Overview

1. Overview of Government Companies and Statutory Corporations

Audit of Government Companies is governed by Section 619 of the Companies Act, 1956. The accounts of Government Companies are audited by Statutory Auditors appointed by the CAG. These accounts are also subject to supplementary audit conducted by the CAG. Audit of Statutory Corporations is governed by their respective legislations. As on 31 March 2011, the State of Karnataka had 75 working Public Sector Undertakings - PSUs (69 Companies and 6 Statutory Corporations) and 14 non-working PSUs (all Companies), which employed 1.82 lakh employees. The State PSUs registered a turnover of ₹ 41,493.51 crore for 2010-11 as per their latest finalised accounts. This turnover was equal to 10.89 per cent of State Gross Domestic Product indicating the important role played by the PSUs in the economy. The PSUs had accumulated profit of ₹1,007.36 crore as per their latest finalised accounts.

Investments in PSUs

As on 31 March 2011, the investment (Capital and long term loans) in 89 PSUs was ₹ 58,137.26 crore. Infrastructure Sector accounted for about 54.30 per cent of total investment and Power Sector about 32.09 per cent in 2010-11. The Government contributed ₹ 8,880.72 crore towards equity, loans and grants / subsidies in 2010-11.

Performance of PSUs

The working State PSUs earned a profit of ₹1,632.42 crore in the aggregate for 2010-11 as per their latest finalised accounts. The major contributors to profit were Karnataka Power Corporation Limited (₹686.19 crore), Mysore Minerals Limited (₹422.87 crore), and The Hutti Gold Mines Company Limited (₹124.71 crore). Heavy losses were incurred by The Mysore Paper Mills Limited (₹ 84.78 crore), The Mysore Sugar Company Limited (₹ 70.21 crore) and Hubli Electricity Supply Company Limited (₹64.71 crore).

Audit noticed various deficiencies in the functioning of PSUs. A review of three years' Audit Reports of CAG shows that the PSUs' losses of ₹ 1,320.47 crore and infructuous investments of ₹ 333.27 crore were controllable with better management. Thus, there was tremendous scope to improve the functioning and enhance the profits. The PSUs can discharge their role efficiently only if they are financially self-reliant. There is a need for greater professionalism and accountability in the functioning of PSUs.

Quality of accounts

The quality of accounts of working companies needs improvement. During the year, out of 60 accounts finalised, the Statutory Auditors had given unqualified reports for 12 accounts, qualified reports for 45 accounts and adverse reports (which meant that accounts did not reflect a true and fair position) for 3 accounts. There were 93 instances of non-compliance with Accounting Standards in 29 Companies during the year. Reports of Statutory Auditors on internal control of the Companies indicated several weak areas.

Arrears in accounts and winding up

Twenty four working PSUs had arrears of twenty five accounts as of September 2011. The arrears pertain only to the years 2009-10 and 2010-11. There were 14 non-working PSUs including seven under liquidation. The Government may consider winding up these non-working Companies.

2. Performance Reviews relating to Government Companies

The Report includes Performance Reviews relating to **Power Distribution Utilities of Karnataka** and **Construction activities in Karnataka Rural Infrastructure Development Limited**. Executive summary of audit findings is given below:

➢ Performance of Power Distribution Utilities of Karnataka.

The distribution system of the power sector constitutes the link between the generation and the consumer. The efficiency of power sector is judged on the basis of performance of distribution network. The reforms in power distribution sector, spelt out in the National Electricity Plan (NEP), focus on system up-gradation, controlling and reduction of Transmission & Distribution (T & D) losses, measures to reduce power thefts and making the sector commercially viable; besides, on framing strategies to generate more financing resources.

Power sector reforms in Karnataka were initiated with the enactment of the Karnataka Electricity Reforms Act in 1999. The regulatory body, Karnataka Electricity Regulatory Commission (KERC) was established in November 1999.

Four Electricity Supply Companies (ESCOMs), viz., Bangalore Electricity Supply Company Limited (BESCOM), Mangalore Electricity Supply Company Limited (MESCOM), Hubli Electricity Supply Company Limited (HESCOM), and Gulbarga Electricity Supply Company Limited (GESCOM) were formed in June 2002. Bifurcating MESCOM, Chamundeshwari Electricity Supply Corporation Limited (CESC) was formed (April 2005). The five ESCOMs, together with a small co-operative society (HRECS), are entrusted with the distribution function in the State.

Audit objectives

The performance review of the working of ESCOMs was conducted to ascertain whether the ESCOMs were able to adhere to the aims and objectives stated in the National Electricity Plan / National Electricity Policy. The objectives of the performance review were to assess whether the network planning and execution was adequate and effective. The implementation of the Central and State schemes, additions to distribution network, operational, billing and collection efficiency, energy conservation and monitoring were also assessed.

Audit findings

Distribution network planning

The transformer capacity has to be enough to meet the connected load. The ideal ratio between connected load and transformer capacity is 1:1. Looking at the trend in growth of connected load during the period 2007-11, we observed that transformer capacity in BESCOM, GESCOM, HESCOM and MESCOM would not meet the ideal ratio by 2012. While the situation in CESC is promising, the situation in HESCOM could be serious, as the addition to connected load was almost twice the increase in transformation capacity during 2007-11. The objective of having a reliable distribution network to provide quality power supply for all by 2012, as per the prime objective of the National Electricity Policy, is doubtful.

Rural electrification

Government of India (GoI) had launched (April 2005) 'Rajiv Gandhi Grameen Vidyutikaran Yojna (RGGVY)' with the goal of electrifying all un-electrified villages and providing access to electricity to all households in five years.

Against 28,191 villages selected for intensive electrification in the State, 23,607 villages were electrified as at March 2011. Further, against the targeted electrification of 8.78 lakh households Below Poverty Line (BPL) and 10.38 lakh other than BPL households, ESCOMs electrified 7.86 lakh BPL households (89.52 per cent) and 1.30 lakh other than BPL households (12.53 per cent) respectively up to the end of March 2011.

Restructured Accelerated Power Development Reforms Programme (R-APDRP)

GoI had launched (July 2008) R-APDRP with a view to achieve loss reduction through establishment of reliable and automated systems for collection of accurate base line data and adoption of Information Technology in the areas of energy accounting, besides distribution strengthening projects.

GoI provided loan for establishment of IT enabled system, which was convertible into grant on completion of the system. The pilot projects were programmed to be completed by December 2010. The implementation of the scheme in 100 identified towns also was lined up for completion by February 2012. The agency appointed for implementation of IT enabled system had not yet (September 2011) completed even the pilot projects and, hence the chances of conversion of loan of ₹391.71 crore into grant were remote.

Transmission, Distribution and Aggregate Technical and Commercial (AT&C) losses

The percentage of transmission loss was higher than that prescribed by KERC in all the years (except in MESCOM) leading to loss of revenue of ₹1,404.27 crore.

Declining trend in distribution losses was observed and the overall percentage of distribution losses decreased from 25.50 per cent in 2006-07 to 16.54 per cent in 2010-11.

As at end of 2010-11, BESCOM and MESCOM were able to bring down the AT&C losses below the 15 per cent norm envisaged.

KERC allowed an incentive of ₹ 64.23 crore and ₹9.77 crore to BESCOM and MESCOM for 2008-09 for reduction in distribution losses. Similarly, incentive of ₹24.72 crore and ₹10.17 crore was allowed for 2009-10 to CESC and HESCOM respectively. KERC imposed penalty of ₹3.82 crore on HESCOM for 2008-09 and ₹8.75 crore on GESCOM for 2009-10 for exceeding the upper limits of distribution losses.

The percentage of failures of distribution transformers was higher than the norms prescribed by KERC in CESC and GESCOM.

Against the norm of 1:1 for HT: LT ratio prescribed by KERC, the actual ratio ranged between 0.43:1 and 0.47:1.

Metering

ESCOMs (except MESCOM) could not achieve any significant progress in metering of IP sets. Progress with regard to metering of BJ/KJ installations in HESCOM and GESCOM was much below par.

Purchase of power

Power requirement of the State is determined by the Energy Department on the basis of the requirements of ESCOMs subject to approval by KERC. On behalf of the ESCOMs, PCKL arranges for short-term power purchases, either through energy exchange or through bidding process. The power so procured is distributed amongst ESCOMs as per the share allocated by the State Government.

Reduction in availability of long-term power was observed in 2010-11 as compared to 2006-07. The reasons attributed were problems in Raichur Thermal Power Station and Bellary Thermal Power Station. This forced the ESCOMs to resort to short term purchases and drawal of power by paying Unscheduled Interchange charges. During 2008-11 ESCOMs incurred extra expenditure of ₹793.93 crore on energy purchases at UI charges and ₹ 3,058.93 crore on short term energy purchases.

Cross subsidy and subsidy support

The level of cross subsidy was beyond the limits of plus or minus 20 per cent of the ACOS prescribed in the National Tariff Policy in agricultural, domestic, commercial establishments, motive power and temporary connection category consumers.

The Government reimbursed electricity charges of KJ/BJ consumers/IP set (up to 10 HP) consumers. The re-imbursement received on these counts was ₹87.27 crore in 2006-07, which increased to ₹3,819.66 crore in 2010-11.

Despite cross subsidization and re-imbursement by the Government, the cost of supply was not fully recovered by the ESCOMs. The State Government bridged the difference by way of further financial support, known as gap subsidy. The gap subsidy released during 2006-07 was ₹1,696.38 crore and during 2010-11 was ₹433 crore.

The ESCOMs would have suffered heavy losses in all the years without subsidy support. The profits in 2006-07 and 2007-08 were because of gap subsidy. Despite substantial increase in subsidy the ESCOMs incurred losses in 2008-09 to 2010-11, mainly due to purchase of energy at high cost.

Inspite of the objective of releasing scarce Government resources to other areas of greater priority envisioned in the Reform Policy (1997) in power sector of the State Government, the Government subsidy showed no let up; in fact, it has been increasing over the years from 2006-07 to 2010-11.

Tariff filing

ESCOMs are required to file expected revenue from charges with KERC each year 120 days before the commencement of the subsequent financial year. ESCOMs filed tariff review petitions belatedly in the years 2009-10 and 2010-11. This had resulted in delayed implementation of tariff orders. Consequently, they could not generate revenue to the tune of ₹941.08 crore.

Financial management

KERC disallowed an expenditure of ₹534.05 crore claimed by ESCOMs towards interest on belated payment of energy bills stating that interest on working capital was allowed separately. KERC also disallowed operation and maintenance charges incurred beyond the norm and excess interest on security deposits, which amounted to ₹308.79 crore.

The electricity tax collected from consumers is required to be remitted to the State Government. The ESCOMs were not regular in payment of electricity tax for which a total interest/penalty of ₹27.21 crore was levied on the ESCOMs.

The dues from consumers increased from ₹3,998.48 crore in 2006-07 to ₹6,378.20 crore in 2010-11. The arrears in terms of months' demand increased year after year. At the end of March 2011, the outstanding amount, pending collection represented 2.81 months' revenue demand in MESCOM, while it was 8.98 months' revenue demand in GESCOM, indicating poor collection efficiency. Further, an amount of ₹217.61 crore was due from permanently disconnected installations.

Irregularities in execution of improvement and extension works were noticed in Kolar and Indi (Bijapur) divisions.

Conclusion and recommendations

The generation of power in the State is insufficient to meet the demand. Absence of committed long-term power supply and increased demand had forced the ESCOMs to resort to short-term power purchases at high cost.

The trend in additions to connected load and transformation capacity during 2007-11 indicate that the distribution network may not be adequate to provide 'power for all by 2012'.

Huge receivables forced the ESCOMs to resort to borrowings.

Aggregate technical and commercial losses and failure of transformers showed a decreasing trend during the last five years.

Energy conservation measures are presently in a nascent stage and need thrust.

The ESCOMs do not have a proper MIS system to generate and supply various information required for efficient functioning of the organisation.

The review contains the following recommendations:

- ***The State has to evolve an integrated energy policy to attain the objective of power for all and also to improve the operational/ financial performance of the ESCOMs.***
- ***The distribution network/infrastructural facilities need to be augmented.***
- ***Providing quality power supply in rural areas and regularisation of unauthorised IP sets need to be accorded priority.***
- ***The aggregate technical and commercial losses have to be reduced further by undertaking energy audit at distribution transformer level, metering of distribution transformers and installations, preventing thefts and improving the billing and collection.***
- ***Efforts need to be made to adhere to the norms and directions prescribed by KERC of failure of transformers and adequacy of HT:LT ratio.***
- ***Efforts should be made to bring down cross subsidy on the lines suggested in the National Electricity Policy.***
- ***Allocation of scarce budgetary resources to meet the gap between revenue and expenditure of the ESCOMs needs a renewed strategy.***
- ***Effective action needs to be taken to realise outstanding dues to improve the financial position and reduce dependence on Government support.***
- ***ESCOMs should give priority to implementation of demand side management and energy conservation measures.***

(Chapter 2.1)

➢ Construction activities in Karnataka Rural Infrastructure Development Limited.

The Karnataka Land Army Corporation, renamed (August 2009) as Karnataka Rural Infrastructure Development Limited, was incorporated (August 1974) as a wholly owned Government Company with the main objectives of undertaking and carrying out all types of rural development works either entrusted to it by Government Departments, Local Bodies, Undertakings, Institutions and individuals and/or obtained through tenders.

The works executed by the Company are broadly divided into directly entrusted works (Entrusted Works) and works obtained through participation in tenders (Tender Works). Over the years the works obtained through participation in tenders have declined steadily.

Audit objectives

The performance review on construction activities of the Company was carried out to assess whether reasonable care was taken in preparing the estimates; works were executed as per the schedules; the delays were analysed; procurement of materials was done economically and in accordance with the provisions of law; works were executed efficiently to achieve economy; the system for timely billing was followed and prompt realization was ensured and effective monitoring system and internal controls were in place.

Audit findings

Entrusted works

The Company failed to include its charges, taxes and labour cess in the estimates resulting in non-recovery of expenditure of ₹ 2.10 crore.

The BBMP Zone entrusted 125 works valued at ₹ 22.28 crore to sub-contractors in violation of Government orders. The sub-contractors were executing these works with their own funds. There were no mobilization advances, work codes and job work rates. The works were not accounted in the books of the Company. The expenditure incurred on these works was ₹ 20.23 crore.

Tender works

Out of 32 works valued at ₹ 55.27 crore, the Company suffered loss of ₹ 5.92 crore in 14 works. The loss was due to cost escalation, levy of liquidated damages and/or penalty and/or fine as a result of delay in completion and non-acceptance of quantities recorded in bills.

Pattern of income

Major part of the Company's profit was earned in the last three years from bank deposits and mutual funds (₹36 crore) and not from the core activities of construction (₹33 crore).

Flow of funds

The Company received funds from Government departments and agencies without any mention or assignment of work orders, especially towards the end of every financial year. Between 2007-08 and 2010-11 the Company had received ₹ 43.90 crore without work orders for the same. Subsequently, the departments/agencies withdrew ₹38 crore without attributing reasons, after periods ranging from one to sixty months.

Billing

Submission of bills in 12 works for ₹ 4.43 crore was delayed for periods ranging between one and 48 months. In 39 works, realisation of bills amounting to ₹ 11.76 crore was delayed for periods ranging between one and 34 months.

The Urban Development Department, Government of Karnataka had directed (July 2007) the Commissioner, BBMP not to recover security deposit from the bills of the Company, as the works were awarded on entrustment basis. BBMP, however, recovered security deposits from bills of ₹ 4.20 crore, which were not refunded (September 2011). This included ₹1.83 crore outstanding for more than three years.

Miscellaneous

Government permitted (February 2010) claiming of reimbursement of Value Added Tax paid on construction materials used in building low cost houses under 'Aasare' scheme within 30th of the month following the purchases of materials. The Company preferred claims for ₹ 2.19 crore after the issue was raised by audit. The balance of ₹ 0.65 crore remained unclaimed.

As per Karnataka Value Added Tax (KVAT) Act, organizations are allowed to adopt either payment under composition or payment under full VAT. The Act allows payment on steel involved in execution of works contract at 4 per cent. The value of steel involved in execution of works was much less than the value considered for the payment of VAT. This had resulted in payment of lesser tax by ₹ 5.02 crore and had concomitant risks such as payment of penalty and interest.

Conclusion and recommendations

The Company has incurred significant losses in major works, as the planning for and estimates of works have been faulty, as all inputs and costs were not taken into account and there were inordinate delays in execution. Compliance with rules and regulations and budgetary control and monitoring system needs improvement.

The following recommendations are made:

- ***The Company has to streamline the works wing to ensure that all inputs and costs are considered, the works are completed within scheduled time, estimated costs are not exceeded and activities are monitored effectively;***
- ***The monetary advantages to the Company embedded in the SR should be retained;***
- ***The system of procurement of materials from unregistered dealers has to be streamlined and the provisions in the KTPP Act should be followed;***
- ***Billing should be done promptly;***
- ***The Company should stop the practice of accepting funds without work orders so as to prevent the Government departments in making use of this facility as a means to avoid lapsing of funds at the end of the year; and***
- ***Internal control system should be tightened and maintenance of records improved.***

(Chapter 2.2)

3. Transaction audit observations

The observations included in this Report highlight deficiencies in planning, investment and activities in the management of PSUs, which resulted in serious financial consequences. The observations are broadly of the following nature:

Imprudent planning, idle investment and improper decisions resulted in unfruitful expenditure of ₹8.71 crore in four cases.

(Paragraphs 3.3, 3.4, 3.8 and 3.9)

Failure to enforce the conditions in the agreement led to loss of revenue of ₹3.31 crore.

(Paragraph 3.2)

Violation of contractual obligations/undue favour to contractor resulted in extra expenditure of ₹7.87 crore in two cases.

(Paragraphs 3.1 and 3.6)

Improper decision to close the insurance cover prematurely resulted in avoidable financial burden of ₹1.24 crore on two transport corporations and their employees.

(Paragraph 3.7)

Lack of internal control on activities and procedure resulted in overpayment of ₹ 0.92 crore in one Company.

(Paragraph 3.5)

Gist of some of the important audit observations is given below:

- **Krishna Bhagya Jala Nigam Limited** awarded a work for ₹ 18.70 crore, at 41.55 *per cent* below the amount put to tender. KBJNL continued to entrust additional works at regular intervals to the same contractor thereby increasing the total value of works to ₹ 73.60 crore without observing the requirements of law and rules.

  (Paragraph 3.1)

- **Cauvery Neeravari Nigama Limited** entered into an agreement without fulfilling the conditions in the bidding document and failed to enforce the provisions in the agreement, which resulted in loss of revenue of ₹ 3.31 crore.

  (Paragraph 3.2)

- Acceptance of offer of premature closure of life insurance cover of Bajaj Allianz Life Insurance Company resulted in avoidable financial burden of ₹ 1.24 crore on two **State Transport Corporations** and their employees.

  (Paragraph 3.7)

- Payment of subsidy for supply of Solar Photovoltaic systems without proper procedures and controls resulted in overpayment of ₹ 0.92 crore in **Karnataka Renewable Energy Development Limited.**

  (Paragraph 3.5)

- The revival of Indian Made Liquor bottling unit failed due to improper decisions in **The Mysore Sugar Company Limited.**

  (Paragraph 3.4)