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CONCEPT PAPER ON
AUDIT COMMITTEE
FOR
MUNICIPAL
BODIES

PREFACE

The increased activities of the municipal bodies post 74th Constitutional Amendment, introduction of municipal accounting reforms & various schemes of Government of India (e.g., Atal Mission for Rejuvenation and Urban Transformation (AMRUT) and Smart City Mission scheme, etc.) have necessitated the Municipal Bodies to become transparent & publicly accountable in its operations and financial activities, emphasised effective & efficient utilisation of funds and other resources, augment revenue, become self-sustainable (i.e. raising of finances on the basis of its own resources and strength) and ensure better fund management, etc., so as to respond to the needs of the citizens and other stakeholders.

However, as we all know, the self-sustainable model of a municipal body needs application of certain recent concepts of fund raising and capital modelling which require professionalisation. To aid in this arena, we hereby propose that there should be a mechanism for constitution of Audit Committee for each municipal body separately which with its guidance can enable a municipal body to operate at higher levels of efficiency, enhance transparency & accountability, improve controls, financial reporting, develop internal audit function apart from resources identification, mobilisation, cost optimisation.

To elaborate on the same, the ICAI Accounting Research Foundation (ICAI ARF) of ICAI has brought out this Concept Paper on Audit Committee for Municipal Bodies that attempts to provide information regarding the role that can be played by the proposed Audit Committee, advantages of constituting the same and the suggested structural framework. I would like to acknowledge the efforts of CA. Rohini Aggarwal in drafting the same.

I believe that the Concept will receive its due consideration from all the stakeholders and the guidance provided in this Concept Paper would be immensely helpful to them. ICAI ARF, being the research and academic initiative of ICAI, would be ready to amplify the concept, if the concept is to be developed further and implemented at the ground level.

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CONCEPT PAPER ON AUDIT COMMITTEE FOR MUNICIPAL BODIES

The **objective** of this concept paper is to suggest the modality of 'Audit Committee' which can support the Municipal Bodies and their administrative heads, to effectively manage and utilize resources, both monetary and non-monetary, and thereby enhance capacity to effectively meet their objectives of urban development leading to overall growth of the country.

A professional Audit Committee can advise the Municipal Bodies about ways and means to raise additional resources and effectively utilize the existing resources by suggesting appropriate internal checks and controls in the system, and to strengthen the accounting and audit system to enable data efficiency and timely actions, whenever and wherever required. Audit committees can also provide a communication link between the elected representatives, municipal officials and independent auditors.

Present Status of Municipal Bodies

In India, the urban local bodies are considered as **third tier of the governance**. The Constitution of India, in its **12th Schedule** lists eighteen functions which can be entrusted by the States to the Municipal Bodies through their respective State Municipal Acts. Most of the States have enacted Municipal Acts containing all such duties, however, practically these Bodies are carrying out only a few these functions, as the States have not entrusted all these functions to them. Most of these functions are performed by other departments of the State. In fact, within a State also, one may see that one Municipal Body is performing four functions while the other is undertaking five functions. This situation reflects a severe capacity issue in the Municipal Bodies.

Analysis of Present Status

The reasons are many fold – The Municipal Bodies do not carry sufficient financial and managerial resources to effectively perform their functions. Their resource structure majorly includes grants from the Central Government and the State Government and power to levy taxes and charges on specified subjects.

There is also an anti-thesis to this situation – the Municipal Bodies do have good powers to levy taxes and charges in their local area, they do have many land and other resources which are capable of generating good funds, they are conduit for many schemes of the Central Government where they have access to large funds for improving their area one way or the other. But they have not been able to capitalize on

their strengths as yet, which can largely be attributed to the weak control and management systems in the organisation.

An effective management of funds and other resources available with the Municipal Body and their effective utilisation can be a game changer for the country. The first question is – what stops the Municipal Bodies from doing it now – the answer is, ‘lack of professional assistance’ to the elected council and the Municipal administration.

If one would pick up the reports of various **State Finance Commissions**, interestingly, the observations and recommendations made by almost all of them are more or less the same, they quote gist of a few reports, Urban Local Bodies need much more funds than what they have, their own tax revenues and non-tax revenues are very less and they are dependent on State or Centre for funds and remain in uncertain position in this context; that Local Bodies have alarmingly short on manpower strength (both quality and quantity) thus whatever they have can’t be utilized properly; that accounting system and records are very poor; that audit mechanism is insufficient and ineffective; that reporting systems are not in place and so on.

The second question is - what can be done to achieve the effectiveness of performance of Municipal Bodies in immediate future without interfering much with the existing systems. The answer is – ‘provision of technical support’ to them with the modality of ‘Audit Committee’ which can work as an advisory and support system for the Municipal Body as well as its Administrative Head.

This Paper sets out specific responsibilities which may be assigned by the Municipal Body to the Audit Committee and details the manner in which the Audit Committee may operate.



ROLE OF AUDIT COMMITTEE

The role to be played by the Audit Committee is critical to provide a mechanism for rendering impartial advice and recommendations to the Municipal Body and its Administrative Head on financial and non-financial matters, to improve accountability and governance over the activities of Municipal Bodies and its affiliated entities. In addition, many oversights (which could later become cause of audit objections) can be prevented or mitigated by the Audit Committee.

The Audit Committee would be **advisory** in nature. It would be Independent in status, would interact with the Municipal Body and its Administrative Head and would also report to the Chief Minister in the context of relevant and important aspects which can be taken up by the State only. A proposed structure of Audit Committee has been discussed in detail in the following paras.

The Committee may consider the following matters (these are select examples only) relating to the Municipal Body in the discharge of their duties –

- ⦿ ensure funds and resource management to obtain maximum returns and to avoid pilferage and inefficiency;
- ⦿ advise and support in context of releasing the resources locked into disputes such as land or property disputes;
- ⦿ support to create efficient tax collection and monitoring systems
- ⦿ safeguard assets;
- ⦿ ensure adequate systems and controls;
- ⦿ review annual financial statements;
- ⦿ assist in rational budgeting;
- ⦿ strengthen audit and control systems;
- ⦿ review of internal audit reports and suggestions to the auditors
- ⦿ ensuring that the audit observations have been responded or action taken upon them
- ⦿ assist in ensuring that the objectives and functions of the Municipal Body and delivery of services are aligned by way of processes followed thereat;
- ⦿ ensure appropriate utilisation of grants and other resources;
- ⦿ any other matter in relation to the financial affairs of the Municipal Body and to the internal and external audit of the its activities.

For effectively taking up these responsibilities, the Audit Committee should have the authority to seek any information it requires from any employee of the Municipal Body, have unrestricted access through its Offices to information relating to all personnel, books of account, records, assets and liabilities of the Municipal Body and to any other sources of relevant information that may be required for the purpose of fulfilling the Committee's duties and responsibilities.

Audit committee may be authorised to take such independent professional advice and action as it considers necessary, but provided that any expenses incurred shall be within the approved budget of the Municipal Body.

The Committee should not perform any management functions or assume any management responsibilities as this could prejudice the objectivity of the Committee. The Committee would mainly make recommendations to management in respect of the activities which form part of the Committee's terms of reference.

STRUCTURAL FRAMEWORK OF MUNICIPAL BODIES – HOW 'AUDIT COMMITTEE' WOULD FIT IN

The organisation structure and framework of management of these bodies has been broadly provided by the Constitution of India in Chapter IX-A thereof read with the respective State legislation.

Municipal Body and its Administrative Head

The Municipal Body exercise the legislative and executive authority. The members of the Municipal Body (be it Municipal Corporation, Municipality or City Council) are elected representatives of political parties. These elected representatives are expected to be well informed about the needs, capacities, strengths and sensitive aspects of the given local area that can be factored in planning and decision making by the Municipal Body.

The top functionaries of the Municipal Body are usually from the administrative services of the State and the functionaries at the technical and general administrative level as well as the support staff are appointed from the State cadre or Municipal Cadre. The Municipal Body may hire contract manpower on temporary basis also.

Existing System of Accounting and Audit

It goes without saying that accounting system in the Municipal Bodies of India is far from appropriate. Even today, most of them are working on single entry basis, even those who report that they are on double entry accounting system, may be practically found far from understanding the meaning of double entry. A robust accounting system in Municipal Bodies is thus an urgent need of the hour. Rather than ensuring on paper about efficacy of accounting system, the need is to check the reality on ground, which can be done effectively only by a professional accountant.

Regular audits of the Municipal Bodies are done by the Local (Fund) Audit Department of the State, which is mostly in the form of pre-audit where the auditors regularly sits in premises of the office of the Municipal Body and verify the expense transactions and at the year end, collate the related observations along with some checks like stock, etc. done in a routine manner, submit their report which usually goes with a delay of 2-3 years. State offices of CAG also conducts audit of Municipal Body, but these are selective audits and because of shortage of staff and difficulty in obtaining sufficient and timely data, these audits are much delayed, at times for years together.

Looking at the structural framework of a Municipal Body in India, the top-level structure consists of elected representatives in the Municipal Council and the Administrative Head. We have also mentioned about Local Fund Auditors and State CAG auditors just to place the position of Audit Committee in proper perspective.

Proposed Structure and Position of Audit Committee

Audit Committee can act as an advisory and monitoring committee for the purposes of Audits, Resource Management, procedures or processes for internal controls etc., having an autonomous status.

Four independent individuals from outside the Council, preferably with a financial background, one of whom should have professional degree in accounts and audit, say a chartered accountant, preferably having an understanding or experience about workings and functions of the Municipal Body; others could be with a professional knowledge in the area of Information systems & processes, engineering, human resource, as the need may be;

Membership and size of the committee

The Committee may comprise of the following persons:

The appointment of the committee members may be made by the Chief Minister of the State. One of the Committee members with Professional background could be designated as the Chairperson who must have the ability to preside over meetings and to direct discussions along constructive lines.

The membership of the Audit Committee may be for a period of three years, which may be extended for a maximum of a further three years, reckoned from the date on which the external member actually assumes duty, on the terms and conditions contained in the contract of appointment.

EX-OFFICIO MEMBERS OF THE COMMITTEE

- ⊙ The Administrative Head (Municipal Commissioner) and the Chief Financial Officer with all the Executive Managers, when needed.
- ⊙ A representative from the Office of the Auditor General and (where applicable) a representative from external auditors;
- ⊙ The head of the internal audit function or his or her nominee;
- ⊙ Other members of management may be invited to attend Audit Committee meetings when there is a functional responsibility to be discussed.
- ⊙ The Municipal Body may provide a staff member to act as Secretary to the Committee.

Detailed norms about the meetings, quorum, minutes, reporting etc. could be drawn up in detail at a later stage. However, reporting by the Audit Committee would acquire significance because the Committee report will convey to the Chief Minister, Members of the Municipal Body, Administrative Head (Commissioner) and other stakeholders, the points where attention of respective offices would be required. Timeliness and periodicity of these reports will ensure effectiveness of Audit Committee.

In India, the institution of Audit Committee has not been recognized much, however, in many countries this institution is working and providing tangible results. An extract from an article by Jean X. Zhang and Kevin T. Rich, in the Journal of Public Budgeting, Accounting & Financial Management (published on 1 March 2016) reads as –

“We investigate whether council audit committees relate to municipal fiscal policies. We find that municipalities with audit committees are associated with greater levels of own-source revenue, in that they finance municipal operations with locally raised revenues driven by charges and fees compared to municipalities without audit committees. Furthermore, municipalities with audit committees are associated with less new debt than those without audit committees, indicating more conservative use of external financing. Overall, our results are consistent with municipal audit committees, in addition to monitoring the financial reporting function, playing an advisory role in fiscal decisions, especially when the cost of local government to citizens is high.”

The above investigation by the authors of the article is reflecting that the audit committee can help in enhancing the performance of Municipal Bodies.

Role of **Audit Committee** in making **Self-sufficient and Self-Sustainable Municipal Bodies**

The resource base of municipal bodies generally consists of their own sources, the state revenue, government grants, loans/ borrowings from Central & State Governments, banks and financial institutions. Municipal bodies, sometimes are not even aware of the available opportunities and the avenues that can be explored for generating revenues through innovative taxation and even non-tax charges. Even if they are aware, they do not have skills to optimise or augment revenue. Municipal Bodies must streamline their activities to become self-sufficient.

The Audit Committee, created as mentioned above, would ensure **strengthening of accounting and auditing system and establishment of internal control mechanism and good governance system that will nurture a system of transparency and accountability** in Municipal Bodies.


The Audit Committee would help municipal bodies in maintaining the **database of existing revenue collection** with requisite details about the source of revenue (e.g., maintaining records of property for property tax revenue), effective assessments, billing and collection and effective control on it.

The Audit Committee could also assist Municipal Bodies in exploring **new ways to raise revenue** such as for more taxation collection, offering innovative incentives to tax payers, percolating tax system to all sections of the society depending on the ability to pay (commercial tax, residential tax and so on), linking tax to market value or area based value, using Geographical Information System (GIS) and information technology/ e-tools for capturing the details about land, tax fixation and recovery, outsourcing of tax collection to professional agency, etc.

The Audit Committee would not only help the Municipal Bodies in **enhancing revenue but also in cost optimisation through performance management techniques and outcome budgeting**.

The Audit Committee would ensure smooth **implementation of accounting reforms and compliance of mandatory provisions** of various schemes of Government of India such as Atal Mission for Rejuvenation and Urban Transformation (AMRUT) scheme to strengthen its accounts and audit system and also help them in improvement of performance, achievement of service delivery objectives and obtaining performance based grants that would also add to the flow of funds in Municipal Body.

As we all know, credit worthiness of an entity plays important role in raising finances or funds in any organisation. The credit worthiness of a Municipal Body depends on the quality of accounting, financial management, availability of reliable financial data and political stability of Local-self Government. Municipal Bodies specially the smaller ones, find it difficult to demonstrate their credit worthiness. Audit Committee could play important role in this regard



to make municipal bodies self-sustainable as it would be responsible for ensuring that the Municipal Body upholds accounting integrity and maintains transparency in its operations and financial reporting, that would help to raise finances on the strength of their own financial statements, from the banks or other financial institutions in the form of borrowings or loans and from other alternative source of funding, i.e., from capital market through issuance of municipal bonds, instead of relying mainly on the grants or funding provided by the higher level of Government to provide for infrastructure and service delivery objectives.

The borrowings or loans are the traditional source for raising funds in a municipal body. The Audit Committees would help the municipal body in preparation of financial projections and detailed project feasibility reports required to be submitted to the funding agencies such as World Bank, Asian Development Bank and other financial institutions and also convincing them about their credit worthiness.

Issuance of Municipal Bonds is an alternative source of funding through which municipal bodies could raise funds from the capital market. The Audit Committee would enable them to access capital market for issuance of municipal bonds in various ways such as advising them to comply with the relevant regulations of Securities and Exchange Board of India (SEBI), getting necessary approvals and certifications, interaction with credit rating agencies for getting rating done of municipal bonds, amending existing Municipal Acts/other relevant Acts (required if any) to make issuance of municipal bonds as a permissible mode of raising funds, assessing revenue systems and financial viability of various investment plans so as to ensure no default is incurred by the municipal body at the time of redemption of municipal bonds, etc.

Audit Committee would not only assist municipal bodies in raising finances and enhancing revenues from new and innovative alternate methods but also ensure their effective and efficient management and utilisation thus enabling evolution of municipal bodies into self-sufficient and self-sustainable one i.e. **Atmanirbhar Municipal Bodies.**



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