GOVERNMENT OF KERALA

Abstract

Finance Department – Seventh State Finance Commission – First Report of the Commission - Orders issued.

FINANCE (SFC Cell - A) DEPARTMENT

G.O.(Ms) No.10/2026/FIN Dated, Thiruvananthapuram, 28-01-2026

Read: Notification issued under G.O.(P) No. 84/2024/Fin dtd: 26/09/2024.

ORDER

The Seventh State Finance Commission constituted vide notification read above has submitted its first report on 13.01.2026.

2) Government after considering the matter are pleased to issue orders accepting the recommendations in the first report of the Seventh State Finance Commission with modifications as detailed in the Annexure to the order.

(By Order of the Governor)

K R JYOTHILAL

ADDITIONAL CHIEF SECRETARY (FINANCE)

To

The Principal Accountant General (Audit-I/ A&E), Kerala,Thiruvananthapuram

The Principal Secretary, LSGD

The Secretary, Seventh State Finance Commission

The Director of Treasury, Thiruvananthapuram

The Principal Director, Local Self Government Department, Thiruvananthapuram

The Director, State Audit Department

The General Administration (SC) Department (vide item no.3583 O.A dated 21/01/2026)

The Nodal Officer, Finance (www.finance.kerala.gov.in)

The Finance (Accounts- A/BW-J/ Dev. Wing) Department

The Bill/Stock File/Office Copy (3388033).

Forwarded/ By order

Section officer

Annexure

Recommendations in the First Report of Seventh SFC and the Decisions there on.

1. The contours of the federal fiscal arrangement of the country are widely anticipated to be reset by the UFC XVI. But there is no way to foresee the recommendations of the UFC XVI. There is no way other than waiting for the formal release of the UFC report and the ATR from the central government. In view of the above, recommendations of the SFCVII contained in this preliminary report will be applicable only for the first year of its period, viz., 2026-27. Commission will finalize the report once the UFC report and the ATR are available and the recommendations thus finalized would be applicable for the rest of the period, 2027-28 to 2030-31**. (Para 11.11)**

   Decision: Commission's recommendation to submit devolution recommendations in two stages may be accepted by the Government.

2. The Commission recommends continuing the practice of devolving a share of the net SOTR to LGs as Non-Plan Devolution, while also retaining the existing (t–2) system. **(Para 9.2, 11.17 & 11.18).**

   Decision: Government may accept the recommendation to continue the non-plan devolution as a share of net SOTR, on the existing (t-2) system.

3. The Commission recommends that LGs be permitted to utilize a certain percentage of the OSR they collect for implementing schemes that require approval only from their respective governance bodies. The LSGD, in consultation with the State Planning Board may prepare and issue detailed guidelines in this regard **(Para 9.13).**

   Decision: The recommendation may be accepted in principle. Detailed guidelines may be prepared in consultation with Finance Department, LSG Department and State Planning Board.

A. General Purpose Fund

Employees Emoluments Fund

4. To address systemic financial and disbursement challenges regarding Salary and Pension benefits of Human Resource deployed at LGs, a dedicated LG Employees' Emoluments Fund (EEF) is proposed as a subset of the General Purpose Fund (GPF). The EEF will have both Salary and Pension parts, under which Central Pension Fund will be a component. In the Salary part, only the salary and allied benefits of those employed in LGs who currently withdraw salary from State Consolidated Fund (except Engineering Wing and Municipal Secretaries), viz; Block Panchayats will be addressed. Rest of the LG Staff salary (both RLG and ULG), including Regular, Municipal Common Service, Contingent and Part-Time Sweepers will be borne by respective LGs from their GPF or Own Source Revenue, as in practice. The salary of Engineering Wing staff deployed at LGs and Municipal Secretaries will continue to be disbursed as per the current practice. **(Para 9.17 & 11.25)**

Decision: The recommendation to establish a Local Government Employees Emoluments Fund to address the systemic financial and disbursement challenges regarding Salary and Pension benefits of Human Resource deployed at LGs is accepted in principle. Guidelines may be prepared in consultation with LSGD based on the approved recommendations of the policy paper to be submitted by the commission in its subsequent report.

5. In pensions part of EEF, pension benefits of employees of all tiers of RLGs and ULGs including Engineering Wing, covering Regular, Contingent and Part-Time Sweepers will be taken care of. This excludes contingent employees of ULGs, whose whole pension benefits will continue to be disbursed by respective ULGs. Also, the Terminal Surrender benefit of employees deployed at RLGs (excluding Block Panchayats) and Municipal Common Service will not be covered under EEF and will continue to be disbursed as per current practice, ie, by respective LGs. This means that the Pension and allied benefits of Municipal Common Service retirees, which is currently disbursed by ULGs will also be disbursed from EEF, but from its component-CPF, by the Principal Director of LSGD. This will be the only additional financial liability of State under EEF, but will be of temporary nature. This also ensures adherence to the current rules and Municipalities Act. To compensate the additional financial commitment of the state in EEF and to streamline the procedure regarding Salary and Pension disbursement, pension contributions of Panchayat shall be deducted from their GPF share and be accounted in EEF. Also, the ULG share of the GPF should undergo a deduction to cover two items; the whole pension benefit liability (inclusive of the pension contribution) and the salaries of Municipal Secretaries. Deduction corresponding to the ULG pension will be credited to CPF for disbursal. This change is primarily intended to resolve existing procedural issues such as the irregular reimbursement of Municipal Secretaries' salaries by ULGs and the failure of LGs to remit their required pension contribution. Since pension benefits for retirees will now be disbursed centrally from the EEF, securing the contribution is also essential. All these deductions will be calculated annually, based on the actual commitment two years prior (on t −2 basis) and deducted in equal amounts from each GPF instalment. **(Para 9.18 & 11.26)**

Decision: The recommendation may be accepted in principle. Detailed orders may be issued in consultation with LSGD and based on the approved recommendations given in the policy paper to be submitted by the 7th SFC in its subsequent report and consultations with other stakeholders.

6. To accurately reflect the State's aforementioned expenditure on LG staff as true devolution, an enhancement of certain percentage points will be recorded in the yearly GPF allocation. This quantity of enhancement is estimated to be 1.5% for 2026-27, which will be subject to change based on actual salary and pension disbursement (t−2) and net SOTR (t−2) of corresponding year. This enhancement will not be devolved to LGs, but be recorded as EEF, which will properly account the salary and pension burden of State Consolidated Fund as GPF. The State Finance Department shall take necessary steps in consultation with the Accountant General to properly account this enhancement as devolution to LGs in each Annual Financial Statement. Further, regarding salary commitments of LGs, they should prioritize salary disbursements from GPF funds first. A detailed Study Report on Employees Emoluments Fund will be submitted with subsequent reports of the Commission. **(Para 9.19 & 11.39)**

Decision: The recommendation may be accepted in principle. Detailed orders will be issued in consultation with LSGD and based on the approved recommendations given in the policy paper to be submitted by the 7th SFC in its subsequent report and consultations with other stakeholders.

Board of Finance for Local Governments

7. Commission recommends that a Board of Finance for Local Governments is established in the state, to empower LGs to realize the potential of revenue and borrowings. **(Para 9.21 & 11.32)**

Decision: The recommendation may be accepted in principle. Detailed orders may be issued in consultation with LSGD and based on the approved recommendations given in the policy paper to be submitted by the 7th SFC in its subsequent report and consultations with other stakeholders.

8. The Board of Finance should also facilitate issue of municipal bonds and borrowings by the eligible LGs. Commission foresees considerable scope for mobilization of funds through the above channels. Given the enhanced availability of development funds, the Commission do not recommend borrowings as a means of financing development or welfare projects in general. The window of bonds or borrowings may be opened to the LGs on a project-to-project basis, ensuring that the selected projects generate reasonable return for meeting the repayment obligations. The union government has schemes to support the Municipalities which come forward for issuing Municipal bonds. The funds proposed by the Commission for the Board of Finance can be used to support appropriate package of incentives and handholding. **(Para 9.23 & 11.34)**

Decision: The recommendation may be accepted in principle. Detailed orders may be issued in consultation with LSGD and based on the approved recommendations given in the policy paper to be submitted by the 7th SFC in its subsequent report and consultations with other stakeholders.

9. The Board of Finance is also expected to take up the regulator's job in permitting the local governments to mobilize funds from the lenders or the capital market. It is important to ensure that the LGs do not borrow beyond their capacity to absorb such funds and that they honour the repayment obligations. **(Para 9.24 & 11.35)**

Decision: The recommendation may be accepted in principle. Detailed orders may be issued in consultation with LSGD and based on the approved recommendations given in the policy paper to be submitted by the 7th SFC in its subsequent report and consultations with other stakeholders.

10. Kerala has a relatively poor track record in availing CSR funds. The LGs have also been reluctant or indifferent in using the CSR window. CSR is an important source of resource for funding development and welfare activities. But LGs need handholding to explore the possibility of CSR funding, which the Board of Finance for LGs should strive to ensure **(Para 9.25 & 11.36)**

Decision: The recommendation may be accepted in principle. Detailed orders

may be issued in consultation with LSGD and based on the approved recommendations given in the policy paper to be submitted by the 7th SFC in its subsequent report and consultations with other stakeholders.

11. Commission opines that the LGs are not capacitated to design and develop large development projects, not to speak of income generating bankable projects, or projects which can qualify for issue of bonds. Therefore, capacity building is a prerequisite for developing appropriate financing strategies. The Board of finance should be equipped to extend or arrange the required financial expertise to the local governments seeking such support. Capacity building can be done in collaboration with KILA, GIFT and other selected academic/training institutions. **(Para 9.26 & 11.37)**

Decision: The recommendation may be accepted in principle. Detailed orders may be issued in consultation with LSGD and based on the approved recommendations given in the policy paper to be submitted by the 7th SFC in its subsequent report and consultations with other stakeholders.

12. Commission recommends an initial allocation of Rs.5 crore per year for the expenses related to the Board of Finance. The allocation may be enhanced subsequently after evaluating the Board's performance. **(Para 9.27 & 11.38)**

Decision: Recommendation to set apart an amount from the GPF for expenses related to the Board of Finance is accepted in principle. The allocation and the specific amount to be set apart will be determined once the detailed guidelines are issued following deliberations on the policy paper to be submitted by the commission in its subsequent report.

13. GPF is recommended to be enhanced by a certain percentage point (estimated to be 1.5%), which is only a statistical addition to account for the salary and pension disbursal from State Consolidated Fund. This enhancement will be directly accounted in EEF, and will not be devolved to LGs. This statistical enhancement will be reworked yearly by State Finance Department to match the actual salary and pension commitments met from the State Consolidated Fund. In addition, a 0.5 percentage point hike is recommended in GPF, to meet potential increase in administrative expenditure on account of possible revision of pay and pension of employees, proposed administrative overhaul in the area of urban governance and enhancement of honorarium of elected representatives. This enhancement will be devolved across all tiers of LGs, which will also absorb any uneven deductions done for pension contributions, pension benefits and the LIFE Debt

Servicing Grant. In summary, GPF is recommended to be hiked to an estimate of 6% of net SOTR (t-2) in 2026-27 (subject to change) from the current 4%, but only 4.5% will be devolved to the LGs. **(Para 9.28, 11.23, 11.24, 11.27)**

Decision: Recommendation to devolve 4.5% of net SOTR on (t-2) basis to the LGs may be accepted. The recommendation for the statistical addition of a certain percentage point (estimated to be 1.5%) to account for the salary and pension disbursal from State Consolidated Fund to be accounted in the proposed EEF may be accepted in principle. Actual rate on this account will be fixed based on the figures in the books of accounts. Book adjustment method will be finalized in consultation with Accountant General.

14. The Commission recommends the following methodology for the horizontal devolution of the GPF. After setting apart Rs.5 crore from the GPF for establishing Board of Finance for Local Governments, the remaining GPF is to be distributed between Rural Local Governments (RLGs) and Urban Local Governments (ULGs) in proportion to their population shares, resulting in an allocation of 77.24% to RLGs and 22.76% to ULGs. **(Para 9.29)**

Decision: The recommendation may be accepted. But the deduction proposed for Board of Finance will done only after the detailed guidelines regarding the constitution of Board of Finance are issued.

15. The share of DPs and BPs should be set apart from within the RLG share itself, determined separately for each tier. For each tier, the allocation in the current year is obtained by adding to the previous year's allocation an increment equal to either (i) 7 per cent of the previous year's allocation, or (ii) an increment based on the growth rate of Net SOTR of (t−2) over (t−3), whichever is higher. **(Para 9.29 a, 9.29 b & 11.40)**

Decision: The recommendation may be accepted.

16. For the inter-se distribution of GPF among DPs and BPs, 90% of the funds may be distributed equally within each category, while the remaining 10% be allocated in proportion to their respective population shares. **(Para 9.29 d & 11.41)**

Decision: The recommendation may be accepted.

17. After deducting the shares of DPs and BPs, the remaining portion of the RLG share shall be distributed among the GPs. Within the ULG share, funds will be apportioned between Municipalities and Corporations in proportion to their population as per 2011 Census re-organized by Delimitation Commission 2024, resulting in allocations of 13.44% to Municipalities and 9.32% to Corporations. **(Para 9.30 & 11.42)**

Decision: The recommendation may be accepted.

18. The Commission recommends the continuation of the current special grants, namely: (i) Rs.15 lakh each per annum to Erumeli, Chittar, Ranni-Perunad, Vadasserikkara, Seethathode, and Naranamuzhi Grama Panchayats which are located in the proximity of Sabarimala; and (ii) Rs.25 lakh per annum to Guruvayoor Municipality. This special grant should be earmarked giving priority for addressing problems related to environment, sanitation, infrastructure, and waste-management arising from the pilgrim influx. But it is important to do a proper review of the utilization of special grants allowed so far, especially during the period of SFC VI. Some of the GPs are reported to have accumulated unspent funds under special grants. Such LGs may be given special handholding to develop appropriate projects to address the development challenges/opportunities created by the growing footfall of pilgrims and tourists. State Level Coordination Committee (SLCC) can take the initiative in this regard. **(para 9.31 & 11.30)**

Decision: The recommendation may be accepted. Director, LSGD will do a proper review on the utilization of special grants awarded during 6th SFC period. Further, LSGD will issue detailed guidelines regarding the utilization of special grants in consultation with State Planning Board and SLCC.

19. For meeting revenue gap if any, commission recommends Gap Fund of Rs.20 Crore for Grama Panchayats and Rs.5 Crore for Municipalities. Considering the demand for gap funds has come down over time for various reasons including improved performance with respect to mobilization of own source revenue (OSR), gap fund of Municipalities is not enhanced from the current, but the allocation for Grama Panchayats is enhanced in view of the change in the devolution schema. The Gap Fund shall be distributed among GPs and Municipalities in proportion to their Revenue–Expenditure gap for the previous year (t − 1), as certified by the Director of the Kerala State Audit Department (KSAD). The additional allocation may also be used to meet the payment difficulties in the transition period. There can be GPs which may not be realising the anticipated annual growth in the devolution package. They may experience difficulty in honouring payment commitments undertaken as part of multiyear projects. The additional amount in the gap fund can be allowed to meet such payment difficulties, if any. This can also be used to give special support to GPs characterized by very low per capita

OSR and low per capita devolution on account of structural resize. The norms regarding eligibility may be developed jointly by the departments of Finance and Local Self-Governments **(Para 9.32, 9.33 & 11.29).**

Decision: The recommendation may be accepted and the disbursal of Gap Fund will follow the exiting guideline. In the case of additional allocation of Gap Fund for Grama Panchayats, applications may be invited from those GPs which may experience a decline in GPF allocation and having difficulties in honoring payment commitments. The norms regarding this will be developed jointly by the Departments of Finance and Local Self-Government.

20. The Commission recommends an amortization grant to cover the LIFE debt burden that exceeds 15% of their Development Fund (General Sector) of LGs. The annual award will be Rs.19 crore out of which Rs.15 crore is for Grama Panchayats and Rs.4 crore for Municipalities. The Finance Department will adjust the awarded amount during the scheduled deductions from the Normal Share of the Development Fund towards LIFE debt repayment for each LG. This mechanism ensures that LGs retain at least 85% of its Development Fund for other development activities. Any unutilized amount from this grant shall be distributed among the respective tier of LGs in the same proportion as the devolution of the GPF. **(Para 9.35 & 11.31)**

Decision: The recommendation may be accepted.

21. The LIFE amortization grant will apply only to the existing LIFE debt for which repayment has commenced on or before 31.03.2025. It will not be applicable to any additional debt incurred by LGs after this cut-off date. **(Para 9.36 & 11.31)**

Decision: The recommendation may be accepted.

22. The allocations for revenue gap fund, special assistance for Guruvayur and Sabarimala, assistance for mitigation of LIFE related debt burden and funds recommended for the Board of Finance would be deducted from the GPF of respective tier before effecting the inter se distribution. For the inter se distribution of remaining funds among Grama Panchayats, Municipalities, and Corporations, the Commission assigns weights of 90% for population and 10% for OSR. **(Para 9.37, 11.39 & 11.44)**

Decision: The recommendation may be accepted. But the deduction proposed for Board of Finance will done only after the detailed guidelines regarding the

constitution of Board of Finance are issued.

23. The 90:10 ratio between population and OSR may be revised to 85:15 beginning in the fourth year, thereby further rewarding LGs that perform well during the initial three years. Since the finalized OSR figures for the last financial year were unavailable, the Commission relied on the average OSR of 2022–23 and 2023–24, as provided by IKM which can be used for devolution for the year 2026-27. It is expected that KSMART will be fully streamlined from 2025–26 onwards, enabling reliable OSR data. Therefore, from 2027–28 onwards, the OSR component should be based on (t–2) figures, in alignment with the overall devolution framework. However, these OSR figures sourced through KSMART by IKM should be used only after due audit by the KSAD. **(Para 9.38, 11.44 & 11.46)**

Decision: The recommendation may be accepted. The Local Self Government Department may ensure the availability of LG wise OSR data from KSMART, duly audited by KSAD, by December each year staring from 2026, for the allocation of GPF for subsequent financial year.

24. The local governments should ensure that the OSR data is made available in the public sphere not only for making inter se distribution possible but also for facilitating audit, democratic engagement, public scrutiny, research, etc. That such data are not yet made available in readily accessible form, in spite of the recommendations of earlier SFCs and various other agencies, is a major concern and an obvious limitation of the decentralization experiment in the state. **(Para 11.46)**

Decision: LSGD and IKM may take necessary steps to publish LG wise OSR details in the public domain.

B. Maintenance Fund

25. Commission recommends a reduction of 0.25 percentage points each from both the maintenance funds- Road and Non-Road. This results in a total Maintenance Fund of 6 per cent of the Net SOTR (t−2) of which 3.75 percentage points will be set apart as Road Maintenance Fund and 2.25 percentage points as Non-Road Maintenance Fund. Reduction is recommended due to i) disproportional growth of Maintenance Fund over Development Fund ii) Increased demand to use the Maintenance Fund for non-maintenance purposes, which is a sign of revealed demand for non-maintenance requirements. **(Para 9.49 & 11.47)**

Decision: The recommendation may be accepted.

Non-Road Maintenance Fund

26. The commission recommends to continue using the existing data, and methodology for devolution of Non-Road Maintenance Fund for the year 2026-27. Commission would revise the devolution pattern and finalize our recommendations for the rest of the period once updated data on non-road assets are made available **(Para 9.50 & 11.48).**

Decision: The recommendation may be accepted.

27. Commission recommends updating and purification of non-Road Asset data on R-Track platform, making use of latest technologies including GIS. The whole process shall be time-bound, which will be monitored at the level of Local Self Government Department ensuring availability of data for the devolution starting from 2027-28. The data collected should extend to the same variables used in current devolution formula, i.e., Type of Building, Plinth Area, and Age. It should include the latest user data, but if not available, the current user data may be carried forward. Recommendations for non-road maintenance for rest of the period of the commission shall be made later. **(Para 9.51 & 11.48)**

Decision: The recommendation may be accepted.

Road Maintenance Fund

28. Commission recommends using the Road Area data available in R-Track for assessment of Road Maintenance Fund. Furthermore, weightages for road surface types are being updated as per the recommendations of the SFC VII Working Group on Maintenance Fund **(Para 9.52)**

Road Surface Type	Weightage
BM&BC	0.10
Interlock	0.10
Concrete	0.15
Earthen	0.50
Metal & Gravel	1.00
Bituminous	1.00

Decision: The recommendation may be accepted.

29. To address the impact of urbanization, the commission recommends allocating funds between RLGs and ULGs based on population rather than the current metric of road length. This approach allocates 77.24 % of the funds to RLGs and 22.76 % to ULGs. Within ULGs, the same principle is applied, using population as the criterion to distribute funds, resulting in 13.44% for municipalities and 9.32% for corporations. For inter-se distribution among LGs within each category, an 80% weight is given to the weighted road area and a 20% weight to population. This 80:20 ratio offers a balanced approach that fairly considers both the primary factor—road area—and the secondary factor—population. **(Para 9.53 & 11.50)**

Decision: The recommendation may be accepted.

30. Block Panchayats do not possess any road assets, making only Gram Panchayats and District Panchayats eligible RLGs for the Road Maintenance Fund. Unlike the devolution strategy applied to ULGs, population cannot be used here, as the population base for both the District Panchayat and the underlying Grama Panchayats is identical. Therefore, the allocation of funds between District and Grama Panchayats is determined by weighted Road Area. For the inter se distribution among LGs within each category, an 80% weightage is assigned to the weighted Road Area, while a 20% weightage is given to population, similar to the approach used for ULGs. **(Para 9.54 & 11.50)**.

Decision: The recommendation may be accepted.

31. The commission recommends that the LGs be allowed to use up to 20% of the annual non-road maintenance fund for maintaining their own assets, provided, the Panchayat/Municipal Samiti certify that all urgent maintenance work related to the transferred institutions are provided for. The government issued GO(MS)

No. 90/2023/LSGD dated 09-04-2023, which includes a comprehensive list of permissible and non-permissible expenditures from the Maintenance Fund. This guideline allows for the use of the non-Road Maintenance Fund on non-transferred institutions such as libraries, balavadis, nurseries, BUDS schools, and old age homes, as per clause 2.6(1). Since it is recommended to permit the use of up to 20% of the Non-Road Maintenance Fund on all assets owned by LGs, this specific clause is no longer relevant and should be removed from the guideline. **(Para 9.55 & 11.51)**

Decision: The recommendation may be accepted and guidelines regarding the utilization of Maintenance Fund will be revised accordingly.

32. In the cases of both the development fund and the maintenance fund, commission recommends that the local governments be allowed to carryover unspent funds to the next financial year subject to a maximum of twenty per cent of all unspent funds. The operational details can be developed jointly by finance, planning and local self-government departments **(Para 9.55, 10.18, 11.19)**

Decision: The recommendation may be accepted. The local governments are being allowed to carryover unspent funds subject to a maximum of 20%. Guidelines will be issued defining eligibility.

33. Commission recommends relaxing the current prohibition on using the Road Maintenance Fund for road upgrades. However, this relaxation should apply only to earthen, metal, and gravel roads, allowing them to be upgraded to any suitable superior surface type. It is recommended that clauses 3.2(6) and 3.2(7) of the guideline (GO (MS) No. 90/2023/LSGD dated 09-04-2023) be modified accordingly. Nonetheless, the construction of any new assets, including Green Field roads, shall remain strictly prohibited from both Road and Non-Road Maintenance Funds. **(Para 9.56 & 11.51)**

Decision: The recommendation may be accepted and guidelines regarding the utilization of Maintenance Fund may be revised accordingly.

34. Commission recommends removing clause 3.2 (3) from the guideline (GO (MS) No. 90/2023/LSGD dated 09-04-2023), which effectively categorizes earthen roads as of the lowest priority and thereby allocating maintenance projects to them only after other roads. **(Para 9.57)**

Decision: The recommendation may be accepted and guidelines regarding the utilization of Maintenance Fund may be revised accordingly.

35. The commission is of the view that there should be very well-kept maintenance plan as well as a Maintenance Diary in every local government. All maintenance work undertaken with respect to each asset should be recorded with required details in the Maintenance Diary. Commission recommend that keeping Maintenance Plan and Maintenance Diary should be made a pre-condition for releasing the maintenance grant. **(Para 9.58 & 11.52)**

Decision: Instructions to keep Maintenance Plan and Maintenance Diary may be issued in consultation with LSGD. Putting pre-condition of keeping Maintenance Plan and Maintenance Diary for release of Maintenance Fund may be examined in consultation with LSGD.

36. The Commission also recommends bunching together smaller maintenance tasks for assigning competitive bidding and arranging maintenance contracts. It will help the contractors to achieve minimum efficiency scale and reduce transaction costs considerably and will help effective monitoring by Engineers. Limiting the number would also help improve traceability and accountability. The LSG Department may formulate guidelines with respect to Maintenance Plan, Maintenance Diary and bunching of maintenance tasks for competitive bidding. **(Para 9.59 & 11.53)**

Decision: The recommendation may be accepted and guidelines regarding the utilization of Maintenance Fund may be revised accordingly.

37. The General Purpose Fund, as it is a transfer in lieu of revenue entitlements of local governments, should continue to be treated as non-lapsable and on par with own source of revenue of the local governments. But, in order to promote transparency and accountability, Commission recommends the departments of Local Self-Government, Finance and Planning to jointly prepare a ‘position paper’ on unspent balance of GPF allocations, and all other possible funds, kept by the local governments in financial institutions other than the Treasury. Commission consider it urgent because of the surprisingly huge sums kept in deposits about which local government administration is reluctant to share information even with the elected councils. This is suggested not to deprive the local governments of their right over such resources but to ensure accountability and fiscal discipline**. (Para 11.20)**

Decision: The recommendation may be accepted.

38. The new census data are likely to be available in 2027. The devolution recommendations of SFC VII presented in this preliminary report is based on 2011 census data. It is important to use the new census figures as soon as they are made available. Commission recommends a phased transition to the new census to avoid sudden shifts in the allocation pattern. In the first year of transition one half of the amount may be apportioned in the same pattern as we have outlined in the present report. The second half of the amount shall be devolved on the basis of the new census data. But, next year onwards commission recommends complete transition of devolution based on the new census (2027) figures. **(Para 10.23 & 11.13)**

Decision: The recommendation may be accepted.

39.SFC VII recommends a thorough overhaul of urban governance in the state, which should cover not only the Municipalities and Municipal Corporations but also the Grama Panchayats encompassing census towns. Commission's suggestions regarding reforming governance would be included in the subsequent reports. **(Para 11.27)**

Decision: The recommendation may be accepted in principle, subject to acceptance of further recommendations in subsequent reports.

40. Commission recommends an enhancement in the honorarium of elected representatives of Local Governments in the following pattern. The honorarium of the main office bearers may be doubled; that of Standing Committee Chairpersons enhanced by 75 per cent and Councilors/ Members enhanced by 50 percent. **(Para 11.28)**

Decision: The recommendation may be accepted in principle, subject to detailed deliberations with stakeholders and considering additional financial commitments in this regard.

41. LGs in the state are better endowed in terms of revenue entitlements compared to the state government. They also possess significant unused potential for tapping the capital market and the window of borrowings. They are unlikely to be plagued by severe resource constraints if revenue potential is efficiently used. But, if past experience is an indication, they are likely to suffer from inadequate administrative, technological and management capabilities. It is important to think of filling this widening gap in the system. We have five distinct ways out to suggest. **(Para 10.3)**

Decision: Recommendation may be accepted in principle. Further guidelines and orders may be issued subject to detailed deliberations with stakeholders.

42. First one is that of the state government departments playing a proactive role. They can offer consultancy and technical support to the LGs in their respective areas of competency. They can also design projects in which local governments are invited to participate. There are some projects already in existence such as LIFE Mission housing program. A note of caution may be added here. Participation in such projects designed from above should be voluntary and left completely to the choice of the local government. All projects designed by the centre or the state might not be equally needed or preferred everywhere. The present practice of mandating participation has affected the space for autonomous Decision making significantly. What is needed is a healthy competition among departments to get maximum LGs to participate in their programs without any compulsion whatsoever. Each department should have a shelf of such projects seeking participation from below, besides offering consultancy services in their respective areas of competency. **(Para 10.4)**

Decision: Recommendation may be accepted in principle. Further guidelines and orders may be issued subject to detailed deliberations with stakeholders.

43. The second way out to recommend is to encourage academy- local government-local economy interaction. In view of the rapid progress in science and technology there should be concerted effort to improve knowledge and technology content of local development projects and plans. Academic institutions and the academic community in general and other knowledgeable people may be encouraged to participate in designing local development projects. Such cooperation would benefit the academic institutions as well. As of now there is no institutional arrangement to facilitate such academy-local government- local economy interaction. In our opinion the District Planning Committees (DPCs), assisted by the DPC secretariat can fill the identified institutional gap. DPC can develop District Resource Centres by nominating members from the local knowledge community. They can also bring in local economy leaders representing farming, industry etc. DPC can also arrange consultancy services involving academic institutions to help LGs in solving their development problems. The LGs may also be allowed permission to pay service charges to academic institutions which offer such services. In order to facilitate the District Resource Centres, we recommend an allocation of **10 crore** each to the DPCs in the state. The amount allocated can be used to develop common facility centres, to initiate design and pilot innovative projects, offer incentive fund to the academic institutions for coming up with model extension programs, etc. The State Level Coordination Committee may be entrusted to prepare the guidelines for the DRCs and the use of the outlay recommended. **(Para 10.5 & 11.78)**

Decision: May be deferred and reviewed in the alteration budget 2026-27, if required

44. The third way out is related to gaining scale economies. Local governments suffer from an atomization syndrome because they tend to take up annualized, ward based, micro or what may be referred to as atomized projects that lack scale advantage. In sectors/activities involving market exposure and competition scale economies do matter. For instance, scale may not be too decisive in the case of farming. But value addition and marketing are scale sensitive. Therefore, there should be mechanisms which can save petty commodity producers of primary or manufactured products from scale disadvantage they encounter. For instance, aggregation of fresh vegetables and other small farm products and their marketing, home delivery, warehousing, value addition, etc., pose big dilemmas in the sectors concerned. Interventions to solve the problem may require sufficiently large endeavors which can reap scale advantages. Vertical and horizontal cooperation among governments can offer a way out. **(Para 10.6)**

Decision: Recommendation may be accepted in principle. Further guidelines and orders may be issued subject to detailed deliberations with stakeholders.

45. The fourth way out suggested is institutional innovation. It is suggested as a solution to the poor track record of continuity of local government projects, which is true even in the case of projects which are considered as model projects. Most projects are dependent on allocation in the annual plans. Change in leadership or shift in priorities result in termination of programs. One solution to the problem is institutional innovation. The local governments may have to be encouraged to establish institutions which enjoy relative autonomy from the parent local government. Institutional vehicles such as cooperative societies, charitable societies, producer companies, section 8 companies, public limited companies, etc., may have to be more widely experimented. The Local Self Government Department may issue guidelines regarding the role that local governments can play in such institutions including sharing of ownership. The state government can also initiate arrangements to offer initial capital contribution for such special purpose vehicles. **(Para 10.7)**

Decision: Recommendation may be accepted in principle. Further guidelines and orders may be issued subject to detailed deliberations with stakeholders.

46. The fifth point is related to administrative reforms which should cover Municipalities, City Corporations and Census Towns located within rural local governments. A complete overhaul of the administrative machinery is required. However, it is important to design the reforms in advance in detail. The approach should not be biased in favor of inflating the size of the bureaucracy. There is an urgent need to improve human resources. But the idea should not be to have an in-house bureaucracy for doing everything in the local government office. What is required is to have a core group of professionals who can get things done inside as well as by hiring competent individuals/agencies. Obviously, every municipality need not have permanent employees in every line of expertise. Nevertheless, SFC VII has recommended (Chapter IX) an increase in the GPF to accommodate possible rise in administrative expenses. The anticipated rise in OSR would also help meet the additional administrative expenditure. The government may also consider converting more Grama Panchayats with urban characteristics as municipalities in view of possible pro-urban shift in the policy of the union government. The UFC XVI is also anticipated to announce policies favoring statutory urban areas. **(Para 10.8)**

Decision: Recommendation may be accepted in principle. Further guidelines and orders may be issued subject to detailed deliberations with stakeholders.

47. A closely related critical dimension of local governance is that of the failure to keep up with the process of technological change. The knowledge/technology content of all possible activities of life are deepening quite dramatically over time. It poses a major challenge for the governments to constantly adapt and improve the mechanisms of governance. The LGs should also be able to improve the knowledge/technology content of the development projects they are required to formulate and implement. The governments can also encourage non-government actors to build technological capabilities. Ideally, different tiers of government should together help the state achieve the goal of transitioning into a knowledge economy/society. **(Para 10.14)**

Decision: Recommendation may be accepted in principle. Further guidelines and orders may be issued subject to detailed deliberations with stakeholders.

48. We recommend establishment of a Co-ordination and Integration Fund of **Rs.300 crore** at the disposal of the State Level Coordination Committee to initiate different coordination and integration activities. This will be an allocation from the development fund. The amount may be replenished every year. After reviewing its utility, the amount shall also be enhanced in later years of the SFC VII period. We also recommend that a supplementary allocation be made in the state government plan for the Coordination Fund. The fund can be used to encourage academy-local governments-local economy interaction initiatives at the state level. It can be used to encourage universities and apex academic institutions to design extension programmes that reach the LGs and help solve development problems. The Coordination Fund can also be used to announce a competition programme for awarding best extension programmes. We recommend that the state government institute such an award of the value of at least Rs.1 crore on the occasion of the thirtieth anniversary of the People's Campaign in Kerala. The Coordination Fund can also be used to help local governments to get projects designed by competent agencies where such support is required. The fund can also be used to partake in the financing of creation of common facilities catering a group of local governments. It can also be used to help institutional innovation mentioned in paragraph 10.7. For instance, it can be used for providing seed capital for special purpose vehicles. The guidelines for use of the Coordination Fund can be formulated by the State Level Coordination Committee. **(Para 10.15, 11.76 & 11.77)**

Decision: May be deferred and reviewed in the alteration budget 2026-27, if required.

49.SFC VII recommends continuation of the practice of defining the size of the development fund as a proportion of the state plan. Considering the growing gap between gross and net SOTR, the SFC VII recommends that 29 per cent of the state plan be devolved to the LGs in the year 2026-27 without counting the Kerala Solid Waste Management Project (KSWMP) outlay. The KSWMP outlay is project specific and therefore not fungible to be evenly disbursed across LGs. We endorse the suggestion of the SFC VI to raise the Development Fund by 0.5 per cent points of the state plan every year until it reaches 30 per cent of the annual plan of the state government. Once the 30% threshold is attained, it may be maintained at that level for the remaining years of the award period. **(Para 10.16 & 11.14)**

Decision: 28.5 percent may be recommended for 2026-27 and may be reviewed

in the alteration budget 2026-27, if required.

50. Coming to local governments it is important to minimize the impact of the declining plan size. Considering the uncertainties regarding the state plan size, the SFC VII is in favor of recommending a floor level for plan devolution in terms of SOTR. It is recommended that the Development Fund should be equal to or above 11 per cent of the Net SOTR (t − 2). This is a floor level and as such purposely kept lower than the lowest level announced in the state budgets in the recent past. We also endorse the position taken by the previous commissions that local governments should be given immunity from intra-year plan cuts announced by the state government. **(Para 10.17 & 11.16)**

Decision: Recommendation may be accepted in principle.

51. Regarding the question of treating UFC grants as an addition to state level devolution, The UFC grants shall be treated as Development Fund, but such grants should be transferred as soon as they are received through Public Financial Management System (PFMS) or equivalent method to the designated bank account of local governments, as is mandatory according to the recommendations of the UFC. The UFC grants would be non-lapsable and the local governments would prepare a plan of action out of their plan and budget and maintain separate accounts on their utilization. The UFC grants would be treated as non-lapsable unless otherwise specified by the UFC. Our position on UFC grants are subject to revision pending the UFC XVI report. Given the terms of reference of the SFC we are supposed to come up with detailed recommendations for ensuring efficient utilization of the UFC grants which we would take up in subsequent reports. **(Para 10.19 & 11.21)**

Decision: Recommendation may be accepted.

52. Inter-se allocation of UFC grants will depend on the recommendations of the UFC. If funds are fungible, it would be possible to distribute the UFC grant according to the devolution formula prescribed by the SFC VII for distribution of development fund. If UFC funds are not fungible, SFC VII would suggest a formula that is in conformity with the UFC norms, but also suit the state's requirements. **(Para 10.20 & 11.22)**

Decision: Recommendation may be accepted.

53. Devolution of General Sector Fund - The Commission recommends that the General Sector fund which includes primarily the normal share, be initially divided among Rural Local Governments, Municipalities, and Municipal Corporations based on ratio of the population figures from the 2011 Census re-organized by the Delimitation Commission 2024; that is in the ratio 77.24:13.44:9.32. The difference proposed is to use total population, notably not the non-SC and ST population. **(Para 10.22 & 11.55)**

Decision: Recommendation may be accepted.

54. Tier - wise Distribution of General Sector Funds - Historically, the General Sector Development Fund has been allocated among GPs, BPs, and DPs in the ratio of 70:15:15. it is recommended continuation of the same pattern. The rural portion of the General Sector Development Fund may continue to be distributed in the same ratio of 70:15:15 among Grama Panchayats, Block Panchayats, and District Panchayats. **(Para 10.24 & 11.56)**

Decision: Recommendation may be accepted.

55. Inter-se Distribution Formula of General Sector Funds – below Table presents a summary picture of the criteria for horizontal devolution. We recommend the use of aggregate population. The area criterion conventionally used is retained, but forest area is included only up to a maximum of one-fourth of its extent. **(Para 10.25,10.26,10.27,10.28,10.29,10.30,11.57,11.58,11.59,11.60,11.61 & 11.62)**

Sl. No.	Indicator	GP	BP	DP	Municipality	Municipal Corporation
1	Population	60	65	65	60	65
2	Area	10	15	15	10	–
3	Density	15	–	–	15	15
4	Aged Population	10	15	15	10	15
5	Environmental Vulnerability	5	5	5	5	5
	Total	**100**	**100**	**100**	**100**	**100**

Decision: Recommendation may be accepted.

56. It is recommended creating a Local Government Environment Fund (LGEF) of Rs.**100 crore** which would be replenished every year until 2030-31. The Fund may be managed by the principal director of the local self-government department under the guidance of the State Level Coordination Committee. The local self-government department can involve local governments, Department of

Environment, SDMA and other related agencies in designing appropriate intervention strategies. The LGs receiving funds on account of environmental vulnerability may be encouraged to use such resources for implementing jointly conceived, funded and designed projects. **(Para 10.30 & 11.63)**

Decision: May be deferred and reviewed in the alteration budget 2026-27, if required.

57. With respect to apportioning of the SCSP between local governments and the SC development department, it would be ideal to suitably increase the portion of the fund retained by the department to implement state wide programs, especially those which can address the second-generation developmental issues. In the meeting conducted by the SFC VII with representatives of SC organizations, several participants raised the demand for increasing the departmental share of funds earmarked for SC development. The Commission has decided to recommend continuation of the existing pattern in 2026-27. The decision may be reviewed for the rest of the period after considering pros and cons in more detail. **(Para 10.38 & 11.67)**

Decision: Recommendation may be accepted.

58. Tier Wise Distribution of SCSP Fund - SCSP funds are distributed according to the SC population in 2011 census. The fund is divided between RLGs, Municipalities and corporations in the ratio 83.25:10.25:6.50. The share of RLGs is divided among GPs, BPs, and DPs in the ratio 60:20:20. **(Para 10.39 & 11.68)**

Decision: Recommendation may be accepted.

59. Inter-Se Distribution of SCSP Fund - The SCSP Fund may be distributed on the basis of population and the deprivation index (see table), assigning weightage in the ratio of 80:20. The deprivation index is calculated using the methodology suggested by SFC VI by giving equal weightage to the following criteria (based on the SC Survey 2011) **(Para 10.40 & 11.69).**

1. Landless and House-less Households
2. Housing status measured by proportion of dilapidated houses and single room houses
3. Houses without electricity
4. Unemployment of population
5. Population with education below 10th standard
6. Population in habitats

Sl.No	Indicator	GP	BP	DP	Municipality	Municipal Corporation
1	Population	80	80	80	80	80
2	Index of Deprivation	20	20	20	20	20
	Total	100	100	100	100	100

Decision: Recommendation may be accepted.

60. **Tier Wise Distribution of Tribal Sub Plan - TSP** funds are distributed according to the ST population in 2011 census. The fund is divided among RLGs, Municipalities and Corporations in the ratio 91.96:6.08:1.96. The share to rural local governments is divided among GPs, BPs and DPs in the ratio 60:20:20. **(Para 10.42 & 11.70)**

Decision: Recommendation may be accepted.

61. **Inter-Se Distribution of Tribal Sub Plan -** TSP Fund may be distributed on the basis of population and the deprivation index, assigning weightage in the ratio of 80:20. The deprivation index is calculated using the variables;

    1. Landless and houseless households
    2. Housing status-dilapidated houses
    3. Houses without electricity
    4. Population with education below Std. X

Decision: Recommendation may be accepted.

62. The weightage given to the deprivation index is reduced to 20 per cent as in the case of SCSP. **(Para 10.43 & 11.71)**

SL.No	Indicator	GP	BP	DP	Municipality	Municipal Corporation
1	Population	80	80	80	80	80
2	Index of Deprivation	20	20	20	20	20
	Total	100	100	100	100	100

Decision: Recommendation may be accepted.

63. There is a case for a rethink in the approach towards scheduled caste and scheduled tribes' development. The focus should shift from the first-generation problems to the question of upward mobility. The regions which had solved the first-generation issues such as sanitation, housing, drinking water, electricity connection, etc.; should be able to focus on imparting required capabilities to ensure upward mobility of the community members. Those who have addressed the primary problems should be encouraged to move on to tackle issues such as skill development, employment, entrepreneurship, access to capital, building social capital, etc. Each local government can divide their resources between competing demands depending on their relative importance in the region. Denying funds to those who have addressed the first-generation problems in our opinion might adversely affect the endeavor to gain upward mobility. It is in this context that we recommend that the weightage given to the deprivation index shall be brought down from 40 to 20 per cent in the cases of SCSP and TSP. In fact, any green shoot of upward mobility should be seen as precious to be protected and supported. **(Para 10.41 & 11.72)**

Decision: Recommendation may be accepted.

64. Special Assistance for Vulnerable SC communities - the SFC VII recommend that 2.9% of the total SCSP fund, corresponding to the proportion of the vulnerable population within the total SC population from the rural share of SCSP shall be devolved to District Panchayats (DPs) for implementing targeted plans for their welfare and development. The plans supported by this fund should focus exclusively on vulnerable communities. The Commission further emphasizes that, in addition to this special assistance, these communities should continue to receive their due share from the remaining portion of the SCSP and should not be excluded from any other benefits under the SCSP. **(Para 10.46 & 11.73)**

Decision: Recommendation may be accepted.

65. Special Assistance for Particularly Vulnerable Tribal Groups (PVTGs) - The tribal communities such as Kadar, Kattunaikkan, Koraga, Kurumba/ Kurumbar, and Cholanaikan are identified as Particularly Vulnerable Tribal Groups (PVTGs) which require special support and focused attention. Accordingly, 6.4% of the total TSP fund, corresponding to the proportion of the PVTG population within the total tribal population from the rural share of the TSP shall be devolved to District Panchayats (DPs) for implementing targeted programs for their upliftment. The fund shall be used exclusively for initiatives benefiting PVTGs. The Commission also emphasizes that, notwithstanding this special assistance, these communities should not be excluded from receiving their due share from the remaining portion of the TSP. They should be treated as equally eligible beneficiaries. **(Para 10.47 & 11.74)**

Decision: Recommendation may be accepted.

66. As per the First Report of the SFC VI, a local government (LG) is required to have a minimum Scheduled Tribe (ST) population of 50 persons, based on the 2011 Census, to qualify for direct Tribal Sub-Plan (TSP) fund devolution. The SFC VII recommends that the condition of minimum number to qualify for TSP shall be continued. Several LGs have represented that their current ST population exceeds 50, although they did not meet this threshold as per the 2011 Census. In such cases Commission recommends that TSP funds may be devolved on the basis of a certification from the Director, Scheduled Tribes Development Department (STDD), confirming that the LG has an ST population of 50 or more. **(Para 10.48 & 10.49)**

Decision: Recommendation may be accepted.

67. Reallocation of Funds/Creation of a Common Pool - The present TSP devolution relies on the 2011 Census population figures. Since then, demographic shifts, especially in urban areas have led to situations where some local Governments (LGs) have no ST population now but continue to receive TSP allocations. As a result, these funds often remain unutilized and are eventually reverted to the state exchequer. To ensure better targeting, the Commission recommends creation of a Common Pool. A district-level common pool may be constituted to optimize the use of TSP resources. Excess funds from local governments with very small ST populations, where meaningful utilization is not feasible may be transferred to this pool with the approval of the DPC. The DPC should assess district-level TSP needs and recommend reallocation of the unspent funds to LGs with substantial ST populations and genuine requirements. The Government should implement such reallocations promptly based on DPC recommendations. This approach will ensure that TSP resources are utilized effectively, and reach the intended beneficiaries, and avoid idle or misallocated funds. **(Para 10.50 & 10.51)**

Decision: Recommendation may be accepted in principle. Detailed guidelines may be issued subject to deliberations with stakeholders.

68. Currently, shortfalls in SCSP and TSP expenditure are offset by diverting resources from the following year's Development Fund (General Sector). Many LGs have noted that this adversely affects overall development, particularly when shortfalls arise due to circumstances beyond their control. However, the" sacrosanct practice" of making good any shortfall in SCSP/TSP expenditure from the normal share of the General Sector Development Fund in the succeeding year, must be continued. But, the fact that the size of the normal share has been getting cut on account of many reasons should also be kept in mind while taking a decision. Transferring the funds which the local government is convinced cannot be spent to a common pool at the disposal of the DPC or the SC/ST development departments shall be considered as a solution to the problem. If such transfer can be done with the approval of the DPC sufficiently early in the year such amount can be exempted from the condition of compensation. **(Para 10.52)**

Decision: Recommendation may be accepted.

69. In this report, Commission has identified some general problems adversely affecting the performance of the local governments and hence the decentralization experiment in Kerala. A leading issue is that of atomization of LG interventions that prevent aggregation of their power to critical minimum levels to successfully address the development problems. Commission would like to refer to it as an aggregation dilemma of decentralization. What is required is a mechanism to reap advantages of both worlds; of decentralization as well as aggregation. Such an approach is indispensable in the case of activities involving scale economies and rapid technological change. The advantage of decentralization will be ensured by the local governments. Advantage of aggregation can be ensured by larger projects within individual LGs on the one hand and horizontal and vertical integration among governments. The state government departments can play a role in this by initiating programmes involving state government and the local governments. However, it is not advisable to impose such programmes on LGs by making participation mandatory. What is desirable is to have healthy competition among departments to convince and get participation from maximum number of LGs. It will help the LGs to choose what is required the most in their locale. **(Para 11.75)**

Decision: Recommendation may be accepted.

70. A closely related critical dimension of local governance is that of the failure to keep up with the process of technological change. The knowledge/ technology content of all possible activities of life are deepening quite dramatically over time. It poses a major challenge for the governments to constantly adapt and improve the mechanisms of governance. The local governments should also be able to improve the knowledge/technology content of the development projects they are required to formulate and implement. The governments can also encourage non-government actors to build technological capabilities. Ideally, different tiers of government should together help the state achieve the goal of transitioning into a knowledge economy/society. (**Para 11.10**)

Decision: Recommendation may be accepted.

71. The allocations recommended for Local Government Environment Fund (Rs.100 crore) Coordination and Integration Fund (Rs.300 crore) and District Resource Centres (Rs.140 crores) are meant to improve the quality and effectiveness of projects undertaken by local governments. As such it is meant to benefit all categories of projects. Therefore, funds for the additional allocations suggested here may be taken from the Development Fund; reducing General Sector Fund, SCSP and TSP proportionally according to population share. **(Para 11.79)**

Decision: May be deferred and reviewed in the alteration budget 2026-27, if required.

72. The Constitution suggests preparation of District Plans as a solution for integration/coordination problems. Kerala is the first state to prepare district plans for all districts in the state. The District plan documents suggested possible coordination/integration programmes to be undertaken. But they could not be implemented because of confusion regarding responsibilities and funding. The State Level Coordination Committee for Decentralization and DPCs may find ways of addressing the integration challenges. The Fund allocated to the Coordination Committee and the District Resource Centre can be used for the purpose of furthering integration. **(Para 11.80)**

Decision: May be deferred and reviewed in the alteration budget 2026-27, if required.