EXECUTIVE SUMMARY

Background

In Karnataka, fiscal reforms and consolidation were brought to the forefront with the State Government formulating the first Medium Term Fiscal Plan (MTFP) for the period 2000-05 based on broad parameters of fiscal correction laid down by the Eleventh Finance Commission (EFC). MTFP became a rolling annual document and the fiscal targets and policies set out in MTFP were dovetailed to the annual budgetary exercise to operationalise the restructuring plan. Karnataka was the first State to enact (September 2002) the Fiscal Responsibility Act (FRA) providing statutory backing to MTFP. The Act aims at ensuring fiscal stability and sustainability, enhance the scope for improving social and physical infrastructure and human development by achieving revenue surplus, reducing fiscal deficit, removing impediments to effective conduct of fiscal policy and prudent debt management through limits on borrowings, debt and deficits, greater transparency in fiscal operations by the use of medium-term fiscal framework.

The Report

Based on the audited accounts of the Government of Karnataka for the year ending March 2011, the report provides an analytical review of the annual accounts of the State Government. The financial performance of the State has been assessed based on the FRA, budget documents, Thirteenth Finance Commission Report (XIII FC) and other financial data obtained from various Government departments and organizations. The report is structured in three chapters.

Chapter 1 is based on the audit of Finance Accounts and makes an assessment of Government of Karnataka's fiscal position as at 31 March 2011. It, *inter-alia*, provides an insight into trends in committed expenditure, borrowing pattern besides, a brief account of Government of India funds transferred directly to the State implementing agencies through off-budget route.

Chapter 2 is based on the audit of Appropriation Accounts, gives description of appropriations and the manner in which the allocated resources were managed by the service delivery departments.

Chapter 3 is an inventory of Karnataka Government's compliance with various reporting requirements and financial rules.

The report also includes appendices of additional data collected from several sources in support of these findings. A glossary of selected terms has been given at the end of the Report.

Audit findings and recommendations

- **Fiscal position**

The state continued to maintain revenue surplus during 2006-11 and kept fiscal deficit relative to GSDP below the limit laid down under FRA as amended from time to time. The State which was on the road to recovery from the effects of economic slowdown in 2009-10, was expected to consolidate its position in the year 2010-11. During 2010-11, the State attained huge revenue surplus of ₹ 4,172 crore. This was on account of increase in revenue receipts by 18 *per cent* over previous year and increase in revenue expenditure by 14 *per cent*. Further, the compression of expenditure on account of delay in government sanctions, limiting transfers to fund accounts etc., also contributed to increase in revenue surplus.

For the first time, incremental non-debt receipts was higher than the incremental primary expenditure by ₹ 615 crore which could cover the incremental interest burden. The State Government lost debt relief amount of ₹ 358.33 crore for the year 2008-09 on account of actual ratio of fiscal deficit to GSDP being more than the budget estimates for that year.

- **State's own resources**

The ratio of the State's tax revenue to GSDP which had shown declining trend since 2006-07 revived itself and was 10.10 *per cent* during the year. Arrears of tax revenue amounted to ₹ 4,009 crore.

Ratio of non-tax revenue to GSDP continued its declining trend. Special emphasis needs to be given for mobilizing non-tax revenue in the coming years.

- **Revenue expenditure**

There was 16 and 13 *per cent* growth under social and economic services sectors of expenditure over the previous year, while the growth in general services was 10 *per cent*. The share of plan expenditure to total expenditure increased from 26 *per cent* in 2009-10 to 28 *per cent* in 2010-11. Fifty two *per cent* of revenue expenditure consisted of committed expenditure on salaries, pensions, interest payments and subsidies. Total subsidy of ₹ 6,303 crore was partial as it excluded implicit subsidy of around ₹ 2,280 crore during 2010-11. As per the recommendation of TFC, expenditure forming implicit subsidy may be brought out in Finance Accounts for transparency.

- **Quality of expenditure**

The share of capital expenditure to total expenditure during the current year (22 *per cent*) remained same as in the previous year. It included interest expenditure of ₹ 202 crore on off budget borrowings. Funds aggregating ₹ 1,203 crore were blocked in incomplete projects as at the end of 2010-11. The return from investment of ₹ 38,421 crore as of March 2011 in companies / corporations was negligible (₹ 43.47 crore). The investment included ₹ 20,085 crore (52 *per cent*) to companies/ corporations under perennial loss.

The State Government should also review the working of State public sector undertakings incurring huge losses and work out either a revival strategy or close down such units. The State Government should formulate guidelines for quick completion of incomplete projects and strictly monitor time and cost over runs with a view to take corrective action.

- **Oversight of funds transferred directly from the Union to the State implementing agencies**

The Central Government transferred a sizeable quantum of funds (₹ 7,342 crore during 2010-11) directly to the State implementing agencies for implementation of Central plan schemes. Funds flowing directly to the implementing agencies through off-budget route inhibit FRA requirements of transparency and therefore, escape accountability. There is no single agency monitoring its use and there is no readily available data on the amounts spent in any particular year on major flagship and other important schemes.

A system has to be put in place to ensure proper accounting of these funds and the updated information should be validated by the State Government.

- **Assets and Liabilities**

Reserve funds of the State viz., corpus fund of Consumer Welfare Fund, Guarantee Redemption Fund, etc were not created / revived. No rules have been framed regarding administration of Fiscal Management Fund.

Rules with regard to administration and investment pattern of various reserve funds require to be framed.

- **Debt sustainability**

The repayment obligation of the State would increase from 2012-13 due to huge market borrowings under debt swap scheme during 2002-03 and 2004-05. Further, repayment would increase enormously in 2017-18 onwards also, due to huge market borrowings in 2008-10.

The Government should consider reviving the sinking fund as it would help the State to meet the sudden increase in the amount of debt servicing from 2013 onwards.

- **Financial Management and Budgetary Control**

Against total provision of ₹ 85,193.90 crore during 2010-11, an expenditure of ₹ 72,915.19 crore was incurred under revenue/capital. This resulted in an unspent provision of ₹ 12,278.71 crore (14 *per cent*). An excess expenditure of ₹ 85.39 crore incurred against two grants during 2010-11 and ₹ 4,707.89 crore relating to the period 1989-90 to 2009-10 required regularisation under Article 205 of the Constitution. Expenditure aggregating ₹ 282.64 crore in 21 cases which should have been treated as 'New Service/New instrument of service' was incurred without the approval of the Legislature. While, supplementary provision of ₹ 333.28 crore in 31 cases was unnecessary, re-appropriation of funds in 60 cases was made injudiciously resulting in either un-utilised provision or excess over provision. In 24 grants, ₹ 6,188.83 crore was surrendered in the last two working days of the financial year. Contingency Fund drawals sanctioned in two cases aggregating to ₹ 2.66 crore was not drawn during the year 2010-11.

Budgetary control should be strengthened in all departments to avoid cases of provision remaining unutilized. The departmental budgets should be more realistic and cases of persistent non-utilisation of funds, excessive provision of funds should be avoided.

- **Financial Reporting**

The Departmental compliance towards disposal of cases of losses, misappropriations, etc. was deficient. Detailed bills against abstract bills were wanting since long and large sums of money were being retained in PD Accounts against the principle of Legislative financial control. Non-reconciliation of expenditure and receipts was to the extent of 14 *per cent* of total expenditure and two *per cent* of total receipts respectively. There were adverse balances under certain DDR heads which required remedial action for their clearance. Transparency in accounts is required to indicate important details like salary (PR Institutions), implicit subsidy etc. as recommended by the Finance Commission.

Departmental enquiries in all the cases of misappropriations, losses, defalcations, etc., should be expedited to bring the defaulters to book. For this purpose, the internal controls in various departments should be strengthened to prevent recurrence of such cases. Accounting reforms are required to capture data as recommended by the Finance Commission. Review of deposit accounts is required to be taken to weed out all in-operative / such operative heads which have outlived their utility. Review of suspense heads needs to be done to bring the transactions to the final heads in the year of accounts itself.