CURRENCY EQUIVALENTS

Currency Unit = Indian Rupee (Rs)
US$1 = approx. Rs. 43
1 Crore = 10 million

FISCAL YEAR

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ABBREVIATIONS AND ACRONYMS

CAG  Comptroller and Auditor General of India
CDD  Community-driven development
DFID Department for International Development (United Kingdom)
GOI  Government of India
IMF  International Monetary Fund
MoPR Ministry of Panchayat Raj
NGO  Nongovernmental organization
OP/BP Operational Policy/Bank Procedure
PEFA Public Expenditure and Financial Accountability
PFM  Public Financial Management
PFMA Public Financial Management and Accountability
PRI  Panchayati Raj Institutions

GLOSSARY

Panchayati Raj Institutions  Collective description of the 3 tiers of rural local governments across India, numbering 539 Zilla Panchayat (district level); 6,105 Kshettra Panchayat (block level), and 233,251 Gram Panchayats (village level).

Gram Panchayat  Smallest elected PRI body at village level.

Panchayat Samiti or Kshettra Panchayat  Intermediate elected PRI body at the block level.

Zilla Parishad or Zilla Panchayat  Largest elected PRI body at the district level.

Pradhans or Pramukh or Sarpanch  Chairperson of the Panchayat at the village level

Gram Sabha (also called Gram Sansad)  Body consisting of persons registered in the electoral rolls relating to a village comprised within the area of Panchayat at the village level.
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Acknowledgments

In this report, the World Bank responds to a request from the Government of India to integrate and provide a central role to PRIs in World Bank-financed operations. The report’s findings will help to improve the understanding of the parameters of compliance with the decentralization framework and an agreement on the principles and elements of a common PFMA platform for all relevant World Bank-financed operations.

The study was conducted during January and June 2007. The World Bank Task Team was led by Manvinder Mamak, who worked closely with Dhimant Baxi (SARPS), Geeta Sethi (SASES), Rajat Narula (LOAG2), Paramita Dasgupta (SASPR), Shelka Arora (SARIM) and S. Satish (SASES) under the overall guidance of Robert Saum and P. K. Subramanian (SARFM). Consulting support for the study was provided by Manoj Agarwal.

The study would not have been possible without the comments and advice of Mr. T. R. Raghunandan (Joint Secretary, Ministry of Panchayat Raj, Government of India), Mr. S. M. Vijayanand (Principal Secretary, Department of Local Self Government, Government of Kerala) and Mr. R. N. Ghosh (Principal Director, Local Bodies, Comptroller and Auditor General of India). The Task Team for the study appreciates the assistance provided by the State Teams of several World Bank-financed operations in facilitating field visits and sharing their implementation experiences with the World Bank Team.

The report builds on the earlier work of the Synthesis Study on Public Financial Management and Accountability (PFMA) in Panchayati Raj Institutions (PRIs) which provided a reference point for mapping of the PFMA arrangements currently in place and highlighted good practices that have emerged across the States. The report also draws on the several State Financial Accountability Assessments and PFMA studies of the Panchayati Raj Institutions, including those conducted as part of the preparation of projects.

The Team gratefully acknowledges the collaboration of the many people (within the World Bank and outside) who contributed in clarifying the decentralization principles and concepts and development of the agreed approach in the context of public financial management processes. The opinions presented here and any errors are the sole responsibility of the authors and should not be attributed to the individuals or institutions acknowledged above.
EXECUTIVE SUMMARY

The Government of India (GOI) is committed to strengthening Panchayati Raj Institutions (PRI) with a concerted effort to integrate and secure a central role for the village- to district-level governments in World Bank-financed operations. The World Bank is actively seeking ways of achieving a greater degree of internal coherence between Bank-financed operations and consistency with the GOI approach to decentralization.

With these objectives as backdrop, the report Financing of Panchayati Raj Institutions (PRIs) in World Bank-Financed Operations provides advice to World Bank task teams and clients for designing appropriate fiduciary mechanisms of PRI financing, ones that are consistent with the GOI Constitutional framework and comply with World Bank operational policies and procedures. The report uses findings from a mapping exercise of ongoing Bank-financed operations in Panchayati Raj Institutions, analyzing the public financial management and accountability (PFMA) and procurement arrangements to determine what has or has not worked well and whether any can be replicated or mainstreamed. The report also covers the efficiency issues of Panchayati Raj Institutions dealing with multiple financing sources with a resulting heavy-load of reporting requirements; the extent to which existing PRI systems are being utilized or could have been utilized, and the views of PRI staff.

The Department of Economic Affairs, Ministry of Finance, wrote the following at the start of the report process:

Ministry of Panchayati Raj [MOPR] feels that till now in all the projects including DPIP [District Poverty Initiatives Program] and sector support programs taken up by the World Bank, the emphasis has been on implementation and fund flows through parallel bodies, while the MOPR has been emphasizing on central role to PRIs in all World Bank financed operations. This study may help to integrate all PRIs in all World Bank supported operations in future.

This issue of PRI centrality was exemplified in Karnataka when in 2003 the Government issued a Government Order transferring functions, finances, and functionaries to PRIs based on an activity map. In 2004, another Government Order required the transfer of State sector schemes to PRIs. This follow-up order has particular significance for World Bank operations in Karnataka as it (a) prohibits “parallel bodies” from implementing operations in subject areas devolved to PRIs; and (b) explicitly requires World Bank operations to be implemented “through PRIs only”.

PFMA Institutional Framework in PRIs

The 73rd Constitutional Amendment Act and the 12 years succeeding its passage can be considered the first generation reform period with its central theme being creation and empowerment of strong Panchayati Raj Institutions. However, the Constitutional provisions alone have not been an effective trigger for several reasons. Working now within the second generation of reforms, the focus is on devolution of an effective functional transfer to Panchayati Raj Institution. From an operational perspective, the focus will be on strengthening administrative mechanisms that enhance the efficiency and capacities of Panchayats.
The 73rd Constitutional Amendment required the establishment of a 3-tier PRI structure with elected bodies at village, block, and district levels—Zilla Parishad (district level); Kshettra Panchayat (block level); and Gram Panchayat (village level). State legislation sets out the powers, responsibilities, functions, and obligations of the three-tiered PRIs with regard to public financial management and accountability. The extent of devolution varies across the States and generally takes three forms: functions, functionaries, and finances. By and large, the framework prescribed in State Acts rules.

The Central Finance Commission has had the legislative mandate to give directions with regard to the finances of the PRIs. This practice began with the 10th Finance Commission constituted after the 73rd and 74th Amendment to the Constitution. The 11th Finance Commission in its report expressed concern over the maintenance of accounts and audits, and noted that while most States had made provisions by way of legislation for maintenance of accounts by the Panchayats, detailed guidelines or rules had not been laid out in several cases. In many States, the formats and procedures for maintenance of accounts by these bodies prescribed decades earlier were continuing without improvements that take into account the increase in PRI powers, resources, and responsibilities.

Overall Fiduciary Environment

There is a growing acknowledgement of the centrality of improved PFM arrangements in PRIs within Central Government and the States. This is evidenced by the increased level of dialogue on the need for improvements and the measures being taken at both levels. This opens up significant opportunities for the World Bank in moving toward a common platform of financial management arrangements which are consistent with the PRI’s own systems.

A 2005 World Bank-conducted study on PFM arrangements at the PRI level concluded that even while a well-defined legal and institutional PFM framework exists, there was considerable room for improvement in implementation. Budgeting in all three PRI tiers is top-down rather than bottom-up and demand driven, prepared often to comply with statutory requirements and not as a tool for financial control or long-term planning.

The PRI-adopted accounting practices have not kept pace with the increased and diversified flow of resources despite legislation that provides for a tight set of internal controls on the use of PRI resources. There are no accounting standards or uniform accounting codes. Organized financial reporting is scant in any of the three PRI tiers. Expenditures reported up the line are not verified for genuineness or accuracy. Although there are many audits, they tend to be late. Audit procedures are also lacking or deficient.

On a more encouraging note, there are ongoing initiatives and success stories coming from Central and State levels that have potential for altering the accountability landscape. The innovative People’s Campaign for decentralized planning in the State of Kerala has provided an excellent model for grassroots participatory planning. The State of Karnataka has demonstrated that by its efforts to standardize property tax rates in rural areas, tax collection at the PRI level can be increased substantively. The 11th Finance Commission entrusted the technical guidance and supervision of PRI accounts to the Office of the Comptroller and Auditor General of India.
To fulfill this mandate, the Comptroller and Auditor General have prescribed accounting formats for PRIs, as well as auditing standards. The States of Orissa and West Bengal are making major headway in strengthening the accounting functions through information technology and inter-connectivity.

Community-Driven Development

For several decades the World Bank together with client countries has promoted community-driven development as means toward empowerment of communities and local governments. The increasing trend of a new generation of projects is funding innovative and flexible approaches to integrating community-driven development and decentralization. The new genre of projects reflect a trajectory of control that ranges from community control over development funds to local government control, with a number of emerging combinations depending on the scope and nature of investments. In such local government development projects as in Bangladesh, Indonesia, Mozambique, Rwanda, Uganda, and Zimbabwe, the World Bank’s point of entry is mainly in financing fiscal transfers and providing technical assistance for local government capacity building. Under most projects, local governments are eligible to receive funding up to a ceiling by jurisdiction or per capita, sometimes with poverty incidence included. Over time, performance-based criteria determine ceilings. Other criteria models for determining eligibility are emerging—central to the process is establishment of appropriate ‘rules of the game’ for effective participation and accountability.

A more systematic effort by the World Bank Office in Indonesia, in cooperation with the Ministry of Home Affairs (Government of Indonesia) and other donors, was designed to develop a measurement framework for local government financial management. This framework comprises a set of strategic areas from the PFMA cycle, each with a selection of key PFMA outcomes, a diagnostic tool kit of selected indicators to help assess the outcomes, and a scorecard. The selected PFMA outcomes, presented in a modular structure, were considered important and relevant in the Indonesian context. The scorecard conveys the state of PFM systems and practices of the assessed local governments. Taken together, these would help identify those processes that are weak and not likely to support positive outcomes and help identify strengths and weaknesses of PFMA systems, institutions, and processes at the local level. The scoring methodology sensitizes this framework to both the high performer and low performer yet allows a reasonable degree of variation between the two ends. The measurement framework was tested in two “well performing” districts enabling the team to benchmark the outcomes.

Approaches to PRI Financing: State and Centrally Sponsored Schemes

A centrally sponsored scheme tends to be implemented departmentally or through parallel arrangements—such as with user associations, District Rural Development Agencies, program-specific agencies, nongovernmental organizations, self-help groups—virtually by-passing the Panchayati Raj Institutions. At the 5th Round Table of Ministers of Panchayat Raj at Srinagar, the Ministry of Panchayat Raj constituted a task force of State PRI representatives to examine centrally sponsored schemes from the perspective of Panchayats and State governments. Considering the strategic importance placed on these national programs and recognizing that
centrally sponsored scheme were likely to remain an important source for development funds, the time was right to consider a scenario wherein the PRIs continue to perform as implementing agents for central programs, but given due consideration to the increasing convergence of financial management requirements for individual programs. It is this point at which a common set of rules, regulations, and procedures (to be read as use of PRI own PFMA systems) emerges as a framework for the required scenario.

By adopting a “Big Bang” approach to decentralization, Kerala is clearly the front-runner in India. Kerala pursued and adopted a wide range of reforms, including setting up a fiscal transfer system that assigned 20 percent of the State capital budget as the vertical share for local governments. Derived from various legislative acts, rules, and bylaws, the PFMA framework in Kerala covers the range of components of the PFMA cycle, including budget preparation, approval and execution, internal control and internal audit, accounting and financial reporting, and external audit and legislative scrutiny. The framework is designed to provide a strong platform for the State to obtain fiduciary assurances for the effective and economical use of funds provided to the Panchayat Raj Institutions. In practice, however, the financial control framework lacks rigor and oversight. In its effort to cope with the increasing funds handled by the Panchayats, the State of Kerala issued several regulations on the use of funds, which have resulted in an overly complex system. The challenge for the State now is to simplify, consolidate, and institutionalize the various rules and operating procedures into a fully encompassing legal and institutional framework, updating and modernizing many of the archaic accounting and reporting systems to support decisionmaking and local governance.

**Current Approaches to PRI Financing in World Bank-Financed Operations**

In an investment lending portfolio of 65 ongoing operations financed by the World Bank, there are 18 projects that are wholly or in part implemented either through PRIs or its subcommittees and parallel bodies. Conducted for this report, detailed desk reviews and on-site visits of 12 of the 18 projects, essentially in rural water supply and sanitation, watershed development and management, and rehabilitation and maintenance of tanks, indicate that the portfolio is aligned with the decentralization process. The move to give PRIs an appropriate, central role in implementation arrangements is clearly visible in rural water supply and watershed projects; the other sectoral projects such as management of water bodies and rural roads are still not quite aligned.

Financing of PRIs in World Bank-financed operations has traditionally fallen under sector specific investment lending operations. These are normally tied into strict administrative procedures and expenditures categories that do not give decisionmaking discretion to local governments, making them mere agents of the Central and State governments. An alternative model of financing PRIs has emerged wherein the World Bank finances the State in the transfer of block grants or untied grants to PRIs. By definition, an untied grant should provide a near total freedom of use to the PRIs. At best, only broad sectoral ceilings and a negative list of unacceptable works need be prescribed. These transfers are accompanied by significant capacity-building and policy reforms, particularly in the context of modernizing the PFM systems at the PRIs.
All World Bank policies required under investment lending also apply to PRI financing operations. In the context of PRI financing, it means that for each type of resource transfer to PRIs, the conditions or supporting fiduciary environment should provide assurance that disbursed funds are used for intended purposes. In applying the new country financing parameters to PRI financing, the World Bank Operations Policy (OP) 6.0, *Bank Financing*, provides additional flexibility in financing block grants, the expenditure composition of which may at best be broadly determined for the project. The requirements of OP 10.02, *Financial Management*, pose some special challenges by way of conducting assessments of adequacy of financial management capacity, determination of a framework that can apply across a disparate set of institutions, ability to provide consolidated financial reports of actual expenditures, as well as determination of acceptable audit arrangements. World Bank procurement requirements (OP 11.00) apply to operations which finance PRIs as well. OP/BP 12.0, *Disbursements*, requires that World Bank funds are disbursed for expenditures eligible under the project’s legal agreement. In identifying eligible project expenditures which finance PRIs for block grants, the key challenge arises from the difficulty in establishing the point at which the expenditures become eligible for disbursement - on transfer of funds by the State or when the transfer is utilized and accounted for. As with all World Bank investment operations, those which finance PRIs are subject to the same fraud, anti-corruption, and relative sanctions, provisions, and remedies.

The approaches followed reflect different, though not always contradictory, perceptions of the role of local government, and the principles and objectives of the decentralization process. Complete consensus or coherence on the decentralization agenda among the Government of India and the States is not always the case. Line ministries and departments have differing levels of ownership of State’s decentralization agenda. The institutional project arrangements may not quite reflect the State’s overall vision for decentralization or be consistent with the legal framework for PRIs. As such, the sector line departments and the World Bank task teams may be unable to engage substantively the State Panchayat Raj Departments and their field-level functionaries in the project preparation processes. In some sectors, the presence of parallel user institutions with undetermined linkages to the PRIs and legislated by State Acts, like the Water User Associations and Joint Forestry Committees, may overtake project roles of the PRIs. This course of action would likely continue to emphasize the ambiguities in the current framework and to pose a continuing challenge for the World Bank in responding to the decentralization agenda.

Another important dimension of the decentralization agenda is agreement on standardized fiduciary arrangement that allows the existing fiduciary framework to be used for all projects/schemes of the Central and State governments and other donor partners (including the World Bank). This approach is consistent with the World Bank’s view that the use of “country systems” has significant potential to improve development impact. The use of country systems in procurement is still evolving but its application for financial management has increasingly become a part of regular business practice. In practice, however this poses its own set of challenges, particularly in view of the significant compliance gaps in PFMA practice at the PRI levels, which puts accountability at risk.
The Way Forward

Institutional arrangements in World Bank-financed operations can be seen as moving toward achieving a greater degree of internal coherence and consistency with the GOI Constitutional framework for decentralization. While there is clearly an agreement on the principles, the progress in determining the elements of a common platform for financial management arrangements for all relevant Bank-financed operations is at fairly early stages of development. As part of project preparation, diagnostic studies of PFM arrangements have been undertaken to understand the extent of divergence between relevant laws and their practical implementation at the PRI level. The extent to which the financial management systems in Bank-financed operations align with country (PRI) systems will require an assessment of the adequacy of systems in place. Normally a demand driven selection method would be adopted in projects with due consideration of geographic and technical aspects. Given that financial management capacity at Panchayats may be at disparate levels, project teams might consider including a summary assessment of fiduciary capacity of the selected PRIs as part of the sub-project cycle, a point further discussed in the recommendations below.

The India Country Assistance Strategy (FY2005-08) states that the World Bank will ensure its programs are both consistent with and supportive of a progressive shift to decentralized government. This implies that coherence in Bank-financed operations would be forged around the principles of subsidiarity, downward accountability, and local discretion, alongside specific interventions to support community participation and enhance financial accountability. The long-term goal would be to move toward a scenario wherein all resources are made available to PRIs. The PRI would be allowed to allocate fully according to its own priorities and subject to common processes on planning, financial management, procurement, and community accountability. But among the key stakeholders, it is recognized that this scenario may take several years to emerge. In the medium and short term, the World Bank will work toward phased convergence of a common platform of implementation to manage the flow of funds, accounting, procurement, and auditing arrangements across all Bank-financed lending where PRIs may have a key role within the decentralization framework.

State-level consensus plays a key role in achieving coherence on the trajectory of the decentralization of governance and service delivery arrangements. A decision by a World Bank task team would still to some extent be measured by the State’s own commitment to the decentralization agenda. Nonetheless, a default position might be assumed that for World Bank financing in sectors where PRIs have a central role—most evidently in rural drinking water, rural roads, rural electrification, tanks, education, and health—arrangements would ensure PRI authority over project planning and implementation. In most instances this would require a user group (or independent organization) to serve as the PRI subcommittee. It should be noted that financial management is not the sole determinant over decisions of whether or not existing institutions will be used for implementing Bank-supported operations. From the PFM perspective however and subject to the incorporation of any necessary capacity strengthening measures, the default position would be that the existing PFM institutional frameworks are used for purposes of Bank-supported operations.
Recommendations and Actions

This report provides a set of recommendations aimed at providing options toward building appropriate financing mechanism while financing through the PRIs. The manner and extent to which these may be applied would to a large extent need to be calibrated on the assessment of fiduciary risk and the overall enabling reform environment. In the two scenarios that emerge as financing options for the World Bank, the suggested approaches may be summarized as follows:

- Scenario 1, using *tied funds* for sector specific funding, would entail building into the project design measures that will ensure (a) the centrality of the role of the State line departments implementing the project to be accountable for the effectiveness of spending across the PRIs; and (b) the fiduciary arrangements are focused on enhanced levels of compliance with the existing framework of rules and procedures. There would however be some challenges in implementing this scenario which might require an incremental approach, calibrated to the perceived risks.

- Scenario 2, using *block grants* or untied funds, would make available untied resources to PRIs for allocation according to their own priorities, subject to common fiduciary standards as established by State legislation and through which they are held accountable by their communities. Higher tiers of government focus on establishing service standards, monitoring compliance with prescribed rules, and intervening in the case of severe service delivery or financial failures. These operations typically aim to strengthen the PRI system as a whole, including the fiduciary framework and may include a broader set of financial management and procurement reforms.

The key challenge in taking the findings of this report forward would be to initiate a broader discussion within the task teams, with an objective to ensure that the findings are taken on board in the design of future Bank operations. While this evidently applies to World Bank task teams, the findings have significant bearing on the manner that several GOI programs are designed and the role ascribed to PRIs and therein the fiduciary arrangements. The suggested actions are summarized for the various stakeholders as follows:

**Government of India:**

- Develop a coherent framework for financial and performance reporting of Panchayati Raj Institutions that will provide timely feedback to the State governments as well as GOI on the efficiency of revenue mobilization as well as public expenditures at the PRI level.
- Actively review present portfolio of centrally sponsored schemes to ensure centrality of Panchayati Raj Institutions and use of common fiduciary framework
State Governments:

- Update and modernize accounting and reporting rules for Panchayati Raj Institutions, in line with the common fiduciary framework.
- Provide guidance for treatment of project funds in PRI planning, budgeting, accounting, and reporting requirements.
- Review and strengthen Local Fund Audit’s capacity to undertake timely and quality audits of Panchayati Raj Institutions.

World Bank Task Teams:

- Arrange discussion forums within the World Bank to disseminate findings of the report.
- Organize workshop/s with external stakeholders (including Government of India and State governments) to initiate broader discussion on how the findings of the report apply to the GOI programs.
- Pilot suggested approaches to the fiduciary arrangements in the design of selected operations from the present pipeline.
- Form a core team within the Financial Management and Procurement Units to work on the project design of the selected pilots.
I. INTRODUCTION

Mindful of the commitment by the Government of India (GOI) to strengthening Panchayati Raj Institutions (PRI), the World Bank's India Country Assistance Strategy for FY05-08 states that support to decentralization will be an important focus of World Bank work with the Central Government and the State governments. To help India realize the potential of the country's Constitutional amendments, the World Bank will ensure that its programs are both consistent with and supportive of a progressive shift to decentralized government.

In World Bank-financed operations where Panchayati Raj Institutions have mandated roles under the Constitution, the Government has requested that these local village-level to district-level government bodies be fully integrated and provided with a central role. The World Bank has responded by actively seeking ways of achieving a greater degree of internal coherence between World Bank-financed operations and consistency with the GOI approach to decentralization. This action requires an understanding of the parameters of compliance with the decentralization framework and an agreement on the principles and elements of a common platform for all relevant World Bank operations.

A. Background

A World Bank synthesis study on public financial management and accountability (PFMA) in Panchayati Raj Institutions provides a reference point for mapping PFMA arrangements in place and highlights good practices that have emerged across the States.1 The study concludes that while PRI accountability systems have many weaknesses, incremental steps to improve systems and processes are being taken. Government Round Tables, the Office of Comptroller and Auditor General (CAG), successive Finance Commissions, as well as civil society have all made a case for improving accounting and procurement, strengthening audit function, building capacity of accountants and auditors, and bringing about a culture of transparency. However, given the disparate levels of improvements in different States, it is quite difficult to set out the weaknesses or the mitigation measures for a generic framework across the country.

In furthering the decentralization agenda, it is envisaged that an increasing number of World Bank-financed operations will involve transfer of funds to PRIs in sector specific investments or tied grants, block or untied grants, or any variations of the same. While a bulk of Bank-financed operations have previously dealt with Gram (village-level) Panchayat, there are increasing instances where Zilla (district-level) Parishads and Panchayat Samitis (block-level) have been funded under Bank-financed operations as well. The nature of fiduciary issues tends to vary across the three different tiers, particularly for the Zilla Parishads, which are quite large in some States.

The weaknesses in the fiduciary environment and the regional variations (also noted are disparities within the State) in the levels of the fiduciary framework often pose major challenges to World Bank staff in designing operations in line the World Bank Operational Policy and Bank Procedure on financial management (OP/BP 10.02) and on procurement (OP 11.00). The ability

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to finance block or untied grants without pre-determined specific end use by PRIs in an investment operation has been extensively discussed within the World Bank. The discussions deal specifically with the context of identification of productive expenditures (OP/BP 6.0, Bank Financing) and establishing the point at which the expenditures become eligible for disbursement—on transfer of funds by the State or when the transfer is utilized and accounted for (OP/BP 12.0, Disbursements). The fiduciary arrangements should be responsive to the nature of the resource transfer.

Building from the synthesis study, this report Financing of Panchayati Raj Institutions in World Bank-Financed Operations looks specifically at issues of arrangements for PRI-level public financial management. The arrangements being considered mean the use of country systems at the PRI level as defined in individual State legislation or rules and regulations defined for the purpose. This report is designed to provide practical advice that will better enable task teams and clients to understand how PRI financing with appropriate fiduciary arrangements could occur in World Bank-financed operations within the GOI Constitutional framework and World Bank policies. This report examines the ways in which funds can flow to PRIs, the conditions or supporting fiduciary environment that surrounds each of the financing methods, and the PFMA issues and how they could be addressed.

B. Approach & Methodology

This report used the active environment of ongoing World Bank-financed operations to map PFM arrangements. The objective was to analyze what has or has not worked well and determine whether any emerging good practices can be replicated or mainstreamed. While this task essentially entailed desk reviews, onsite visits were also made to the States of Uttarakhand, Maharashtra, Kerala, and Karnataka. The visits provided opportunities for consultations with project staff, key officials in the State government, as well as the Panchayat members. Literature reviews and consultations with experts and stakeholders from Central and State governments and local organizations aided in preparing this report. Efforts also went in the understanding and explanation of the PRI efficiency issues dealing with multiple financing sources and the myriad reporting requirements. Along with view of PRI staff, the reporting also looks at the extent to which existing PRI systems are being utilized or could have been utilized. This is quite pertinent to a Panchayati Raj Institutions that must deal with higher transaction costs when tied funds far exceed PRI’s own revenue and individual funding sources, including Central Government and centrally sponsored schemes, have the own reporting requirements.

This report does not address the fiscal decentralization or equity and inclusiveness issues in PRI-level planning and decisionmaking nor does it seek to define in any manner the rules of engagement, which is the subject of other decentralization studies and sector-specific activities.

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2 Financial management arrangements comprise accounting, procurement, financial reporting, internal controls, audit and oversight functions, fund flow, transparency, and accountability mechanisms.
II. PFMA FIDUCIARY & INSTITUTIONAL FRAMEWORK

A. The Constitution (73rd Amendment) Act, 1992

The Statement of Objects and Reasons enacted in the GOI Constitution (73rd Amendment) Act, 1992, observes that though the Panchayati Raj Institutions have existed for a long time, they had not acquired the status and dignity of viable and responsive people's bodies. This has been in part due to an absence of regular elections; lack of financial resources; prolonged super sessions; inadequate devolution of powers; and insufficient representation of such weaker groups as scheduled castes, scheduled tribes and women.

Article 40 of the Constitution, which enshrined one of the directive principles of State policy, directs States to organize village-level Panchayats and endow them with such powers and authority as may be necessary to enable them to function as self-governing units. In the light of experience in the past 40 years and in view of observed shortcomings, the Government recognized an imperative need to enshrine in the Constitution certain basic and essential features of Panchayati Raj Institutions to impart certainty, continuity, and strength to them. Box 1 gives major Constitutional provisions related to planning and PFMA-related PRI roles and responsibilities.

Box 1: Major Constitutional Provisions on Planning and PFMA-related Roles and Responsibilities of Panchayati Raj Institutions

**Article 40** enjoins that the States shall take steps to organize village *Panchayats* with such powers and authority as may be necessary to enable them to function as units of self-government.

**Article 243 (b)** defines a *Panchayat* as an institution of self government and a *Gram Sabha* as consisting of all persons registered as voters in the electoral roll relating to the village within the area of the *Panchayat* at the village level.

**Article 243 A** states that the *Gram Sabha* may exercise such powers and perform such functions at the village level as the legislature of a State may by law provide.

**Article 243 G** provides that State legislatures endow the *Panchayats* with such powers and authority to enable them to function as institutions of self-government and such law may contain provisions for the devolution of powers and responsibilities upon *Panchayats* for preparation of plans and their implementation for economic development and social justice.

**Article 243 H** requires the States to authorize *Panchayats* to levy taxes, duties, etc.; to assign taxes, duties, etc.; and to provide grants and create funds for crediting money received and withdrawals there from.

**Article 243 I** provides for the constitution of a State Finance Commission to review the financial position of *Panchayats* and to make recommendations regarding principles governing distribution of taxes, etc. between the State and the *Panchayats*, determination of the taxes, etc., which may be assigned to or appropriated by the *Panchayats*, extending grants-in-aid to the *Panchayats*, and the measures needed to improve the financial position of the *Panchayats*.

**Article 243 J** stipulates that the States shall make provisions for maintenance of accounts by the PRIs.

**Article 243 ZD** provides that the States are required to constitute District Planning Committees to facilitate the process of decentralized planning. To be set up in each district, the committees would prepare composite plans covering both urban and rural areas.
With the promulgation of the Constitutional (73rd Amendment) Act, a new era in federal democratic set-up dawned in 1993 conferring Constitutional status to the PRIs, envisaging establishment of a democratic decentralized development process through people’s participation in decisionmaking, and implementation and delivery with devolution of powers and responsibilities upon Panchayats at appropriate levels. As per Article 243G of the Constitution, 29 subjects listed in the 11th Schedule of the Constitution were identified for devolution to the PRIs. The Government’s Ministry of Rural Development was designated for implementation of the 73rd Constitutional Amendment. The Ministry of Panchayat Raj was created in May 2004 as a reflection of GOI commitment to decentralization.

B. State Legislative Framework

Article 243 G of the Constitution establishes the legal basis for the empowerment of Panchayats. It mandates that State governments endow Panchayats with such powers and authority as necessary to govern them, while holding the Ministry of Panchayati Raj responsible for ensuring conformity with the Constitutional provisions. State Acts set out powers, responsibilities, functions, and obligations with regard to public financial management. The extent of devolution varies across the States in generally three forms—function, functionary, and finance. By and large, the framework prescribed in State legislation rules provide a common platform (Table 1) for basic level of PFMA procedures, with some variations across States.

Table 1. Typical Contents of PFMA-related Provisions in Selected State Acts and Rules

<table>
<thead>
<tr>
<th>PFMA-related Provisions</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Powers, duties, function and Administration of Gram Panchayats</td>
</tr>
<tr>
<td>- Preparation of plan</td>
</tr>
<tr>
<td>2 Acquisition of land, Gram Fund and property</td>
</tr>
<tr>
<td>- Gram fund</td>
</tr>
<tr>
<td>- Finance Commission</td>
</tr>
<tr>
<td>- Audit</td>
</tr>
<tr>
<td>- Budget of Gram Panchayat</td>
</tr>
<tr>
<td>3 External control</td>
</tr>
<tr>
<td>- Inspection</td>
</tr>
<tr>
<td>- Power of State government</td>
</tr>
<tr>
<td>4 Gram Sabha, Gram Panchayat and committees</td>
</tr>
<tr>
<td>- Rules regarding the sitting and quorum of Gram Sabha and Gram Panchayat and conduct of their proceedings</td>
</tr>
<tr>
<td>5 Records and Inspections</td>
</tr>
<tr>
<td>- Rules regarding the maintenance of records and registers by Gram Panchayat</td>
</tr>
<tr>
<td>6 Preparation of projects and execution of works:</td>
</tr>
<tr>
<td>- Rules for the preparation of plans and estimates for works in Gram Panchayat and the execution of works and conditions of sanctions</td>
</tr>
<tr>
<td>7 Appointment etc. of servants</td>
</tr>
<tr>
<td>- Officers and servants, their salaries, allowances, and duties</td>
</tr>
<tr>
<td>- Appointment of Panchayat secretary</td>
</tr>
<tr>
<td>- Duties of secretary</td>
</tr>
<tr>
<td>8 Custody and administration of the Gram fund</td>
</tr>
<tr>
<td>- Maintenance of Gram fund and its transactions</td>
</tr>
</tbody>
</table>
### PFMA-related Provisions

- Sanction of expenditures from Gram fund
- Instructions for maintaining accounts
- Audit, steps for dispatch of audit notes
- Payment and adjustment of advances
- Payment of bills, vouchers and claims
- Maintenance of general cash book
- Maintenance of deposit registers
- Maintenance and verification of stock book
- Maintenance of register of public works
- Bills for works
- Details of completion certificates
- Muster rolls for daily labor

### Finance (annual estimate of income and expenditure)

- Estimates
- Minimum cash balance of Gram Panchayat
- Gram Panchayat’s expenditures under different heads

## C. Structures of PRIs – District, Block, and Village Panchayats

The 73rd Constitutional Amendment requires the establishment of a 3-tier PRI structure with elected bodies at village, block, and district levels. These structures are generally uniform across the country. A sample of the structure prevalent in Uttarakhand is shown in Figure 1.

**Figure 1. PRI-related Membership & Linkages**

![PRI-related Membership & Linkages diagram](image_url)
Uttarakhand has a 3-tiered Panchayat system—Zilla Panchayat (district level); Kshettra Panchayat (block level); and Gram Panchayat (village level). All 3 tiers are organizationally inter-linked in as much as the Pradhans of the Gram Panchayat are members of the immediate superior body; the Kshettra Panchayats; and the Pramukhs of the Kshettra Panchayat are members of the Zilla Panchayat. The Zilla Panchayat can delegate its functions to the Kshettra Panchayat which can likewise delegate to the Gram Panchayat. The members of the Zilla Panchayat and Kshettra Panchayat include other directly elected representatives while all members of the Gram Panchayat are directly elected.

Table 2. Data on Panchayats and Elected Representatives across 30 States/Union Territories

<table>
<thead>
<tr>
<th>Number of Panchayats</th>
<th>Number of elected representatives</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gram (village) Panchayats</td>
<td>233,251</td>
</tr>
<tr>
<td>Kshettra (block/intermediate) Panchayats</td>
<td>6,105</td>
</tr>
<tr>
<td>Zilla (district) Panchayats</td>
<td>539</td>
</tr>
</tbody>
</table>

Note: Numbers are from data as of December 1, 2006. 

D. Accountability Framework for the Panchayats

Figure 2 provides an overview of the basic ingredients of a PFMA framework that can be applied to the Panchayats. It is based on provisions of the Constitution, State legislation, and subsidiary rules. These are built upon the fundamental tenets of propriety, probity, transparency, and participation and are derived from the following imperatives:

- Panchayat Raj Act and rules relating to conduct of business by Panchayats, such as how often and how meetings are to be conducted, and records maintained and disclosed;
- State Panchayat Raj legislation creating Gram Sabhas and empowering them in plan approval, beneficiary selection, plan implementation monitoring, payment approval, and social audit;
- Established procedures for accounting and auditing;
- Framework for participatory bottom-up planning, which reflect the local needs and priorities;
- Structure for budgeting of the Panchayats with adequate linkages to plans;
- Legislative provisions for Right to Information;
- Mechanisms for periodic disclosure of information;
- Legislative provisions for an ombudsman, complaints-/grievance-handling mechanisms;
- Agreed minimum staffing pattern particularly at the village level;
- Administrative mechanism that provides for adequate technical assistance and support to the Panchayat;
- Legislative or administrative provisions which enable Panchayats to forge links and provide support to local citizen’s associations and user groups;
- Well-functioning system of standing committees operating at each Panchayat level, which ensures committee-based decisions;
- Clearly defined system for timely, independent, and effective external audit in place;
- Capacity-building plans for training village Panchayat members, functionaries, and departments in place.
Figure 2: Public Financial Management & Accountability Framework

E. Roles of Statutory Institutions

**Central Finance Commission:** Beginning with the 10th Central Finance Commission constituted after the 73rd and 74th Amendment to the Constitution, the Commission has been giving directions with regard to PRI finances. The 11th Finance Commission expressed concern over the maintenance of accounts and audit and noted in its report that, while most States had made provisions by way of legislation for maintenance of accounts by the Panchayats, detailed guidelines or rules had not been laid out in several cases (Box 2). In many States, the formats and procedures for maintenance of accounts by PRIs prescribed decades ago are continued without making any improvements taking into account the manifold increase in their powers, resources, and responsibilities. The Central Finance Commission also noted that there was no mechanism for collection of data on the revenue and expenditure of the three tiers of Panchayats at a centralized place where it could be compiled and processed.

**Box 2: Key Recommendations of 11th Central Finance Commission with Reference to Accounts and Audit of Local Governments**

- States should review the existing accounting heads under which funds are transferred to Panchayats; separate demand heads should be created in the state budgets for the rural local governments.
- The Comptroller and Audit General should be entrusted with the responsibility of exercising control and supervision over the proper maintenance of accounts and their audit for all the tiers of Panchayats.
- The director, Local Fund Audit, or any other agency made responsible for the audit of accounts of the Panchayats, should work under the technical and administrative supervision of the CAG.
- The Comptroller and Audit General should prescribe the format for preparation of budgets and for keeping of accounts.
- Local bodies, particularly the village and intermediate-level panchayats that do not have trained accounts staff may contract out the upkeep of accounts to outside agencies/persons.
- The Comptroller and Audit General report relating to the accounts of the panchayats should be placed before a Committee of the State Legislature constituted in the same lines as the Public Accounts Committee.
The 12th Central Finance Commission, while noting that substantial progress had been made in the implementation of the above recommendations, also recommended that funding support continue to be provided to the Panchayats by the States for maintenance of accounts and building of a database helping to assure credible information on the PRI finances. Subsequently, guidelines issued by the Ministry of Finance have made it mandatory to transfer grants released by the Central Government to the Panchayats within 15 days of the same being credited to the State’s accounts, as recommended by the 12th Finance Commission.

**State Finance Commission:** Article 243 I provides for each State to constitute a State Finance Commission. The State Finance Commission reviews the measures needed to improve the financial position of Panchayats and makes recommendations regarding principles governing distribution of taxes and other things between the State and the Panchayats; determines the taxes, which may be assigned to or appropriated by the Panchayats; and extends grants-in-aid to the Panchayats. Box 3 provides an example of the State Finance Commission recommendations in the State of Uttarakhand. The 12th Central Finance Commission in its report noted however that the convention established at the national level of accepting the principal recommendations of the Central Finance Commission without modification is not being followed by the States.

**Box 3: Incentive-based Transfer of Funds Pursuant to State Finance Commission Recommendations in Uttarakhand**

<table>
<thead>
<tr>
<th>Financial performance (15 percent):</th>
<th>Financial performance (15 percent): Four sets of indicators would be adopted:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Competitive &amp; productivity tax, as per norms adopted for the resource forecasts;</td>
<td>• Competitive &amp; productivity tax, as per norms adopted for the resource forecasts;</td>
</tr>
<tr>
<td>Non-tax revenues to achieve a minimum growth rate of 5 percent per annum;</td>
<td>• Non-tax revenues to achieve a minimum growth rate of 5 percent per annum;</td>
</tr>
<tr>
<td>Clearance of tax and non-tax arrears; and</td>
<td>• Clearance of tax and non-tax arrears; and</td>
</tr>
<tr>
<td>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).</td>
<td>• 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).</td>
</tr>
</tbody>
</table>

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

- Frequency and quality of proceedings of formal meetings of the Zilla Panchayat and its committees;
- Financial record-keeping; budget quality; and clarity of content, timely decisions, and particularly adherence to approval processes for incurring expenditure;
- Grading achieved in audit reports, and timely placement of reports before the Zilla Panchayat for discussion and reply.

**District Planning Committee:** As per Article 243 ZD of the Constitution, States are required to constitute District Planning Committees to facilitate the process of decentralized planning. District plans should emerge from input by each Gram (village) Panchayat, Kshettra (block) Panchayat, and Zilla (district) Panchayat. District Planning Committees are required to consolidate these plans and draft them into district development plans for finalization by State governments. The process of consolidation involves searching for optimal solutions when conflicts arise and clarifying technical and economic issues that require reconciliation. The Planning Committee circulars of October 24, 2005 and August 25, 2006, laid down detailed guidelines to State governments on bottom-up planning through Panchayat, municipalities, and
District Planning Committees in conformity with the Constitutional provisions. The 2nd Round Table of State Ministers of Panchayat Raj (Mysore, August 2004) resolved that the District Planning Committee ensures discussions for the 11th Annual Plan are based on district plans prepared in accordance with Article 243ZD of Part IXA of the Constitution. Presently, there are 13 States/Union Territories that have constituted District Planning Committees in accordance with Article 243 ZD of the Constitution. Many more States are moving to bridge this gap in their preparation for the 11th Plan and are expected to constitute their District Planning Committee soon.

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3 Article 243ZD of Part IXA of the Constitution of India requires every State to constitute at the district level a District Planning Committee (DPC) to consolidate the plans prepared by the Panchayats and the Municipalities in the district and to prepare a draft development plan for the district as a whole. The detailed provisions relating to the composition of the DPC, manner in which the seats are to be filled, functions which may be assigned to sub-committees and selection of Chairpersons of the DPC are to be determined by the State Legislatures.
III. OVERALL FIDUCIARY ENVIRONMENT: POLICY AND PRACTICE

With the devolution of significant funds, along with funds and functionaries to the Panchayati Raj Institutions, it is imperative that they have in place an appropriate institutional framework for public financial management and accountability as well as systems and processes to effectively discharge their responsibilities to the people.

A. Summary Findings of Synthesis Study

The 2005 World Bank-conducted Public Financial Management and Accountability (PFMA) in Panchayati Raj Institutions (PRIs) (Rural Local Governments) Synthesis Study covered six Indian States—Karnataka, Orissa, Uttar Pradesh, Rajasthan, West Bengal, and Uttarakhand. The study was designed to serve as a reference point for mapping the PFMA arrangements, highlighting good practices, and summarizing issues that are most relevant to stakeholders.

The study finds that even while a well-defined legal and institutional PFMA framework at the PRIs exists, there is considerable room for improvement in implementation. Although Gram (village) Panchayats have their own revenues from various taxes and fees, these funds constitute an insignificant portion of their total revenues. The PRIs continue to remain largely dependent on plan assistance from Central and State governments, often resulting in their functioning as extensions of the State and not as independent self-governing bodies in the true sense. The almost complete dependence on external assistance means that budgeting in all three Panchayat tiers is top-down rather than bottom-up. Also being demand driven, budgets are often prepared only to comply with statutory requirements and not used as a tool for financial control or long-term planning.

While legislation provides for a tight set of internal controls on use of PRI resources, these controls have not curbed thousands of reported frauds and embezzlements. The accounting practices adopted by the Panchayats have not kept pace with the increased and diversified flow of resources entrusted to them. There are no accounting standards or uniform accounting codes for Panchayats. Organized financial reporting is scant in any three PRI tiers. 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. The statutory auditor of all Panchayats is either the Local Fund Audit Department or the Office of Comptroller and Auditor General. Chartered accountants engaged by the District Rural Development Agency audit centrally sponsored scheme funds. Although there are many audits, they tend to be late. Audit procedures are also lacking or deficient.
On a more encouraging note, the synthesis study documents several instances of ongoing initiatives and success stories at the Central and State levels that have the potential for altering the accountability landscape. The innovative People’s Campaign for decentralized planning in Kerala has provided an excellent model for other States. Following the detailed activity mapping exercise, Karnataka has taken the lead in implementing the devolution of funds, functions, and functionaries for all 29 subjects assigned to the PRIs. Karnataka has demonstrated that by its efforts to standardize property tax rates in rural areas, tax collection at the PRI level can be increased substantively. The 11th Central Finance Commission entrusted the technical guidance and supervision of PRI accounts to the Office of the Comptroller and Auditor General. To fulfill the mandate for technical guidance and supervision, the Comptroller and Auditor General has prescribed accounting formats for PRIs, as well as auditing standards. States like Orissa and West Bengal are making major headway in strengthening the accounting functions through information technology and inter-connectivity.

Giving the electorate access to information and introducing social audits at the Gram Sabha level help to ensure accountability and transparency. Good practices, like the Right to Information Act (pioneered in Rajasthan and introduced in 7 other States) and posting of Gram Panchayat accounts for public display (in Karnataka, Uttar Pradesh, and Kerala among others) are emerging.

In summarizing the key issues with respect to PFMA policy and practice in Panchayats, an attempt has been made to adapt the Performance Measurement Framework issued by the Public Expenditure & Financial Accountability (PEFA) Secretariat to suit the local requirements. The key components of the PFMA framework, as may be applicable to Panchayats and desired policy outcome in each strategic area, are presented in Table 3. The practices described in Table 3 are derived from the World Bank synthesis study. While the observations generally represent the overall practice, there are notable exceptions and good practice examples are documented in the study. Many new initiatives are also underway and discussed in the following section.

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4 The Eleventh Schedule of the Constitution of India lists 29 subjects ranging across agriculture, infrastructure, health, education etc.
5 The PEFA Framework incorporates a PFM performance report and a set of high-level indicators that draw on the HIPC expenditure tracking benchmarks, IMF fiscal transparency code and other international standards. It forms part of the strengthened approach to supporting PFMA reform, which emphasizes country-led reform, donor harmonization and alignment around the country strategy, and a focus on monitoring and results. This approach seeks to mainstream better practices that are already being applied in some countries. See Public Financial Management, Performance Measurement Framework, PEFA Secretariat, June 2005, www.pefa.org


<table>
<thead>
<tr>
<th>Table 3: PFMA Components – Desired Policy Outcomes and Practice</th>
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</thead>
<tbody>
<tr>
<td><strong>Desired policy outcomes</strong></td>
</tr>
<tr>
<td>---</td>
</tr>
<tr>
<td><strong>1 Budgeting</strong></td>
</tr>
<tr>
<td>Each PRI has a budget that covers all sources and utilization of funds; the budget is available to all members of the General Assembly in an easy and understandable form.</td>
</tr>
<tr>
<td><strong>2 Cash and fund flow management</strong></td>
</tr>
<tr>
<td>All revenues and grants are received in a predicted manner.</td>
</tr>
<tr>
<td><strong>3 Internal controls</strong></td>
</tr>
<tr>
<td>Basic procedural controls are in place; all payments properly authorized and documented, all receipts properly accounted for, reconciliations/confirmation carried out on a regular basis, key financial decisions recorded in proceedings (minute books).</td>
</tr>
<tr>
<td><strong>4 Accounting</strong></td>
</tr>
<tr>
<td>Accounting books are maintained regularly and cover all receipts and payments; Accounting follows double entry bookkeeping systems and is maintained on a cash basis.</td>
</tr>
<tr>
<td><strong>5 Asset management</strong></td>
</tr>
<tr>
<td>Complete records of the assets of the PRI are maintained and updated on a timely basis.</td>
</tr>
<tr>
<td><strong>6 Procurement</strong></td>
</tr>
<tr>
<td>An efficient system of procurement is in place promoting increased competition among vendors and providing greater value for money to the PRIs.</td>
</tr>
<tr>
<td><strong>7 Financial reporting</strong></td>
</tr>
<tr>
<td>Financial reports (receipts &amp; payments statements, statement of assets) are regularly prepared and presented to the General Assembly and the authorities.</td>
</tr>
<tr>
<td>Desired policy outcomes</td>
</tr>
<tr>
<td>-------------------------</td>
</tr>
<tr>
<td><strong>8 External audit</strong></td>
</tr>
<tr>
<td><strong>9 Oversight and local transparency</strong></td>
</tr>
</tbody>
</table>

**Note 1:** Several models of integrated planning approaches have emerged. In Kerala, the use of Voluntary Technical Corps to assist the Gram Panchayats in the 'People's Planning Process' was a bold initiative, even as new thinking of the subject suggests that the model is being considered as overregulated and essentially unsustainable. In West Bengal, Gram Sansads have been given a significant role in identification of schemes, which the Panchayats are obliged to incorporate in the annual plans. Similarly, NGOs such as the Consumer Unity and Trust Society in Rajasthan, have shown that bottom-up needs assessment is feasible through careful micro-planning at the village level. The Karnataka Local Fund Authorities Fiscal Responsibility Act 2003, covering the PRIs establishes an overarching framework for preparation of a Medium-Term Fiscal Plan that outlines the mission and goals of the entity.

**Note 2:** Good practices emerging from Karnataka include the significant increase in property tax collections following a massive survey of the dwelling units within the boundaries of each Gram Panchayat. In another initiative taken by the Government of Karnataka, the funds transfer process from the State to the local rural governments has been streamlined by entering into service agreements with 18 banks for e-transfers.

**Note 3:** New Initiatives are being taken in Orissa to strengthen accountability through an ambitious e-governance program. This includes web-based data management systems to (a) track funds transferred across the three PRI tiers and online information on the cash/bank scheme-wise balances; (b) provide access to citizens to track allocations, expenditures, etc. on wage employment schemes; and (c) facilitate transmission of block accounts to districts/State. The new set of accounting rules drawn up by the Government of Karnataka for Gram Panchayats is yet another example of good practice and aims at modernizing and updating the accounting rules.

**Note 4:** Several good practice examples have emerged in the area of financial reporting. In West Bengal, some Panchayats (Howrah Zilla Panchayat) routinely publish their annual accounts/reports and make this available to the public. In Rajasthan, the Panchayati Raj Department receives quarterly and annual progress reports from all district and block PRIs; the reports from the Gram Panchayat are retained at the block level. In Maharashtra, the Zilla Panchayat accounts are published in the Official Gazette. Introduction of Right to Information Act in Rajasthan, Karnataka, Uttar Pradesh and Kerala grant every citizen the right to obtain copies of official documents by paying a small fee.

**Note 5:** Pursuant to the 11th Finance Commission recommendations, the Office of Comptroller and Auditor General has prescribed Auditing Standards and Guidelines for Certification of PRI Accounts.

**Note 6:** This is an area which has perhaps seen the largest number of innovations. Some noteworthy developments are (a) introduction of public displays (Karnataka, Uttar Pradesh, Kerala among others); (b) televising the proceedings of Gram Sabha (Beandur Gram Sabha, Tamilnadu); (c) issuing a Citizens' Charter (Andaman & Nicobar); (d) holding Jan Sunvai or public hearings (Rajasthan); (e) initiating Jamabandi as a form of social audit (Karnataka) and (f) enlisting an ombudsman to deal with complaints regarding corruption at PRI levels.
B. New Initiatives for Improvement of PFMA

Initiatives taken by the Office of the Comptroller and Auditor General aim to achieve harmony in budgeting, accounting, financial reporting, and auditing across the country. Pursuant to the recommendations of the 11th Finance Commission in 2001, the Comptroller and Auditor General has undertaken several initiatives aimed to standardize and improve PFMA arrangements of PRIs:

- Twenty-two States have entrusted account maintenance and auditing to the CAG technical guidance and supervision for all three PRI tiers. The CAG has approved parameters in 5 States for engaging outside agencies to clear arrears in 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. Eighteen 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.
- The Office of the Comptroller and Auditor General has prescribed auditing standards for PRIs (Box 5).

Box 5: CAG-Prescribed Auditing Standards and Guidelines for PRIs

These CAG-prescribed standards govern the conduct of the audit and determine what the auditor must do. The Office of the Comptroller and Auditor General is hopeful that these standards for audit of PRIs will help government auditors to foster a greater sense of responsibility, promote public accountability, and provide valuable assurance to concerned state and union territory agencies and other stakeholders.

At present, as part of the audit of local bodies, the Director of the Local Fund Audit Department or the Examiner of the Local Fund does not generally certify the accounts. Rather it is a transaction audit only. Current audit procedures do not include physical verification procedures. Moreover, there is no provision for publishing the annual performance reports or the certified financial statements. The "presents fairly" basis of accounting should not be significantly different from, and no less onerous than, the "true and fair view" basis of accounting adopted in the private sector. The former derives from generally accepted audit practices.

Incentives for empowerment and accountability in Panchayati Raj: At an All India Panchayat Adyaksha Sammelan held in New Delhi, April 2002, a resolution passed that recommended an appropriate structure of providing incentives to recognize and encourage the Panchayats for outstanding performance. From this genesis, a scheme for Panchayat awards was instituted in 2005-06. In addition, the Ministry for Panchayati Raj felt that it was equally important to recognize the role of State governments and broadened the awards for the best performing States and Panchayats.

The award indicators included the adequate devolution of functions, funds, and functionaries as exemplified by activity mapping, the extent of devolution of funds in accordance with activity mapping, and the control vested in Gram Panchayats over village-level functionaries. States were graded on the basis of the enabling powers given to Gram Sabha, particularly the steps taken and orders issued with regard to facilitating regular and proper functioning of Gram
Sabhas. Their efforts to ensure effective participation of the marginalized and for putting in place proper arrangements for enabling the Gram Sabhas to undertake social audit were also considered. Three monetary awards of Rs.5 crore, Rs.3 crore, and Rs.1.2 crore were given to three top-ranking States, respectively.

Following on this scheme, the Ministry has also piloted a small scheme (awarding Rs.5 crore) to provide incentives recognizing Panchayat empowerment. Important milestones would trigger the proposed incentives to operate. These incentives were signing of a memorandum of understanding with the Union Government, deputing of functionaries for administrative functions in the Panchayats, transferring funds in the State budgets directly to Panchayat accounts, ensuring appointment of a Secretary for each Gram (village) Panchayat, assigning powers to the Gram Sabhas for selection of beneficiaries, and constituting District Planning Committees. The Ministry is now designing a more comprehensive scheme of incentives, based not on individual criteria but a more nuanced devolution index. The scheme will also cover the aspect of accountability of performance of Panchayats.

**Round tables for consensus building.** In order to ensure that a national consensus is evolved through mutual consultations on the roadmap for Panchayati Raj, several round tables of State Panchayati Raj Ministers with the Union Minister have been convened to discuss identified dimensions of Panchayati Raj ranging from devolution of functions, funds, and functionaries; to district planning, training, capacity building, and technology for enabling e-governance. Key actions coming out of the 6th Round Table convened by the Ministry of Panchayati Raj are summarized in Box 6.

**Box 6: The Future of PRI Accountability, 6th Round Table of the Ministry or Panchayati Raj**

<table>
<thead>
<tr>
<th>The following actions should be considered to strengthen PRI accountability:</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Standard should be issued to ensure that audits are efficient and achieve their purpose and there should be 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:</td>
</tr>
<tr>
<td>• When transactions should be examined;</td>
</tr>
<tr>
<td>• What should be monitored;</td>
</tr>
<tr>
<td>• How transactions should be documented; and</td>
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<tr>
<td>• How they should be disclosed.</td>
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<tr>
<td>2. For auditing to be effective, a National Accounting Standards Board should be established for local government accounts. This Board should complement the establishment of audit commissions or similar regulatory bodies at the State level.</td>
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<tr>
<td>3. An effective system of internal audit should be set up.</td>
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<tr>
<td>4. Public Accounts Committees specific to PRIs should be set up. Alternatively, PRI accounts should be submitted to Panchayati Raj Committees of the State Legislatures. A State-level committee to settle audit paragraphs is also an option.</td>
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<tr>
<td>5. PRI staffing capacity and their audit offices should be expanded and staffing constraints removed.</td>
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<td>6. Social audits and other social accountability mechanisms should be encouraged. These mechanisms should exist not only at the Gram (village) Panchayat level but also at higher levels. There also needs to be adequate provision for follow up and public disclosure of audit findings.</td>
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<tr>
<td>7. Those States that have not yet adopted the CAG-issued Technical Guidance and Supervision Guidelines should consider doing so.</td>
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C. **Recommended Actions from Synthesis Study**

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 in several directions. The Government's Round Tables, CAG-issued guidelines for technical guidance and supervision, 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 key action steps included in the World Bank synthesis study remain valid:

- Devolution in principle should be followed by practical steps for the devolution of funds, functions, and functionaries.
- The budgeting and budget execution functions are dependent on the amount and timeliness of funds flowing to PRIs. It is thus critical that timely transfer of funds is made directly to the level for which they are meant.
- Given the importance of timely, accurate, and reliable financial reports as the basis of accountability to civil society for usage of public funds, due attention to the accounting function is required. In this context, efforts would be required to strengthen accounting capacity at the village level, to ensure that the Gram (village) Secretaries who are responsible for accounting are trained and that the accounting requirements simplified to meet the increasing levels of public funds handled at each level.
- A vibrant control environment is important to a well-functioning PFMA system. New developments with respect to creating demand for accountability are seen as important steps in this direction.
- The external audit function serves the role of independent scrutiny and attestation and therefore serves as an important means of assurance. The steps taken by the Office of the Comptroller and Auditor General to strengthen the process and quality of audits through its mandate for technical guidance and supervision is a good beginning and will help restore the validity of the assurance function.
IV. APPROACHES TO PRI FINANCING: METHODS AND SCHEMES

This chapter discusses the methods and schemes for distributing fund to the Panchayat.

A. Tied and Untied Funds

Funds are distributed to PRIs in either of two methods: tied funds or untied (or block grant) funds.

(1) Tied funds

Tied funds generally refer to all scheme-based, non-discretionary grants tied to a specific investment or activity transferred to PRIs. These include a multitude of Central schemes, centrally sponsored schemes, State schemes, and all externally aided projects. These are normally tied into strict administrative procedures and expenditure categories that do not give discretion to local governments for making their own decisions and, in essence, making them mere agents of the Central and State governments. Typical features of tied grants include:

- Limited expenditure discretion to meet local needs and preference,
- Uniform entitlements independent of need or fiscal capacity,
- Often unpredictable transfers rendering planning meaningless,
- Generally ring-fenced financial management arrangement.

In the present scenario wherein the PRIs own revenue sources are negligible or limited, these grants often form a bulk of the funds available to the PRIs. Partly in order to meet the scheme requirements, these funds are typically maintained in separate bank accounts, accounted for, and reported separately at periodic intervals through utilization certificates. Many of these scheme accounts are also subject to audit by private chartered accountancy firms engaged by District Rural Development Agencies (the normal conduit for fund flows for Central and centrally sponsored schemes). Meeting the separate system and reporting requirements of the different schemes can easily overwhelm the capacity of the already stretched administrative capacity of the PRIs and detract from development impact. While the obvious fallout is increased administrative costs in meeting the myriad reporting requirements, accountability to voters is an implication that must not be overlooked.

(2) Untied funds or block grants

By definition, a block grant (also called untied funds) would provide near total freedom of use to the PRIs. At best, only broad sectoral ceilings and a list of unacceptable works need be prescribed. Within this broad framework, PRIs are allowed to prepare any program in consonance with local needs. Thus PRIs are permitted to sanction administratively any scheme that they develop within the budgetary allocation and guidelines for usage without reference to any agency. The PFM framework has evolved substantively over the last decade to adapt to the block grant type of transfers from the State. Not much experience is available nationwide in the use of untied grants, with the exception of Kerala and (to a small extent) Karnataka.

A defining feature of the Panchayati Raj Institutions in Kerala is the fairly large share of State-provided block grants and the PFM framework put in place for the State to derive assurance on the use of funds for intended purposes. In adopting the “Big Bang” approach to decentralization
and adopting a wide range of reforms, including setting up a fiscal transfer system that assigned 20 percent of the State capital budget as the vertical share for local governments, Kerala is quite clearly the front-runner of decentralization in India. Derived from various legislative acts, rules, and bylaws, the PFMA framework covers the range of different components of the PFM cycle. Budget preparation; approval and execution; internal control, including internal audit, accounting and financial reporting, and external audit; and legislative scrutiny are designed to provide a strong platform for the State to obtain fiduciary assurances for the effective and economical use of funds provided to the Panchayat Raj Institutions. In practice, however the financial control framework lacks rigor and oversight. In its effort to cope with the manifold increase in the abundant funds handled by the Panchayats, the State of Kerala has issued several regulations on the use of funds, which have resulted in an overly complex system. The challenge for Kerala now is to simplify, consolidate, and institutionalize the various rules and operating procedures into a fully encompassing legal and institutional framework, updating and modernizing many of the archaic accounting and reporting systems to support decision making and local governance. Annex A provides a preliminary assessment of the practice of public financial management in Kerala.

The major challenge from an accountability aspect in case of untied block grant funding is to establish mechanisms to track and confirm that the use of resources are consistent with the intended purposes and that remedies have been defined and processes elaborated to recover misused resources and/or penalize these misuses. Accountability is defined as the state or responsibility of being required to give an explanation for one’s action or inaction. In the context of local governments, accountability also refers to answerability of the elected functionaries or institutions to the public and includes the existence of mechanisms, which ensure that appointed officials and elected functionaries are answerable for their actions and use of public resources. The primary tools used to enhance accountability include Gram/Ward Sabhas, beneficiary committees, citizens’ charter, Right to Information, internal, external and performance audits, suggestion boxes, complaint-handling mechanisms, and social audits. Box 7 gives examples of recent developments in Karnataka related to transparency and social accountability.

B. Central and State Sponsored Schemes

(1) Centrally sponsored schemes

Centrally sponsored schemes have been part of the fiscal transfer landscape of India for decades. At present, there are more than 200 centrally sponsored schemes, involving over Rs.72,000 crores per annum given either as grants, loans, or other contributions by the Central Government to the States. At an operational level, the largest inflow of resources to State governments is through centrally sponsored schemes. Design and implementation of the centrally sponsored schemes need to ensure Panchayats complete control over the funds as well as ownership. A task force constituted in 2001 by the District Planning Committee to formulate operational guidelines departments observed that centrally sponsored schemes continue to be implemented departmentally or through parallel arrangements—user associations, District Rural Development Agencies, program-specific agencies, nongovernmental organizations, self-help groups virtually by-passing the PRIs.
Box 7: Recent Developments Relating to Transparency and Social Accountability in Karnataka

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 (village) 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.

Ward Sabha and Gram Sabha – Ward Sabha may forward various issues to the Gram Panchayat. The Gram Panchayat, 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. Gram Sabhas may also generate proposals and determine the priority of all schemes and development programs for implementation in the Panchayat area by the Zilla Panchayat or Taluk Panchayats (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 Zilla Panchayat and Taluk Panchayats to furnish election expenses to the State Election Commission. Likewise, elected members of Zilla Panchayat and Taluk Panchayats 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 poor administration and corruption by the PRI. The Ombudsman will act as a fact-finding and problem-solving body without the trappings of a court.

During the 5th Round Table of Ministers of Panchayat Raj at Srinagar, the Ministry of Panchayat Raj constituted a task force to examine centrally sponsored schemes from the perspective of Panchayats and State Governments. The task force, comprising State representatives of Panchayati Raj, submitted its reports in December 2004 and issued the following main recommendations:

- Institute safeguards to prevent diversion of Central funds meant for Panchayats;
- Issue baseline standards in accounting and auditing;
- Implement a legal and administrative framework that emphatically holds Panchayats to account for transparency and for full disclosure of information; and
- Devise prompt, web-based monitoring of performance of Panchayats down to the village level.

Since 2004, several Central ministries have incorporated appropriate provisions in critical programs, such as the National Rural Employment Guarantee Act, the National Rural Health Mission, Sarva Shikha Abhiyan, and the Mid-Day Meal Program, to ensure the centrality of the Panchayats in planning and implementing these schemes.

Considering the strategic importance placed on these national programs and recognizing that centrally sponsored schemes are likely to remain an important source for development funds, it
may be useful to consider a scenario wherein the PRIs continue to perform as implementing agents for central programs. There would be an increasing convergence of financial management and procurement requirements placed upon PRIs in individual programs, to the point at which a common set of rules, regulations, and procedures (to be read as use of PRI-owned PFM systems) begins to emerge. Emerging from this scenario would be requirements for greater levels of transparency and realism in fund allocations and disbursement in accordance with the PRI budget calendar. Funds would flow to specific bank accounts but be accounted for in the PRI books of accounts, reported from the PRIs own monthly consolidated financial reports, and audited as part of the annual consolidated audit of the PRI. A rationale for such an approach could be promoted by the evident reduction of transaction costs to the PRI, enhanced ownership, and strengthened systems to close the gap between policy and practice. Overall, use of its own systems would have significant potential to improve PRI development impact.

A review of the financial management and procurement requirements of selected flagship centrally sponsored schemes from this perspective in Annex B suggests that there are significant opportunities for achieving a greater degree of coherence between both the financial management and procurement requirements of the various centrally sponsored schemes and consistency with the PRIs own systems and for the Central ministries to make concerted efforts to harmonize around strengthened country systems.

(2) Rapid transfer of funds to Panchayats.

The Government of India made a commitment to ensure that all funds given to States for implementation of poverty alleviation and rural development schemes by Panchayats are neither delayed nor diverted. In light of this commitment, the Ministry of Panchayat Raj constituted a task force in January 2005 to examine the feasibility of rapid fund transfers. Once the task force agreed to the feasibility, the Ministry recommended adoption of the system to the Central and State governments. Computer-based software has now been prepared by the Ministry of Panchayat Raj to maintain a database of the bank accounts of all 240,000 Panchayati Raj Institutions to facilitate transfer of funds through banking channels, preferably electronically.

Karnataka has implemented the system, using the fast expanding electronic network of banks to transfer funds from the State Treasury to individual Panchayats. The Karnataka State Government sends (12th Finance Commission) funds and its own untied statutory grant to all Panchayats through banks without any intermediary directly from the State Department of Panchayati Raj. The arrangement includes 6 nationalized banks and 12 Grameen Banks, in which all 5,800 Panchayats at all levels hold accounts. The system protects Panchayats from Treasury bans and has reduced the maximum time taken for funds to reach each Panchayat from 2 months to 12 days.
C. GOI/State Government Approaches to World Bank Financing to PRIs

The Department of Economic Affairs, Ministry of Finance, wrote the following at the start of the report process:

Ministry of Panchayati Raj feels that till now in all the projects including DPIP [District Poverty Initiatives Program] and sector support programs taken up by the World Bank, the emphasis has been on implementation and fund flows through parallel bodies, while the MOPR has been emphasizing on central role to PRIs in all World Bank financed operations. This study may help to integrate all PRIs in all World Bank supported operations in future [from letter dated March 17, 2006].

The 37th report of the Standing Committee on Urban and Rural development observed that “not only pre-Part IX parallel bodies like District Rural Development Agencies, joint forest management, and water user groups are working, but certain post-amendment parallel bodies like expert committee in Kerala and Janmobhoomi in Andhra Pradesh are also there”. The Committee also noted that although the Line Ministries and Departments agrees that these parallel bodies are undermining the decisionmaking powers of Gram Sabha and Gram Panchayat in respective States, nothing concrete has been done to remedy the situation. The Committee, therefore strongly recommended that all parallel bodies and programs working in various States should be brought under the overall monitoring and supervision of Panchayats at the appropriate level. The Second Round Table of State Ministers of Panchayat Raj (Mysore, August 2004) agreed that “the Central and State governments may evolve modalities and mechanisms for granting permission to parallel bodies, including those established by foreign and multilateral donor agencies, so that parallel bodies do not undermine the Constitutional authority of PRIs as institutions of self-government but work together to their mutual benefit and the common benefit of the community”.

Over the last decade, many States have made several increasingly significant commitments toward functional and fiscal decentralization to local governments, including Panchayat Raj Institutions. These commitments have taken the form of State Acts, subsidiary regulations, and Government Order covering matters from financial management and procurement to elections. In Karnataka, a 2003 Government Order transferred functions, finances, and functionaries to PRIs based on an activity map. In 2004, another Government Order required the transfer of State sector schemes to PRIs. The latter Government Order has particular significance for World Bank operations in Karnataka as it (a) prohibits “parallel bodies” from implementing projects in subject areas devolved to PRIs; and (b) explicitly requires World Bank operations to be implemented "through PRIs only”.

Several reasons are given why project authorities and village communities prefer the user group route rather than the Gram Panchayat subcommittee option: (a) members of Gram Panchayat subcommittees are nominated by the Panchayat whereas executive body of societies are elected; (b) more party politics leads to increased conflict (for example, a newly elected sarpanch stalled payments for work done under the previous incumbent); (c) sometimes the subcommittee

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6 From the Standing Committee report on the implementation of Part IX of the Constitution presented to the Lok Sabha on 28 June 2002 and the Rajya Sabha on 20 November 2002.
members expect kick-backs from works implemented, barring which payments are delayed; and (d) there is a fear that user charges may be used for other developmental works in the village.

Conceptually however, a clear distinction needs to be made between projects supporting the delivery of basic local services, where local governments have a readily identifiable and high-priority responsibility, and those projects that are focused on supporting livelihoods (or private goods). This distinction assists in determining the institutional arrangements within World Bank operations to conform to the decentralization framework and avoids placing functions that are best left outside of direct local government responsibility within their operational domain.
V. WORLD BANK POLICIES AND PROCEDURES AS APPLY TO PRI FINANCING

All World Bank policies required under investment lending apply to PRI financing operations. An overarching requirement, as stated in OP 10.00, Investment Lending: Identification to Board Presentation, is that all investment operations must be consistent with the World Bank's Articles of Agreement. In particular, this refers to the clause regarding use of financing proceeds for the purposes intended. In the context of PRI financing, it also means that for each type of resource transfer to PRIs (e.g., block grants, specific investment), the conditions, or supporting fiduciary environment be determined in a manner so as to provide assurance that disbursed funds are used for intended purposes.

A. Expenditure Eligibility Policy

With the approval of the country financing parameters for India in March 2005, the expenditure eligibility policy (OP 6.0, Bank Financing) applies to all investment lending operations in the country. In applying the policy to financing of block grants to Panchayati Raj Institutions, the expenditure eligibility policy provides additional flexibility. The expenditure composition of block grants may now be more broadly defined as expenditures required meeting the objectives of the block grants being made under the project. Other implications of the policy on operations financing PRIs especially for block grants, relate to the greater flexibility in financing recurrent expenditures, a determination of which is made based on sustainability at the sector and project levels, including sustainability of the project achievements/outcomes and the implied future budgetary resources.

B. Financial Management Policy

In the design of investment operations that finance Panchayati Raj Institutions, the financial management standards and reporting requirements must fully adhere to OP 10.02, Financial Management. In the case of projects that finance PRIs, this poses some special challenges by way of conducting assessments of adequacy of financial management capacity, determination of a framework that can apply across a disparate set of institutions, ability to provide consolidated financial reports of actual expenditures, as well as determination of acceptable audit arrangements. These challenges become more pronounced for operations that finance block grants to PRIs.

C. Procurement Policy

As in all investment operations, World Bank procurement requirements (OP 11.00, Procurement) apply to projects that finance PRIs as well. While the linkages to investment-style

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8 Country financing parameters provide an overall framework for all projects in the country covering (a) cost sharing, (b) recurrent cost financing, (c) local cost financing, and (d) financing of taxes and duties.

9 The Bank's expenditures policy rests on three guiding principles: (a) the expenditures are productive; (b) the impact of the operations financed under such loans on the borrowing country's fiscal sustainability is acceptable; and (c) acceptable oversight arrangements, including fiduciary oversight arrangements, are in place to ensure that such loan proceeds are used only for the purposes for which the loan is granted, with due attention to considerations of economy and efficiency.

10 Block grants to PRIs are often classified as recurrent expenditures for the State Governments.
operations implemented by PRIs are easier to establish, block-grant-style operations are not exempt from the same procurement requirements. Block-grant-style operations are characterized by an open-ended menu of investments determined by the local governments as per their needs but being to some extent limited to the constitutional and functional devolution of activities. For block grant operations, the policy requires that the underlying procurement processes conducted for the acquisition of normally procurable inputs representing output cost items are sound and in line with World Bank procurement principles. The purpose of this is to assure that the borrower has used competitive and fair practices. In a typical case, this would involve many institutions with disparate capacities involved in many small-scale procurement operations, which would not be subject to World Bank prior review; and where national procurement procedures are used, the task team and procurement staff need to be assured that such procedures meet agreed national competitive bidding criteria or contain equivalent controls. Under sector specific investment operations, there is an increased reliance on ex post reviews to ensure that contracting, shopping, or larger purchases have met World Bank standards of transparency and fairness. Post review is used on a representative sample basis to check such compliance, as for example when national competitive bidding is used as the underlying modality of contracting/acquisition. On the other hand, in block-grant-style operations, the emphasis is primarily on capacity building, and thus more reliance is placed on the statutory and community oversight processes to obtain assurances on intended use of funds.

D. Disbursement Policy

The World Bank’s Articles of Agreement require that the World Bank "make arrangements to ensure that the proceeds of any loan are used only for the purposes for which the loan was granted" and that the borrower may withdraw the loan proceeds “only to meet expenditures made in connection with the operation as they are actually incurred.” The World Bank’s disbursement policies are part of the overall institutional control framework that enables these requirements to be met. Disbursement is the mechanism by which the World Bank makes payments for eligible project expenditures. OP/BP 12.0, Disbursements, requires that World Bank funds are disbursed for expenditures eligible under the project’s legal agreement. Expenditures must be all within the project and category descriptions in the legal agreement and must be incurred for goods, works, and services procured in accordance with the Procurement Guidelines and Consultant Guidelines as provided for in the procurement schedule in the legal agreement. From a disbursement perspective, a key challenge for operations, which finance PRIs through block grants, may be to determine the point at which the expenditures become eligible for disbursement—on transfer of grant funds by the State or when the transferred funds have been used and accounted for.

E. Disbursement Procedures and Eligibility

For the purposes of disbursements from the World Bank, the considerations for eligibility differ for operations that finance sector specific investments and those which finance block grants to the PRIs. For the sector specific investments or tied funds the principles by and large follow the community-driven development (CDD) guidelines in determining the eligibility of expenditures for World Bank financing that include lump sum payments or actual expenditure (Box 8). On the other hand, transfers to PRIs for block grants are recognized as eligible expenditures for
purposes of disbursements from the World Bank on evidence of transfers from the State
government through interim financial reports, further substantiated by annual audit reports. Any
discrepancies between the amounts of grants-in-aid reported in the interim financial statements
and the annual audit reports would typically lead to adjustments of subsequent disbursements,
either recovered or reimbursed. This is supplemented by the fiduciary measures, which may
include (a) determination of a list of eligible activities to be financed from the block grant as
determined in line with the Constitutionally mandated functions devolved to PRIs; (b)
implementation of an agreed action plan of financial management reforms; and (c) assurance on
end use of funds through audit and social accountability mechanisms.

F. Community-Driven Development Approaches

Partly on account of the synergies inherent in the objectives of decentralization and CDD
programs, the guidance provided by the World Bank on the general principles of CDD
approaches could well apply to operations which finance Panchayati Raj Institutions.\(^{11}\) The
decentralized nature of CDD-type operations, where implementation takes place at the
subnational level (village level), requires a good understanding of the overall PFMA
environment in which the project will be based, paying special attention to local government
arrangements.\(^{12}\) This may often entail additional subnational diagnostics be undertaken with an
objective of identifying areas of divergence between relevant laws and their practical
implementation at subnational level. Recognizing that it will not be practicable or feasible to
conduct fiduciary assessments of all the local governments expected to participate in the project,
the guidance note suggests that Bank staff should work with government counterparts to select a
representative sample of local governments/communities and perform assessments thereon.
Results from these representative assessments can help inform project design particularly as it
relates to accounting, funds flow mechanisms, procurement and disbursement arrangements, and
reporting and auditing arrangements. The format of the assessment as well as the findings from
the representative sample can also provide a template or useful yardstick by which Government
itself can conduct ongoing fiduciary assessments that can be used as an input to the World Bank
supervision process. The results of these assessments can well be used to develop a capacity
strengthening plan for local government financial management and procurement, depending on
the level of government buy-in to the reform.

G. Anti-Corruption Standards

As with all World Bank investment operations, those which finance PRIs are subject to the same
fraud, anti-corruption, and sanctions provisions and remedies. An argument used by many
against devolution has been the perception of high levels of corruption at the PRI level. Some of
these perceptions are based on anecdotal second-hand information; there is no hard evidence that

\(^{11}\) *Fiduciary Management For Community-Driven Development Projects – A Reference Guide*

\(^{12}\) Community-driven development gives control of decisions and resources to community groups. These groups often work in
partnership with demand-responsive support organizations and service providers including elected local governments, the private
sector, nongovernmental organizations and central government entities. While normal Bank FM policy applies, CDD projects
provide particular challenges because they typically involve the use of multiple implementing and sub-implementing entities and
many of these entities, as well as the communities they support, are in remote and geographically dispersed locations with poor
communications, limited access to banking facilities and low levels of implementation capacity.
corruption has increased due to devolution. It may well be the case that since Panchayats are much closer to the people than other forms of government, some corruption is easily revealed to the public eye. Notwithstanding the perceptions, in the preparation of the project, the governance environment should be considered and where risks are deemed significant, additional ex ante controls may be warranted and built-in mitigation measures determined.

Box 8: Disbursement Procedures: Lump Sum Payment or Actual Expenditure

**Lump sum payments.** If the funding is made on a lump sum basis, as in Maharashtra Rural Water Supply & Sanitation project, the periodic payments (tranches) to the community group are eligible expenditures. The initial payment could be an advance but should be made in line with the provisions of the financing agreement; typically, a bank guarantee is not required. Progress payments are not considered advances since they are payments made against physical progress. This method of financing PRIs is not widely practiced in the present country portfolio.

Lump sum is the preferred method for subprojects that are large in number, small in scope, and technically simple. This method is based on the following criteria: subproject eligibility, method of implementation, and cost estimates, along with a defined outcome or delivery of an end product. The financing agreement is a contract between the State (through the concerned line department) and the PRI, against which disbursements will be made, usually in one or several tranches, and on the basis of physical progress. The review of the subproject will focus on the delivery of the end product described in the financing agreement. This financing method involves direct community participation and often will include in-kind labor or materials contributed by the community, or subcontracting or procurement of goods and skilled labor. Such subcontracting must comply with the financing agreement, and thus with the procurement procedures and financial management requirements set forth in the project operational manual. Such subprojects are relatively simple to administer, as documentation and reporting is kept to a minimum, and the line department receives progress and completion reports as well as technical inspection certificates from its staff and from consultants that the line department hired. Another advantage is that the community has a built-in incentive for economy and efficiency, which allows for fewer and less onerous process controls by the line department.

**Actual expenditures.** The funding provided to the community group is based on actual expenditures as in the various watershed projects, with the initial advances to the community treated as an eligible expenditure as long as they are made in line with the provisions of the financing agreement. The final payment to the community would need to be based on the actual expenditures to ensure that advances to the community were not in excess of the actual cost and that actual expenditures are properly recorded. The above are only eligible to the extent that the work of the community group will be completed by the closing date of the loan.

Actual expenditures should only be applied when (a) the subprojects are few and of large value (e.g., water supply schemes, watershed development) and are identified during project preparation; or (b) the cost cannot be satisfactorily estimated, but it has been determined that the community has the requisite capacity to implement the appropriate procurement procedures. (The formal procurement procedures associated with this method require a high level of technical knowledge; if the community does not have sufficient capacity, technical assistance from the line department, a local government agency, an NGO, or a consultant would be a prerequisite). In either case, the community acts like an extended arm of the line department when this method is used to finance subprojects. The procurement procedures to be applied should be reviewed to determine their consistency with the loan agreement and the project operational manual. Disbursements to the community are made on the basis of eligible expenditures incurred or to be incurred by the community; hence the implementation of such subprojects involves a significant amount of paperwork, expenditure reporting, and fiduciary controls by the line department.
H. Treatment of Fund Transfers to PRIs in the State Accounts

In the context of financing of PRIs, all fund releases by the State governments to the PRIs are treated as grants-in-aid. The PRI accounts are separate, and consequently the ownership of the capital assets created and the liabilities incurred thereby lie with the PRIs themselves. As per well-established accounting principles, grants-in-aid disbursed by the State are to be treated as revenue expenditure in the accounts of the State, irrespective of the purpose for which the same is spent. However, in case such grants are utilized for the ultimate objective of creation of capital assets, the issue arises as to whether the accounts should reflect such grants in aid spent for capital asset creation as capital expenditure in the State books. The issue has assumed increased importance after the 73rd Constitutional Amendment Act which envisages transfer of substantial funds to PRIs for discharging their mandated functions. As a result, the revenue expenditure component of the State government stands to increase significantly and thereby the revenue deficits.

The Government Accounting Standards Advisory Board (GASAB) in its Exposure Draft 2 has attempted to address this issue and prescribe the principles of accounting and classification of grants-in-aid by the State to the PRIs (and other grantees) in the financial statements of the State. The Exposure Draft specifies that grants-in-aid be classified as revenue expenditure in the financial statements of the grantor irrespective of the purpose for which the funds disbursed as grants-in-aid are to be spent by the grantee. Where the financial statements of the grantor classify the grants-in-aid as revenue expenditure, the financial statements of the grantor should disclose details of total funds released to the grantee and funds allocated for creation of capital assets out of the grants-in-aid released during the financial year.

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13 Grant-in-aid are payments, transfers or devolution of funds, in cash or in kind, in the nature of donations or contributions by one government (grantor) to another government, body, institution, or individual (grantee). See Exposure Draft 2, dated 01 April 2004, issued for comments by the Government Accounting Standards Advisory Board.
VI. FIDUCIARY ASPECTS IN WORLD BANK-FINANCED OPERATIONS

In the current World Bank investment lending portfolio of 65 ongoing projects, there are 18 projects (about 28 percent) which are wholly or in part implemented either through PRIs or its subcommittees and user groups. The components implemented through PRIs or user groups would typically support the delivery of basic local public services where local governments have a readily identifiable and high-priority responsibility, with the exception of 5 projects that are focused on supporting livelihoods (or private goods). Annex C provides details of the implementation arrangements for the 18 projects.

For the purposes of this report, a combination of desk reviews and field visits were carried out on 12 projects wholly or in part implemented directly by PRIs or subcommittees; these essentially are in the rural water supply and sanitation, watershed development and management, rehabilitation and maintenance of tanks. Table 4 lists State and sector distribution of the 12 projects. In an effort to understand the fiduciary environment in which the project funds flow to the PRIs in these projects, the financial management and procurement arrangements have been mapped (Annex D).

A. Key Characteristics of the Fiduciary Framework for Methods of Financing PRIs

Within the two key methods of financing PRIs—tied funds and untied or block grants—by World Bank-financed operations, key characteristics of the fiduciary framework for the two methods of financing can be summarized as follows:

1. Characteristics of tied funds:
   - This is a traditional method of financing followed in 16 out of 18 projects in the portfolio and follows sector approaches under specific investment plans.
   - Diagnostic studies of the PFMA arrangements at PRI level may have been undertaken during preparation.
   - Criteria for selection of PRIs typically based on technical and geographic considerations; adequacy of fiduciary arrangements not a consideration for selection of PRIs to be financed under the project.
   - Project is budgeted for as a single line in the annual State budget under the line department.
   - Implementation responsibilities at the State level vest essentially with the sector line departments.
   - Limited role of the State department/s of Panchayat Raj in project preparation and implementation.
   - Depending of the present levels of devolution of functions and functionaries at the district level, implementation at the district level is managed either by field units of

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<th>Table 4: State &amp; Sector Distribution of Bank-Financed Projects Implemented through PRIs or its Subcommittees</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Area</strong></td>
</tr>
<tr>
<td>Panchayat Strengthening</td>
</tr>
<tr>
<td>Watershed Development &amp; Management</td>
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<tr>
<td></td>
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<tr>
<td></td>
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<td>Rural Water Supply &amp; Sanitation</td>
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<td></td>
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<tr>
<td></td>
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<tr>
<td>Tank Rehabilitation &amp; Management</td>
</tr>
<tr>
<td>Health</td>
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<tr>
<td>Poverty Reduction</td>
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</tbody>
</table>
the line departments (as in Uttarakhand and Punjab) or the district/block Panchayats (as in Maharashtra and Karnataka).

- Planning processes are by and large, limited to the project activities. A likely implication is that the project may or may not be included in the PRIs budget or annual work plans, largely, on account of the inability to synchronize with the budget and planning calendars.
- Technical and administrative sanctions for subprojects at the PRI level are provided by the line departments at district or subdistrict levels.
- Typically, the project would not attempt generic PRI capacity-building or decentralization reforms in the State.
- By and large, financial management and procurement arrangements remain ring-fenced, even when the funds may flow through the PRIs. Though, increasing usage of existing PRI rules and systems for financial management, procurement, and monitoring (including auditing) is being attempted (as in Uttarakhand and Himachal Watershed projects).
- Likewise, procurement procedures would be ring-fenced, primarily in order to allow an enhanced authority to PRI officials to take the procurement decisions that normally would be outside their delegated authority.
- In almost all cases, the project funds are not included in the ‘village funds,’ i.e., annual financial statements of the PRIs do not include the project.
- From the State and PRI’s perspective, multiple projects requiring similar capacities result in high transaction costs. Cost duplication may be occurring in supervision, capacity-building activities and in community mobilization. For instance, all projects require independent auditing but often restrict this to project expenditures alone. Projects also typically employ facilitation teams doing quite similar work. In some cases expenditures go beyond the traditional scope of projects to assist in community mobilization, as is the case with the watersheds project funding entry point and income-generating activities.

(2) **Characteristics of untied funds or block grants:**

- Diagnostic studies of the PFMA arrangements at State and PRI levels would be undertaken during preparation and follow-up actions by the State to implement the recommendations.
- The World Bank is engaged with overall fiscal and public expenditure reforms at the State or sector level—reforms focus on improving accountability arrangements.
- The fiduciary design of the sector projects (e.g., funds flow, financial reporting, monitoring, auditing) in the State are increasingly moving to greater use of country systems and follow normal government policies, procedures, and fund flows; these are not implementation arrangements created for the benefit of the projects.
- There is a high and uniform level of commitment to decentralization at the State level, which is not likely to be reversed.
- The development of a coordinated planning and budgeting cycle applicable across all PRI functions is seen as critical factor, toward the development of meaningful local budgets and associated local accountabilities for outcomes.
Basic accounting rules to ensure the completeness of accounts, timely and transparent reporting, procurement procedures, and adequate external auditing are being implemented.

As a tier of government, the PRIs have a larger degree of discretion in the use of resources, limited by the positive list of functions devolved by the State legislation.

There is greater predictability in the flow of funds within the budget cycle, clear financial accountability, and specific measures to strengthen overall institutional capacity across services.

A clear planning framework and guidelines are in place, requiring each of the PRIs to prepare a plan that shows how the block grant is meant to be used; this plan is subject to some sort of quality review by the State.

There is an agreement between the State and the Gram Panchayat that the block grant is meant for implementation of the village's plan; unused funds are not returned to the State but are used for additional activities within the framework of the block grant program and village plan.

The State has a monitoring mechanism for the block grant program; there is a possibility in later years (say year 3) that some villages will not receive the block grant due to poor performance or non-achievement of certain agreed milestones.

Each village is subject to an audit of its own operations and will publish its accounts, along with doing other transparency activities; these accounts and audits will be monitored as part of the State’s monitoring and World Bank’s supervision, but not as part of the World Bank’s fiduciary requirement for ”audit of project expenditures.”

There is a separate project component for village capacity building on strengthening the ability at the PRI level to manage their funds; a consistent implementation plan and system of support for all PRIs is evolving in the State.

The project component is defined as the block grants and the project finances block grants provided by the State to the PRIs; these are accounted for as grants-in-aid in the State Accounts as well as the audited project financial statements.

The emphasis of accountability is shifting from the traditional notion of ‘upward accountability’ toward more innovative methods of community participation, social responsibility, and transparency in decisionmaking - all aimed at enhancing accountability to the constituents.

B. Mapping Exercise of World Bank-Financed Operations in India

There is significant discretion open to the States for implementing the Constitutional amendment on decentralization. Legal measures to implement the relevant Constitutional amendments have taken time to emerge but now exist alongside an extensive set of regulations and implementation arrangements. Collectively these require decentralization of functional authority over selected subjects to PRIs, associated with common fiscal arrangements (intergovernmental allocations and disbursements), financial management arrangements (local budgeting, accounting reporting and auditing rules), and procurement arrangements. Considerable effort has also been directed to legal requirements for community participation, social audit, and other measures which promote downward accountability.
The World Bank portfolio is already moving in the direction of better alignment with the decentralization process as reflected in the design of projects that were approved prior to and after the changes in the legal framework in 2003 and 2004. While the move to develop implementation arrangements, which give PRIs a central role at the appropriate level, is visible in rural water supply and watershed projects, projects in other sectors such as management of water bodies and rural roads are still not quite clearly aligned.

The approaches reflect different, though not always contradictory, perceptions of the role of local government and the principles and objectives of the decentralization process. While it may be assumed that full consensus or coherence exists within the Government of India and the States on the decentralization agenda, this is not always the case. This is not unusual. Various line departments have differing levels of ownership of the State’s decentralization agenda, and some interest groups oppose it outright. The inability to substantially engage the State Panchayat Raj Departments and their field operatives in the project preparation processes means that the institutional arrangements may not quite reflect the State’s overall vision for decentralization or be consistent with the legal framework for PRIs. In some sectors, the presence of parallel user institutions legislated by State Acts, like the Water User Associations, Joint Forestry Committees with undetermined linkages to the PRIs may overtake the role of the PRIs in the projects. The ambiguities in the current framework are likely to be a result of this and will continue to pose a challenge for the World Bank in responding to the GOI agenda.

Another important dimension to the move toward phased convergence to a common platform is the agreement on standardized fiduciary arrangements in a manner that allows the existing fiduciary framework to be used for the purposes of all projects/schemes of the Central and State governments and other donors (including the World Bank). This approach is consistent with the World Bank’s view that the use of country systems has significant potential to improve development impact. While the enabling policy framework for the practical application of this approach for financial management has increasingly become a part of regular business, the position on use of country systems in procurement is still evolving. At one level, strict adherence to detailed World Bank rules is required for international competitive bidding. However, the guidelines do flexibly permit the use of national competitive bidding procedures for public procurement in the borrower country, specifying that the country procedures may be used in Bank-financed procurement if they are reviewed and modified as necessary to ensure economy, efficiency, transparency, and are broadly consistent with the Bank’s procurement rules. This essentially means that supplemental measures to meet Bank’s requirements that go beyond local practices and policies are specified in the Loan Agreement or in a parallel letter or agreement that is incorporated by reference into the Loan Agreement.

14 State Panchayat Raj Departments are responsible for determination of policies and procedures for PRIs in the State. Typically, the block grants to PRIs (based on agreed State Finance Commission recommendations) are budgeted under the Panchayat Raj Departments. District Panchayat Raj Officers (DPRO) at the district level and Block Development Officers (BDOs) at the block level administer and arrange the transfer of funds to the PRIs. Under the State Act and rules, the District Collector and DPRO/BDO wield a substantive amount of control on the functioning of PRIs, including inspections. Centrally sponsored schemes are typically administered by District Rural Development Agencies through the Development Commissioners (also CEO of Zilla Parishads) and BDOs (also CEO of Kshettra Panchayats) at the block level.

15 Country systems constitute the use of the country’s national, subnational or sectoral institutions and applicable laws, regulations, rules and procedures for the operation being supported by the World Bank. See Expanding the Use of Country Systems in Bank-financed Operations, Issues and Proposals, R2005-001812, March 9, 2005.
In practice, however, the move to using the existing fiduciary systems at PRIs poses its own set of challenges. The significant compliance gaps in the PFM practice at the PRI level has the potential of denting the accountability architecture as contained in well-documented system and procedures for financial management and accountability. There is also a need to modernize and simplify the outdated accounting systems in order to cope with the increased volume of Panchayat funds and keep up with good practice.

Notwithstanding the above, institutional arrangements in World Bank-financed operations can be seen as moving toward achieving a greater degree of internal coherence between World Bank-financed operations and consistency with the Constitutional framework for decentralization. While there is quite clearly an agreement on the principles, the progress in determining the elements of a common platform for financial management and procurement arrangements for all relevant World Bank-financed operations is at fairly early stages of development.

As part of the project preparation, diagnostic studies of the PFM arrangements have been undertaken to understand the extent of divergence between relevant laws and their practical implementation at the PRI level. The extent to which the financial management systems in World Bank-financed operations align with the country (PRI) systems will necessarily need to respond to an assessment of the adequacy of the systems in place. Normally a self-selection method by the Gram Panchayats is adopted in the projects with due consideration of the geographic and technical aspects. Given that financial management and procurement capacities at Panchayats are at disparate levels, it may be useful to consider including a summary assessment of fiduciary capacity of the selected PRIs by the project staff as part of the project cycle (discussed further in the recommendations section).

There is a growing acknowledgement of the centrality of improved PFM arrangements in PRIs within the Government of India and the States. This is evidenced by the increased level of dialogue on the need for improvements and the several measures being taken, both at the Central and State levels. This opens up significant opportunities for the World Bank in moving toward a common platform of fiduciary arrangements, which are consistent with the PRI’s own systems. Table 5 provides a quick checklist of the key parameters of the fiduciary arrangements in selected World Bank-financed operations followed by a discussion on the 8 elements of financial management and procurement arrangements that were used for mapping the 12 projects wholly or in part implemented directly by PRIs or subcommittees. Refer to Annex D for detailed mapping of the 12 projects.
Table 5: Summary Checklist of Financial Management & Procurement Arrangements in Select Projects in World Bank Investment Lending Portfolio

<table>
<thead>
<tr>
<th>NO</th>
<th>QUESTIONS</th>
<th>UWDP</th>
<th>KWDP</th>
<th>HPMHWDP</th>
<th>MRWSSP</th>
<th>URWSSP</th>
<th>SKRWSSP</th>
<th>KRWSSP</th>
<th>PRWSSP</th>
<th>KCBTP</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Is the implementing entity (user committee level) an officially constituted/recognized subcommittee of the local government?</td>
<td>Y</td>
<td>N</td>
<td>Y</td>
<td>Y</td>
<td>Y</td>
<td>Y</td>
<td>Y</td>
<td>Y</td>
<td>N</td>
</tr>
<tr>
<td>2</td>
<td>Does the project design provide for an assessment of the fiduciary capacity of PRI as selection criteria?</td>
<td>N</td>
<td>N</td>
<td>N</td>
<td>N</td>
<td>N</td>
<td>N</td>
<td>N</td>
<td>N</td>
<td>N</td>
</tr>
<tr>
<td>3</td>
<td>Are the procedures for operation of project bank accounts at the sub project level in line with the provisions of the PR Act and Rules?</td>
<td>N</td>
<td>N</td>
<td>Y</td>
<td>N</td>
<td>N</td>
<td>Y</td>
<td>N</td>
<td>Y</td>
<td>N</td>
</tr>
<tr>
<td>4</td>
<td>Are the sub project funds included in the “fund” of the local government as defined by the PR Act and Rules?</td>
<td>N</td>
<td>N</td>
<td>N</td>
<td>N</td>
<td>N</td>
<td>Y</td>
<td>N</td>
<td>N</td>
<td>N</td>
</tr>
<tr>
<td>5</td>
<td>In preparing the annual plans/budgets and annual financial statements, does the local PRI include the sub project funds?</td>
<td>N</td>
<td>N</td>
<td>N</td>
<td>N</td>
<td>N</td>
<td>N</td>
<td>N</td>
<td>N</td>
<td>N</td>
</tr>
<tr>
<td>6</td>
<td>Are the procurement processes prescribed for the project aligned with the PRIs financial rules/regulations, with respect to approval of the Procurement plan, grievance redressal and complaint mechanism, Public display of all procurement related information, limits for administrative and technical sanction of estimates and contracts and procurement methods to be used?</td>
<td>N</td>
<td>N</td>
<td>N</td>
<td>N</td>
<td>N</td>
<td>N</td>
<td>N</td>
<td>N</td>
<td>N</td>
</tr>
<tr>
<td>7</td>
<td>Does the project design use the audit reports of PRIs to provide assurance for end use of the project funds?</td>
<td>N</td>
<td>N</td>
<td>N</td>
<td>N</td>
<td>N</td>
<td>N</td>
<td>N</td>
<td>N</td>
<td>N</td>
</tr>
</tbody>
</table>

UWDP (Uttarakhand Water Shed Development Project); URWSSP (Uttarakhand Rural Water Supply and Sanitation Project); PRWSSP (Punjab Rural Water Supply and Sanitation Project); MRWSSP (Maharashtra Rural Water Supply and Sanitation Project); KRWSSP (Kerala Rural Water Supply and Sanitation Project); KWDP (Karnataka Watershed Development Project); KCBTP (Karnataka Community-Based Tank Project); SKRWSSP (Second Karnataka Rural Water Supply and Sanitation Project); HPMHWDP (Himachal Pradesh Mid Himalayan Watershed Development Project).

**Element 1: Budgeting**

World Bank-financed operations are budgeted at the GOI and State levels. However, the project may or may not be included in the PRIs budget or annual work plans, partly, on account of the inability to synchronize with the budget and planning calendars. This is also a reflection of the duplication and overlapping responsibilities for budget approvals across various agencies, rendering the task of preparing an integrated budget difficult.

Good practice model is however emerging in Karnataka where a significant initiative is underway to assist the Gram Panchayats in the preparation of perspective five-year development plans that reflect all projects/schemes. The provision of a separate Panchayat window in the State budget through link documents will help PRIs get a better picture of the fund allocations. The budget formats and templates—provided by the Comptroller and Auditor General under the technical guidance and supervision function entrusted to it by the 11th Central Finance Commission—should go a long way if implemented in ensuring development of meaningful local budgets and associated local accountabilities for outcomes.
**Element 2: Staffing**

Partly on account of inadequate staffing of the fiduciary functions at the PRI level, the design of the financial management arrangements in World Bank projects has resorted to engaging external accountants or training bookkeepers at the subcommittee level to be responsible for the project accounting functions. This often overlooks or undermines the centrality of the role of the Panchayat Secretary in the accountability framework established by legislation.

Instances of good practices are increasingly emerging from projects (Kerala Rural Water Supply, Uttarakhand and Himachal Watershed Projects) where the project supplements the accounting resources available to the Gram Panchayat by engaging assistants to the Panchayat Secretary. The benefits of the approach are (i) accounts assistants would be hired by the Gram Panchayats themselves and are therefore accountable to them; (ii) they would provide full-time assistance to the Gram Panchayat Secretary to meet the project-specific requirements of accounting and reporting; and (iii) training provided to the accounts assistants will prepare a cadre of well-trained persons with a potential to become Gram Panchayat Secretaries in the future.

**Element 3: Fund flows**

The project funds flow directly into the segregated project bank accounts of the subcommittees of the Gram Panchayat. Only in a few instances, as in Kerala Rural Water Supply & Sanitation Project, the project funds are routed through the Gram Panchayat bank accounts to the Beneficiary Committee bank account. While the State Act and rules provide flexibility in the matter of number of bank accounts that the Panchayat can maintain, they is not quite clear if the Panchayat has the power to be able to delegate the operation of bank accounts to subcommittees. In many projects, the State has used the enabling clause in the State Act to issue Executive Orders to this effect.

As a case in point, Uttarakhand State Act and rules mandate that all funds of the Gram Panchayat be maintained in the Gram Nidhi only, and no funds are to be maintained in the name of any subcommittee. The fiduciary arrangements for the Watershed Project and Rural Water Supply & Sanitation Project thus reflect this approach. In a subsequent development under the Watershed Project, by virtue of a Government Order, dated July 24, 2006, the State arranged for the responsibilities of the Panchayat Secretary under the Watershed Project, including operation of bank account, to be transferred to the female member of the Water & Watershed Committee or in absence of such female member, to any nominated Panchayat member. For the Rural Water Supply & Sanitation Project, the notification, dated May 19, 2005, allows the responsibilities of the Gram Panchayat Secretary under the project to be transferred to a nominated departmental worker, who can be appointed as a Co-Secretary.

Commonly advanced reason why the project authorities and village communities prefer to bypass the Panchayat Secretary is the unavailability of Panchayat Secretary, partly because each Secretary is responsible for 4-5 Panchayats. Another unstated reason could be that the Secretary, who is a Government staff on deputation, prefers to go by the book of rules and delays payments. There is also a fear that user charges may be used for other developmental works in the village.
All of the above results in isolating or 'ring-fencing' the project arrangements from the PRI systems. These ring-fenced arrangements eliminate or limit the role of the Panchayat Secretaries, who is by statute the custodian of the Panchayat funds and thereby an integral part of the control framework.

**Element 4: Accounting**

The accounting function at the Gram Panchayat level is by statute the responsibility of the Panchayat Secretary. The State Acts and rules, supplemented by Accounts & Budget Rules issued by the State provide the essential framework, which is based on single entry manual accounting system. The accounting architecture is essentially built around the main cash book and supporting registers; the number of books/registers (ranging from 28-35) to be maintained and their templates are prescribed in the bylaws. The cash book is required to provide a scheme-wise breakup of the closing balances; the rules do not provide for preparation of trial balances or bank reconciliation statements.

World Bank-financed operations would typically prescribe their own accounting requirements, documented in the Community Operational Manuals. The books of accounts are required to be maintained at the subcommittee or user group level and are simplified for use at the community level. The Manuals normally would not suggest the manner in which the project accounts at the subcommittee should be treated in the books of the Panchayat nor does the State provide any clarification or guidance on the matter. Consequently, in most cases, the project funds would not be considered as part of the Panchayat funds.

While many of the States have adopted the new accounts and budget formats developed as part of the technical guidance and support provided by the Comptroller & Auditor General, only a few States have revised the bylaws to reflect the new requirements. The new formats provide a uniform code-based chart of accounts that should, if implemented, enable the PRIs to prepare integrated financial statements (including receipts & payment accounts and balance sheet). This opens up new opportunities for the World Bank and indeed all other donors (including the Government of India) to use the PRIs' own accounting systems to provide the information required on the project/scheme-related expenditures, supplemented by schedules providing detailed information if required. This will obviate the need for maintaining parallel set of accounts and substantively reduce the transaction costs to the PRIs and the State.

**Element 5: Procurement**

Procurement rules and procedures to be followed at the PRI level are laid out in detail in all State Acts and rules. By and large, these are characterized by low threshold limits for the Gram Panchayats; the rules do not take into account the increased levels of funds now being handled. Consequently, most procurement decisions require administrative and technical approvals by the "competent authority" as prescribed. The competent authority for the Gram Panchayat is either the block development officer or engineering staff of the line departments. It is thus not surprising that procurement capacity at the Gram Panchayat levels is low and Procurement Committees, where formed, are by and large dormant.
On the other hand, several good practice models have emerged from World Bank-financed operations, where communities (by way of user groups or subcommittees of Panchayats) have demonstrated ability to undertake development works of superior quality and costs lower than their Government counterparts. In all World Bank-financed operations implemented at community levels, the procurement procedures are detailed in the Community Operational Manuals and provide for processes that may not necessarily be consistent with the State rules. The procurement processes for the project emphasizes the need for transparency in the procurement cycle. This could be achieved through publishing contract opportunities and contract awards and specifying in bidding documents the criteria for evaluating bids; in addition through enhanced internal and external auditing of procurement and evidence that audit findings are being acted upon; as well as through enhanced opportunity for public oversight through establishing effective complaint mechanisms, setting up public meetings to discuss procurement operations, and providing clear and simple information on procurement practices.

In the revised Accounting & Budget Rules, 2006, Karnataka has updated the procurement procedures for development works to be undertaken by the Gram Panchayat. The revised rules allow the Panchayat to provide administrative sanctions for all works below Rs.10 lakhs (approximately US$25,000) provided that adequate budget allocations exist. Estimates are to be prepared by the Gram Panchayat engineer, who can provide technical sanctions for works up to Rs.50,000. The basic principles of Cannon’s of Financial Propriety as envisaged under the provisions of Karnataka Financial Code forms the basis for awarding works, which necessarily have to follow competitive tendering processes. Work orders are required to be issued for all contracts signed for all supply of material and execution of works. Measurement books are required to be maintained and checked measurements recorded. Each Gram Panchayat is required to install a display board containing details of (a) works, location and assets to be created; (b) amount provided; (c) contribution to be collected; (d) amount to be spent from Panchayat fund; and (e) total expenditure proposed.

**Element 6: Internal Control & Audit**

All the State Acts and rules contain several traditional methods of internal and external controls. Internal control mechanisms would include rules for disqualification of members, avoiding conflict of interest situations, initiating motion of no-confidence, and empowering the Gram Sabha to remove the President. Elaborate provisions for external oversight over the functioning of the PRIs are in-built into the legislation, empowering the Government to block execution of resolutions and hold enquiries, as required in public interest. Recognizing the principle that the primary accountability of the PRIs should be to its own constituents, many States have put in place such non-traditional and innovative mechanisms as social audit, public displays, Right to Information, ombudsman, and Citizen Charters.

In the present circumstances, wherein the accountability structure is sharply fragmented by the aggregate of the scheme/project requirements, the traditional controls do not really work. While some of this can be attributed to the weaknesses in accounting and audit, the fear that large-scale irregularities in financial transactions may invite disciplinary actions is also diminishing, because reports on such misdemeanors come out long after the concerned officials have finished their terms. Social audits and other more innovative accountability mechanism are still at nascent
stages and much remains to be done to institutionalize the tools and methods. Internal audit arrangements are normally not in place or ineffective where available.

Prepared for each project, an Operational Manual includes a section on operational and financial controls. Additional controls are put in place through the requirement of independent interim audits by chartered accountancy firms engaged by the project, either at the point of release of funds or on a periodic basis. The Operational Manuals re-emphasize the non-traditional methods of accountability, often requiring social audit committees to certify utilization of funds or public displays on financial and physical progress.

Overall, the need for such Manuals, which result in ring-fencing the project from the PRI systems, can be seen both as a cause and effect of the perceived weakness in the control framework. This scenario is likely to continue, until at least such a time that there is a convergence of requirements placed upon the PRIs in individual projects/schemes, to the point at which a common set of rules, regulations, and procedures, which are based on their own systems, begins to emerge.

**Element 7: Financial Reporting**

While the requirements for interim financial reporting may vary across the States, annual financial reporting of the PRIs is a standard feature in all the State Acts and rules. All PRIs are required to prepare annual financial statements covering all sources and uses of funds. However, the multiplicity of accounts, accounting centers, accountants, and reporting streams result in delays of several months in preparing and submitting financial statements. Of more concern however is the fact that the Panchayat financial statements remain incomplete and fail to fully capture the extent of financial resources they handle. This is attributed to two primary causes: (a) the financial statements reflect only own funds (State block grants and own revenues) and do not include other sources of funds (centrally sponsored schemes, plan funds that flow through line departments etc.); and (b) regular intercepts made by the State for electricity bills. For the centrally sponsored schemes, the Panchayats regularly furnish utilization certificates; these are however poor substitutes for annual financial statements.

For all World Bank-financed operations, PRIs prepare monthly financial reports in form and content agreed and documented in the Operational Manuals. These reports are generated from the project books of accounts maintained by accountants engaged and trained under the project.

This is quite clearly a less than ideal scenario as it does not seek to build significant transversal institutional capacity or systems in the State government or PRIs that would support effective decentralized systems of governance. However, as mentioned earlier, the budget formats and templates provided by the Comptroller and Audit General under the technical guidance and supervision function, if implemented, should enhance the ability of the PRIs to prepare consolidated financial statements and thereby pave the way for the World Bank and other donors (including the Government of India) to be able to obtain information on project finances from the PRIs own systems.
Element 8: External Audit

The State Acts and rules provide authority to the State government to determine the auditors for the PRIs. In general, the Gram Panchayats are audited by the Examiner of Local Fund Accounts under the respective Local Fund Audit Acts of the State. Block and district level Panchayats are typically audited by the Comptroller and Auditor General. The Local Fund Auditors Act empowers the auditors with the powers of the civil court under the Code of Civil Procedure with respect to surcharge and recovery of funds. The Acts also provide for the manner in which the audit objections will be dealt with, requiring the President to convene a special meeting of the Panchayat to consider the objections made by the auditors and decide about actions to be taken.

In practice, however, there are huge arrears in audits, many of the pending audits dating back 10-15 years. Audits tend to be transaction based and the reports do not express an opinion on the financial statements.

For the World Bank-financed operations, determining the auditing arrangements pose many challenges, arising in part from the said weaknesses in the audit process. The implementation arrangements which transcend across different audit jurisdictions (Comptroller and Auditor General, and Local Fund Audit) pose other difficulties, with respect to obtaining a single audit report for the project. This is often overcome by instituting separate chartered accountancy audits for the PRIs, supplemented by sample audits undertaken by the project auditor. On the overall, the audit arrangement becomes complex and results in high additional costs to the State.

Arising from the observations and recommendations of the 11th Finance Commission, several initiatives have been taken to strengthen the audit functions of the PRIs. The Auditing Standards for Panchayati Raj Institutions and Urban Local Bodies and Guidelines for Certification Audit of Accounts of Panchayati Raj Institutions prescribed by the Comptroller and Auditor General had been forwarded to the Government for adoption and use by the Department of the Local Fund Audit. Under technical guidance and supervision entrusted, the Office of Comptroller and Auditor General is conducting supplemental audits of PRIs. These measures should go a long way in improving the quality of audits at the PRI level.

In the best scenario, the project funds would be audited as part of the annual consolidated audit of the PRI, thereby eliminating the need for instituting parallel audit processes. The new measures being taken to strengthen the capacity of PRI audit, accompanied by other improvement initiatives in accounting provide significant opportunities for the design of World Bank-financed operations to become formally compliant with the legal framework.
C. Experiences from World Bank Financed Operations Outside India

For several decades now, the World Bank together with client countries across the globe has promoted community-driven development as the means to empower communities and local governments, often phasing in empowerment by starting with communities. The approach to local planning in these projects has been limited, usually focusing on a community’s selection of projects from a menu supported by each project. While this reflects a clear demand within communities, the process does not substitute for local planning that would elucidate the range of community development needs and establish a basis both for government budgeting and for leveraging other sources of funding in a coherent and complimentary way. Lessons emerging from the experiences across the broad range of CDD projects are now being reflected in the increasing trend of new generation of projects that aim to fund innovative and flexible approaches to integrating community-driven development and decentralization. The new genre of projects reflect a trajectory of control that ranges from community control over development funds to government control, with a number of emerging combinations depending on the scope and nature of investments.

In the local government development projects in Uganda, Mozambique, Zimbabwe, Rwanda, Indonesia, Bangladesh (among others), the World Bank’s point of entry is mainly in financing fiscal transfers and providing technical assistance for local government capacity building. Under most projects, local governments are eligible to receive funding up to a ceiling by jurisdiction or per capita, sometimes with poverty incidence included. Over time, performance-based criteria determine ceilings. Various models of determining the criteria for eligibility to participate are emerging; central to the process is the establishment of appropriate “rules of the game” for effective participation and accountability. As a case in point, some select examples of innovative approaches in which the local governments are being engaged in World Bank financed operations are discussed below.

(1) Tanzania: Local Government Support Project (P070736)

Financial management performance is a key criterion for selection of local government. For selection of local government agencies for funding under the project, minimum access conditions have been identified and are included in the Assessment Manual. One of the seven parameters for selection include an assessment of financial management performance, further subdivided into the following: (a) filling in position of Council Director, Treasurer, and internal auditor; (b) final accounts of previous financial year produced as per Local Government Act, 1982, and submitted for audit on time; (c) clean audit opinion for the last fiscal audit accounts; (d) no financial irregularities have been reported by the internal or external auditors in the past twelve months; (e) bank reconciliation statements for all accounts prepared monthly; (f) internal audit in place and functional and (g) regular production of financial reports on a quarterly basis. Assessment of participating local government agencies, in terms of both minimum conditions and performance measures, will take place every year by a team of four members representing a broad range of expertise. The well-performing local government agencies would be rewarded with access to 20 percent additional funds and those that do not perform well will have their allocation reduced by 20 percent. Noncompliance with the minimum conditions will result in no grants for the next period.
(2) **Bangladesh: Local Governance Support Project (P098273)**

Integrating social accountability into the financial and procurement audit processes is a key innovation under the project and the means by which accountability permeates and is integrated into existing procedures and practices. Its role in making auditors aware of requirements of transparency in addition to financial propriety is also expected to be an important contribution to reforms.

The Comptroller & Auditor General of Bangladesh has the mandate for the external audit of public sector entities, but due to capacity and resource constraints has not been able to carry out annual audit of Union Parishad (local governments) on a regular and timely basis. The project proposes to introduce timely audits by forging a partnership between Local Government Department, Comptroller & Auditor General, and the Institute of Chartered Accountants of Bangladesh (ICAB). The Local Government Department in collaboration with the Comptroller & Auditor General has prepared an audit strategy laying down the details of implementation arrangements and arrangements for dissemination, follow-up, and quality control of the audit process.

The annual external audits of the eligible Union Parishads will be carried out by chartered accountants under the project. The primary objective of the audit will be to provide financial assurance on the annual financial statements of the Union Parishads. The scope of audit will also be extended to provide limited assurance on the Union Parishads procurement activities, its compliance with transparency and participation requirements, and the environmental and social framework. The Comptroller & Auditor General will ensure quality and integrity of the audit process through its Audit Quality Assurance cell by conducting a professional review of an annual sample of approximately 20 percent of the audits conducted of eligible Union Parishads. On completion of the quality assurance checks, the Audit Quality Assurance cell will present a report on their findings to the Comptroller & Auditor General, who will share it with the Local Government Department. The ICAB through its professional development committee and its Investigation and Disciplinary Committees will provide strong professional oversight over the chartered accountants conducting the audits and have assured the World Bank that any references to the ICAB by the Comptroller & Auditor General and/or Local Government Department on audit quality concerns will be objectively investigated and that the ICAB will take disciplinary action against its members. The Local Government Department will also blacklist those auditors against whom allegations of professional malpractice are proven and will explore the possibility of taking punitive legal action, if required.

(3) **Indonesia: Initiatives for Local Governance Reform Project (P076174)**

Component A for Local Governance Reforms includes a subset for reforms relating to procurement. Under this subcomponent, participating kabupatenes (local governments) will be required to institute a series of graduated reforms in procurement over a period of 3-4 years, with agreed benchmarks for monitoring progress. These will be institutionalized through the issuance of Bupati (head kabupaten executive) decrees and supported by capacity building of kabupaten staff and provision of equipment and software.
At entry, participating kabupatens are required to assign an appropriate officer as a focal point to lead and coordinate the procurement reforms. At the outset a local procurement policy will be developed which is in line with national procurement reforms stipulated by Presidential Decree. The procurement reform focal point will work with other key parts of kabupaten government to streamline regulations to promote economy, efficiency, and open competition. Transparency related to procurement policies, procedures, and practices will also be ensured. A workable mechanism to handle complaints and apply sanctions will be established in addition to an annual survey of bidders and civil society about kabupaten procurement practices. Under the capacity-building component, training will be provided to key Dines (technical agencies at regional level), BAWASDA (internal auditors), and procurement watchdogs.

D. Assessing Performance of the PRI: The Devolution Index

A decade after the 73rd Constitutional Amendment Act and what many may consider as the first generation of reforms with the central theme being creation and empowerment of strong Panchayats, it is widely acknowledged that the Constitutional provisions alone have not been an effective trigger for the empowerment of Panchayats. The progress in achieving effective decentralized governance has not been uniform across the States. In an effort to better understand the enabling environment and the efforts underway by the various States to fulfill the constitutional mandates, the National Council for Applied Economic Research (NCAER) at the request of the Ministry of Panchayati Raj has developed a Devolution Index.

The Devolution Index is a first such attempt at measuring the three fundamental dimensions of decentralization, namely, functions, funds, and functionaries. The Index does not aim to measure the outcome of decentralization. The sub-index for devolution of finances, designed to assess the success in creating conditions that strengthen PRIs financial abilities, focuses largely on fiscal aspects of devolution; one out of nine indicators relating to finances deals with the efficiency in the audit processes at the PRI level—percentage of PRIs whose accounts are audited within one year of the end of each financial year.

Under the World Bank-financed operations (Maharashtra Rural Water Supply & Sanitation Project, Uttarakhand Watershed Development project and Tamilnadu Womens’ Empowerment project), some efforts have been made on a pilot basis to develop a set of criteria on which to assess the performance of PRIs, specifically from the perspective of accountability, transparency in decisionmaking, and efficiency in public service delivery. Box 9 provides some aspects of the pilot.
Box 9: Maharashtra Local Government Incentive Fund: US$4 million

The support would allow selected Gram (village) Panchayats and Zilla (district) Panchayats to develop an approach to institutional building to become more effective, accountable, and responsive; and contribute to improving quality of decentralization, devolution, and local governance.

The incentive fund would provide grants to nine selected Zilla Panchayats at about US$150,000 each to make them more accountable to people and assume a greater development role. Zilla Panchayats use the project grants to finance expenditures on consultant fees for institutional restructuring and capacity development, including for budget making, implementation, monitoring and evaluation, and introduction of new information technology systems and equipment.

The incentive fund would support about 225 Gram Panchayats in nine districts with one-time grants ranging between US$8,000 to US$10,000 equivalents. The pilot would fund investments in using and adapting innovative approaches used in Gadge Baba Abhiyan (sanitation campaign) for stimulating Gram Panchayats that have worked on management, inclusion, and good governance to participate in a development marketplace and showcase their efforts.

Based on this competitive process, selected Gram Panchayats would be provided intensive capacity building support in various areas, including participatory planning and budgeting, community organization, promotion of self-help groups, inclusive decisionmaking, community-based procurement, financial management, negotiation skills, and development of a community report card system to support user evaluation of village-provided services and self-evaluation by the Gram Panchayats.

The key outcome of the proposed pilot would be a tested institution-building approach for Zilla Panchayats, which could be scaled up to include the other districts of Maharashtra. The project would also invest in cross Zilla Panchayat learning and knowledge management activities to draw key lessons for other decentralization programs of the Maharashtra Government. The lessons learned would be shared and used to initiate dialogue to develop a programmatic approach to developing demand-driven approaches in decentralization.

A more systematic and significant effort has been made by the World Bank Office in Indonesia, in cooperation with the Ministry of Home Affairs and with inputs from several other donors to develop a measurement framework for local government PFM arrangements. This framework comprises a set of strategic areas from the PFM cycle, each with a selection of key PFM outcomes, a diagnostic tool kit of selected indicators to help assess the outcomes and a scorecard. The selected PFM outcomes, presented in a modular structure, are those that were considered important and relevant in the Indonesian context. The scorecard conveys the state of PFM systems and practices of the assessed local governments. Brief notes have been provided for guidance of enumerators. Taken together, these would help identify those processes that are weak and not likely to support positive outcomes and helps identify strengths and weaknesses of PFM systems, institutions, and processes at the local level. A scoring methodology has been developed that sensitizes this framework to both the high performer and the low performer of local governments, yet allowing a reasonable degree of variation between the two ends. The measurement framework was tested in two districts that are commonly regarded as “well performing” in the context of local Indonesian governments, to enable the team to benchmark the outcomes. Box 10 provides additional information on the cascade of core modules within the framework.
## Box 10: Indonesia: Local Government PFM Measurement Framework

The methodology draws on the conventional PFM processes employed at the national level, comprising segments of budget outturns, budget planning and formulation, cash and treasury management, procurement, accounting and reporting, internal controls, and oversight. The adopted methodology differs slightly from generally accepted national PFM assessments as it has been modified to reflect current PFM trends, desired short-term outcomes in PFM processes, and binding constraints at the local government in Indonesia.

In order to achieve these long-term PFM outcomes and with the aim of making the measurement framework workable, nine core “strategic areas” (or modules) of PFM were identified, representing the core dimensions of an open and orderly PFM system at local level. For each of these strategic areas, a strategic objective was articulated to help define the benchmark of good practice thereby providing a logical link between the larger objectives sought to be achieved and the related outcomes that are to be measured. Further, for each such strategic area, desirable outcomes were selected that would logically contribute to the achievement of the strategic objective needed to be measured. A total of 27 such outcomes were developed across the entire framework.

Finally, for each of these 27 outcomes, a set of selective indicators was defined that will help measure if the outcomes are likely to be achieved. This downward cascade, from strategic areas to outcomes to indicators, is embedded in this measurement framework and provides the basis for an assessment of the state of affairs at each level of this framework. Outcomes in PFM strategic areas are designed to collectively contribute to the achievement of strategic objectives through the attainment of particular PFM outcomes; the drill-down indicators provide the tools for assessing the overall level of performance associated with each PFM outcome and within each strategic area.

In a relevant development, the PEFA Secretariat is actively engaged in development of guidelines for adopting the PEFA Performance Measurement Framework to the application at subnational government level. The advantages of the PEFA Framework at central government level equally apply at subnational level, particularly in terms of providing an assessment on the basis of a full overview of the PFMA system with ability to track progress over time. The Framework therefore could be instrumental in assessing and developing essential PFMA systems at the subnational level and provide a common platform for reform dialogue.

In an effort to facilitate a consistent approach to the application of the indicators developed by the OECD/DAC–World Bank Round Table on Strengthening Procurement Capacities in Developing Countries, OECD/DAC has published a User’s Guide laying down the methodology for assessment of procurement systems. The indicators are intended to provide harmonized tools for use in the assessment of procurement systems. Although the

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16 PEFA is a partnership between the World Bank, the European Commission, the UK Department for International Development, the Swiss State Secretariat for Economic Affairs, the French Ministry of Foreign Affairs, the Royal Norwegian Ministry of Foreign Affairs, the International Monetary Fund and the Strategic Partnership with Africa.

17 The PFM Performance Measurement Framework is an integrated monitoring framework that allows measurement of country PFM performance over time. It has been developed by the PEFA partners, in collaboration with the OECD/DAC Joint Venture on PFM as a tool that would provide reliable information on the performance of PFM systems, processes and institutions over time.

18 The Development Assistance Committee (DAC) is the principal body through which the Organization for Economic Cooperation and Development (OECD) deals with issues related to co-operation with developing countries. See www.oecd.org/dac.
indicators are designed for use in the assessment of the central government or national procurement system in a country, they can be adapted for use in subnational or agency-level assessments.

Subnational applications of PEFA have already been conducted countrywide for districts and municipalities in Uganda and Tanzania (based on samples on such entities), and stand-alone activities in Punjab and Baluchistan Provinces in Pakistan and Bogota City in Colombia. Ongoing cases include further provinces in Pakistan, Ethiopia, Kurdistan Regional Government of Iraq, and partial applications at the State level in Nigeria. Given the increased demand for these types of activities, there is a need to learn lessons and develop guidelines for such future activities.
VII. BRIDGING PRI FINANCING APPROACHES THROUGH DECENTRALIZATION

Recognizing the Government of India's commitment to strengthening Panchayati Raj Institutions, the World Bank's India Country Assistance Strategy for FY05-08 states that support to decentralization will be an important focus of World Bank work with the Government of India. To help India realize the potential of the Constitutional amendments, the World Bank will ensure that its programs are both consistent with and supportive of a progressive shift to decentralized governments. This implies that World Bank operations would be forged around the principles of subsidiary, downward accountability, and local discretion, alongside specific interventions to support community participation and enhance financial accountability. Even as there is a general agreement that the long-term goal would be to move toward a scenario wherein all resources be made available to PRIs to allocate fully according to their own priorities (by way of block grants) and subject to common processes on planning, financial management, procurement, and community accountability, it is recognized that this scenario may take several years to uniformly emerge across all the States.

A. Aligning with World Bank's Fiduciary Framework: Two Scenarios

Achieving greater coherence across World Bank-financed operations requires a degree of consensus on the trajectory of the decentralization of governance and service delivery arrangements at the State level. The determination of the most appropriate place in the continuum of options available will be a judgment call of the World Bank task teams and will to some extent be a measure of the State's own commitment to the decentralization agenda. In the medium and short term and as a measured response to the decentralized agenda, two clear scenarios emerge as options for the World Bank.

**Scenario 1: Financing of tied grants for sector investments**

The World Bank would continue to finance operations where PRIs perform as implementing agents for the Central Government or the State in the form of tied funds. But there would be an increasing convergence of requirements placed upon PRIs in individual programs to the point at which a common set of rules, regulations, and procedures begin to emerge—a set of rules and procedures that align with the PRI's own systems as determined by the State legislation. A default position might be assumed that for World Bank financing in sectors where PRIs have a central implementation role—most evidently in rural drinking water, rural roads, rural electrification, tanks, education and health—implementation arrangements in World Bank-financed operations would ensure PRI authority over project planning and implementation. In most instances this would require user groups (or independent societies) to be subcommittees of the Panchayats. It may be added that fiduciary considerations are not however the sole determinant of decisions of whether or not existing institutions will be used for the purposes of

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19. "The United Progressive Alliance (UPA) Government will ensure that all funds given to states for implementation of poverty alleviation and rural development schemes by Panchayats are neither delayed nor diverted. Monitoring will be strict. In addition, after consultations with the States, the UPA Government will consider crediting elected Panchayats with such funds directly. Devolution of funds will be accompanied by similar devolution of functions and functionaries as well. Regular elections to panchayat bodies will be ensured and the amended Act in respect of the Fifth and Sixth Schedule Areas will be implemented. The UPA Government will ensure that the Gram Sabha is empowered to emerge as the foundation of Panchayati Raj". Excerpt from Common Minimum Program of the United Progressive Alliance
implementing World Bank-supported operations. From the fiduciary perspective, however, this will entail building into the project design measures that will ensure (a) the line departments of the State implementing the project are accountable for the effectiveness of spending across the PRIs; and (b) the fiduciary arrangements are focused on enhanced levels of compliance with the existing framework of rules and procedures, as against efforts to bring about more substantive institutional reforms.

**Scenario 2: Financing of block grants**

In States that have demonstrated commitment to decentralization agenda, the World Bank would seek to finance operations wherein additional united resources are made available to PRIs to allocate according to their own priorities, subject to common fiduciary standards as established by the State legislation and through which they are held accountable by their communities. Higher tiers of government focus on establishing service standards, monitoring compliance with prescribed rules, and intervening in the case of severe service delivery or financial failures. These operations typically aim to strengthen the Panchayat system as a whole, including the fiduciary framework, and may include a broader set of financial management and procurement reforms. These operations essentially focus on providing capacity support to PRIs and specific actions required from the State regarding its fiscal systems of inter-governmental transfers. Allocations are determined in advance of the financial year and are included in relevant PRI budgets. A single transfer of funds is made directly to the bank account of the relevant PRI on a regular disbursement schedule. Expenditures could remain earmarked for specific purposes through transfer conditions that create specific functional “windows”.

B. **Suggestions for Achieving Agreement on the Two Transfer of Fund Scenarios**

The following section summarizes the possible ways for achieving an agreement on the elements of an acceptable fiduciary environment for the two principal scenarios of resource transfer, which can be used as common platform for all relevant World Bank projects. These are suggested steps and are not intended to be a set of definitive recommendations, nor are these in order of preference or priority. The manner and extent to which these may be applied would to a large extent need to be calibrated on the assessment of fiduciary risk and the overall enabling reform environment.

**1. Fiduciary arrangements for tied funds**

(a) A starting point for preparation of projects that are to be implemented by PRI should entail developing an understanding of the enabling fiduciary environment in which the project is to be implemented. As part of the project preparation, the Bank staff may consider **undertaking limited level of diagnostic work on the PFM arrangements at PRI level in the State** with an objective of understanding the levels of compliance with the statutory requirements of the State and the gaps between policy and practice. Existing reports such as State Financial Accountability Assessment or other government/donor documentation are useful source documents for a broad assessment of the local systems.

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(b) Given the large number of PRIs that will be implementing the project, it is unlikely that all participating PRIs will be individually assessed. Typically, not all participating Panchayats are identified prior to project effectiveness. However, with a view to validating the findings of the diagnostic study, World Bank fiduciary staff may, working with the department counterparts, select a representative sample of Panchayats and perform assessments thereon. Results from these representative assessments can help inform project design particularly as relates to accounting, funds flow mechanisms, procurement, disbursement, financial reporting, and auditing arrangements.

(c) As part of the project design, a mechanism may be built in whereby the project management team can conduct ongoing fiduciary assessments as an integral part of the subproject cycle. This will require the determination of a simple template or checklist to measure the level of compliance with the existing fiduciary requirements at the Panchayat level. The yardstick may consider all or some selective elements of financial management, procurement and accountability framework at the PRIs level; see Box 10 for typical contents of a PFM framework. In determining the benchmarks, it may be useful to involve the State Panchayat Raj departments to the extent feasible. An important consideration in the determination of the benchmarks should be that the process should not be such as would unduly slow down the project implementation.

(d) The assessment of readiness is not intended to disqualify or reject the Panchayat, in the event that the Panchayat is unable to meet the agreed benchmarks but to enable corrective actions to be taken. This is an alternative to what may be a typical response of donors (including the World Bank) to agree to ring-fence the project funds. Typical examples of corrective actions could include (i) preparation of annual financial statements of previous financial year (or earlier financial years, if these are in arrears); (ii) completion of backlog in audits; (iii) filling in vacant positions of Panchayat Secretary (iv) bank reconciliation statements for all accounts prepared; and (v) follow-up actions to the audit observations initiated. A timetable for the corrective actions so determined for each Panchayat will need to be prepared and agreed upon, led by the district- or block-level functionaries of the Panchayat Raj Department or the project management unit of the line departments in consultation with the Panchayat Raj Department. In all circumstances, the related costs, if any, may be financed under the project. This may include costs of engaging qualified accountants to assist the Panchayat or a cluster of Panchayats or costs of retaining audit firms.

(e) Several good practice examples have emerged in ongoing projects in context of providing technical assistance in accounting and bookkeeping to user committees. While these interventions have been limited to the accounting requirements under World Bank-financed operations, there are good reasons to believe that the scope of the technical assistance in financial management and procurement provided under the project could well be extended to cover the entire PRI, the underlying premise being that working within the PRIs own PFMA framework, including supporting efforts to strengthen the systems, would substantively enhance sustainability of the project investments. To the extent possible, these initiatives
should leverage the State’s own medium-term plans and initiatives underway to strengthen the accounting functions at the PRI level or at the least help pilot or test new approaches, which if successful may be scaled up by the State.

(f) By the very nature of the institutional arrangements wherein user groups implementing World Bank-financed operations are mandated (by the Act itself or through State’s executive order) as subcommittees of the Panchayats, a fair assumption would be that the project funds are included in the PRI budget and annual financial statements. In reality, however, the project funds (as with the other Central/State or donor funds) are not included. The PRI budgets and financial statements reflect essentially own revenue funds and untied funds from the Central and State government. A prerequisite to establishing a common platform would be to **ensure that the PRI accounts for the funds provided under the World Bank-financed operation are in its books of accounts.** As part of the project preparation tasks, the task team may consider the following specific measures: (i) require the State to clarify or confirm through an executive order that the funds under the said project are to be included as part of the PRI funds; and (ii) ensure that the financial management arrangements are designed in a manner to ensure that income and expenditures related to the project (regardless of the operational arrangements) are brought into the Panchayat accounts. This may require explicit arrangements to be documented in the Project Operational Manual (if any).

(g) With the underlying assumption that all World Bank operations that finance investments in sections or functions devolved to PRIs will ensure PRI authority over project planning and implementation, then **fund flow arrangements will need to be designed in a manner that project funds flow to PRI-controlled bank accounts.** By and large, all State PRI Acts and rules permit PRIs to open separate bank accounts; this means that project funds could still flow to separate bank accounts and be earmarked solely for project-related expenditures, if required. In order to formally comply with the legal framework, all such segregated project bank accounts should necessarily be operated by officials authorized by statute. Some States (as in Uttarakhand), through enabling provisions in the State PRI Act, have issued executive orders to allow the operation of bank accounts to be transferred to members of subcommittees. While such measures are seen to significantly enhance the local discretion and downward accountability at the subcommittee level, decisions in this regard will need to be carefully considered to ensure that the principles of ownership and subsidiarity are not compromised.

(h) Accounting arrangements for the project (regardless of the implementation arrangements) will need to be **designed in a manner that the financial information required can be derived from the monthly financial reports of the PRIs.** This will require the Chart of Accounts to be adapted to properly account for and report on project activities. The design of accounting arrangements at the user committee level (if any) will need to be specified in operational manuals but should essentially follow the PRIs own systems. Internal controls will necessarily have to be based on PRIs own rules/delegation of authority as defined in the legislation and subsidiary bylaws and rules. Such measures will significantly reduce transaction costs for the State and
the PRI and help leverage the capacity-building initiatives taken under the project to strengthen PRI systems.

(i) The existing control framework provides extremely limited discretion at the Gram Panchayat level to take financial and procurements decisions and requires prior approval from officials at the block level. In response, the project design often resorts to specifying enhanced delegation of financial powers for the project operations. These measures, where considered essential for smooth project implementation, should necessarily be supplemented by specific initiatives aimed to enhance downward accountability and transparency. Several good practice examples have emerged from the ongoing portfolio of World Bank projects, including increasing transparency through the requirement of publishing contract opportunities and contract awards, and/or specifying in bidding documents the criteria for evaluating bids, public displays of financial progress, etc. These initiatives if seen in the broader perspective of capacity building provide ready demonstrable models of excellence, which can be scaled up at the PRI level.

(j) In designing procurement arrangements, special efforts will need to be made to re-energize the dormant procurement committees of the Panchayats, ensuring that the subcommittees are accorded a central role in the procurement decisions for the project. These measures may be supplemented by enhanced opportunities for public oversight through establishing effective complaint mechanisms, setting up public meetings to discuss procurement operations, and providing clear and simple information on procurement matters.

(k) The practice of instituting separate chartered accountancy audits for the project funds at the PRI level is not very cost effective and does not result per se in providing adequate fiduciary assurances (partly on account of the variable levels of audit capacity within the private sector). As an alternative, the World Bank team should look at available options to leverage on the audit reforms underway and reach upfront agreements with the Local Fund Auditors (or any other State-designated bodies responsible for PRI audits) to provide timely audit reports for the PRIs covered under the project. These measures may be supplemented by (i) instituting social audit processes, which entail obtaining a Gram Sabha resolution on the annual financial statements, using score card methods, public hearings, joint on-site appraisals, etc. and (ii) instituting special focused audits on an annual basis on a sample basis; audits may be focused on systems and transaction-based procurement, accounting and reporting, physical verification of assets created, downward accountability mechanisms in place, etc. on a rotation basis.

(2) Financing transfers of 'block grants' by the State to PRIs

(a) As in sector specific lending scenario, diagnostic studies on the PFM arrangements at the PRI level would be a starting point to the preparation process. These studies will however need to cover the wider context of the adequacy of the fiduciary framework to help understand the need for policy reforms. In this context, it would be useful to bring in the good practice examples from other jurisdictions as well lessons learned from implementation experiences. The study would help the task
team to understand the overall decentralization scenario in the State as well as the initiatives underway or in the pipeline for improvements at the PRI level. Existing reports, such as State Financial Accountability Assessment or other government/donor documentation are useful source documents for a broad assessment of the local systems.

(b) Quite typically, the counterpart agency at the State level for operations financing block grants to PRIs will be the State Department of Panchayat Raj or/and State Finance Department. Upfront engagement of the World Bank fiduciary team in preparation activities should necessarily entail seeking active partnership of the counterpart Government agencies in the studies. By following this approach, the task teams can ensure that the fiduciary arrangements are designed to be consistent with the State’s own vision and reforms underway. The extent to which these efforts are successful will to a large extent depend on the level of ownership demonstrated by the State Panchayat Raj departments. Nonetheless, it will allow the team to convey the World Bank’s commitment to work in tandem with the State’s own vision.

(c) In undertaking the diagnostic work, use of PEFA measurement framework as well as the OECD/DAC procurement indicators, suitably adapted to application at the local government level, should be encouraged. Forging partnerships with other active donors would help to harmonize efforts. The Indonesian experience in this respect can provide useful lessons in designing the diagnostic studies. The development and use of an integrated performance measurement framework will help to provide an assessment on the basis of a full overview of the PFMA system with ability to track progress over time as well as a common platform for reform dialogue.

(d) The project design would thus envisage a deeper level of engagement of the World Bank fiduciary staff. While the starting point in designing the project would invariably be to conduct a diagnostic study of the PFMA arrangements at the PRI level in the State (in many cases, this may already be in place), including a review of the ongoing reforms, the objective would to assist the State in developing a broader agenda of PFMA reforms, which may have policy as well as process-related imperatives.

(e) Improvement of the PFM systems would thus be an intrinsic part of the project and designed to assist the State in preparing a credible roadmap that may include several elements of PFM-related reforms ranging from (i) development of planning and budgeting framework; (ii) accounting simplification and modernization of processes, including revising the accounts, procurement and budget rules, introduction of double entry accounting systems; (iii) financial reporting, consolidation, and oversight (including computerization); (iv) capacity-building arrangements or provision of technical assistance in financial management and procurement in-built into the processes; (v) developing a timeline for completing backlog of accounting and audit; (vi) strengthening of audit capacity; and (vii) developing a timetable for resolving the pending audit observations among others.
In following the key principles of subsidiarity, downward accountability, and local discretion, PFM improvement initiatives will need to **support specific interventions to support community participation and enhance financial accountability**. Financial management and procurement staff will need to work with the task team to build in measures designed to improve transparency in financial and procurement decisionmaking forged around the tenets of downward accountability.

In this enabling environment, **fiduciary process for the project would essentially be built around the State and PRI fiduciary framework (including the planned reforms or reforms underway)**. The transfer of funds from the State to the PRIs would be considered as eligible expenditures for purposes of the project and the information for the purpose derived from the State accounts. The State (and the project) would in turn, derive fiduciary assurances on the use of funds for intended purposes from the robustness in implementation of the PFM reforms, duly monitored by the State (and the World Bank). This approach has the benefit of providing a significant boost and leadership to the decentralization agenda of the State and reduces the transaction and compliance costs for all parties. It would secure a key role for the World Bank in the evolution of the decentralization agenda in the State (should this be desired) and ensure that key risks associated with the project are effectively addressed.

**Box 11: Key Elements of PFMA Framework for PRIs**

- Each PRI has a budget which covers all sources and utilization of funds; the budget is available to all members of the General Assembly in an easy and understandable form.
- All revenues and grants are received in a predicted manner.
- Basic procedural controls are in place; for example, all payments properly authorized and documented, all receipts properly accounted for, procurement procedures followed, reconciliations/confirmations carried out on a regular basis, key financial and procurement related decisions recorded in Minute Books.
- Accounting books are maintained regularly and covers all receipts and payments; Accounting follows double entry bookkeeping systems and is maintained on a cash basis.
- Complete records of the assets of the PRI are maintained and updated on a timely basis.
- Financial reports (for example, Receipts & Payments Statements, Statement of Assets) are regularly prepared and presented to the General Assembly and the authorities.
- External audits are carried out regularly; main findings of audit report discussed in General Assembly and appropriate follow-up actions taken.
- There is a high degree of local-level transparency, including public displays in simple and understandable forms, on financial position, procurement, and physical progress.
C. The Way Forward

Quite clearly, any suggestions for the way forward will have to start with building of consensus on the need to adopt approaches that substantively integrate and provide a central role to PRIs in World Bank-financed operations. While this evidently applies to World Bank task teams, the findings have significant bearing on the manner that several GOI programs are designed and the role ascribed to PRIs; and therein the fiduciary arrangements. Accordingly, the next steps would entail the following action points for the respective players:

For Government of India

- Develop a coherent framework for financial and performance reporting of PRIs that will provide timely feedback to the State governments as well as the Government on the efficiency of revenue mobilization, as well as public expenditures at the PRI level.
- Actively review present portfolio of centrally sponsored schemes with the objective to ensuring centrality of PRIs and use of common fiduciary framework.

For State Governments

- Update and modernize accounting and reporting rules for PRIs in line with the common fiduciary framework, incorporating budget formats and templates provided by the Office of the Comptroller and Auditor General under the technical guidance and supervision function entrusted to it by the 11th Central Finance Commission.
- Provide guidance for treatment of project funds in PRI planning, budgeting, accounting, and reporting requirements.
- Review and strengthen Local Fund Audit’s capacity to undertake timely and quality audits of PRIs.

For World Bank Task Teams

- Disseminate the study findings among World Bank task teams through brown bag lunch discussions or other such forums with an objective to actively engage teams on the key findings and suggested approaches;
- Arrange dissemination workshops with key GOI and State line ministries and departments in an effort to initiate a broader discussion on how the findings equally apply to the GOI programs and demonstrate how subjecting the PRIs to separate fiduciary processes often results in undermining local capacity and limits the positive impact to the scale of the individual programs.
- Within the financial management team of the World Bank, it is proposed that the suggested approaches to the fiduciary arrangements be piloted in the design of selected operations from the present pipeline.
• In order to facilitate the above item, it is suggested that a core team be formed within the
Financial Management & Procurement Units to work on project design of the selected
pilots. To the extent feasible, particularly in the context of the assessment of acceptable
levels of fiduciary risks and the overall enabling reform environment, the fiduciary
arrangements will need to ensure the following:

☑ Project or specific scheme funds are included in the PRI annual budget and annual
work plans.

☑ Staffing of the accounting and financial management functions in Bank-financed
operations designed to ensure that the centrality of the role of the Panchayat
Secretary in the accountability framework as established by the Legislation is not
undermined or overlooked.

☑ Project funds flow primarily into PRI-managed bank accounts and, if required,
into segregated project bank accounts.

☑ Guidance provided with respect to the manner in which the project accounts at the
subcommittee should be treated in the books of the Panchayat.

☑ Special efforts made to ensure that arrangements for project results enhance
procurement capacity at the Gram Panchayat levels; and procurement committees,
where formed, are involved in decisionmaking.

☑ Internal financial controls (traditional and non-traditional) instituted by State
statute, like social audit, public displays; Right to Information, ombudsman, and
Citizen Charters, are adopted/adapted to the project design.

☑ To the extent feasible, information on project finances be obtained from PRIs own
financial reports.

☑ In designing audit arrangements for the World Bank-financed operations, special
efforts will be required to adopt a risk-based approach to determine the scope and
coverage of audit; subprojects implemented by local governments, intermediary
tentities, or community groups are typically audited randomly on a sample of low-
amount subprojects and on all high-amount subprojects.
ANNEX A. PUBLIC FINANCIAL MANAGEMENT FRAMEWORK IN KERALA

A Case Study for Block Grants

A defining feature of the Panchayati Raj Institutions in Kerala, particularly in the context of this study, is the fairly large share of the block grants (about 20% of the State’s own annual outlay) provided by the State and the public financial management framework put in place for the State to derive assurance on the use of funds for intended purposes.

The decision to devolve 35 to 40 percent of the State’s 9th Plan (1997-2000) outlay to local self governments for projects and programs drawn by them was followed by several reform measures, including institutional and structural changes, developing a framework for preparation of comprehensive area plans etc. The key initiative was called People’s Campaign for formulation of Ninth Five-Year Plan and Kerala Development Fund during the Tenth Five-Year Plan.

Devolution of Finances. The notable features of devolution of finances in Kerala consisted of the following points:

- The Kerala Panchayat Act, 1994 provides that subject to its provisions and guidelines and financial and other technical assistance provided by the Government, the Panchayats shall have exclusive power to administer the matters enumerated in the Schedules of the Act and to prepare and implement schemes relating thereto. This Panchayats have a wide autonomy of functioning within the spheres devolved upon them.

- The State Budget has a section for a separate Panchayat Sector budget. Appendix IV of the State budget provides details of funds allocated to PRIs, under the different heads of accounts.

- PRIs in Kerala typically receive funds from nine main sources as depicted in Figure A1; the three main categories of funds are as follows:
  - Untied plan allocation, which is about 30 to 40 percent of the State’s Plan allocation;
  - Allocation for different subjects transferred to PRIs, which includes plan and non plan funds that are tied to specific schemes;
  - Maintenance Grant and General purpose grants.

- The funds devolved to Panchayats includes and subsumes within it the Central Finance Commission (CFC) and RIDF (Rural Infrastructure Development Fund). The CFC grants are subsumed into the State devolution, on the ground that the State is already giving substantial grants to Panchayats. In a “Joint Statement of Conclusions of Devolution to

| Table 6: Number and Average Population of PRIs in Kerala |
|-------------|--------|--------------|
| **Level**   | **Number** | **Average population** |
| Gram Panchayat | 999     | 26,846       |
| Block Panchayat | 152    | 175,030      |
| District Panchayat | 14     | 1,900,324    |

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Panchayats – the Way Forward” signed between Government of Kerala and Government of India on 20 August 2006, it was agreed that Block Grants released by the Central Government on the recommendations of the 12th Finance Commission will be released within fifteen days from the State Consolidated Fund to all Panchayats in accordance with the recommendations of the State Finance Commission as mandated under Article 280 of the Constitution.

- From December 2004, the State introduced a bill system for the drawal of Plan/non plan grant funds and General Purpose and Maintenance grants from the Consolidated Fund through the Treasury. For this purpose, the PRI declared the Gram Panchayat Secretary and other implementing officers as Drawing and Disbursing Officers. The Personal Deposit Accounts maintained by the PRIs in the Treasury for transfer of Plan/non plan grants were closed. Allocations are made on a monthly basis at the rate of 1/14th of the annual allocations being released every month for the first 10 months of the financial year; the balance being paid in the last two months based on the financial position of the State. After allocations are made, these funds remain in the consolidated fund of the State till they are drawn. Under the bill system, the PRIs are permitted to draw funds required for payments against contingent bills, on the strength of allocation letters in the name of individual Panchayats. The exception being made for General Purpose grants which may be drawn in lump sum and deposited into the Gram Panchayat bank accounts along with their own funds. The arrears due to Kerala Water Authority from the respective Panchayat is deducted at source. In all other cases, the unutilized funds lapse at the end of the year.
1. Taxes, etc. collected locally by Gram Panchayats, the only tier of the PRIs empowered to levy taxes. Gram Panchayats levy property taxes, professional tax, entertainment tax, service tax, and show tax. In addition, there are other non-tax revenue sources such as rents, other income from properties such as markets, bus stands, shopping complexes etc. Other levels of Panchayats have no self revenues.

2. Funds for Plan Grants for schemes formulated by the PRIs as part of the decentralized planning exercise, relating to functions entrusted to them under the schedules of the respective Acts. The allocations are made by the State (Secretary, Local Self Government) to District Panchayats and by the Rural Development Department, through Assistant Development Commissioner (General) to Block Panchayats and through Deputy Directors of Panchayats to Gram Panchayats.

3. The State sponsored Plan schemes include Special Livestock Breeding Program, distribution of house sites to rural landless. Non plan schemes include unemployment wages, agricultural workers pension etc. The allocations flow through District officers of concerned Line Departments.

4. From the year 2004-05, the State passed on funds for General Purpose Grants (non plan) as per the recommendations of 2nd State Finance Commission recommendations. Fund flows are as in (2) above.

5. From the year 2004-05, the State passed on funds for Maintenance Grants (non plan) as per the recommendations of 2nd State Finance Commission recommendations. Fund flows are as in (2) above.

6. The centrally sponsored scheme include Swarnajayanthi Gram Swarojgar Yojana (SGSY), Indira Awas Yojana (IAY), Total Sanitation Campaign etc. as well as Central Finance Commission grants and funds for these schemes flow through the District Rural Development Agency, State Poverty Eradication Mission (Kudumbasree) to Block Panchayat, Gram Panchayat, and District Panchayat. The Central shares for the centrally sponsored scheme are not routed through the State budget.

7. The funds for drought relief, literacy programs etc. are received through District Collectors and various agencies and kept in separate bank accounts.

8. Loans obtained from State Government and Financial Institutions like HUDCO, Kerala Urban and Rural Development Finance Corporation Ltd. etc.

9. The receipts from other sources are beneficiary contributions, voluntary contributions, contributions in kind, etc.
Public Financial Management and Accountability System. The PFMA framework in Kerala as represented in Figure A2, is quite typical for similar jurisdictions, and has been modified to the extent required to represent the special features of State oversight and downward accountability, considered a hallmark of decentralization reforms in Kerala. The PFMA framework covers the range of different components of the PFM cycle, including budget preparation, approval and execution, internal control including internal audit, accounting and financial reporting, and external audit and legislative scrutiny and together provides a strong platform for the State to obtain fiduciary assurances for the effective and economical use of funds provided to the Panchayati Raj Institutions. In the following paragraphs, an effort has been made to briefly define the desired outcome, policy, practice and progress in each strategic area of the framework, in an effort to understand the strengths, weaknesses and opportunities for improvements.

Figure 4: Public Financial Management and Accountability System – Gram Panchayat

Budgeting

Desired outcome

Each PRI has a budget which covers all sources and utilization of funds; the budget is available to all members of the General Assembly in an easy and understandable form.
Policy

Kerala has by far, the most comprehensive framework for participatory planning, considered as a viable and sustainable model for the whole country. The legislation provides the necessary linkages between the planning and budgeting processes. The Kerala Panchayat (Amendment) Act (2000) requires that all funds, including plan funds be brought into the budget.

The District Planning Commissions have a defined role in the approval and consolidation of Panchayat (and Municipalities) plans into a draft development plan for the district. Detailed guidelines provided for the purpose, ensures that the draft district plans are duly considered while preparation of the State plans.

Practice

Despite the set of rules and regulations, comprehensive budget preparation is still seldom practiced. The budget does not present an integrated picture of finances of a village Panchayat. Nor is there any systematic budget preparation at the block and district level. In a performance review of the plan formulation process conducted by the Office of the Comptroller and Auditor General for the year 2004-05, the auditors observed that:

- The budget of the Panchayats were inaccurate due to non-incorporation of expenditures on plan schemes or Centrally sponsored projects;
- There continues to be a tendency to inflate the estimates and prepare a high surplus budget, specifically in own funds;
- Projects formulated by improperly constituted Working Groups without due care and deliberation;
- Low participation and inadequate deliberation at Gram/Ward Sabhas;
- District Planning Committee approved projects before clearance from Technical Advisory Committees;
- Failure to undertake stock taking of assets created during Ninth Plan means that projects for tenth Plan formulated on insufficient basis;
- As a result of delays in approval of annual plans by the District Planning Committees, before the commencement of the financial year 2004-05, approved annual plans could not be incorporated into the budgets.

The State Planning Board in its review (January 2006) on ten years of decentralization observed that the planning process has become overly regulated with the State micro-managing every aspect of the process and thereby reducing the autonomy of the Village Panchayats. The report recommends that the planning framework needs to be simplified, leaving it to the PRIs to seek technical and other assistance as required.
The weaknesses in the implementation of the planning and budgeting framework as identified by the auditors as well as new thinking emerging on the need for simplifying the processes makes it abundantly clear that the State needs to take a considered view on the continued validity of the ‘People’s Planning Campaign’ and measures needed to ensure that the processes are followed in spirit as well as form. For the budgeting to be a useful exercise as a policy linked planning aid, it is important that the budgets are comprehensive and include all sources and uses of funds.

Cash and Fund Flow Management

Desired outcome

All revenues and grants are received in a predicted manner

Policy

The State laws and rules lay down some basic procedures for managing the ‘Panchayat Fund’, defined to include (a) own income; (b) grants released by the Government for implementation of schemes, projects and plans formulated by the Village Panchayat; (c) grants released by the Government for the implementation of schemes projects or plans assigned, delegated or entrusted to the Village Panchayat under this Act; (d) money raised through donations, contributions and grants from the public and non-Governmental agencies and (e) amounts borrowed by the PRI. All grants received from the State (including plan funds) are through allocations which remain with the Consolidated Fund of the State, drawn only through contingent bills. Consequently, the GOI system of transfer of funds through the banking channels have not been implemented in the State. For all other funds, the Panchayats are allowed to maintain accounts in nationalized banks.

Practice

The Panchayats in Kerala face the problem of an even resource flow that is essential for planning and maintaining a smooth expenditure pattern. For the Village Panchayats, this is applicable to grants as well as own revenues. The peak collections of tax (such as building tax and profession tax) take place during the closing months of February and March each year. The State’s financial situation has also affected normal treasury transactions and treasury bans and restrictions continue to present a problem. The issue of inflated estimates of own revenues has been discussed earlier in the study and is largely attributed to the statutory requirement that the closing balance should be at least five percent of the total revenue. In effect, cash management is by far, limited to prioritization of payments and is primarily on account of the disintegrated manner in which the Panchayat implements its various schemes and projects using a combination of treasury and bank accounts. There are increasing instances of Panchayats availing loan funds from financial institutions, though there is no information on whether these funds were used to meet cash requirements. With enhanced revenue generation measures, efficient cash management will become an important element of financial management for the PRIs.

During the year 2004-05, Gram Panchayats availed loans amounting to Rs. 21.46 crores and DPs availed loans amounting to Rs. 236.47 crores during 2004-05 (Source: Report of the Comptroller and Auditor General of India for the year ended 31 March 2005: Local Self Government Institutions)
Internal Controls

Desired outcome

Basic procedural controls are in place; all payments properly authorized and documented, all receipts properly accounted for, reconciliations/confirmation carried out on a regular basis, key financial decisions recorded in Proceedings (Minute) books.

Policy

The Kerala Panchayat Raj (investment and withdrawal of Panchayat Fund) rules, 1996 lays down the requirement for the President of the Gram Panchayat to authorize, by way of written orders, all withdrawal of money from the Panchayat fund. The Secretary is required to sign all cheques or documents to withdraw money from the Panchayat fund. In addition, Chapter XV of the Kerala Panchayat Raj Act 1994 (as amended by various Acts) provides detailed procedures for conduct of Panchayat meetings, constitution and functions of Standing Committees, functional committees, subcommittees, ward committees and joint committees. In a major initiative to strengthen the control framework, the State created the performance audit2 authority to assist the Panchayats in building their financial management capacity and conduct internal audit. For the purpose, the State appoints Performance Audit Officers at the regional level to conduct performance audit once in three months in various Panchayats through audit teams. The rules define in detail the duties and functions, procedures and provides a detailed checklist for matters to be considered by the performance auditor. The Rules also lay down the follow-up procedure at the level of the Panchayat, which require placing the report at the next Panchayat meeting, correction of the identified mistakes and implementation of the recommendations, requirement of publishing copies of the report on the notice board of the concerned Panchayat Office, discussions in the Grama sabhas,

Practice

A due review of the various audit reports3 indicate that despite the control measures put in place, these are not as effective as they should be in ensuring that systems of internal financial controls work well. Some observations from the audit reports include:

- Misuse of plan funds without considering benefits to the public or the institution (for example, Rs.10 lakh given as advances to officials not collected back);4
- Diversion of plan funds is a common phenomenon in PRIs, including diversion from approved projects to non-approved projects, diversion from sectoral allocations, diversion from SCP/TSP norms etc.;
- Breaking of office procedures- matters related in the purchase of stationeries, tools and equipments etc. for distribution to beneficiaries existing government procedures are not

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2 The Kerala Panchayat Raj (Manner of Inspection and Audit system) Rules, 1997 defines "Performance Audit" as the inspection on the administration intended to evaluate whether the developmental and social welfare functions vested in a Panchayat and the financial and controlling powers entrusted to that Panchayat are being executed and utilised effectively.
only followed but are violated in most of the cases but no actions are initiated against the violation.

- Care is not taken to keep the minutes books of Administrative Committee, other Subcommittees by majority of Panchayats.

There is an increasing view in Kerala that the performance audit is not quite serving the purpose for which it was created. Though the primary duty was defined to examine current accounts and provide management advice, so far the performance audit has only been concerned with a post-mortem examination of accounts. The conventional method of statutory audit is being used and the focus is on formal compliance with financial rules. It has been acting as an external inspecting agency, not as a guide to improve the financial management function of local bodies. On the overall, there is a low level of awareness among Panchayats about the utility of the performance audit arrangements, and its reports are not given the importance they deserve. The importance of an effective internal audit function as an integral part of the control framework cannot be overemphasized and the State will need to consider ways in which the function can be strengthened.

**Accounting**

**Desired outcome**

Accounting books are maintained regularly and covers all receipts and payments; Accounting follows double entry book keeping systems and is maintained on a cash basis.

**Policy**

Accounts are maintained on a single entry system on a manual basis. The Kerala Panchayat Act, 1994 and the Kerala Panchayat (Budget) Rules 1963 provide the essential framework for maintenance of accounts. One clerk in each Gram Panchayat performs the tasks of the Accountant on additional charge. There is a full time accountant at the District Panchayat level. In June 2003, the State accepted the budget and accounting formats for PRIs prescribed by the Controller and Auditor General (CAG) and they came into force with effect from April 1, 2004. The State constituted a committee consisting of Principal Secretary (Finance), Senior Deputy Accountant General (LBA) and the Director of Local Fund Audit for monitoring the progress of implementation of the new accounting regimen.

**Practice**

The account rules currently in force in Gram Panchayats were framed more than forty years back and have not been updated. With multiple accounts required to deal with various State, central and own funds and multiple expenditure centres, the accounting system has become fairly complex. Rules do not capture the present day reality and are thus, unable to cope with the increased levels of funds now handled.
In their comments to the State Planning Board as part of the rapid assessment study of ten years of Panchayati Raj in Kerala, the auditors have suggested that a "Grant-in-aid Finance Code" should be prepared and published, comprising all the rules and regulations dealing with Plan formulation, implementation, monitoring and evaluation, resource mobilization, fund transactions, keeping of registers, receipts and vouchers, filing of annual accounts, and common accounting principles, computerized accounting systems, fixing of liabilities, misappropriation of funds and its disciplinary actions and procedures, process of audit and accounts etc. applicable to PRIs staff, elected members of the PRIs, audit groups related to PRIs etc.

Computerization of the accounting initiated through 'Information Kerala Mission' (see Box A1) has been proceeding extremely slowly. While the software suites have been ready for some time now, the implementation has slowed down because of the delays in the centralized procurement of computers.

**Asset Management**

**Desired outcome**

Complete records of the assets of the PRI are maintained and updated on a timely basis

**Policy**

Kerala Panchayat (Accounts) Rules 1963 prescribes the procedure for record keeping and safeguard of assets. These include various registers and records of immovable property, stock registers, investment registers etc. With effect from 2 October 1995, the Government transferred assets and liabilities of the institutions relating to the transferred functions to the LSGIs in the process of decentralization. The transferred institutions included Krishi Bhavans, Primary Health centers, hospitals and dispensaries, schools and agricultural farms having considerable assets in the form of land, buildings and movable properties.

**Practice**

Asset management continues to be an area of weakness, with inadequate or absent records. The CAG reports for the last two years (2003-04 and 2004-05) have brought to the attention of the State Government the need to take steps in identification of the nature and location and for the valuation of assets and liabilities of the transferred institutions. The transferred assets have not yet been incorporated in the asset registers of the LSGIs and formal transfer in the revenue records has not been made. The LSGIs are reported to have spent Rs. 51.73 crores during 2004-05 (and assets valued at Rs. 552.82 crores out of Plan funds during 2002-03 and 2003-04), as per certificate furnished by Department of the Local Fund Audit for creation of assets. The details of
assets were not available for want of recipient wise details of expenditures incurred. In the absence of identification and valuation of assets and due to incomplete maintenance of asset registers, the auditors have found it difficult to obtain a reasonable assurance regarding proper maintenance and safeguarding of assets.

**Procurement**

*Desired outcome*

An efficient system of procurement is in place promoting increased competition among vendors and providing greater value for money to the PRIs

**Policy**

The Kerala Panchayat Raj Execution of Public Works Rules 1997 provides a detailed set of procedures for procurement related to public works. The rules require the PRI to prepare a priority list of works to be executed at the beginning of each financial year. Other procedures relating to determination of annual rates at district level, preparation of estimates, technical sanctions, publication of tender notices, acceptance of tenders, entrustment of works through negotiations, check measurements; inspections etc. are detailed in the rules. The rules require the Panchayat to place the details of the work to be placed before the Gram Sabha, published in the notice board of the Panchayat Office as well as on the notice board at the work site. All procurement related documents like approved tender, estimate, rate decided by the Panchayat, quality, bills for the purchase of materials and goods etc. of a public work is considered as a public record and the Panchayat is liable to issue the copy of such records on requisition, to any person on realizing fixed fees. No separate guidelines are in place for procurement of equipment or hiring of technical services

**Practice**

Notwithstanding the detailed rules and procedures, audit reports continue to point out instances of inadequate records, absence of physical verification as well as transactions leading to unfruitful investments, idling machinery and dumping of material etc. This suggests that there are significant opportunities to improve efficiency and effectiveness of spending by adopting better planning processes which are linked to the budget and the need for improved oversight and transparency in the processes.

**Financial Reporting**

*Desired outcome*

Financial reports (for example, receipts & payments statements, statement of assets) are regularly prepared and presented to the General Assembly and the Authorities
**Policy**

The Act and related rules prescribe the following procedures for financial reporting by PRIs:

- Submission of accounts to the auditor within four months of the close of each financial year;
- Submission of abstract of annual report as certified by the auditor, showing receipts, charges and the unspent balances with the audit report to the officer authorized by the Government not later than fifteenth day of the second month of the next financial year;
- Consolidation of the report and submission to Government by the authorized officer;
- Government causing the accounts together with the audit reports to be laid before the Legislative Assembly;
- Government to publish the annual accounts of the Panchayats.

The State has constituted a separate committee of legislature, in the lines of Public Expenditure Committee, called the Committee on Local Funds Accounts, with effect from June 2003 to examine the audit reports of the PRIs.

**Practice**

As pointed by the CAG in their various reports, that there are some major ambiguities and conflicting provisions in the existing framework. These relate to inconsistencies in the dates for submission of annual accounts, lack of clarity on dates for submission of audited accounts to Government and Legislature, ambiguity regarding Annual Accounts and Annual Reports, scope and processes for consolidation process from the lowest level to an overall position at the State level and the new CAG formats of budgets and accounts. The legislative intention of publishing the consolidated accounts on an annual basis has consequently, never been fulfilled. However, the biggest weakness in the system lies in the inability of the PRIs to prepare a consolidated annual statement of accounts as prescribed in the Act and rules. The financial statements prepared by the PRIs normally do not include plan funds or funds from other sources and are limited to own funds. As a result, there is no single point source of information of the financial position of the PRIs.

**External Audit**

*Desired outcome*

External audits are carried out regularly; main findings of audit report discussed in General Assembly and appropriate follow-up actions taken
Policy

As per the legislation, the external audit of the PRIs in Kerala is carried out by the Director of Local Fund Audit Department on an annual basis. The Local Fund Audit legislation requires that an annual consolidated audit report to be sent to the Government, who shall place the same before the Legislative Assembly. In 2002 the Kerala Government entrusted the audit of PRIs to the CAG for the purposes of providing technical guidance and supervision of audit. The Government has also accepted the budget and accounts formats prescribed by the CAG’s Office. A committee constituted in June 2005 consisting of Principal Secretary (Finance), Senior Deputy Accountant General (LBA) and the Director of Local Fund Audit for monitoring the progress and provide oversight in the areas of technical guidance and supervision. CAG conducts transaction audit of PRIs under the technical guidance and supervision scheme as well as under sections 14/15 of the Comptroller and Auditor General (DPC) Act 1971.

Practice

Large backlogs in preparation of annual accounts and audits continue to be an area of concern. Of 10,931 accounts which were receivable during the nine year period of 1996-97 to 2004-05, 4,256 accounts (39%) were outstanding as at end-November 2005. Audit by Department of the Local Fund Audit was in arrears in the case of 11.5% of the accounts received. This is largely on account of the inadequate staff strength at Department of the Local Fund Audit to cope with the manifold increase in the workload. Department of the Local Fund Audit also needs to provide its staff with substantive training opportunities to update them with better practices and modern professional trends in accounting and audit.

The Panchayat Raj legislation provides that the audit reports of all levels of Panchayats and the replies furnished by them should be placed before and discussed in Gram Sabhas. Given the delays in audit, incomplete accounts and low turnout in Gram Sabhas, it is unlikely that this stipulation can be met in the spirit intended. The State is actively considering consolidating the audit functions and creating a functional audit commission to support local government management.

Oversight and Local Transparency

Desired outcome

There is a high degree of local level transparency, including public displays in simple and understandable forms on financial position and physical progress

Policy

One of the important contributions made by the People’s Campaign is the introduction of the concept of downward accountability of PRIs. The innovative tools of accountability introduced in Kerala include:

- Social audit through the empowerment of the gram sabha, neighborhood committee and monitoring committee;
- Performance Audit
- Beneficiary Committees to execute public works
- Introducing transparency by:
  - Conferring right to information on citizens
  - Prescribing rules for selection of beneficiaries
  - Providing for the citizen’s charter
- Creating a watchdog institution, the ombudsman to ensure fair play in the functioning of Panchayats.

**Practice**

Kerala provides a good role model in fully recognizing that the primary accountability of the local governments is towards its constituents. But much remains to be done to institutionalize the various innovative accountability tools. For instance, over time the interest and enthusiasm over the creation of the institution of Ombudsman has waned, with the number of Ombudsmen reduced from seven to one with the institution taking on a more formal functioning style with lawyers appearing before it.

**Conclusion**

In adopting the "Big Bang" approach to decentralization and adopting a wide range of reforms, including setting up a fiscal transfer system that assigned 20 percent of the State capital budget as the vertical share for local governments, Kerala is quite clearly the front-runner of decentralization in India. The PFMA framework, derived from the various legislative Acts, rules and bylaws covers the range of different components of the PFMA cycle, including budget preparation, approval and execution, internal control including internal audit, accounting and financial reporting, and external audit and legislative scrutiny are designed to provide a strong platform for the State to obtain fiduciary assurances for the effective and economical use of funds provided to the Panchayati Raj Institutions. In practice, however the financial control framework lacks rigor and oversight. In its effort to cope with the manifold increase in the quantum of funds handled by the Panchayats, the State has issued several regulations on the use of funds, which have resulted in an overly complex system. The challenge for the State now is to simplify, consolidate and institutionalize the various rules and operating procedures into a fully encompassing legal and institutional framework, updating and modernizing many of the archaic accounting and reporting systems to support decision making and local governance.
## ANNEX B. SUMMARIZED INVENTORY OF FINANCIAL MANAGEMENT AND PROCUREMENT ARRANGEMENTS FOR SELECTED FLAGSHIP CENTRALLY SPONSORED PROJECTS

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<th>Central Rural Sanitation Project</th>
<th>Sampoorna Gramin Rozgar Yojana</th>
<th>National Rural Employment Guarantee Program</th>
<th>Haryali (Watershed)</th>
<th>Swajaldhara (Rural Water Supply)</th>
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<td></td>
<td></td>
<td>staffing have been</td>
<td></td>
<td>by Panchayat. No</td>
<td>Secretary and Pradhan are</td>
</tr>
<tr>
<td></td>
<td></td>
<td>stipulated.</td>
<td></td>
<td>separate</td>
<td>responsible for convening</td>
</tr>
<tr>
<td>3</td>
<td>Flow of Funds</td>
<td>Separate bank accounts at</td>
<td>Separate bank accounts at district as well</td>
<td>Separate bank</td>
<td>Separate bank accounts are</td>
</tr>
<tr>
<td></td>
<td></td>
<td>district as well as block</td>
<td>as block level are envisaged with</td>
<td>accounts are</td>
<td>envisaged with signatories</td>
</tr>
<tr>
<td></td>
<td></td>
<td>level are envisaged with</td>
<td></td>
<td>envisaged with</td>
<td>to be same as what is</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>signatories to</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>be same as what is</td>
<td></td>
</tr>
</tbody>
</table>

At Gram Panchayat level Secretary and Pradhan are responsible for convening meetings and operation of bank account.
<table>
<thead>
<tr>
<th>Central Rural Sanitation Project</th>
<th>Sampoorna Gramin Rozgar Yojana</th>
<th>National Rural Employment Guarantee Program</th>
<th>Haryali (Watershed)</th>
<th>Swajaldhara (Rural Water Supply)</th>
</tr>
</thead>
<tbody>
<tr>
<td>signatories to be same as what is prescribed under the State Panchayat act</td>
<td>signatories to be same as what is prescribed under the State Panchayat act</td>
<td>district program coordinator as the joint holder of the account. Detail guidelines have been providing for replenishing the monies periodically.</td>
<td>prescribed under the State Panchayat act</td>
<td>prescribed under the State Panchayat act</td>
</tr>
</tbody>
</table>

**Procurement**

No separate procurement rules have been prescribed in the guidelines. By default, this assumes that country systems for procurement would apply for IEC activities, NGO selection and construction of Community Sanitary complexes, school & anganwadi facilities. Subsidies are provided to individual households for construction of toilets.

No specific procurement rules have been provided in the Guidelines. The default position that may be assumed is that the country systems for procurement followed by the implementing agencies be followed for all procurement of material.

Gram Panchayat /VWSC are required to purchase the materials. No centralized purchasing should be done. However, in exceptional cases and as the situation demands with respect to certain items, centralized purchasing may be opted by the DWSC on behalf of Gram Panchayats but only after receipt of due request from the Gram Panchayat / VWSCs. The DWSC shall guide and assist VWSCs to ensure that materials of standard quality are purchased.

**Accounting**

Detail guidelines have been issued pertaining to records and data to be maintained with formats also provided including Income and expenditure account and Balance Sheet. There is no guideline requiring consolidation of CRSP expenditure with PRI overall expenditure or inclusion in PRI overall expenditure or inclusion in PRI books of accounts. SGRY funds

Detail guidelines have been issued pertaining to records and data to be maintained with formats also provided. There is no guideline requiring consolidation of NREGA expenditure with PRI overall expenditure or inclusion in the PRI books of accounts. NREGA

Detail guidelines have been issued pertaining to records and data to be maintained with formats also provided. There is no guideline requiring consolidation of Haryali expenditure with PRI overall expenditure or inclusion in the PRI books of accounts. Haryali funds do not form part of the PRI overall expenditure or
| 5 | Internal Control and Audit | Detail guidelines are applicable with relation to approval of plans, expenditure and internal audit etc. These are separate from the normal financial rules and regulations of the PRI. Detail guidelines have been issued including formats for reporting under the Project. There is no guidance on inclusion of these in the financial statement for all sources and uses of funds of the PRI entity. |
| 6 | Financial Reporting | Monthly and annual progress reports as per formats provided in the guidelines are required to be furnished to GOI. |
| 7 | External Audit | Chartered accountancy firms are required to audit the project accounts. Though the auditors are the same as the normal external auditors of the PRI as per State legislature, separate audit report and certificate is required as per the guidelines. |
| | Sampoorna Gramin Rozgar Yojana | do not form part of the PRI funds as per statute. Detail guidelines are applicable with relation to approval of plans, expenditure and internal audit etc. These are separate from the normal financial rules and regulations of the PRI. Detail guidelines have been issued including formats for reporting under the Project. There is no guidance on inclusion of these in the financial statement for all sources and uses of funds of the PRI entity. |
| | National Rural Employment Guarantee Program | funds do not form part of the PRI funds as per statute. Detail guidelines are applicable with relation to approval of plans, expenditure and internal audit etc. These are separate from the normal financial rules and regulations of the PRI. Detail guidelines have been issued including formats for reporting under the Project. There is no guidance on inclusion of these in the financial statement for all sources and uses of funds of the PRI entity. |
| | Hariyali (Watershed) | funds as per statute. Detail guidelines are applicable with relation to approval of plans, expenditure and internal audit etc. These are separate from the normal financial rules and regulations of the PRI. Detail guidelines have been issued including formats for reporting under the Project. There is no guidance on inclusion of these in the financial statement for all sources and uses of funds of the PRI entity. |
| | Swajaldhara (Rural Water Supply) | inclusion in the PRI books of accounts. Project funds do not form part of the PRI funds as per statute. Detail guidelines are applicable with relation to approval of plans, expenditure and internal audit etc. These are separate from the normal financial rules and regulations of the PRI. Monthly and annual progress reports as per formats provided in the guidelines are required to be furnished to GOI. |
# Annex C. Checklist of Institutional Arrangements of Projects in World Bank Portfolio Implemented by User Groups

<table>
<thead>
<tr>
<th>Sector</th>
<th>Name of project</th>
<th>Implemented through</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>PRIs or its</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>subcommittees</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>User groups</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Rajasthan District Poverty Initiatives</td>
<td>✗</td>
<td>The project is implemented by Common Interest Groups (CIGs) and finances creation of private or semi-private assets. All sub Completion Certificates are required to be approved by the Gram Sabha.</td>
</tr>
<tr>
<td></td>
<td>MP District Poverty Initiatives</td>
<td>✗</td>
<td>The project is implemented by Common Interest Groups and finances creation of private or semi-private assets. All sub project proposals prepared by CIGs and Completion Certificates are required to be approved/ratified by the Gram Sabha.</td>
</tr>
<tr>
<td></td>
<td>AP Rural Poverty Reduction</td>
<td>✗</td>
<td>The project is implemented by Self Help Groups and finances creation of private or semi-private assets against micro plans. There is no involvement of PRIs.</td>
</tr>
<tr>
<td>Livelihood</td>
<td>Chhattisgarh District Rural Poverty Reduction</td>
<td>✓</td>
<td>The project is implemented by Common Interest Groups and finances creation of private or semi-private assets. All sub project proposals prepared by CIGs and are required to be approved by the Gram Sabha. In addition, the project finances matching grants (US$33.51 million) to Gram Panchayats to co-finance investments within the devolved functions.</td>
</tr>
<tr>
<td></td>
<td>Tamil Nadu Empowerment &amp; Poverty Reduction</td>
<td>✗</td>
<td>The project is implemented by Village Poverty Reduction Committees (VPRC). Close linkages exist between the Gram Panchayats and Gram Sabha, and the VPRC – however, the VPRC is not a subcommittee of the Gram Panchayat nor do project funds flow through the PRIs. The project provides for a small incentive fund (US$11 million) to provide incentives to the VPs to improve their governance by becoming more effective, pro-poor, accountable and responsive to the needs and demands of the village community.</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Watershed Development &amp;</td>
<td>Karnataka Watershed</td>
<td>✗</td>
<td>The project is being implemented through the user groups - the Sujala Watershed Sanghas (SWS), a registered society at the micro-watershed level representing Area Groups and Self Help Groups in each village.</td>
</tr>
<tr>
<td>Management</td>
<td>Uttarakhand Watershed</td>
<td>✓</td>
<td>Implementation responsibility lies with the Gram Panchayats, assisted by the Water &amp; Watershed Committees (WWC).</td>
</tr>
</tbody>
</table>

70
<table>
<thead>
<tr>
<th>Sector</th>
<th>Name of project</th>
<th>Implemented through</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>PRIs or its subcommittees</td>
<td>User groups</td>
</tr>
<tr>
<td>8</td>
<td>Mid-Himalayan (HP) Watersheds</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tank Rehabilitation &amp; Management</td>
<td>9</td>
<td>Karnataka Tank Mgmt</td>
<td>✓</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>10</td>
<td>AP Community Tank Management</td>
<td>✓</td>
</tr>
<tr>
<td>Community Forestry</td>
<td>11</td>
<td>Andhra Pradesh Community Forestry</td>
<td>✓</td>
</tr>
<tr>
<td>Rural Water Supply &amp; Sanitation</td>
<td>12</td>
<td>Kerala Rural Water Supply &amp; Sanitation</td>
<td>✓</td>
</tr>
<tr>
<td></td>
<td>13</td>
<td>Karnataka Rural Water Supply &amp; Sanitation</td>
<td>✓</td>
</tr>
<tr>
<td>Sector</td>
<td>Name of project</td>
<td>Implemented through</td>
<td>Comments</td>
</tr>
<tr>
<td>------------------------</td>
<td>----------------------------------------</td>
<td>---------------------</td>
<td>--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td></td>
<td></td>
<td>PRIs or its subcommittees</td>
<td>User groups</td>
</tr>
<tr>
<td>14</td>
<td>Maharashtra Rural Water Supply &amp; Sanitation</td>
<td>✓</td>
<td>×</td>
</tr>
<tr>
<td>15</td>
<td>Uttarakhand RWSS</td>
<td>✓</td>
<td>×</td>
</tr>
<tr>
<td>16</td>
<td>Punjab Rural WS &amp; Sanitation</td>
<td>✓</td>
<td>×</td>
</tr>
<tr>
<td>Panchayat Strengthening</td>
<td>Karnataka Panchayat Strengthening</td>
<td>✓</td>
<td>×</td>
</tr>
<tr>
<td>Health</td>
<td>Karnataka Health Systems</td>
<td>✓</td>
<td>×</td>
</tr>
</tbody>
</table>
ANNEX D. MAPPING OF FM ARRANGEMENTS FOR PRI FINANCING IN SELECT WORLD BANK-FINANCED OPERATIONS

Sector Specific Investment Operations

D1. Uttarakhand Decentralized Watershed Development Project

<table>
<thead>
<tr>
<th>Name of Project</th>
<th>Uttarakhand Decentralized Watershed Development Project (P078550)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost of Project</td>
<td>US$ 89.35 million (World Bank share: US$ 69.62 million)</td>
</tr>
<tr>
<td>Effectiveness Date</td>
<td>10-Sep-04</td>
</tr>
<tr>
<td>Closing Date</td>
<td>31-Mar-12</td>
</tr>
<tr>
<td>Brief Description</td>
<td>The Project supports the strategic higher level objective of (i) adopting a watershed approach to sustainably manage natural resources; (b) building institutional capacity for the poor through an emphasis on devolution and building local organizational capacity and (iii) encouraging adoption of improved agricultural technologies and diversification to increase productivity and rural growth</td>
</tr>
</tbody>
</table>

Implementation Arrangements:

<table>
<thead>
<tr>
<th>State Level</th>
<th>Watershed Management Directorate (WMD) of Government of Uttarakhand</th>
</tr>
</thead>
<tbody>
<tr>
<td>District level</td>
<td>Multi Disciplinary Team (MDT) under Deputy Project Director (DPD) of WMD</td>
</tr>
<tr>
<td>Village level</td>
<td>Water and Watershed Committee (WWC) of the Gram Panchayat (GP)</td>
</tr>
</tbody>
</table>

Element 1: Planning & budgeting

An initial Memorandum of Understanding (MoU) is signed between the WMD and Gram Panchayats (within the selected project area) who are willing to participate in the project. As per set criteria WMD communicates the total budget envelop for the Gram Panchayat for a period of 5 years. Within the given budget envelop, a 5-year Gram Panchayat Watershed Development Plan (GPWDP) is prepared by the Gram Panchayat with the assistance of MDT and is based on specific proposals from Revenue Village Committee’s (RVC) and other user groups. The GPWDP is a detailed annual action plan for the implementation of the sub project. After approval by the Gram Sabha, the GPWDP is submitted to the DPD for review and appraisal. After approval of the GPWDP, an annual work plan (including procurement plan) is prepared by each Water and Watershed Subcommittee (WWC) of the Gram Panchayat. This is also approved by the Gram Sabha and then submitted to the DPD. On approval, a legal MOU is executed between Gram Panchayat and DPD covering various aspects as per the operational manual.

Element 2: Staffing

During project preparation, one of the potential areas of risk to smooth project implementation was identified as the low number of State appointed GP Secretaries - presently there are 1,398 Secretaries covering 7,227 Gram Panchayats, an average of about five Gram Panchayats per Secretary. As part of the mitigation measures, it was agreed that under the Project, each Gram Panchayat will appoint an accounts assistant locally who will assist the GP Secretary in book keeping, accounting, cash book writing and preparation of vouchers and all matters relating to updating of accounting and reporting pertaining to the project.

In a subsequent development under the project, by virtue of a GO dated 24th July 2006, the State has arranged for the responsibilities of the GP Secretary under the project, including operation of bank account, to be transferred to the female member of the WWC or in absence of such female member, to any GP member nominated by Gram Panchayat.
Element 3: Flow of funds

Fund flows for the project are through WMD. The Gram Panchayats assisted by WWC manage the project funds through a dedicated bank account, operated by the Pradhan and Secretary of the Gram Panchayat (since revised as per GO referred to above).

Element 4: Accounting

A FM Manual and a GP accounting manual has been prepared under the Project. These manuals document in detail the accounting processes and policies relating to the project. All releases to Gram Panchayats as releases against approved work plan are recorded as expenditure in the books of accounts of the Project.

Element 5: Procurement

Gram Panchayats will procure goods, works and services using the procedures and forms detailed in the Community Procurement Manual (CPM) that has been prepared specifically for this project and agreed with the World Bank. The CPM contains procedures, thresholds, forms and formats for all types of procurements required under the project.

The CPM also provides for social audit of procurement decisions by way of (a) requiring the Procurement Plan to be place before the Gram Sabha; (b) information with respect to intended procurement over Rs. 2,500 to be displayed by the Gram Panchayat on notice boards at the Panchayat Bhawans, community halls and other public places; and (c) open all documents and records for public inspection on request and payment of prescribed fees. The manual also describes the complaint handling mechanism set up for the project.

Element 6: Internal Control & audit

A FM Manual and a GP accounting manual has been prepared under the Project, expected to supplement the policies given in State Financial rules. In practice project specific financial rules and regulations are used as the final authority for project implementation. The project adopts the social audit functions at the Gram Panchayat as laid down under the “Hariyali” (GOI guidelines for watershed development programs). The project has specified a firm of Chartered accountants is envisaged to undertake quarterly internal audit of the project.

Element 7: Financial Reporting

Monthly reporting formats from each of the accounting centers have been designed to provide summarized monthly financial information on the project expenditures and activities. These are compiled by WMD on a monthly and quarterly basis to provide meaningful FMRs at the project level. Gram Panchayats are required to prepare monthly expenditure reports and present them in the relevant Gram Sabhas/ WWC/GP meetings and also to be publicly posted on the notice board. For the project, separate financial reports are prepared on a monthly and annual basis.

Element 8: External Audit

The Auditor General, Uttarakhand are the external acceptable auditors for the project. As per the agreed TORs, the AG is required to cover Gram Panchayats on sample basis. The Project auditor is envisaged to certify the financial statements, however conventionally the CAG does not carry out an audit of annual financial statements.
<table>
<thead>
<tr>
<th>S.NO</th>
<th>QUESTIONS</th>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Is the implementing entity (user committee level) an officially constituted/recognized subcommittee of the local government?</td>
<td>Y</td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>Does the project design provide for an assessment of the fiduciary capacity of PRI as selection criteria?</td>
<td>N</td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>Are the procedures for operation of project bank accounts at the sub project level in line with the provisions of the PR Act and Rules?</td>
<td>N</td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>Are the sub project funds included in the “fund” of the local government as defined by the PR Act and Rules?</td>
<td>Y</td>
<td></td>
</tr>
<tr>
<td>5</td>
<td>In preparing the annual plans/budgets and annual financial statements, does the local PRI include the sub project funds?</td>
<td>N</td>
<td></td>
</tr>
<tr>
<td>6</td>
<td>Are the procurement processes prescribed for the project aligned with the PRIs financial rules/regulations, with respect to approval of the Procurement plan, grievance redressal and complaint mechanism, Public display of all procurement related information, limits for administrative and technical sanction of estimates and contracts and procurement methods to be used?</td>
<td>N</td>
<td></td>
</tr>
<tr>
<td>7</td>
<td>Does the project design envisage a separate audit procedure as against using the entity audit reports to provide the required assurance on end use of the project funds?</td>
<td>Y</td>
<td></td>
</tr>
</tbody>
</table>
Element 1: Planning & budgeting

Ward level micro plans formulated at the community level are aggregated and compiled to form Gram Panchayat Watershed Development Plans (GPWDP). The Gram Panchayat supported by the WDCs will be responsible for preparing a GPWDP on the basis of recommendation from user groups from the respective revenue villages and also a detailed annual action plan including cost estimates, cost sharing and identify implementing agencies or groups for specific activities. In addition, the Gram Panchayat is responsible for identification of families eligible for assistance under the livelihood component (based on wealth ranking exercise documented in the Community Operations Manual). Each Gram Panchayat submits the GPWDP and Annual plan to Gram Sabha for approval. At Regional/district level the WDO will (i) review and approve the overall watershed development plan well as the annual work plan of individual Gram Panchayat (ii) consolidate the annual action plan of all the Gram Panchayats under the WDO; (ii) prepare annual work plan for the WDOs. At the State Level the project will (i) compile and consolidate the annual budgets and Annual Work Plan (AWP) of various implementing units and submit the same to the State/NRMS (Finance Committee) for budget approval (ii) allocate the approved budget to WDOs on a timely basis as per approved work plans. The project attempts to institute an incentive fund to reward GPs meeting pre-determined Performance standards with intent to strengthen functioning of Gram Panchayats and fostering long-term sustainability of project activities. The Performance standards will include financial Management benchmarks.

Element 2: Staffing

As per Government of Himachal Pradesh (GoHP) policy, there is one Panchayat Secretary for every 2 Gram Panchayats but due to shortage of GP Secretaries in the State this ratio is often 1:3. In order to address this shortfall GoHP has sanctioned the appointment of Panchayat Sahayaks (Assistants) on contractual basis.

Under the Project each Gram Panchayat will appoint an accounts assistant locally who will assist in book keeping, accounting, cash book writing and preparation of vouchers and all matters relating to updating of accounting relevant to the project. They will complement Panchayat Sahayaks or Secretaries who are primarily responsible for preparation of accounts, minutes of meetings and subsidiary accounting records.

Element 3: Flow of funds

Fund flows for the project are through the Line Department. At GP level, the project funds will be placed in a separate dedicated bank account to be operated by GP president and Secretary. Payments by Gram Panchayats to user groups will be based on financing agreements.
Element 4: Accounting

An operational manual and a GP accounting manual have been prepared under the Project. The accounting processes and policies prescribed for the project essentially builds on the existing records of the GO with focus on addressing the gaps (i.e. accounting for beneficiary contributions, periodic financial reporting) and is designed to meet the World Bank's fiduciary requirements. All releases to Gram Panchayats as releases against approved work plan will be recorded as expenditure in the books of accounts of the Project.

Element 5: Procurement

Gram Panchayats will procure goods, works and services using the procedures and forms detailed in the Community Procurement Manual (CPM) that has been prepared specifically for this project and agreed with the World Bank. The CPM contains procedures, thresholds, forms and formats for all types of procurement at this level.

The CPM also provides for social audit of procurement decisions by way of (a) requiring the procurement plan, audit report, compliance, physical and financial progress, utilization certificates to be place before the Gram Sabha; (b) information with respect to projects, all works, beneficiaries is displayed by the Gram Panchayat on notice boards at the Panchayat Bhawans, community halls and other public places; and (c) open all documents and records for public inspection on request and payment of prescribed fees. Complaint /Grievance redressal mechanism is through Gram Sabha.

Element 6: Internal Control & audit

The GP accounting manual prepared under the Project is expected to supplement the policies given in State Financial rules. In practice project specific financial rules and regulations prevail. The project adopts the social audit functions at the Gram Panchayat as laid down under the “Hariyali”(GO 1 guidelines for watershed development programs). Quarterly internal audit by a firm of chartered accountancy is expected under the Project.

Element 7: Financial Reporting

Monthly reporting formats from each of the accounting centers have been designed to provide summarized monthly financial information on the project expenditures and activities. These are compiled at the State level on a monthly and quarterly basis to provide meaningful FMRs at the project level. Gram Panchayats prepare monthly expenditure reports and present them in the relevant Gram Sabhas/ GP meetings. These reports are also publicly posted on the notice board. Under the project only project monies are reported monthly and annually.

Element 8; External Audit

CAG are the external auditors for the project.GP's financial reports are expected to be reviewed by the internal auditors - chartered accountancy firms.
## CHECK LIST

<table>
<thead>
<tr>
<th>S.NO</th>
<th>QUESTIONS</th>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Is the implementing entity (user committee level) an officially constitued/recognized subcommittee of the local government?</td>
<td>Y</td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>Does the project design provide for an assessment of the fiduciary capacity of PRI as selection criteria?</td>
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<td>N</td>
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<td>3</td>
<td>Are the procedures for operation of project bank accounts at the sub project level in line with the provisions of the PR Act and Rules?</td>
<td>Y</td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>Are the sub project funds included in the “fund” of the local government as defined by the PR Act and Rules?</td>
<td></td>
<td>N</td>
</tr>
<tr>
<td>5</td>
<td>In preparing the annual plans/budgets and annual financial statements, does the local PRI include the sub project funds?</td>
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<td>N</td>
</tr>
<tr>
<td>6</td>
<td>Are the procurement processes prescribed for the project aligned with the PRIs financial rules/regulations, with respect to approval of the Procurement plan, grievance redressal and complaint mechanism, Public display of all procurement related information, limits for administrative and technical sanction of estimates and contracts and procurement methods to be used?</td>
<td></td>
<td>N</td>
</tr>
<tr>
<td>7</td>
<td>Does the project design envisage a separate audit procedure as against using the entity audit reports to provide the required assurance on end use of the project funds?</td>
<td>Y</td>
<td></td>
</tr>
</tbody>
</table>
D3. Karnataka Watershed Development Project

<table>
<thead>
<tr>
<th>Name of Project</th>
<th>Karnataka Watershed Development Project (P067216)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost of Project</td>
<td>US$ 127.6 million (World Bank share: US$ 100.4 million)</td>
</tr>
<tr>
<td>Effectiveness Date</td>
<td>10-Sep-01</td>
</tr>
<tr>
<td>Closing Date</td>
<td>31-Mar-08</td>
</tr>
<tr>
<td>Brief Description</td>
<td>The Project will improve the productive potential of selected watershed and their associated natural resource base and strengthen community and institutional arrangements for natural resource management</td>
</tr>
</tbody>
</table>

Implementation Arrangements:

State Level
- Project Planning & Management Unit (PPMU) within Watershed Development Department (WDD) of Government of Karnataka

District level
- Zilla Parishad (ZP) and District Watershed Development Offices (DWDO) at District and Taluk level

Village level
- Micro Watershed Management Group or Sujala Watershed Societies (SWS)

Element 1: Planning & budgeting

The project will be implemented in three clear batches, each overlapping with the other. Each batch will have duration of about four years, the first year being devoted to social mobilization, the next two years to implementation, and the last year to consolidation. The MWMGs would be registered societies under the Karnataka Societies Registration Act, 1960 by the name of Sujala Watershed Society (SWS). The SWS have since been notified as subcommittees of Gram Panchayats under Sec 61A. The Micro Watershed Development Plans (MWDP) would be prepared by the SWS through a highly participatory and consultative approach. Preparation and implementation of MWDPs will be undertaken by SWS with technical assistance rendered by Taluk Watershed Teams and support from NGOs in social mobilization and community participation. A Memorandum of Understanding (MOU) signed between the SWS, Zilla Panchayat and the NGO after approval of MWDP (endorsed by Gram Sabha) and Sub-plan by the Zilla Panchayat Standing Committee would form the basis for implementation of watershed development activities.

The project is budgeted for in the State budget as a separate single line. For the expenditures to be incurred at the district and village levels the WMD grants are provided to Zilla Panchayats – these form an integral part of the Zilla Panchayat budget and the ‘district sector’ in the State Budget

Element 2: Staffing

The accounting functions at the Zilla Panchayat are managed by the Chief Accounts Officer (CAO), supported by a number of Accounts Officers, Accountants and Accounts Clerks. The DWDOs are also provided with supporting Accounting staff and contractual or redeployed accounting staff to function as satellite accounting units. The WDD & DWDOs has outsourced the operation of the Computerized Financial management System (CFMS) to a chartered accountancy firm, who place their staff at each DWDO and the WDD level to enter all project related accounting transactions, including the SWS into CFMS. Village book keepers, preferably literate or semi-literate women, identified and engaged by the communities would be trained to maintain the primary books of accounts for the SWS. The prime responsibility is of the Secretary of the SWS or GP subcommittee as the case may be.

Element 3: Flow of funds

Fund flow of the project is through the Treasury systems. Zilla Panchayat authorizes the DWDO to make payments as required to SWS through the cheque book facility provided by the Treasury, to the extent of the Letter of Credit (LC) issued on a monthly/quarterly basis. The release of funds to the SWS would be based on the approved MWDP/Sub-plan and MOU signed between the Zilla Panchayat, SWS, and the NGO. The SWS will open and maintain a separate project bank account called the ‘Implementation Account’. The Implementation Account will be operated jointly by one of the office holders of the SWS (Chairperson or Secretary) along with the field officer (as the Treasurer) of WDD. This will apply in 50% of the SWS and in the remaining SWS the Treasurer will be selected from the members of the SWS itself.
Element 4: Accounting

A Financial Management Manual prepared for the project, describes the financial management system that will apply to all project-related transactions. All sources of funds, including contributions from beneficiaries, would be accounted for and reflected in the project financial statements; and similarly all project expenditures will be reflected in the project financial statements. All payments made through the State Treasury will be recorded in the computerized accounting system. The Zilla Panchayat and the DWDO will be separate accounting centers and will record expenditures against supporting documents after approval of competent authorities. The release of funds to SWS will be recorded as advances and accounted for only when the SWS provide supporting documentation on actual expenditures incurred. Monthly abstracts of expenditures at the SWS along with vouchers, bank pass books will be submitted to the DWDO Office and incorporated into the project accounting system. Formats of simple accounting records to be maintained by the community groups have been developed.

Element 5: Procurement

All project activities to be financed under the Credit would be procured in accordance with the World Bank Guidelines for Procurement of Goods, Works and Consultancy Guidelines for hiring Consulting Services (including NGO services) to be financed under the Credit. All civil works, goods and services would be procured using India specific World Bank's model documents.

Element 6: Internal Control & audit

To ensure that sound internal control is maintained throughout implementation, the project design provides for an independent chartered accountancy firm to carry out an internal financial review on a quarterly basis. The audit would cover financial transactions and an assessment of the operation of the financial management system (including internal control mechanisms) at all expenditure centers, including the district offices of the watershed department and the SWS.

The first release of funds to the SWS is based on the requirement of the sub-project for two months activities. Subsequent releases of funds are made on a monthly basis and are (a) based on an abstract of expenditures against the earlier release along with the vouchers for the month; and (b) linked to an independent verification, certification and documentation process of the physical works undertaken or completed by the SWS. The verification/certification process is the joint responsibility of the field officer of the watershed department and the designated NGO.

Element 7: Financial Reporting

Zilla Panchayat and DWDO prepare monthly financial reports and submit them to the WDD and other reporting authorities either electronically or through diskettes. WDD consolidates these reports for the entire project. The SWS is required to submit an abstract of expenditures along with the bank cheque counterfoils and deposit challans and bank reconciliation statement. In addition, the books/registers, vouchers and bank pass books would be open for perusal by members.

Element 8: External Audit

The financial statements of the project are audited by the Comptroller and Auditor General of India.
CHECK LIST

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<thead>
<tr>
<th>S.NO</th>
<th>QUESTIONS</th>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
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<td>Is the implementing entity (user committee level) an officially constituted/recognized subcommittee of the local government?</td>
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<td>3</td>
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<td>Are the procurement processes prescribed for the project aligned with the PRIs financial rules/regulations, with respect to approval of the Procurement plan, grievance redressal and complaint mechanism, Public display of all procurement related information, limits for administrative and technical sanction of estimates and contracts and procurement methods to be used?</td>
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D4. Maharashtra Rural Water Supply and Sanitation Project

<table>
<thead>
<tr>
<th>Name of Project</th>
<th>Maharashtra Rural Water Supply and Sanitation Project (P073369)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost of Project</td>
<td>US$ 268.6 million (World Bank share: US$ 181 million)</td>
</tr>
<tr>
<td>Effectiveness Date</td>
<td>29-Oct-03</td>
</tr>
<tr>
<td>Closing Date</td>
<td>30-Sep-09</td>
</tr>
<tr>
<td>Brief Description</td>
<td>The Project will increase rural household access to improved and sustainable RWSS services and institutionalised decentralization of RWSS services to rural local government and communities.</td>
</tr>
</tbody>
</table>

Implementation Arrangements:
- State Level: Jalswarajya office in Water Supply and Sanitation Department of GOM
- District level: Zilla Panchayat, including District Facilitation Team (DFT), District Appraisal & Monitoring Team (DAMT) and District Financial Management Team (DFMT) through its District Water Management and Sanitation Committees (DWMSC)
- Village level: Village Water and Sanitation Committee (VWSC) of the Gram Panchayat (GP)

Element 1: Planning & budgeting

The Executive Engineer, Water Management and Sanitation Department will be the Team Leader of the District Appraisal & Monitoring Team (DAMT) and will be responsible for appraising and approving or recommending administrative, financial, technical and process sanction of the Village Action Plan to the Project Coordinator, Project Director or DWMSC depending upon the estimated cost and delegated powers of sanction., monitoring the progress of Village Action Plan implementation and recommend to DFMT, release of installments to the Gram Panchayats based on achievement of milestones of activities as planned by the Gram Panchayat in the Village Action Plan and conduct performance audit of Village Action Plan implementation covering technical, social, environmental aspects by engaging an external agency.

At the village level the Gram Sabha will be responsible for: (a) approving participation in the Project and approving any contracts/MoU to be signed between Gram Panchayat and Zilla Panchayat; (b) appointment of the VWSC; (c) approving the Village Action Plans; (d) recommend levels of community contribution, tariff rates, operation and maintenance charges etc. to be collected from community members; (e) appointing Social Audit Committee (SAC) and take action by itself or to direct Gram Panchayat to take appropriate legal action based on the reports of SAC; (f) review the progress of activities undertaken by the VWSC, periodically for ensuring inclusiveness, equity, transparency, cost effectiveness and other principles of the Project; (g) approving statements of accounts and other reports, budget and annual accounts etc. on Project implementation presented by the Gram Panchayat; and (h) recommend agencies for performance audit, financial audit and technical audit on the working of VWSC and Project implementation.

Gram Panchayat under the Bombay Village Panchayat Act 1958 will be responsible for overall coordination of project activities and specifically: (a) facilitate and monitor the VWSC activities; (b) request and receive all funds under the project and maintain separate books of accounts with the assistance from VWSC; (c) approve the appointment of Procurement Sub-committee, Finance Sub-committee and such other sub-committees suggested by VWSC; (d) recommend to the Gram Sabha for its approval, the Village Action Plan for water supply and sanitation prepared by VWSC; (e) coordinate with the DAMT for obtaining the required sanctions for the Village Action Plan; (f) finalize and incorporate the accounts of VWSC with GP accounts and place before the Gram Sabha for approval; (g) arrange to get the accounts of VWSC audited by Local Fund Audit or firm of chartered accountants, take action on the reports of SAC as recommended by Gram Sabha; (h) arrange to demand community contribution, water charges etc. from the community members as approved by Gram Sabha through VWSC; and (i) enter into contractual agreements/MoU with Zilla Panchayat for implementing the Project and contract SOs, consultants and other service providers required for availing various technical assistance services from among the panel prepared by the ZP and with the approval of Gram Sabha and monitor their activities. VWSC will maintain and operate the bank account on behalf of the Gram Panchayat through persons authorized by Gram Sabha from amongst the VWSC members and prepare financial statements, maintain books of accounts and other records on behalf of the Gram Panchayat and submit them to Gram Sabha for approval. The VWSC will operate through various Sub-committees on Finance, Procurement etc. and execute contracts and procure materials and services on behalf of the VP as approved by the Gram Sabha.
Element 2: Staffing

DFMT is a small team consisting of a finance officer assisted by accounts clerks and two administrative clerks will take care of the financial support activities to the district level arrangement. The DFMT will also be responsible for arranging and coordinating the financial audit of Project account of Gram Panchayats. An accountant with adequate skills and experience in community accounting and capacity building will be an integral part of the DFT and will be responsible for GP level facilitation and training functions. At the village level, the finance, accounts and social audit functions will be with different committees. At the GP level the VWSC can hire the services of an accountant or entrust the responsibility to a member of VWSC duly trained under the project for book keeping and maintaining accounts. If necessary skills are not available at the village level, a suitable person can be identified and trained as a para-professional.

Element 3: Flow of funds

All project funds will be accounted for in dedicated accounts at the district and Village-level governments. Release of funds to Gram Panchayats for implementation of schemes will be based on achievement of predetermined and mutually agreed physical and process milestones. Funds will be released in installments as per the agreed Financing Agreements.

GOM will transfer the funds based on the annual work plans to the PL account maintained by the OMT in installments. From the PL account funds required for State level Project expenditure will be met. The funds for the district level operations will be transferred to the Zilla Panchayat from the PL account. A separate bank account in a scheduled bank will be maintained at the Zilla Panchayat level, which will be operated by the District Team in Zilla Panchayat under single or joint signatures, depending upon the amount of transaction. The officers may be Chief Executive Officer, Additional Chief Executive Officer, and Senior Accounts Officers of the District Financial Management Team or other officers in WSSD in Zilla Panchayat as approved by OMT. The expenses for the district level operations and expenses of the DFT, DAMT, DFMT and the Administration Unit will be met from this account. As per the approved village level action plan and agreed milestones therein, funds will be transferred from this account to the Gram Panchayat. A dedicated account will be opened at the GP level, to receive funds from the Zilla Panchayat and also to credit capital contribution by the community. This account will be operated on behalf of VP by VWSC members under the joint signature of at least two officer bearers of Village WSSC, nominated for the purpose by the Gram Sabha. At least one signatory shall be a woman.

At both Zilla Panchayat and GP levels, the sub project funds are not considered as part of their own budgets or accounts.

Element 4: Accounting

Gram Panchayats participating in the project to: (i) open and maintain separate bank account for the project funds; and (ii) maintain separate record and accounts for the said funds. A FM Manual and COM has been prepared under the Project which document in detail the accounting processes and policies. All releases to Gram Panchayats as releases against approved work plan will be recorded as expenditure in the books of accounts of the Project. At all accounting centers, separate books of accounts will be maintained for the project funds as per the requirements specified in the Financial Management Manual. VWSC/Gram Panchayat will maintain simple accounts record/registers as prescribed in the manual.

Element 5: Procurement

Gram Panchayats will procure goods, works and services using the procedures and forms detailed in the Community Operational Manual (COM) that has been prepared specifically for this project and agreed with the World Bank.

The COM contains procedures, thresholds, forms and formats for all types of procurement at this level. The CPM also provides for social audit of procurement decisions by way of (a) requiring the Procurement Plan to be place before the Gram Sabha; (b) information with respect to intended procurement over Rs. 2,500 to be displayed by the Gram Panchayat on notice boards at the Panchayat Bhawans, community halls and other public places; and (c) open all documents and records for public inspection on request and payment of prescribed fees.
Element 6: Internal Control & audit

A Project Financial Management Manual and the Community Operational Manual (COM) prepared under the Project provides the control framework for the budgeting and expenditure management. DAMT is responsible for carrying out the performance audit of implementation of the Village Action Plan. The Social Audit Committee (SAC) is a self-check and internal monitoring mechanism for the Gram Sabha and the Gram Panchayat on the activities of the VWSC and other sub-committees. The specific roles are to (a) continuously review the functioning of the VWSC and its various sub-committees in order to ensure that they carry out their roles and responsibilities in a just and fair manner and not violating the principles of the project like, inclusion, equity, cost-effectiveness, transparency, environmental soundness etc.; (b) conduct detailed scrutiny of such actions or decisions and report the findings along with recommended remedial measures to the Gram Sabha; (c) request for convening special Gram Sabha to discuss findings of social audit, which are of very serious nature. The report of the SAC, as approved by Gram Sabha will be forwarded by the Gram Panchayat to the DWMSC. Such reports will be made available to any member of the Gram Sabha upon request and payment of a fee. The important findings in the report will be prominently displayed in the notice board of the Gram Panchayat at least seven days in advance of the Gram Sabha; and (d) chair the Gram Sabha discussing social audit report, if the Sarpanch is a member in VWSC or any of its sub-committees.

Element 7: Financial Reporting

Monthly reporting formats from each of the accounting centers have been designed to provide summarized monthly financial information on the project expenditures and activities. These are compiled by OMT on a monthly and quarterly basis to provide meaningful FMRs. Expenditures reported under the project would need to be regularly reconciled with the reports submitted to the Accountant General’s Office. Gram Panchayats will prepare monthly expenditure reports and present them in the relevant Gram Sabha/VWSC/GP meetings and also to be publicly posted on the notice board. The financial arrangements between the Zilla Panchayat and Gram Panchayat will not require financial accounting for the sub project expenditures in the project books. All payments against the contracts will be recorded as expenditures in project books. However, the Gram Panchayats will be required to submit regular statements of expenditures summarizing sources and uses of funds against the plans in order to build accountability and demonstrate the presence of adequate accounting and bookkeeping arrangements. Gram Panchayats will prepare a simple report which will be presented to its members and in the Gram Sabha and provide all records for scrutiny by members and is also publicly posted in the notice board in the Gram Sabha.

Element 8: External Audit

The Comptroller and Auditor General of India (CAG) through its offices in Maharashtra will be the statutory auditor for the project. The AG’s office will conduct annual audit of the operations of the OMT at the State level, Drinking Water Management and Sanitation Department at the Zilla Panchayat level and a selected sample of Gram Panchayats at the village level.

Gram Panchayats as constituents of local rural governments are audited by the State Government under the Bombay Local Fund Audit Act, 1930. As a demonstration of good practice, each of the Gram Panchayats implementing the project will be required to submit audited statements of expenditures and audit reports for the project within 6 months of the close of the financial year. The Gram Panchayats will also have the option of engaging firms of chartered accountants from the panel prepared by the Zilla Panchayat. Follow-up of the audit observations will be monitored by the District Financial Management Teams. This arrangement is limited to the sub project expenditure by the VWSC only.
<table>
<thead>
<tr>
<th>S.NO</th>
<th>QUESTIONS</th>
<th>Yes</th>
<th>No</th>
</tr>
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<td>1</td>
<td>Is the implementing entity (user committee level) an officially constituted/recognized subcommittee of the local government?</td>
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<td>Does the project design provide for an assessment of the fiduciary capacity of PRI as selection criteria?</td>
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<td>Are the procedures for operation of project bank accounts at the sub project level in line with the provisions of the PR Act and Rules?</td>
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<td>Are the procurement processes prescribed for the project aligned with the PRIs financial rules/regulations, with respect to approval of the Procurement plan, grievance redressal and complaint mechanism, Public display of all procurement related information, limits for administrative and technical sanction of estimates and contracts and procurement methods to be used?</td>
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<td>Does the project design envisage a separate audit procedure as against using the entity audit reports to provide the required assurance on end use of the project funds?</td>
<td>Y</td>
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D5. Uttar Pradesh Rural Water Supply and Sanitation Project

<table>
<thead>
<tr>
<th>Name of Project</th>
<th>Uttar Pradesh Rural Water Supply &amp; Sanitation Project (P083187)</th>
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<tbody>
<tr>
<td>Cost of Project</td>
<td>US$ 224 million (World Bank share: US$ 120 million)</td>
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<td>Effectiveness Date</td>
<td>30-Nov-06</td>
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<tr>
<td>Closing Date</td>
<td>30-Jun-12</td>
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<tr>
<td>Brief Description</td>
<td>Improving the effectiveness of RWSS services through decentralization and increased role of PRIs and involvement of local communities.</td>
</tr>
<tr>
<td>Implementation Arrangements:</td>
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</tr>
<tr>
<td>State Level</td>
<td>State Water &amp; Sanitation Mission (SWSM) a registered society, supported by PMU</td>
</tr>
<tr>
<td>District level</td>
<td>District Water &amp; Sanitation Mission (DWSM) and District Water &amp; Sanitation Committee (DWSC) supported by District Project Management Unit (DPMU)</td>
</tr>
<tr>
<td>Village level</td>
<td>User Water Supply &amp; Sanitation Committee (UWSSC) under the Jal Prabandhak Committee (Water Management Committee) of the Gram Panchayat.</td>
</tr>
</tbody>
</table>

Element 1: Planning & Budgeting

Overall Work Plan (OWP) is agreed between GoUA and WB contains year wise physical and financial targets for each activity under each component of the Project. OWP is prepared by PMU. This forms the basis for year wise budget preparation for the year. PMU prepares DWSM/DPMU wise physical and financial targets for each year. The DPMU wise targets are based on number of GPs/UWSSCs controlled by them. This shall provide the overall framework for each DWSM/DPMU. Based on this the DPMU prepares the Annual Work Plan along with Budget which is submitted to DWSC and the Governing body of DWSM for approval. The approved AWP is submitted to PMU where they are analyzed for deviations from OWP. A consolidated AWP is prepared at PMU to the Governing body of the SWSM for approval. Budget is re appropriated in the manner and mode as stipulated by the Finance Committee of the PMU to individuals and project offices.

The Project follows a scheme cycle not exceeding 24 months consisting of four distinct phases namely pre planning, planning, implementation and post project completion phase. The main output of pre planning phase is prioritizing of Gram Panchayats. During the planning phase UWSSC are formed depending on number of schemes to be implemented in a Gram Panchayat, preparation of Detailed Project Reports (DPR) for each of the UWSSCs. All Single Village Schemes (SVS) will be based on demand driven approach. UWSSC and Gram Panchayats have the main role of planning and implementing of all SVS. SVSM supported by PMU is responsible for approving the District annual work plans and the budgets for support activities to be taken up by sector institutions. SWSM supported by PMU is responsible for preparing the over all sector budget. MOUs for works over 2 million are signed by SWSM. DWSM supported by DPMU are responsible for preparing annual district work plans and for signing the MOUs for SVS and smaller MVS. Gram Panchayat with support from DPMU are responsible for plans and budgets for the schemes under the Gram Panchayat These plans are approved in Gram Sabha before they are sent to DPMU.

Element 2: Staffing

During project preparation, one of the potential areas of risk to smooth project implementation was identified as the low number of State appointed GP Secretaries - presently there are 1,398 Secretaries covering 7,227 Gram Panchayats, an average of about five Gram Panchayats per Secretary. As part of the mitigation measures, it was agreed that under the Project an accounts manager and an assistant at each district and junior accounts assistant at sub – district level, each covering a cluster of eight UWSSCs. The junior accounts assistant will assist in book keeping, accounting, cash book writing and preparation of vouchers and all matters relating to updating of accounting relevant to the project.

In a subsequent development, by virtue of a GO dated 19th May 2005, UWSSC has been declared a subcommittee of the Jal Prabandhak Committee of the Gram Panchayat. Further as per notification the responsibilities of the GP Secretary under the project can be transferred to a nominated worker who can be appointed as a Co secretary.
Element 3: Flow of funds

Fund flows for the project are through the Line Department. The Funds received by Gram Panchayat shall be deposited in the Nidhi 1 Bank Account of the Gram Panchayat. These funds would be transferred to the bank account of UWSSC within 15 days of the receipt of the funds. The GP bank account is operated by Pradhan and Secretary (refer above notification) and the UWSSC bank account is operated by Chairman (Gram Pradhan) and Treasurer (elected from subcommittee).

Element 4: Accounting

A FM Manual and a GP accounting manual has been prepared under the Project. They document in detail the accounting processes and policies. All releases to Gram Panchayats as releases against approved work plan will be recorded as expenditure in the books of accounts of the Project. UWSSC reports expenditure reports to DWSM through Gram Panchayat. At sub DPMU level the reports from UWSSC are converted into double entry in accounting software. At DWSM level computerized accounts are prepared. At SWSM level consolidation of reports of DWSM and sector institutions is done.

Element 5: Procurement

GPs/UWSSCs will procure goods, works and services using the procedures and forms detailed in the Procurement Manual (PM) that has been prepared specifically for this project and agreed with the World Bank.

The PM contains procedures, thresholds, forms and formats for all types of procurement at this level. The PM also provides for constitution of social audit committee by the Gram Panchayat. This committee ensures that PM is followed and reports any violation or deviation to the Gram Panchayat together with monitoring the adherence of project principles and rules in selection of beneficiaries, implementation of sub projects and all decisions of UWSSC. The manual also describes the complaint handling mechanism.

Element 6: Internal Control & audit

A FM Manual and a GP accounting manual has been prepared under the Project, expected to supplement the policies given in State Financial rules. In practice project specific financial rules and regulations are used as the final authority for project implementation. The Project requires a setting up of internal audit wing in SWSM to cover DWSM, PMU and others.

Element 7: Financial Reporting

Monthly reporting formats from each of the accounting centers have been designed to provide summarized monthly financial information on the project expenditures and activities. These are upwardly consolidated from UWSSC – GP-SUB DPMU – DPMU – PMU to provide meaningful FMRs at project level. UWSSCs prepare monthly expenditure reports and present them in the relevant Gram Sabha/ WWC/GP meetings and also to be publicly posted on the notice board. Under the project only project monies are reported monthly and annually.

Element 8: External Audit

Private Chartered Accountant firm are the External auditors for the Project.
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<thead>
<tr>
<th>S.NO</th>
<th>QUESTIONS</th>
<th>Yes</th>
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<td>Does the project design envisage a separate audit procedure as against using the entity audit reports to provide the required assurance on end use of the project funds?</td>
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D6. Second Karnataka Rural Water Supply and Sanitation Project

<table>
<thead>
<tr>
<th>Name of Project</th>
<th>Second Karnataka Rural Water Supply and Sanitation Project (P050653)</th>
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<tr>
<td>Cost of Project</td>
<td>USS 193.44 million (World Bank share: USS 151.6 million)</td>
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<td>Effectiveness Date</td>
<td>19-Apr-02</td>
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<td>Closing Date</td>
<td>31-Dec-07</td>
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<tr>
<td>Brief Description</td>
<td>The Project will assist in improving rural communities' access to improved and sustainable drinking water and sanitation services and institutionalizing decentralisation of RWSS service delivery to Gram Panchayats and user groups.</td>
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<tr>
<td>Implementation Arrangements:</td>
<td></td>
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<tr>
<td>State Level</td>
<td>Karnataka Rural Water Supply &amp; Sanitation Agency (Society) under the Department of Rural Development and Panchayati Raj of Government of Karnataka</td>
</tr>
<tr>
<td>District level</td>
<td>Karnataka Rural Water Supply &amp; Sanitation Agency (KRWSSA) with Zilla Parishad</td>
</tr>
<tr>
<td>Village level</td>
<td>Village Water &amp; Sanitation Committee (VWSC) as a subcommittee of the Gram Panchayat (GP) with support agencies</td>
</tr>
</tbody>
</table>

Element 1: Planning & budgeting

The project is implemented in about 700 Gram Panchayats (some 2,100 villages) in 4 successive but overlapping batches. A detailed project implementation schedule has been developed for a six-year implementation period. Each batch has a 24-month scheme cycle consisting of four distinct phases (preplanning-3 months, planning-6 months, implementation-12 months, and post implementation-3 months). The District Project Approvals Committee (DPAC), chaired by the Chief Executive Officer (CEO) provides the administrative approval for the projects. The Zilla Parishad Engineering Department (through their sub-divisions) provides social and technical support to Gram Panchayats and ensures that only sound design and construction engineering practices are adopted by the Gram Panchayats.

The sub project does not form an integral part of the Panchayats annual plan and budget. The Project funds are budgeted in the State Sector in the State Budget.

Element 2: Staffing

The project has engaged a chartered accountancy firm at the district level to place one accountant per two Gram Panchayats for regular and timely maintenance of accounts for the project. The accountant hired at the GP level will also be responsible for training on the job - the GP secretary/bill collector/members and VWSC members in simple maintenance of books of accounts for O&M records. Training on the operation of project computerized financial management system to the finance and accounting personnel at KRWSSA and DSUs has been imparted by the consultants appointed for design and development of the software. The primary responsibility of financial management at the GP level remains with the Panchayat Secretary, who is assisted by the accountant from the chartered accountancy firm. At Zilla Panchayat level the financial management function is handled by the Chief Accounts Officer on deputation from the State Accounts Department. He is also responsible for the accounting and reporting function for the Taluk Panchayat.

Element 3: Flow of funds

RWSS II project is budgeted in the GoK budget as an identifiable single head budget item. GoK transfers the funds required for the project in advance, including its own share, on a quarterly basis, to KRWSSA's bank account. KRWSSA, in turn, transfers funds in advance to the Zilla Panchayat-DSUs (separate bank account) also on a quarterly basis. There is no funds transfer to Gram Panchayats during the preplanning and planning phase. In the implementation phase, Zilla Panchayat-DSUs provide advances to Gram Panchayats (separate bank accounts) in four installments of 25% each. GP cheques are signed jointly by the GP President and Secretary. While the Zilla Panchayat-DSU makes direct payments to the chartered accountancy firms, these are certified by the Gram Panchayat.
Element 4: Accounting

At the GP level, the existing accounting system will be enhanced to improve efficiency. A cashbook, a Scheme wise ledger, works register including the contractor's receivables/payable position and a register for recording subsidies payments will be maintained. The improvements in the accounting system will feed into the overall efforts being made for improving efficiency in accounting systems at the State level in the decentralized institutions of the State. For O&M, VWSCs will maintain a separate bank account per village.

Element 5: Procurement

All project activities to be financed under the Credit would be procured in accordance with the World Bank Guidelines for Procurement of Goods, Works and Consultancy Guidelines for hiring Consulting Services (including NGO services) to be financed under the Credit. All civil works, goods and services would be procured using India specific World Bank's model documents.

Element 6: Internal Control & audit

A FM Manual has been prepared under the Project which supplements the policies given in State Financial rules. In practice, project specific financial rules and regulations prevail.

There is no provision for a separate internal audit in the project. The FM manual provides that KRWSSA appoints internal auditors for its activities, in case considered essential. The project auditors are expected to carry out their audit on a quarterly basis with sample Gram Panchayats each quarter being subject to audit. At GP level, the accounting firm will be required to certify the utilization certificate before the subsequent installment for a scheme could be released. In the implementation phase, Zilla Panchayat-DSUs would advance funds to Gram Panchayats (separate bank accounts) in four installments of 25% each. The first installment would be released on: (a) approval by CEO, Zilla Panchayat of the Implementation Phase Proposal (IPP) which will also include a confirmation of the availability of a full time secretary in the Gram Panchayat, and (b) evidence that the beneficiary contribution due from the community and the Gram Panchayat has been received in the GP project account. Subsequent installment will be released on the basis of: (i) a utilization certificate from the GP accounting firm certifying 80% utilization of the last installment plus 100% utilization of the previous installments, and (ii) a certificate from the Zilla Panchayat-ED indicating that the simple benchmarks set for achieving physical targets have indeed been met. The payment to the contractor/supplier will be made by the Gram Panchayat on the basis of bills being certified and recommended for payment by Zilla Panchayat-ED. The Gram Panchayat will also countersign on the contractors' bills certifying their approval of the performance of the contractor.

Element 7: Financial Reporting

Monthly reporting formats from each of the accounting centers have been designed to provide summarized monthly financial information on the project expenditures and activities. These reports flow vertically up from VWSC—>GP—>DSU—> KRWSSA and are consolidated at each step to provide for meaningful project financial reports. The Financial manual requires that at each Gram Panchayat, there will be a public display of the status of project receipts and usage village wise and scheme wise. At VWSC level, the operations and maintenance data in terms of receipt and usage of money will be displayed publicly in the VWSC office.

Element 8: External Audit

Private Chartered Accountant firm is the external auditor for the Project and accordingly will audit KRWSSA. Gram Panchayats are audited by the Local Audit Department. This would include audit of VWSC also.
<table>
<thead>
<tr>
<th>S.NO</th>
<th>QUESTIONS</th>
<th>Yes</th>
<th>No</th>
</tr>
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<td>1</td>
<td>Is the implementing entity (user committee level) an officially constituted/recognized subcommittee of the local government?</td>
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<td>Does the project design provide for an assessment of the fiduciary capacity of PRI as selection criteria?</td>
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<td>N</td>
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<td>Are the procedures for operation of project bank accounts at the sub project level in line with the provisions of the PR Act and Rules?</td>
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<td>Are the sub project funds included in the “fund” of the local government as defined by the PR Act and Rules?</td>
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<td>6</td>
<td>Are the procurement processes prescribed for the project aligned with the PRIs financial rules/regulations, with respect to approval of the Procurement plan, grievance redressal and complaint mechanism, Public display of all procurement related information, limits for administrative and technical sanction of estimates and contracts and procurement methods to be used?</td>
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<td>N</td>
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<td>7</td>
<td>Does the project design envisage a separate audit procedure for as against using the entity audit reports to provide the required assurance on end use of the project funds?</td>
<td>Y</td>
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</tbody>
</table>
The project will be implemented in 80 Gram Panchayats in five successive but overlapping batches, consisting of 5, 15, 20, 25, and 15 Gram Panchayats respectively. A detailed project implementation schedule has been developed for a six-year project implementation period. Each batch would follow a 27-month scheme cycle consisting of four distinct phases (preplanning-3 months, planning-12 months, implementation-8 months, and post implementation-4 months).

**Preplanning** - The main activities would be SO prequalification, GP selection, and the signing of a planning phase tripartite agreement (PPTA) between KRWSA, GP, and SO. Planning - main activity would be orientation and capacity building for Gram Panchayats and SOs, take-over of existing Kerala Water Authority (KWA) schemes by Gram Panchayats, BG registration, forming the BCs, opening bank accounts, resource mapping, and preparing and signing the "agree to do" reports between KRWSA and Gram Panchayat. The planning phase would conclude with signing of an Implementation Phase Quadrilateral Agreement (IPQA) between KRWSA, Gram Panchayat, SO, and the participating BGs. A separate Implementation Phase Tripartite Agreement (IPTA) would be signed between SO, Gram Panchayat (GP) with the assistance of Support Organizations (SO).

**Element 2: Staffing**

DPMU's FM functions are managed by Accounts Officers. Due to the increased work load on the GP staff as a result of decentralization, KRWSA has decided to provide one accountant to each Gram Panchayat for accounts keeping and report preparation. KRWSA would make adequate provision for training the finance and accounting staff both in KRWSA and DPMU in financial management and use of computerized systems. For providing training and implementation assistance in accounting and reporting to SOs, Gram Panchayats, and BCs, KRWSA would appoint two chartered accountancy firms.

**Element 3: Flow of funds**

Each Gram Panchayat will open a separate Bank account for managing the project funds. During the planning phase, transfer to Gram Panchayat would be made in two equal installments. However, during implementation phase the first installment would be 40%, the second 40%, and the last installment 20%. BC would open a separate Bank account for managing the project funds. During the preplanning and planning phases, there will not be any transfer of funds to BC. During the implementation phase the first installment would be 40%, the second 40%, and the last installment 20%. The second and third installments would be released by Gram Panchayat upon receipt of audited utilization certificates.

**Element 4: Accounting**

GP accounting systems would be strengthened to meet the project accounting requirements particularly scheme-wise project cost details. Simple manual accounting systems would be implemented at BC level.
Element 5: Procurement

BCs and Gram Panchayats will procure goods, works and services using the procedures and forms detailed in the WB procurement guidelines.

Element 6: Internal Control & audit

A financial management manual is in place which contains detailed description of the financial accounting, budgeting, funds flow, and reporting systems and procedures. KRWSA will appoint separate audit firm(s) to audit and certify the use of funds by SO, Gram Panchayat, and BC during the preplanning, planning, and implementation phase of each batch. For providing training and implementation assistance in accounting and reporting to SOs, Gram Panchayats, and BCs, KRWSA will appoint two chartered accountant firms. At Gram Panchayats, there will be a public display of the status of project receipts and usage village wise and scheme wise. At BC level, the operations and maintenance data in terms of receipt and usage of money will be displayed publicly in the BC office.

Element 7: Financial Reporting

Monthly reporting formats from each of the accounting centers have been designed to provide summarized monthly financial information on the project expenditures and activities. These are upwardly consolidated from BC -GP-DPMU - KRWSA. This will provide meaningful FMRs at the project level. At Gram Panchayats, there will be a public display of the status of project receipts and usage village wise and scheme wise. At BC level, the operations and maintenance data in terms of receipt and usage of money will be displayed publicly in the BC office.

Element 8: External Audit

KRWSA will appoint an independent chartered accountant firm to audit KRWSA’s and the DPMU’s account books, and to certify the annual project financial statements.
<table>
<thead>
<tr>
<th>S.NO</th>
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D8. Punjab Rural Water Supply and Sanitation Project

<table>
<thead>
<tr>
<th>Name of Project</th>
<th>Punjab Rural Water Supply and Sanitation Project (P090592)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost of Project</td>
<td>USS 261.4 million (World Bank share: USS 154 million)</td>
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<tr>
<td>Effective Date</td>
<td>26-Mar-07</td>
</tr>
<tr>
<td>Closing Date</td>
<td>31-Mar-12</td>
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<tr>
<td>Brief Description</td>
<td>The Project will improve the effectiveness of RWSS services through decentralisation through increased role of PRIs and involvement of local communities</td>
</tr>
</tbody>
</table>

**Implementation Arrangements:**

- **State Level**
  - State Water & Sanitation Mission (SWSM) supported by State Project Management Committee (SPMC)

- **District level**
  - District Water & Sanitation Mission (DWSM) and District Water & Sanitation Committee (DWSC) supported by District Project Management Committee (DPMC)

- **Village level**
  - Gram Panchayat Water & Sanitation Committee (GPWSC) under Gram Panchayat (GP)

**Element 1: Planning & budgeting**

Overall Work Plan (OWP) is agreed between GOP and WB contains year wise physical and financial targets for each activity under each component of the Project. OWP is prepared by SPMC. This forms the basis for year wise budget preparation for the year. SPMC prepares DWSC/DPMC wise physical and financial targets for each year. The DPMC wise targets are based on number of GPs/GPWSCs controlled by them. This shall provide the overall framework for each DWSM/DPMC. Based on this the DPMC prepares the Annual Work Plan (AWP) along with Budget which is submitted to DWSC and the Governing body of DWSM for approval. The approved AWP is submitted to SPMC where they are analyzed for deviations from OWP. A consolidated AWP is prepared at SPMC to the Governing body of the SWSM for approval. Budget is re appropriated in the manner and mode as stipulated by the Finance Committee of the SPMC to individuals and project offices.

The Project follows a scheme cycle not exceeding 21 months consisting of four distinct phases namely pre planning, planning, implementation and post project completion phase. The main output of pre planning phase is prioritizing of Gram Panchayats. During the planning phase GPWSC are formed depending on number of schemes to be implemented in a Gram Panchayat, preparation of Detailed Project Reports (DPR) and Community Action Plans for each of the GPWSCs. All Single Village Schemes (SVS) will be based on demand driven approach. GPWSC and Gram Panchayats have the main role of planning and implementing of all SVS. SWSM supported by SPMC is responsible for approving the District annual work plans and the budgets for support activities to be taken up by sector institutions. SWSM supported by PMU is responsible for preparing the over all sector budget. DWSM supported by DPMC are responsible for preparing annual district work plans and for signing the MOUs for SVS and smaller Multi Village Schemes (MVS). Gram Panchayat with support from DPMC are responsible for plans and budgets for the schemes under the Gram Panchayat. These plans are approved in Gram Sabha before they are sent to DPMC. Gram Sabha under the law have the power and responsibility to approve annual budget and plan of development program and review annual statement of accounts and annual progress reports. District plans are approved by the DWSC. GPWSC has been set up as a sub-committee under the Section 25 of the Punjab Panchayat Raj Act (PPRA). The GP's Sarpanch will be the Chairperson of the GPWSC.

**Element 2: Staffing**

Panchayat Secretary at the GP level maintains Panchayat accounts. Number of GP Secretaries in the State are very less and often there are 5-8 Gram Panchayats sharing one secretary. There are 2,555 secretaries (1,690 permanent + balance contractual) working for 12,443 Gram Panchayats in the State.

As part of mitigation measures, an accountant will be recruited by the GPWSC (to be financed by the project) to take care of the accounting requirements at the GPWSC. At each DPMC, a Divisional Accountant will be deputed to the Divisions. He will be supported by an Assistant Finance Manager as per terms of reference and job descriptions acceptable to IDA, hired from the market on contractual basis. They will be supported by two Finance Assistants, commerce graduate with experience of computer applications. Training of accountants, GP Secretaries and GPWSC members on book-keeping, procurement procedures, reporting, banking, reconciliations, records retention, audit certification and social audit is part of the project design.
Element 3: Flow of funds

Fund flows for the project are through the Line Department. Funds will be transferred by SPMC to GPs/GPWSCs through an independent channel of SPMC-DPMC-GPWSC (and not through DWSS divisions providing technical and monitoring support) for Single Village Schemes and for intra-village works of Multi Village schemes. The GOP would budget for the project by the components split between GOI funded and World Bank funded schemes on the expenditure side with corresponding provisions in the receipt side in the State Budget. This will facilitate accounting by components using mainstream government accounting systems. This will be supported by a detailed Annual Work Plan. Finance Dept. will issue Letters of Credit (LOC) to SPMC (within 2 weeks of the request from DWSS) based on its quarterly requirement of funds, which will in turn reallocate these funds (LOC) to various DPMCs. DPMCs will be responsible for further release of funds to GPWSCs and allocation of LOC to DWSS Divisions. The LOC system would be used in the project, except at the GPWSC level, where a separate bank account will be maintained for receipt and payment of project funds. The bank account will be operated jointly by the GPWSC Chairman (GPs Sarpanch) and Secretary. Presently, drawls are made under the joint signature of the Sarpanch and the Panchayat Secretary subject to a threshold limit of Rs. 50,000/- . For any amount over and above Rs.50,000/- the cheque has to be countersigned by BDPO. The current notification with regard to threshold limits also requires attachment of attested copy of resolution passed by Gram Panchayat for release of payment by bank.

Element 4: Accounting

A FM Manual and a GP accounting manual has been prepared under the Project. They document in detail the accounting processes and policies. Books of accounts by the SPMC, DPMC and Divisions of DWSS will be maintained under the standard government Accounting Systems and monthly accounts will be rendered to the AG and reconciled on a quarterly basis. Tranche releases to GPWSCs recorded as Grant-in-aid in the books and will be eligible for reimbursement consistent with guidance on CDD type projects. A simple, manual system of book-keeping (cash book) and reporting has been developed for the GPWSCs.

Element 5: Procurement

Gram Panchayats will procure goods, works and services using the procedures and forms detailed in the Procurement Manual (PM) that has been prepared specifically for this project and agreed with the World Bank. The PM contains procedures, thresholds, forms and formats for all types of procurement at this level. As per PM, complaint redressal mechanism will be set up at State as well as District level. All complaints are to be handled at a level higher than that of a level at which the procurement process is being undertaken.

Element 6: Internal Control & audit

A FM Manual and a GP accounting manual has been prepared under the Project and expected to supplement the policies given in State Financial rules. In practice project specific financial rules and regulations are applied to the project/sub project. Internal audit of the project (for SPMC, DPMC and divisions of DWSS) and concurrent audit of GPWSCs is by independent firms of Chartered Accountants as per TOR consented by the World Bank.

Element 7: Financial Reporting

Monthly reporting formats from each of the accounting centers have been designed to provide summarized monthly financial information on the project expenditures and activities. These are upwardly consolidated from GPWSC-GP-DPMC-SPMC to provide meaningful FMRs. GPWSCs prepare monthly expenditure reports and present them in the relevant Gram Sabha/ GP meetings and also to be publicly posted on the notice board. Under the project only project monies are reported monthly and annually.

Element 8: External Audit

The Comptroller and Auditor General of India (CAG) through its offices in Punjab will be the external auditor for the project. The CAG’s office will conduct an annual audit of the financial statements of the project covering all sources of funds (GOI and the World Bank). Audit by the CAG may include a sample review of the GPs implementing the project also.
# CHECK LIST

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<thead>
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**D9. Karnataka Community based Tank Project**

<table>
<thead>
<tr>
<th>Name of Project</th>
<th>Karnataka Community based Tank Project (P071033)</th>
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<tbody>
<tr>
<td>Cost of Project</td>
<td>US$ 124.97 million (World Bank share: US$ 98.9 million)</td>
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<tr>
<td>Effective Date</td>
<td>25-Apr-02</td>
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<td>Closing Date</td>
<td>31-Jan-09</td>
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<tr>
<td>Brief Description</td>
<td>The Project will improve rural livelihood and reduce poverty by developing and strengthening community based approaches to improving and managing selected tank systems</td>
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<tr>
<td>Implementation Arrangements:</td>
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</tr>
<tr>
<td>State Level</td>
<td>State Project Unit of Jala Samvardhane Yojana Sangha (JSYS) – set up as a society under Department of Minor Irrigation, Government of Karnataka (GoK)</td>
</tr>
<tr>
<td>District level</td>
<td>District Project Units (DPU) of JSYS</td>
</tr>
<tr>
<td>Village level</td>
<td>Tank User groups (TUG), most are registered as societies and some are subcommittees under Gram Panchayats supported by Cluster Facilitation Teams (CFT)</td>
</tr>
</tbody>
</table>

**Element 1: Planning & budgeting**

Government of Karnataka (GoK) will provide the budget for the project as an identifiable budget line item each year under Water Resources Department - Minor Irrigation. The annual budget will be based on the annual action plan and financial requirements prepared by JSYS. JSYS will enter into bi/tri-partite Memorandum of Agreement (MOA) i.e. contractual arrangements with CFTs and the TUGs. These MOAs will be based on Tank System Integrated Tank Development Plans (ITDPs). MOAs would specify performance milestones and payment terms linked to these milestones. The ITDPs are approved at Village Sabha and are then vetted by the CFTs and District Project Committees, set up under the project and forwarded to the DPUs for consolidation. The consolidated district plans are sent to the State Project Unit (SPU) for State wide consolidation. Only in 68 cases out of 1300, the TUGs have taken the option to be constituted as subcommittees of Gram Panchayats – the balance have been formed as registered societies (95%). The Project funds are budgeted in the State Sector in the State Budget.

**Element 2: Staffing**

At TUG level, the support for book keeping and accounting and financial planning is provided by the CFT. The prime responsibility is of the secretary of the society or the GP Subcommittee as the case may be.

**Element 3: Flow of funds**

JSYS on a quarterly basis requests for the release of funds from WRD (Minor Irrigation) which forwards the requisition to the Finance Department to obtain a Letter of Credit (LoC). Based on the LoC obtained, WRD issues an order sanctioning the quarterly allocation for JSYS. JSYS will draw the funds from Treasury after obtaining a countersignature from WRD. JSYS makes the funds available in advance to the DPUs on a quarterly basis. DPU in turn, provides funds to the TUGs as per the payments schedules in the sub-project agreements (i.e. ITDP and MOA). Each sub project agreement specifies the payments schedule based on the requirement of the TUGs on the basis of physical milestones (including TUGS own contributions to the sub-project costs). TUGS open separate bank accounts for project funds. Where TUGs are part of the Gram Panchayats, the Gram Panchayat opens separate bank accounts earmarked for this purpose. The authorized signatories for the bank account are the Societies/Gram Panchayats President and Secretary.

The ITDP funds are deposited in a bank account called ‘Tank ITDP’ and used for accounting for the JSYS funds. Two office bearers of the TUG operate the bank account. For all Tank System Sub-Project MOAs of value more than US$30,000, the bank accounts are operated by three office bearers (Treasurer of society added) of the TUG.

**Element 4: Accounting**

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A Financial Management Manual has been developed for the project, which documents in detail the applicable accounting policies and procedures. The books of account are maintained on a hybrid system of cash/accrual. The Manual has a separate section for the bookkeeping and accounting arrangements for the TUGs. Books of accounts for the project are to be maintained using double-entry bookkeeping principles. Standard books of accounts (cash and bank books, journals, ledgers, etc.) would be maintained at the JSYS and DPU levels. For the TUGs registered as societies, a simple cash book, stocks, works register is prescribed. Formats of the books/registers have been provided in the Manual. At the GP level, the existing accounting system will be used. However, the CFTs (as part of their tasks) are required to ensure that the existing accounting systems are enhanced to improve quality and to meet the World Bank’s requirements as documented in the Financial Management Manual. Gram Panchayat will maintain a separate Bank Account to account for the project.

Element 5: Procurement

All project activities to be financed under the Credit would be procured in accordance with the World Bank Guidelines for Procurement of Goods, Works and Consultancy Guidelines for hiring Consulting Services (including NGO services) to be financed under the Credit. All civil works, goods and services would be procured using India specific World Bank’s model documents as well as the formats of the community contracts specifically approved for the Project.

Element 6: Internal Control & audit

A FM Manual has been prepared under the Project which is expected to supplement the policies given for societies and Gram Panchayats. In practice project specific financial rules and regulations prevail, There is no provision for a separate internal audit in the project. However, JSYS is required to appoint a separate audit firm to certify the use of funds by TUGs on a sample basis. Also the CFTs and District Planning Committee are co signatories to the utilization certificates besides the President/secretary of TUG and DPU. Payment would be made after achievement of the performance milestones are certified by the CFTs. If the ITDP funds are not utilized in 12 months they are re transferred back to JSYS. For making these funds available again certain conditions have to be fulfilled by the TUGs e.g. resolution of gram sabha seeking extension of time and specific reasons for non utilization, audited certificate of monies spent, the society renewal certificate, recommendation from CFT and DPU and proof of community contribution.

Element 7: Financial Reporting

Monthly reporting formats from each of the accounting centers have been designed to provide summarized monthly financial information on the project expenditures and activities. These are consolidated from TUGS ->DPU>SPU to provide meaningful financial reports. Payments against the TUG contracts are recorded as expenditures in JSYS books. However, the TUGs are required to submit quarterly statement of expenditures summarizing sources and uses of funds against the plans in order to build accountability and demonstrate the presence of adequate accounting and bookkeeping arrangements. In order to ensure transparency, the TUG is required to publicly post on the notice board in the GP Office, a simple summary of the accounts (amounts received from the members and JSYS, amount spent and balances in hand). In addition, the books/registers, vouchers and bank pass books would be open for perusal by members.

Element 8: External Audit

Private chartered accountancy firm is the external auditor for the Project. Entity financial statements and audit reports are submitted to the World Bank within six months of the close of each financial year. TUGs registered as societies will be required to get their accounts audited annually as per the requirements of the Karnataka Societies Registration Act (1960). Where the TUGs form part of Gram Panchayats, the GP accounts will be audited by Controller of State Accounts, Government of Karnataka. JSYS accounts will also be open for audit by the State Accountant.

CHECK LIST
<table>
<thead>
<tr>
<th>S.NO</th>
<th>QUESTIONS</th>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Is the implementing entity (user committee level) an officially constituted/recognized subcommittee of the local government?</td>
<td>Y</td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>Does the project design provide for an assessment of the fiduciary capacity of PRI as selection criteria?</td>
<td>N</td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>Are the procedures for operation of project bank accounts at the sub project level in line with the provisions of the PR Act and Rules?</td>
<td>Y</td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>Are the sub project funds included in the “fund” of the local government as defined by the PR Act and Rules?</td>
<td>N</td>
<td></td>
</tr>
<tr>
<td>5</td>
<td>In preparing the annual plans/budgets and annual financial statements, does the local PRI include the sub project funds?</td>
<td>N</td>
<td></td>
</tr>
<tr>
<td>6</td>
<td>Are the procurement processes prescribed for the project aligned with the PRIs financial rules/regulations, with respect to approval of the Procurement plan, grievance redressal and complaint mechanism, Public display of all procurement related information, limits for administrative and technical sanction of estimates and contracts and procurement methods to be used?</td>
<td>N</td>
<td></td>
</tr>
<tr>
<td>7</td>
<td>Does the project design envisage a separate audit procedure as against using the entity audit reports to provide the required assurance on end use of the project funds?</td>
<td>Y</td>
<td></td>
</tr>
</tbody>
</table>
Projects financing block grants to PRIs

D10. Chhattisgarh District Rural Poverty Project

<table>
<thead>
<tr>
<th>Name of Project</th>
<th>Chhattisgarh District Rural Poverty Project (P076467)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost of Project</td>
<td>US$ 129.35 million (World Bank share: US$ 112.56 million)</td>
</tr>
<tr>
<td>Effective date</td>
<td>13-Nov-03</td>
</tr>
<tr>
<td>Closing Date</td>
<td>31-Mar-09</td>
</tr>
<tr>
<td>Brief Description</td>
<td>The Project’s development objective is to improve opportunities for the poor and vulnerable, especially women and tribal. One of the sub components of the project (US$ 33.51 million) is to support village governments in becoming more responsive and effective in assisting the poor and vulnerable by increasing the capacity of local governments for financial management, participatory budgeting (Panchayat plans) and dissemination of information.</td>
</tr>
</tbody>
</table>

Implementation Arrangements:

State Level

State Project Unit (SPU) set up as a registered society in the Panchayats and Rural Development Department of Government of Chhattisgarh.

District level

District Project Unit (DPU) established in Zilla Panchayats (ZP) supported by Project Facilitation Teams (PFT) for clusters of villages.

Village level

Gram Panchayats (GP) and Common Interest Groups (CIG).

Element 1: Planning & budgeting

The project would co-finance subprojects in Panchayat plans in about 2000 Panchayats covering the selected villages. These small subprojects would cover investments within the functions devolved to Panchayats, such as small rural roads, health posts, community halls, school rehabilitation, drinking water, sanitation, electrification, management of Panchayat lands, management of tanks, etc. All target Panchayats would initially be eligible to receive a small budget from the project, but for continuing project support they would need to meet the following criteria: (a) positive support to the project through communications, CIG formation and conducting of participatory Gram Sabhas; (b) provision of safe drinking water to the poorest habitations; and (c) satisfying basic financial management standards. All GP subprojects would require community contributions of up to 5% in cash and the GS would decide how funds would be raised. Panchayat plans would be financed from other sources of funding as well, and would need to be discussed and approved by the Gram Sabha. Panchayat Plans, covering public goods and services within the functions devolved to Panchayats in the State Panchayat Act, would be elaborated annually in a participatory manner and taking into consideration available schemes, own resources and the funds available from DRPP.

Element 2: Staffing

As for all GP funds, the accounting for project funds are managed by the Panchayat Secretary and Sarpanch – no special arrangements have been made under the project.

Element 3: Flow of funds

The sub project is embedded in the Panchayat Plans and therefore forms an integral part of the Panchayats annual budget. For each approved sub project, the funds are released by the Zilla Panchayat in two-three tranches into the bank accounts of the Gram Panchayat. While the first release is an advance, subsequent releases are conditional on submission of utilization certificates confirming the use of funds and physical verification of assets created conducted by the technical staff at Zilla Panchayat.

Element 4: Accounting

Mainstream Panchayat accounting system is used for recording/reporting of expenditures.
**Element 5: Procurement**
The Community Operational Manual specifies the procurement processes to be followed for the sub projects and are based on para 3.15 of the World Bank’s Procurement Guidelines.

**Element 6: Internal Control & audit**
The sub project funds are subject to the standard accountability and oversight processes in place at the GP level, including social audit, approval of plans by the Gram Sabha etc. The project has put in place a mechanism of conducting six monthly financial reviews for the project funds utilized at the GP level. These audits are conducted by chartered accountancy firms empanelled at the district level, against agreed TORs.

**Element 7: Financial Reporting**
Submission of utilization certificates for the funds provided by the project are the primary means of obtaining assurance on intended use of funds. No other financial reports are provided.

**Element 8: External Audit**
External audit for Gram Panchayats is conducted by the Local Fund Audit – no arrangements have however been made under the project to obtain copies of these reports.
D11. Karnataka Health System Development and Reforms Project

<table>
<thead>
<tr>
<th>Name of Project</th>
<th>Karnataka Health System Development and Reforms Project (P071160)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost of Project</td>
<td>US$ 206.48 million (World Bank share: US$ 141.83 million)</td>
</tr>
<tr>
<td>Effective date</td>
<td>11-Jan-07</td>
</tr>
<tr>
<td>Closing Date</td>
<td>31-Mar-12</td>
</tr>
<tr>
<td>Brief Description</td>
<td>The Project main objective to increase utilisation of essential health services using a dual approach of funding, programmatic as well as project</td>
</tr>
</tbody>
</table>

**Implementation Arrangements:**

<table>
<thead>
<tr>
<th>State Level</th>
<th>State Project Management Unit (SPMU) with Department of Health &amp; Family Welfare (DoHFW)</th>
</tr>
</thead>
<tbody>
<tr>
<td>District level</td>
<td>District Project Management Unit (DPMU) with District Health Office (DHO) and Zilla or District Panchayat (ZP)</td>
</tr>
<tr>
<td>Village level</td>
<td>Taluk Health Office under Taluk or Block Panchayat (TP)</td>
</tr>
</tbody>
</table>

**Element 1: Planning & budgeting**

Support under KHSDRP will follow a dual approach of 'programmatic support' for existing government programs in primary and secondary care (for subcomponent 1B Improving primary and secondary care services' effectiveness) and traditional project support for the innovations that form all other project components. In case of the programmatic support component, a substantial part of the funds would be used by the Panchayati Raj Institutions (PRIs); given the current state of the decentralization reforms, the World Bank support in this case would be for expenditure at the Zilla (District) Panchayats and releases to the Taluk (Block) Panchayats.

The World Bank will provide support for the programmatic support subcomponent (1B) against certain existing lines of GoK budget covering expenditure on existing activities at the State as well as the PRI level. This support will be provided on an incremental basis, funding increase in GoK's own expenditure as per a pre-defined formula. The sub project is embedded in GoK budget and therefore forms an integral part of the Panchayats annual plan and budget at the district and Taluk level.

**Element 2: Staffing**

Regular departmental staffs at district level as well as Taluk level are expected to carry out the FM functions. At Zilla Panchayat level, the finance and accounting function will be handled by one divisional accountant assisted by clerical staff.

**Element 3: Flow of funds**

The sub project is embedded in GoK budget and therefore forms an integral part of the Panchayats annual plan and budget at the district and Taluk level. The Project funds are budgeted in the State as well as district sector in the State Budget. The State has put in place a system of district sector in the State Budget which is in effect a Panchayat budget window wef 1987. The budget is also accompanied by a link book, which gives details of how allocations are further separated district wise. Thus each Zilla Panchayat knows how much funds is to come to Panchayats as a whole in the district.

The Budget for these devolves from Finance Department to SPMU in DoHFW and from SPMU to DHOs as well as Zilla Panchayat/TP. Funds will be released through the treasury system in the form of a budget release order. No separate institutional arrangements have been envisaged and existing Govt arrangements are used for obtaining fiduciary assurance.
Element 4: Accounting

A Financial Management Manual has already been developed which lays down in detail the applicable accounting policies and procedures. Mainstream Govt accounting system is used for budgeting and recording/reporting of expenditures. The project components are embedded in GoK accounting and treasury systems. Specific and unique heads of accounts will be created for each of the components to facilitate correct reporting of financial progress. Releases to Taluks will be considered expenditures.

Element 5: Procurement

Goods and services under Component IB of the project would be procured following the provisions of the Karnataka Transparency in Public Procurement Act (KTPP) and Act and Rules 2000 and the various circulars, orders being issued in pursuance of the implementation of the Procurement Reform Action for the State as a follow up to the State Procurement Assessment Report (2001). As envisaged in the agreed Health Sector Procurement Reform Action Plan, specific Procurement Manual and Standard Bidding Documents for equipment and drugs will be developed and adopted for use. In the case of International Competitive Bidding, Bank procedures would be followed. Expenditures on pharmaceuticals (including medical supplies) and medical equipment will not be eligible for IDA financing unless such Manual and SBD are established. Subject to the implementation of the agreed Health Sector Procurement Reform Action Plan, the existing procurement legal framework would be generally acceptable under sub component IB of the project.

Element 6: Internal Control & audit

Certain portion of the finds provided to the Zilla Panchayat will be further transferred to the TP for incurring of expenditure; these are recorded as ‘transfers’ in the Zilla Panchayat audited financial statements. Though it will be possible to extract information on actual ‘expenditure’ against these transfers from 174 separate TP Audit Reports; in accordance with the block grant approach, the project plans to derive alternative assurance on these funds on the following basis.
(a) Review performance of the entire project based on the monitoring of annual agreed milestones.
(b) Since funds released will be against specific heads of the budget, possible misuse of the same is
(c) Performance on the ground will be regularly monitored

Element 7: Financial Reporting

Mainstream Government accounting systems are being used and the project activities are embedded in heads of accounts of GoK Accounting/treasury systems. Information from treasury will be used to prepare Project Financial Management Reports.

Element 8: External Audit

Funds for a certain portion of the programmatic support component will be transferred to the PRI Sector for expenditure on the health related activities. Information on the same will be available through the Zilla Panchayat (district) audit reports. Since all expenditure at the Zilla Panchayat level is already audited by the CAG and this also includes expenditure relating to the health sector; KHSDRP intends to rely on the existing audit mechanism whenever possible. Therefore, the DoHFW will provide the World Bank with a consolidated report on Audit of the Health Sector related expenditure by Zilla Panchayats. This report will provide (district-wise) information on the expenditure incurred by Zilla Panchayats on health care services. Individual Zilla Panchayat audit reports will be available upon request.
### Element 1: Planning & budgeting

Gram and Ward Sabha would be the key points of consultation and planning. They would approve plans and budgets of Gram Panchayats and review the GP performance. Gram Panchayat will make expenditure decisions as per the Activity Mapping and the annual plans to be implemented following the new Planning Guidelines and in a participatory and open manner. Technical support to Gram Panchayat will be provided by RDPR by creating resource centers at the Taluk level. TP, where agreed with the SIRD, would assume responsibility for O&M of the Taluk resource centers. Each Taluk would be equipped with services of at least an engineer (to review GP infrastructure projects and carry out the initial environmental screening), an accountant (to review the extent to which Gram Panchayats are following the Financial Guidelines, to provide assistance on the matter where needed, and to collate Panchayat accounts at the block level for transfer to the district), and a social specialist. Zilla Panchayat through the District Planning Cell would monitor the planning process of Panchayats to ensure that they follow the guidelines. The sub project forms an integral part of the Panchayats (at all levels) annual plan and budget. The Project funds are budgeted in the State Sector as well as the district sector in the State Budget.

The Block Grants will be budgeted as a Capital head of expenditure under appropriate guidance from National Government Accounting Standards Board (GASAB) and the Comptroller and Auditor General (CAG). The budget codes of these expenditure heads will be decided at the time of budget preparation by GoK.

### Element 2: Staffing

Accounts Superintendent at the TP, Secretaries at Gram Panchayats will be responsible for maintaining and submitting expenditure reports and relevant supporting documentation of project funds expended by their respective agencies. The TP-CEO and Gram Panchayat-Sarpanch will be responsible for exercising control on expenditures. At the village level, the Secretary, who is an official of the State Government, is deputed to the Gram Panchayat and is routinely responsible for all the financial and administrative matters will also account for the Block Grants. All project funds will be in the nature of Block Grants (for the specific purpose of improvement and expansion of services) and will be accounted for within the existing accounting, reporting and audit framework of the Gram Panchayats.

### Element 3: Flow of funds

GoK will provide advance funds to commence the project. At the beginning of each year, the allocation to the Rural Development & Panchayati Raj Department under the respective heads for the investment and the programmatic components would be made available. Thereafter, the block grants will be transferred directly to the bank accounts of the Gram Panchayats and release spending authority to TPs to spend through the Treasury.
Element 4: Accounting

The accounting arrangements at the village will be mainstreamed. The GP accounts as mandated by the Karnataka PRI Act will account for the Block Grant funds from the project received as well. GoK would continue with the existing accounting treatment of block grants in its Books and thereafter will revise the accounting treatment, if required, on the basis of final advice received from GASAB. For the Block Grant component, the Annual Financial Statement for the project will reflect transfers from GoK to the Gram Panchayats. Transfers reflected in the project AFS will be reconciled with the transfers shown in the books of accounts of the State. These transfers are considered as part of Zilla Panchayat and Gram Panchayat funds.

Element 5: Procurement

Government of Karnataka has undertaken a program of reforms in public procurement. The Karnataka Transparency in Public Procurements Act, 1999 prohibits procurement other than by invitation of tenders. As mentioned below the Government of Karnataka has fixed thresholds above which the Act will be applicable. The project has adopted the same thresholds. The Government has also issued rules and circulars under the Act. The Act provides for (a) open invitation of bids; (ii) adequate time for bidding period; (iii) public opening of bids; (iv) evaluation to be on the basis of responsiveness to the bidding documents; and (v) mechanism for handling complaints. The Government of Karnataka has also issued guidelines for specifying qualification criteria, evaluation of bids etc. The major difference between the accepted national competitive bidding procedures in other Indian projects and the procedures under the Karnataka Act relates to: (i) two cover tender system; (ii) conducting negotiations; and (iii) DGS&D Rate contracts are acceptable as substitute of tendering.

In view of above for the purpose of national competitive bidding the procedures followed under Karnataka Transparency in Public Procurements Act, 1999 will be followed under the project except the above three provisions which differ from World Bank’s accepted procedures under national competitive bidding. The DGS&D rate contracts will however be acceptable as substitute for shopping procedures. Gram Panchayats using block grant monies, goods estimated to cost more than $2,100 equivalent per contract, and works estimated to cost more than $4,200 equivalent per contract, may be procured under contracts awarded on the basis of national competitive bidding using the procedures under the Karnataka Transparency in Public Procurements Act of 1999 (as amended) and the additional provisions agreed between the Borrower and the Association in writing from time to time. Otherwise, goods and work estimated to cost more than $30,000 equivalent may be procured under contracts awarded on the basis of national competitive bidding using the procedures developed by the Government of Karnataka, will be used for national competitive bidding. These documents are based on the World Bank New Delhi Office documents. However, for contracts above Rs. 5 million, the documents are based on two cover system. Since the two cover system is not acceptable, the W-2 document of the World Bank will be used in case there is any contract above Rs. 5 million.

Shopping: For Gram Panchayats using block grant monies, goods and work estimated to cost respectively less than $2,100 and $4,200 equivalent may be procured under contracts awarded on the basis of Shopping. Otherwise, goods and work estimated to cost less than $30,000 equivalent may be procured under contracts awarded on the basis of Shopping.

Direct Contracting: Goods and works which the Association agrees meet the requirements for Direct Contracting may be procured in accordance with the provisions of said procurement method. Contracts above $10,000 equivalent will require prior clearance from the Association.

Community Driven Procurement: Works such as Water Supply, Forestry, Plantation, Sanitation, etc., maybe carried out by the community, in accordance with procedures described in operational Manual.

Force Account: Works which the Association agrees meet the requirements for Force Account may be carried out in accordance with the provisions of said procurement method.

Consultants: Consultants would be selected using the following methods: Quality- and Cost-Based Selection (QCBS), Quality-Based Selection (QBS), Single-Source Selection, and Selection based on Consultants' Qualifications. The standard Request for Proposals (RFP) and conditions of contracts will be used for all contracts.

Social audit through participatory and transparent process - Institutional arrangements for social audits at the village level will provide the framework needed to ensure that there is checks and balances and transparency in the procurement process, including access to information relating to procurement. The information related to procurement under block grants would also be put up to Gram sabha.
Element 6:  Internal Control & audit

Controls on the Block Grant funds will be through the fiduciary framework that is put in place in this project. This framework will ensure that directives from the RDPR regarding the eligible expenditures for use of Block Grant funds, that regular Gram Sabhas are held to document the proposed uses of Block Grants; that there are approval procedures in place which ensure that Block Grants are proposed to be used only for the extension and expansion of services as envisaged under the 29 items devolved to the Gram Panchayats. For the purposes of monitoring, capacity building and assurance on end use of Block Grant funds, the RDPR will monitor the consolidated audit report of Gram Panchayats receiving Block Grants audited by Karnataka State Audit Department and additional fiduciary reviews of a sample of Gram Panchayats receiving Block Grants will be undertaken by a firm of private accountants periodically during the implementation phase. Inadequate assurance on the end use of Block Grant funds will result in disallowances.

Element 7:  Financial Reporting

New accounts, audit and works manual for Gram Panchayats has been prepared and approved by GoK. The accounting and reporting arrangements at the Panchayat will be mainstreamed. The GP accounts as mandated by the Karnataka PRI Act will account for the Block Grant funds received as well.

The GP accounts and budget rules 2006 provides for specific formats of monthly and yearly reporting as well as formats for maintaining books of accounts. As per rule 11, as specified under sec 241 of the act, the secretary of the Gram Panchayat shall prepare and lay before the Gram Panchayat at a meeting which shall be held between the first day of Feb and the tenth day of March, a complete account of the actual and expected receipts and expenditure for the official year ending on the 31st March next following together with a budget estimate of the income and expenditure of the Gram Panchayat for the official year to commence on the 1st of April next following. Rule 108 describes monthly preparation of receipt and payment statement in form 50, monthly trial balance in form 51 by Secretary and places it for review by the Gram Panchayat. Rule 109 describes annual accounts of the Gram Panchayat in form 50, 52 and 53 which requires approval by Gram Panchayat under sec 243(3) of the act to be ready by 30th April of each year. Rule 99 deals with grants received by the Gram Panchayat and their utilization to be entered in Form 42. At the end of the year an abstract showing opening balance, grants received, and grants utilized and the balance at the end is recorded and attested by the Adyaksha and Secretary. The Secretary ensures that the UCs in form 43 are sent to competent authorities as indicated in the terms of the grants.

The State has accepted the technical guidance and supervision system of the CAG. The State has also approved and adopted the CAG formats for accounting with some modifications.

Element 8:  External Audit

Audit of annual financial statements and FMRs (on all components) will be conducted by a firm of private Chartered Accountants.

There is no separate PAC for reviewing audit paras of Panchayats. Karnataka is the first State to enact a separate fiscal responsibility act for elected local authorities. Rule 112(1) read with sec 246 envisages the annual audit of GP accounts by the Controller State Accounts. Rule 112(2) deals with certification of audit report within one month after completion of audit and ensures audit report contains certified statement of annual receipt and payment account, income and expenditure account and balance sheet of the Gram Panchayat. Rule 113 deals with action on annual audit report. Actions by secretary to recoveries and place action taken report before the audit committee (rule 114 – can be formed under section 61A) of the Gram Panchayat along with Audit report. Audit committee to review quarterly and place a report before Gram Panchayat. Gram Panchayat through Secretary to prepare compliance report and sent to Assistant controller Local audit Circle.
## ANNEX E. LIST OF PERSONS MET AND CONTACTED

<table>
<thead>
<tr>
<th>S.No</th>
<th>NAME</th>
<th>DESIGNATION</th>
<th>ORGANIZATION</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Mr. Gambhir Singh</td>
<td>Director</td>
<td>Uttarakhand Rural Water Supply &amp; Sanitation Project</td>
</tr>
<tr>
<td>2.</td>
<td>Mr. Jagdish Chandra</td>
<td>Finance Controller</td>
<td>Uttarakhand Rural Water Supply &amp; Sanitation Project</td>
</tr>
<tr>
<td>3.</td>
<td>Mr. Utpal Kumar Singh</td>
<td>Chief Project Director &amp; Secretary, PWD and Horticulture</td>
<td>Uttarakhand Decentralized Watershed Development Project</td>
</tr>
<tr>
<td>4.</td>
<td>Mr. DJK Sharma</td>
<td>Additional Director</td>
<td>Uttarakhand Decentralized Watershed Development Project</td>
</tr>
<tr>
<td>5.</td>
<td>Mr. JP Joshi</td>
<td>Deputy Secretary, Department of Panchayati Raj</td>
<td>Government of Uttarakhand</td>
</tr>
<tr>
<td>6.</td>
<td>Prof. N Ramakantan</td>
<td>Director</td>
<td>Kerala Institute of Local Administration (KILA)</td>
</tr>
<tr>
<td>7.</td>
<td>Mr PV Unnikrishnan</td>
<td>Member, State Planning Board &amp; ex-Executive Mission Director</td>
<td>Information Kerala Mission</td>
</tr>
<tr>
<td>8.</td>
<td>Ms Shahina</td>
<td>Associate Professor</td>
<td>Cooperation Banking College, Kerala Agricultural University, Thrissur</td>
</tr>
<tr>
<td>9.</td>
<td>Mr U.B. Kandeth</td>
<td>Consultant</td>
<td>Retd Senior Audit Officer, AG Office &amp; Guest Faculty, KILA</td>
</tr>
<tr>
<td>10.</td>
<td></td>
<td>Professor</td>
<td>KILA</td>
</tr>
<tr>
<td>11.</td>
<td></td>
<td></td>
<td>Talikulam</td>
</tr>
<tr>
<td>12.</td>
<td>Mr. S M Vijayanand</td>
<td>Principal Secretary</td>
<td>Department of Local Self Government, Government of Kerala</td>
</tr>
<tr>
<td>13.</td>
<td>Mr. SD Pillai</td>
<td>Senior Deputy [Accountant General]</td>
<td>Office of the Principal Accountant General (Audit) Kerala</td>
</tr>
<tr>
<td>14.</td>
<td>Mr. T Bhasi</td>
<td>Director</td>
<td>Local Fund Audit Office, Kerala</td>
</tr>
<tr>
<td>15.</td>
<td>Mr. NS Pillai</td>
<td>Sr. Deputy [Accountant General (on deputation as State Performance Auditor)]</td>
<td>Local Self Government, Government of Kerala</td>
</tr>
<tr>
<td>16.</td>
<td>Prof M A Oommen</td>
<td>Economist &amp; Coordinator</td>
<td>Institute of Social Sciences, Kerala Office</td>
</tr>
<tr>
<td>17.</td>
<td>Mr. K Premkumar</td>
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<td>18.</td>
<td>Dr. K Gopalan</td>
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<tr>
<td>19.</td>
<td>Ms. Geeta Meshram</td>
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</tr>
<tr>
<td>20.</td>
<td>Mr. JP Shende</td>
<td>Sr.AO &amp; Team Leader</td>
<td>District Financial Management Team, Nagpur</td>
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<tr>
<td>S.No</td>
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<td>21.</td>
<td>Officials</td>
<td>Members of VWSC Subcommittee</td>
<td>Mangli Village, Nagpur</td>
</tr>
<tr>
<td>22.</td>
<td>Mr. Pratap Mohite</td>
<td>Controller of Accounts</td>
<td>Reform Support &amp; Project Management Unit (RSPMU) Jalswarajya (Maharashtra Rural Water Supply &amp; Sanitation Project)</td>
</tr>
<tr>
<td>23.</td>
<td>Mr. Sunil Gedam</td>
<td>Regional Facilitator</td>
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<td>Taluk Ramtek Panchayat Samiti, Gram Panchayat – Dongertaal, Maharashtra</td>
</tr>
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<td>25.</td>
<td>Sandeep Deshmukh</td>
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</tr>
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<td>26.</td>
<td>Ms Mrudul Sambare</td>
<td>Senior Accounts Officer</td>
<td>Maharashtra RWSP</td>
</tr>
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<td>27.</td>
<td>Mr. BS Ram Prasad</td>
<td>Executive Director</td>
<td>Jala Samvardhane Yojana Sangha, (Karnataka Community based Tank Project)</td>
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<tr>
<td>28.</td>
<td>Mr. BS Ramanand</td>
<td>Participatory Management Specialist</td>
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<td>29.</td>
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</tr>
<tr>
<td>30.</td>
<td>Mr. HR Sriniwas</td>
<td>Additional Project Director (Coordination)</td>
<td>Sujala Watershed Project</td>
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<td>31.</td>
<td>Mr. V Nagaraj</td>
<td>Chief Accounts Officer</td>
<td>Sujala Watershed Project</td>
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<td>32.</td>
<td>Mr. Shrikant B Vanahalli</td>
<td>Additional Director (Finance &amp; Administration) Advisor</td>
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<tr>
<td>33.</td>
<td>Mr Hamid Ahmad</td>
<td>Deputy Director (Operations)</td>
<td>Karnataka Rural Water Supply &amp; Sanitation Agency</td>
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<tr>
<td>34.</td>
<td>Mr. Prakash</td>
<td>Panchayat Facilitation Expert</td>
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<td>35.</td>
<td>Mr. DS Ramesh</td>
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<td>36.</td>
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<td>37.</td>
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<td>Karnataka Health Systems Development and Reforms Project</td>
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<td>38.</td>
<td>Mr. TR Raghunandan</td>
<td>Joint Secretary</td>
<td>Ministry of Panchayati Raj, Government of India</td>
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<td>39.</td>
<td>Mr. RN Ghosh</td>
<td>Director</td>
<td>Comptroller &amp; Auditor General, Delhi</td>
</tr>
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</table>
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