

Action Taken Report on the Recommendations of the 3rd Kerala State Finance Commission

Devolution of State Tax Revenues to LSGs (Chapter 6)

Recommendation - 14. 1

During the financial year 2006-2007, an amount of Rs. 2050 crore may be transferred to Local Self Governments, as their share of State tax revenues. Out of this amount, Rs. 300 crore will be for expenditure on their traditional functions, Rs. 350 crore for expenditure on maintenance of assets and Rs. 1400 crore for expenditure on developing and expanding services and institutions transferred to them by the State Government. During each of the four subsequent years, amounts derived by applying annual growth of ten percent may be so transferred. The total amount to be so transferred during the five years 2006-07 to 2010-11 will be Rs.12515 cr.

Action Taken

The recommendation is accepted. Any NABARD allocation will be over and above this allocation.

As to whether the amounts to be devolved will include the Local Bodies Grant received by the Govt of Kerala from Govt of India under the XII Finance Commission Recommendations, till a directive to the contrary is received from the Ministry of Finance, Govt of India, the amount being devolved will be considered as inclusive of the XII FC grants (which is the practice being followed for the past 5 years).

In case there is a serious resources problem, the procedure suggested by the 3rd SFC vide their recommendation at Para 9.14 will be followed.

Recommendation - 14. 2

Funds meant for expenditure on traditional functions and maintenance (eg. Rs. 300 crore and Rs. 350 crore respectively in 2006-07) will be distributed among the LSGs following the same ratios as applied to the distribution of 3.5% and 5.5 % of State tax revenue (final audited figures) recommended by the Second State Finance Commission. The funds meant for expenditure on development (eg. Rs.1400 crore in 2006-07) will be distributed among the LSGs following the ratio applied for distributing plan funds. The amounts to be transferred to each LSG for each of the five years for the three different types of expenditure are given in Appendix I (not enclosed).

Action Taken

This recommendation is accepted as far as funds for traditional functions (eg. Rs 300 cr. in 2006-07) and funds for expenditure on development (eg. Rs 1400 cr. in 2006-07) are concerned. However, in respect of funds for expenditure on development in 2006-07 (i.e., Rs 1400 cr.), the LSGI wise allocation will be as proposed by the State Planning Board. As far as funds for maintenance (eg. Rs. 350 cr. in 2006-07) are concerned, the recommendation is accepted for the first 4 months of 2006-07. For the remaining 4 years and 8 months, while keeping the total at levels recommended by the 3rd SFC, the horizontal distribution of funds among the LSGIs will be based on the value of the actual assets transferred and the need for maintaining such assets, for which a separate formula is being evolved by the Government. The formula will be finalized by June 2006 and the actual amount due to each LSGI for the remaining 4 years & 8 months will be announced by July, 2006. The share of new LSGIs will be calculated as per formula by reducing the share of the “parent” LSGIs.

Recommendation - 14. 3

The entire amount will be provided in the State Government budget of the relevant years as 'Compensation and assignment to Local Self Governments' in Non-Plan revenue account under the major head of account 3604.

Action Taken

Accepted. However, Funds for Road Maintenance will be provided under an appropriate PWD head of account, because the 12th Finance Commission and the Government of India have linked XII FC Road Maintenance Grants (which will cover roads transferred to LSGIs as well) to the State Government making certain minimum provisions and incurring certain actual expenditure under the PWD Maintenance head of account. The manner of release of such road maintenance funds to the LSGIs will be the same as suggested by the 3rd SFC for Maintenance Funds. The controlling officer for the funds set apart under the PWD head of account will be an officer of the Local Self Government Department.

Recommendation - 14. 4

Additional resources of three types can be raised by LSGs, (i) increase in tax and non tax revenues (ii) Public contribution (iii) borrowing. Additional revenue receipts should be raised through systemic improvement in administration of tax and non tax revenue items.

Action Taken

Accepted. However, in line with the recommendation in para 12.13, the borrowal in a year will be limited to 5% of the total own revenue receipts anticipated in the year in the case of Grama Panchayats and 5% of the funds for development allocated in the year, in respect of Block Panchayats and District Panchayats. The limit of 5% will not apply in respect of purely commercial projects, the cash flows from which will, on their own, repay the loan. Also, the borrowal will have to conform to the requirements of the Kerala Local Authorities Loans Act, 1963.

Recommendation - 14. 5

Increasing rates may be done only after examining all the implications and not merely on the ground that there will be consequent increase in revenue receipts. Public contribution should be raised as cash contributions. Borrowing should be done only to a limited extent and there should be a clear schedule for repayment of outstanding debt.

Action Taken

Accepted. Also, as recommended in Para 8.14, a Commission will be set up to review the tax structure in the State (both at the State and the local Self Government level), keeping in view the incidence of Central taxes also.

Recommendation - 14. 6

For systemic improvement, specific steps listed in para 8. 21 may be implemented.

Action Taken

Accepted

Release of Funds (Chapter 9)

Recommendation - 14. 7

Release of the share of tax revenue recommended in chapter 6 should be as per a schedule known to LSGs, so that they can plan their expenditure accordingly. Funds meant for traditional functions expenditure (eg. Rs. 300 crore in 2006-07) should be released in twelve equal monthly installments from April to March. Funds meant for maintenance expenditure (eg. Rs. 350 crore in 2006-07) should be released in ten equal monthly installments from April to January. Funds meant for development expenditure (Rs. 1400 crore in 2006-07) should be released in ten equal monthly installments from May to February (As illustration, for release of funds in 2006-07, a Table is given in para 9. 10).

Action Taken

Accepted

Recommendation - 14. 8

Problems arising in the smooth release of funds should be resolved through joint consultations, in a spirit of co-operation and mutual understanding, outlined in paras 9. 13 and 9. 14.

Action Taken

Accepted

Drawal of Funds (Chapter 10)

Recommendation - 14. 9

Funds released as per the schedule specified in chapter 9 should be transfer credited from head of account 3604 to Public Account (major head of account 8448) before the 5th of every month. There will be three Deposit Accounts under 8448. Account I will be for funds for traditional expenditure (eg. Rs. 300 crore in 2006-07). Account II will be for funds for maintenance (eg. Rs. 350 crore in 2006-07). Account III will be for development expenditure (eg. Rs. 1400 crore in 2006-07). The officers authorised to do the transfer credit are indicated in para 10.11.

Action Taken

Accepted

Recommendation - 14. 10

From head of account 8448, LSGs will draw funds for maintenance and development expenditure through Bills presented in the treasury, supported by all necessary documents based on actual requirement and for immediate disbursement. Funds for traditional functions (eg. Rs. 300 crore in 2006-07) can be drawn by cheques as is the practice now. Details of accounting procedure may be finalised in consultation with the Accountant General.

Action Taken

Accepted. Finalization of the accounting procedure will be done by the Local Self Govt Dept. in consultation with the Accountant General and Finance Dept.

Recommendation - 14. 11

If the amounts (for maintenance and development) remaining in the Public Account to the credit of individual LSGs on 31st March closing, is more than 10 (ten) percent of the total amount released (deposited in the Public Account to the credit of that LSG) during that

financial year, the excess over ten (10) per cent will be reduced from the budget provision for that LSG for next year, as illustrated in para 10.15.

Action Taken

Accepted

Recommendation - 14. 12

For bills presented for drawal from Public Account within the limits of monthly release credited to the account of the LSG, there should not be any treasury restrictions or need for ways and means clearance from Finance Department. However for utilising that part of the fund, if any, carried over from the previous month's release, special authorisation from Finance Department will be required.

Action Taken

Treasury restrictions are imposed only when the State is on overdraft or is likely to get into overdraft. There could be very serious situations when no payment at all, not even salary, can be authorized from the Treasury (although this has not happened in the last 5 years or so). Subject to such emergency situations, Government supports the recommendation that there shall not be any treasury restriction for bills presented for drawal from public account. Government will ensure that every month there will be at least 10 working days during which the LSGs can present bills and get payment without any Treasury restriction. The recommendation that there shall not be any need for ways and means clearance for bills is also acceptable within the 10-day period. The recommendation that for utilizing that part of the funds, if any, carried over from the previous months release, special authorization from Finance Department will be required, is also acceptable to Government.

Fiscal Freedom of LSGs (Chapter 11)

Recommendation - 14. 13

Procedure specified in chapter 10 will be an interim arrangement till a system of full fiscal freedom is put in place. Under that system, funds released by Government from head of account 3604 should be allowed to be held by LSGs in Government controlled banks. LSGs should draw funds from bank, by cheques. Such drawal should be preceded by a procedure of financial scrutiny.

Action Taken

Accepted. This will be implemented after the full fiscal freedom regime is in place (i.e. 2008-09, as recommended in para 14.21 below).

Recommendation - 14. 14

There should be four bank accounts for each LSG (i) for traditional functions expenditure, (ii) for maintenance expenditure (iii) for expenditure on development of services and institutions (now known as decentralised plan) (iv) for agency functions like State sponsored schemes, centrally sponsored schemes, welfare pensions etc.

Action Taken

Accepted. This will be implemented after the full fiscal freedom regime is in place (ie. 2008-09, as recommended in para 14.21 below).

Recommendation - 14. 15

Own tax and non-tax receipts and tax share for traditional functions (eg. Rs. 300 crore in 2006-07), will be the inflow in the first account. Tax share from State Government for maintenance (eg. Rs. 350 crore in 2006-07) will be the inflow in the second account. Tax share for development (eg. Rs. 1400 crore in 2006-07) will be the inflow in the third account. Funds received from State and Central agencies should be the inflow in the fourth account. There should be a separate stream of inflow and outflow for borrowed funds, their repayment and for the public contribution. The details of these accounts will have to be worked out in consultation with the Accountant General and Director of Local Fund Audit.

Action Taken

Accepted. This will be implemented after the full fiscal freedom regime is in place (ie. 2008-09, as recommended in para 14.21 below).

Recommendation - 14. 16

It is essential to have a Finance and Accounts Wing even in Grama Panchayats. At least one person competent to handle these functions should be made available to each LSG. That could be on deputation to the maximum extent possible and unavoidable minimum number by fresh recruitment through Public Service Commission. The staff of the Performance audit can also be used to strengthen this structure. The personnel so appointed will be the nucleus of a Finance Wing in LSGs.

Action Taken

This is agreed to in principle. Since creation of additional staff cannot be readily agreed to, emphasis will be on developing a computer based system of accounting and giving the necessary training to the staff of LSGs to handle this. The details will be worked out separately by the LSG Department, in consultation with Finance Dept. Posts will be created only if it is absolutely necessary.

Recommendation - 14. 17

Major expenditure proposals (over a limit laid down depending on the volume of financial transactions of each LSG) should be seen by that unit, before the Secretary of the LSG clears it. After the Secretary clears the proposal it should be seen by the Chairperson of the respective standing Committee and the Chairperson of the Finance Standing Committee before approval by Chairman/Council. After the proposal is so approved, cheques will have to be prepared for drawal of funds. Such cheques should be signed both by the Secretary and the Chairperson of the Finance Standing committee.

Action Taken

Accepted. This will be implemented after the full fiscal freedom regime is in place (ie. 2008-09, as recommended in para 14.21 below).

Recommendation - 14. 18

It will be the duty of the Finance Wing and the Secretary to point out the pros and cons of a decision proposed to be taken. If higher authorities (Chairpersons of Standing Committees, Deputy Chairperson, Chairperson) overrule them, they will have to own the responsibility for that decision.

Action Taken

Accepted. This will be implemented after the full fiscal freedom regime is in place (i.e. 2008-09, as recommended in para 14.21 below).

Recommendation - 14. 19

There should be a clear system to discourage delayed use of funds. The system will be as specified in para 11.15.

Action Taken

Accepted

Recommendation - 14. 20

There should also be a system for monitoring performance, as specified in para 11. 16.

Action Taken

Accepted

Structure of Developmental Financing (Chapter 12)

Recommendation - 14. 21

The new system of fiscal freedom can be put in position only after necessary staff are deployed, accounting details worked out and monitoring agencies formed. The new system should come into force in 2008-09.

Action Taken

Accepted

Recommendation - 14. 22

There should be a structure of developmental financing in which both the Government and the LSGs participate. Funds assessed as available for developmental expenditure in the financial profiles in Appendix II, enhanced by further mobilisation of resources from revenue receipts, borrowing and public contribution should be taken as LSGs' contribution in the Plan Financing Table. What Government gives as share of State taxes to LSGs should reflect in the item 'Balance from Revenues' in the Plan Financing Table. In the Plan outlay, the contribution from LSGs should be the outlay for decentralised Plan.

Action Taken

Accepted

Recommendation - 14. 23

If however the Government want that LSGs should have a higher share of State Plan (depending on Government policy) the difference between funds available with LSGs and that share of outlay should be given as grant by Government to LSGs. Detailed Tables given in chapter 12 illustrate the position regarding availability of funds with LSGs.

Action Taken

Accepted. The actual higher share of State Plan that the Government want LSGs to have, will be decided every year, while finalizing the annual plan.

Recommendation - 14. 24

In respect of a very small number of LSGs their total availability of funds for development expenditure is less than what Government gives as share of taxes for development expenditure. In such cases, gap grants may be given as indicated in Appendix III (of 3rd SFC Recommendation).

Action Taken

Accepted, subject to the condition that if the figures of revenue vary after detailed audit, suitable downward modifications will be made.

Recommendation - 14. 25

To update the financial profiles in Appendix II from time to time, make a resources assessment of LSGs each year before finalising the size of the decentralised plan to be implemented by LSGs and also to make other studies relevant in this area, a 'Board of Fiscal Research' headed by the Chief Secretary may be constituted. The details are in Para 12.21.

Action Taken

Accepted. As suggested by the 3rd SFC, only 2 or 3 additional posts of financial experts will be created. The rest of the staff will be found by redeployment from Finance and LSG Departments as well as the Directorates of Panchayat and Urban Affairs.

Other Issues (Chapter 13)

Recommendation - 14. 26

Regarding transfer of budget for payment of salary of employees working in institutions transferred to Panchayats and Municipalities, the existing arrangement may continue.

Action Taken

Accepted.

Recommendation - 14. 27

For settlement of dues and claims between LSGs and Government agencies, there should a system of continual dialogue. The details are in para 13.6.

Action Taken

The recommendation regarding continual dialogue is accepted. The recommendation in para 13.6 of the report that for 50% of the arrears from LSGs to KWA and KSEB, the State Government may provide a block grant will be examined in detail and a separate decision taken.

For resolution of disputes between the LSGIs on the one hand and KSEB/KWA on the other, an appropriate mechanism will be built in separately in consultation with the Power and Water Resources Departments.

Recommendation - 14. 28

Work of disbursement (not the selection of beneficiaries) of welfare pensions may be transferred to the concerned Departments.

Action Taken

Accepted. However, instead of transferring this to individual Departments, this may be centralized at the level of the Finance Department or the Directorate of Treasuries. A system for constant flow of information between the centralized agency and the LSGIs will have to be put in place. The details will be worked out by Fin. Dept. in consultation with the concerned Depts.

Recommendation - 14. 29

Some addition to staff strength of Grama Panchayats may be unavoidable.

Action Taken

This will have to be found mostly by redeployment. Specific details will be worked out by the LSG Rural and Urban Departments and the matter taken up with Finance Department for a separate decision. Posts will be created only if it is absolutely necessary. Recommendation is accepted with the above conditions.

Recommendation - 14. 30

In consultation with Accountant General and Director of Local Fund Audit, a limit should be fixed on the number of days (in a month) when audit parties of any organisation would visit LSGs.

Action Taken

Accepted. This will be fixed by the concerned officers of the Dept of Local Fund Audit for every LSGI, in consultation with them. In exceptional situations, however, the audit parties may visit LSGI on other days as well. The number of such exceptional visits will not exceed 15 in a year.

Recommendation - 14. 31

Levy of audit fees may be dispensed with.

Action Taken

The rate of fees which was 1% of the income has recently been reduced to 0.5% with retrospective effect. The recommendation to dispense with audit fees altogether for LSGIs will be considered separately, after its impact on other local bodies (who also have to pay audit fees @0.5% to the Local Fund Audit Department) is properly assessed.

Recommendation - 14. 32

Before ordering any exemption/reduction in taxation which would adversely affect LSGs, Government should obtain the recommendation of the LSGs.

Action Taken

Accepted.