, 2338 66 22 Fax : 011-2338 61 18

ANNEX IV

ANNUAL REPORT OF HOWRAH ZP IN WEST BENGAL

হাওড়া জিলা সংসদ

বাৎসরিক অধিবেশন

তারিখ ১৩ই আগষ্ট, ২০০৪
বেলা ১০ ঘটিকা
স্থান ঃ- শরৎ সদন (১নং কক্ষ)
হাওড়া

হাওড়া জিলা পরিষদ

জিলা ঃ হাওড়া

ANNEX V

ADMINISTRATIVE STRUCTURE OF A GP

[Source: Decentralization Report, World Bank]

ANNEX VI

LIST OF PEOPLE MET OR SPOKEN TO

alphabetically listed S. No.	Name	Position	Department/ Office/ Organization
1.	**Aniruddha Chatterjee**	Manager	CMIE, West Bengal
2.	**Arvind Deewan**	Accounts Officer	Department of Panchayati Raj, Government of Rajasthan
3.	**Ashutosh Dikshit**	Private Secretary to Minister of Petroleum and Panchayati Raj	Ministry of Panchayati Raj
4.	**BG Madappa**	Consultant to Government of Karnataka	ANSIRD, Mysore
5.	**BP Yadav**	Senior Deputy Accountant General	Office of Principal Accountant General (Audit), Rajasthan
6.	**Dilip Ghosh**	Joint Secretary	Panchayats & Rural Development Department, Government of West Bengal
7.	**George Cherian**	Director	CUTS, Jaipur, Rajasthan
8.	**George Mathew**	Director	Institute for Social Sciences
9.	**M Govind Rao**	Director	NIPFP
10.	**M Pran Konchady**	Chief Controller of Accounts	**Ministry of Rural Development,** GoI
11.	**Madhu Pokhran**	Director, CSS	Department of Rural Development, Government of Rajasthan
12.	**Manoj Rai**	Head, PRI Program	PRIA
13.	**MK Khanna**	Principal Secretary	Department of Panchayati Raj, Government of Rajasthan
14.	**NK Mishra**	Deputy Controller of Accounts	Ministry of Rural Development, GoI
15.	**Nikhil Dey**	Secretary	MKSS, Rajsamand, Rajasthan
16.	**PK Jha**	CEO	Zilla Parishad Chittorgarh
17.	**PN Vijayvarghi**	Chief Accounts Officer	Department of Panchayati Raj, Government of Rajasthan
18.	**Rajesh Bhardwaj**	Project Director & Joint Director (SIRD)	Indira Gandhi Panchayati Raj & Gramin Vikas Sansthan (IGPRS)
19.	**Rajesh Singh**	Director, Local Bodies	CAG
20.	**RN Dash**	Director, Special Projects	Panchayati Raj Department, Government of Orissa
21.	**RN Ghosh**	Principal Director, Local Bodies	CAG
22.	**Sitaram Chaudhari**	Junior Accountant	Panchayat Samiti Nemahera, Chittorgarh, Rajasthan
23.	**SK Mathur**	Director	National Institute of Financial Management

24.	**Soma Roy Burman**	Director	Government Accounting Standards Advisory Board (GASAB)
25.	**Sudha Pillai**	Additional Secretary	Ministry of Panchayati Raj, GoI
26.	**Suneela Ajmera**	Director	LFA Department, Department of Finance, Government of Rajasthan
27.	**Srinivasan Aiyer**	Team Leader	DFID
28.	**Swapneshwar Baya**	Commissioner-cum-Secretary	Panchayati Raj Department, Government of Orissa
29.	**TR Raghunandan**	Joint Secretary	Ministry of Panchayati Raj, GoI
30.	**Vivek Khanna**	Centre Coordinator	CUTS-CHD, Chittorgarh, Rajasthan

ANNEX VII

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2. www.Panchayat.nic.in
3. www.wbprd.wb.nic.in
4. http://orissagov.nic.in/Panchayat
5. www.planningcommission.nic.in
6. www.rural.nic.in
7. www.righttoinformation.org
8. www.priasoft.nic.in

V. Videos

1. Movie on Right to Information Campaign in Rajasthan, 2000