Chapter - II

Performance Audits of Government Companies

Chapter - II

2. Performance Audits relating to Government Companies

2.1 Performance Audit on the 'Construction of roads and bridges by Karnataka Road Development Corporation Limited'.

Executive Summary

The Company

The Company incorporated to construct, erect, build, re-model, repair, execute, develop, improve and maintain express routes, roads and bridges is fully owned by the Government.

Objectives of the Performance Audit

The objectives of the Performance Audit were to assess whether the conceptualization of projects for execution was done properly after adequate study; the process of acquisition of land was speedy; there was transparency in inviting tenders; the projects with private participation were undertaken after fair and objective assessment of the critical elements of financial viability; the projects were managed effectively to achieve the intended results; and the monitoring and controls were adequate and effective.

Audit findings

Brief outlines of our findings are as follows.

Targets and achievements

Major roads for a length of 404.67 Kms were targeted for completion during the five year period 2008-13. The Company had achieved only 86.47 Kms within the scheduled time. Similarly, the Company had completed only four of the nine major bridges as per the schedule. As regards the Projects proposed for implementation with private participation, only Wagdhari to Ribbanpally Road has since been completed (August 2012) and Dharwad-Alnavar-Ramnagar Road is facing the problem of forest clearance. And the Chikkanayakanahalli – Tiptur -Hassan Road was abandoned by the contractor and is now under litigation.

Roads and major bridges

Changes in designs, wrong assumptions, inept estimations and delayed executions

Design changes after award of contracts, wrong estimates and failure to initiate the process of land acquisition resulted in time and cost over run in many cases. Some of them are as follows.

- **In Mysore-Bantwal Road (Package B), the design was changed from two lane (7 metres) to intermediary lane (5.5 metres) and additional works were entrusted to the contractor after award of the contract. Source of material as mentioned in the DPR was not actually available.**
- **Works of Mysore-Bantwal Road (Package-C), approach road to Mangalore Airport and construction of grade separator at Harohalli, Bidadi were awarded without acquisition of land. These works were delayed. Outer Ring Road around Hassan town is still not completed (2013) even after 4 years.**
- **Wrong assumptions in the DPR of bridge on Sagar-Pattagoppa road led to increase in cost of the work by ₹ 6.59 crore and in delay of 3 ½ years.**

Phase bridges

Tendering and award of works

There were irregularities in calling tenders and award of works, instances of non-adherence to the terms of the contracts and reduction in scope of contracts.

Fixation of high pre-qualification criteria created entry barrier. Consequently, competition was curtailed in bidding of contracts. As a result only three contractors *viz.*, L&T Limited, Gammon India Limited

and Nagarjuna Construction Company Limited (NCCL) had qualified for the tenders in all the three phases.

Letters of Intent/Agreements, were issued/entered into without designs and drawings and Bill of Quantities. Payments were made based on certification, without check measurements by the Company in violation of the Government Order (January 2005).

Only 345 out of 496 bridges were completed in Phase II, III and IV within the stipulated contract period. Though the delay in construction of the balance bridges was attributable to contractors, the Company had not levied liquidated damages amounting to ₹ 13.26 crore.

Projects with private participation

Even though the GoK had announced the proposal of taking up the projects in the State budget for 2005-06 with private participation, the actual implementation of the projects took almost five years.

The Company had proposed to float a Special Purpose Vehicle (SPV) for executing the projects on BOT/BOOT basis. The SPV was to raise resources through commercial borrowings and the State Government was to fund viability gap. The SPV was to collect toll as well. The Government, however, issued order for construction of the roads on BOT basis, without forming SPV, allowing the private partners to toll and appropriate the revenue to themselves during the concession period of 30 years.

Critical elements of financial viability

The concession periods of projects were not determined on project-specific basis giving due consideration to traffic volume, projected traffic and level of service.

Considering the Net Present Value (NPV) of net operating income after tax of ₹ 208.15 crore, ₹ 61.01 crore and ₹ 616.51 crore for Wagdhari-Ribbanpally Road, Dharwad-Alnavar-Ramnagar Road and Chikkanayakanahalli-Tiptur-Hassan Road respectively, the Company should have insisted for shorter concession period, especially in respect of Chikkanayakanahalli-Tiptur-Hassan Road, where the NPV was very high.

Concessionaire raised loans from banks far in excess of project cost

The private partners had projected the cost of the projects to the bankers much higher than the costs approved by the Planning Commission for all the three projects. This had facilitated them to avail more loan (₹ 185.27 crore in total) than required.

Acquisition of land

Notification for acquisition of land under Section 4(1) of the Land Acquisition Act, 1894 was issued 6 months after the date of financial closure of Dharwad-Ramnagar Road. Similarly, the notification for the Chikkanayakanahally-Tiptur-Hassan Road was issued 2 months after the date of financial closure.

Financial Closure

Penalties amounting to ₹ 0.40 crore and ₹ 1.19 crore were not recovered from GVRMP Whagdhari – Ribbanpally Tollway Private Limited and GVRMP Dharwad – Ramnagar Tollway Private Limited respectively for delayed financial closure.

Observations on specific roads having private participation

Wagdhari-Ribbanpally Road

The major portion of the road had only 100 mm of GSB material in the earthen shoulder portion against 200mm as specified in the agreement. The wearing course executed was not as per the scope of work, as the concessionaire had used lower grade '60/70 grade' bitumen (VG 30) in place of Polymer Modified Bitumen.

Dharwad- Ramnagar Road

The project cost was not re-estimated even though scope of work was downsized. The Concessionaire had completed the road in one stretch running through the forest with 5.5 metres carriageway with varying soft shoulders, against the design of 7.5 metres. Owing to this the actual cost and the VGF required should have been reworked. Either the concession period should have been reassessed or the toll reduced.

Chikkanayakanahalli- Hassan Road

Road with Rigid pavement was ₹ 210.74 crore 'with shoulders'. The concession period was proposed to be 20 years after construction period. The decision of the Board of Directors to offer the construction of the road with rigid pavement with concession period of 30 years, in contravention of the proposal of the Technical Committee had resulted in foregoing the revenue from the 21st year to 30th year to the concessionaire.

Monitoring of projects

The two tier monitoring mechanism suggested by the Planning Commission for overseeing the implementation of agreed terms and delivery of specified services of the concessionaire agreement has not been implemented.

Funding

We observed that the Company has not been able to generate funds from the envisaged sources and was entirely dependent on budgetary support of the Government.

Even the allotted funds were not fully utilized in any of the years, because of the works lingering on.

Our conclusions and recommendations are given at the end of the Performance Audit Report.

Overview

2.1.1 The Karnataka Road Development Corporation Limited (Company) was incorporated (July 1999) under the Companies Act, 1956. The objectives of the Company were to construct, erect, build, re-model, repair, execute, develop, improve and maintain, express routes and roads and bridges, sideways, tunnels, *etc*., either under the Build Own Transfer (BOT) or Build Own Operate Transfer (BOOT) or Build Own Lease Transfer (BOLT) schemes or otherwise in a manner which will facilitate the above mentioned works and also facilitate the BOT entrepreneur to decide, levy and collect toll/service charges.

In Karnataka, the construction, improvement and maintenance works of National Highways (NH), State Highways (SH), Major District Roads (MDRs) are carried out by Communications and Buildings Wing of Public Works Department (PWD), Karnataka State Highways Improvement Project (KSHIP), National Highways Department and the Company. The Gram Panchayat Engineering Division and Karnataka Rural Road Development Agency, coming under the Ministry of Rural Development and Panchayat Raj, are responsible for maintenance of rural roads and development of roads under Prime Minister Gram Sadak Yojana (PMGSY) respectively.

Organizational setup

2.1.2 The Management of the Company is vested with the Board of Directors (BoD) consisting of 12 Directors including the Chairman, and Managing Director. The Managing Director is the full time Director. There are five field offices at Gulbarga, Mysore, Hubli, Hassan and Davanagere, each headed by an Executive Engineer/Assistant Executive Engineer. The Company functions under the administrative control of Public Works, Ports and Inland Water Transport (PWP &IWT) Department.

Scope of Audit

2.1.3 The performance audit covers the construction of 16 Roads[19], 13 Major bridges, 496 Phase bridges and 3 roads under Public Private Participation (PPP) mode, altogether costing ₹ 2,900.19 crore, executed during 2008-13.

The construction of Phase bridges under Phase[20] II, III and IV were reviewed on sample basis. The Company had divided the Phase bridges into four packages, of which audit test checked Package 2 and 4 in each of the Phases-II, III and IV, which were selected adopting judgmental sampling considering monetary value. The roads and the major bridges were reviewed *in toto.* The three roads taken up for construction under PPP were also reviewed.

[19] **Excludes two roads for which tenders were under finalization.**

[20] **Phase I was completed during November 2001 and hence has not been included in scope of audit.**

Audit Objectives

2.1.4 The objectives of the performance audit are to assess/ascertain whether:

- Conceptualization and planning for execution of projects as well as designing and estimates were done properly after adequate study.
- The process of acquisition of required land was timely, observing all the relevant acts and procedures.
- There was transparency in inviting tenders and awarding contracts and the execution of the projects was in conformity with the design parameters, terms of the tenders and agreements.
- The PPP projects provided fair and objective assessment of public resources and are being managed responsibly and effectively to achieve the intended results.
- There existed monitoring controls to ensure that the roads and bridges were constructed as planned.
- The financial requirements were met from envisaged sources, budgets were prepared realistically and funds were utilized as per plan.

Audit Criteria

2.1.5 The Audit criteria adopted for assessing the achievement of the audit objectives were derived from:

- Guidelines/ norms/instructions issued by PWD, Government of Karnataka (Government), provisions in various Acts of the Government/GoI made applicable in the State, the policies of Governments, relevant publications of Indian Road Congress (IRC), specifications of Ministry of Road Transport & Highways (MoRTH) on roads and CVC guidelines;
- Detailed Project Reports (DPR), detailed investigation / survey reports, external consultancy reports, Notice Inviting Tenders (NIT), agreements, and Schedule of Rates (SR); and
- Periodical reports of Monitoring Cell at Corporate Office / project and instructions / directions of the Company to the field offices.

Audit Methodology

2.1.6 We scrutinized the guidelines/norms/rules/acts of the PWD/GoK/MoRTH; minutes and agenda papers of the meetings of the BoD and Technical Committee, correspondence with Administrative Departments of the GoK, inter-departmental communications, Consultants' Reports, DPRs, Survey Reports, investigations and estimates, contract documents, progress reports, running account bills and Measurement Books.

An Entry conference was held in April 2013 to appraise the Government and the Management about the objectives of the Performance Audit. The audit findings were reported to the Government/Management and discussed during an Exit conference held on 24 October 2013. Both the Entry and Exit conferences were attended by Principal Secretary to the Government, PWP&IWT Department and the Principal Accountant General.

Pavement Composition / Road Construction Process

2.1.7 The roads have two characteristics: carriageway width and surface quality. Carriageway width is classified under four categories: (a) Single Lane: 3.75 metres, (b) Intermediate Lane: 5.5 metres, (c) Two Lanes: 7 to 7.5 metres and (d) Four Lanes: 14 to 15 metres. Road surface can be of cement concrete (CC), black top (BT) or water bound macadam (WBM).

The work involved in road construction consists of (a) filling of earth as per the alignment/design (b) construction of sub-grade (c) construction of granular sub-base (GSB) (d) laying of wet mix macadam (WMM) (e) laying of dense bituminous macadam (DBM) and (f) laying of bituminous concrete (BC).

Audit Findings

2.1.8 The audit findings are discussed in the succeeding paragraphs. The views expressed by the Government and Management have been considered while finalizing the Performance audit report.

Planning

2.1.9 The proposal for improvements to the State Highways and construction/re-construction of bridges are received from Government, Government agencies, Public Sector Undertakings and elected representatives. The Company appoints Detailed Project Report (DPR) Consultants for preparation of DPRs, by prioritizing the proposals received. The DPRs are, thereafter, forwarded to the Government for approval and funding. After receipt of approvals and budgetary allocation the works are tendered. A Technical Cell under the aegis of a Chief Engineer assists the consultants in evaluation of the DPRs and tenders[21]. Project Management Consultant (PMC), appointed subsequently after award of contracts, supervise the works till completion.

Short closure of DPRs

2.1.9.1 The Company had undertaken (2000-01 onwards) preparation of Feasibility reports / DPRs for construction of Roads and Bridges and as at the end of March 2009 there were 50 DPRs under various stages of preparation.

In June 2009, the BoD decided that all the works for which DPRs were prepared cannot be taken up simultaneously due to non-availability of funds. The Company therefore, decided (September 2009) to terminate the process of preparation of DPRs.

[21] **From 2012 onwards, Tender Scrutinizing Committee has been formed for this activity.**

We observed that tenders were called in respect of 12 out of 50 works for which DPRs were prepared. The Company had incurred expenditure of ₹ 2.49 crore for preparation of 22 DPRs and 11 feasibility reports[22], which became wasteful.

The Government stated (November 2013) that expenditure was not wasteful as the DPRs could be used in future. The reply is not acceptable as the Company had not taken up road works under PPP mode or under regular methods of execution utilizing these DPRs in the past five years. The possibility of the DPRs becoming outdated owing to changed conditions and improved technologies because of efflux of time cannot be ruled out. The Company has also not forwarded these DPRs/feasibility reports to PWP&IWT Department for their use.

Execution of projects from budgetary funds

2.1.10 Roads and Major Bridges

Targets and achievements

2.1.10.1 The Government of Karnataka allotted roads and major bridges to the Company for construction with allocation of funds from budgets. The table below indicates the roads and major bridges targeted for completion in each of the years 2008-09 to 2012-13, achievements in the respective years and the year in which the target of each year was fulfilled.

Table 2.1.1: Targets and achievements of road works

Year	Parti-culars	Target set for completion in the year in numbers (Kms in brackets)	Achievement in numbers (Kms in brackets) within scheduled period of completion	Our remarks
2008-09	Roads	4 (145.00)	1 (42)	34.80 Kilometres (Kms) completed in June 2010; 8 Kms by January 2011 and 60.20 Kms by March 2012.
	Bridges	2	1	One was completed only in May 2011
2009-10	Roads	2 (103.10)	-	50.10 Kms was completed in April 2013 and 53.00 Kms was not taken up due to dispute
	Bridges	1	1	-
2010-11	Roads	2 (10.20)	1 (1.80)	8.40 Kms was completed in July 2011
	Bridges	2	1	One bridge is still under construction.
2011-12	Roads	1 (42.67)	1 (42.67)	-
	Bridges	3	1	Two bridges were completed in November 2012 and August 2012
2012-13	Roads	3 (103.70)	-	5 Kms was completed in April 2013.
	Bridges	1	-	The bridge is still under construction.
Total		**404.67**	**86.47**	

(Source: Progress reports of the Company)

[22] No expenditure was incurred on the balance five feasibility reports.

- Out of 404.67 Kms of major roads targeted for completion during the five year period 2008-13, the Company had achieved only 86.47 Kms within the scheduled time.
- Completion of 166.50 Kms of roads was delayed, which ranged up to two years from the scheduled dates.
- The works of 98.70 Kms were still in progress (December 2013). A road of length of 53 Kms proposed for completion in 2009-10 had not started as commented in Sl.No.3 of Table 2.1.2.
- The Company had completed only four of the nine major bridges within the scheduled time; three were completed with delays ranging up to two years. The balance two bridges were under progress (December 2013).

Execution of projects

2.1.11 The factors which affected the construction of roads and bridges, the consequential events and the effect of which as observed by us are described in the following paragraphs. Complete details of works are given in the **Annexure-8.**

Table 2.1.2: Factors which affected the progress of works in test checked cases

Sl. No	Name of the work	Factors which affected the construction	Consequential events	Audit Remarks
Major Roads (Sl No. refers to Sl No. in Annexure No.8)				
1	Mysore-Bantwal Road (Package B).	• Changed the design after award of work. • Additional works entrusted after award of contract. • Source of material as mentioned in the DPR was not actually available.	• Carriage way was reduced from 2 lane (7 metres) to intermediate lane (5.5 metres) for length of 22.30 Kms. • The Contractor cited that source of raw materials as mentioned in the DPR were not available in the site.	• Road length of 22.30 Kms is not as per the original design. • Cost of the work increased by ₹ 30.04 crore, due to deficiencies in estimates. • Work was delayed by 2 years and 9 months.
2	Improvement to existing road from Peeranwadi up to Goa Border (Chorla).	• Land was not acquired in time.	• A detailed survey done in December 2008, one year after the award of work, revealed that the requirement of forest area was only 4.62 hectares, against the assessed requirement of 30 hectares requested for earlier. • In view of non-availability of forest land the Government approved (December 2011) construction and blacktopping the road to the width of 5.5 meters.	• The Company has constructed a 5.5 metre road for ₹ 96.88 crore against a 7.5 metre road, which was to cost only ₹ 75.59 crore. • The re-designed work was entrusted to the same party (April 2011) through a supplementary agreement without calling for tenders.
3	Outer Ring Road around Hassan town.	• Land not acquired in time.	• The identified alignment was passing through 'Barudalubore' reserve	• Fresh notifications for non-forest lands as per new alignment have not been issued.

Sl. No	Name of the work	Factors which affected the construction	Consequential events	Audit Remarks
Major Roads (Sl No. refers to Sl No. in Annexure No.8)				
			forest area. The notification issued (from January 2008) for acquiring 137.14 acres had to be withdrawn.	• The matter of awarding the work without acquiring land is under investigation of Karnataka Lokayukta on the directions (November 2008) of the Government. • The contractor claimed (April / September 2010) compensation and issued (August 2011) a legal notice claiming ₹ 43.50 crore towards loss and damages suffered due to non-Performance of contract.
4	Widening and Improvements to Mysore-Bantwal Road (Package C)	• Additional works were entrusted after award of contract. • The land required was 18 acres against 12.36 acres of land assessed in the DPR.	• The last stretch of land required for 26 Kms length of road was handed over to the contractor only in March 2013; three years and 4 months after award of contract.	• Cost of the work increased by ₹ 14.83 crore. • The work which was scheduled for completion in June 2012 is still under construction (December 2013). • Extension of time was granted (July 2013) up to May 2014 without penalty and with price adjustment.
5	Mangalore airport Road.	• Land not acquired in time. • Work was entrusted without DPR.	• The Contractor had stopped the work (June 2013) as his demand for additional rates was not decided upon.	• 1.40 acres of land required is not acquired yet (December 2013).
6	Grade separator at Harohalli, Bidadi.	• Land not acquired in time.	• Karnataka Industrial Area Development Board had issued preliminary notification for acquisition of land only in November 2011 and final notification was not issued.	• Work was not taken up due to land acquisition problems.
Major Bridges (Sl No. refers to Sl No. in Annexure No.8)				
7	Sagarkatte Bridge.	• Changed the design after award of work. • Work was entrusted without DPR.	• The width of carriage way was reduced to 7.5 metres from 12 metres as a cost reduction measure. The width of the approach road was retained at 12 metres.	• Estimate was revised 6 times. The estimate went up from ₹ 22.30 crore in December 2006 to ₹ 35.82 crore in April 2013. • The bridge has not been completed even after lapse of five years (December 2013). • The amount of ₹ 14.81 crore spent on embankment for approach road, foundation, sub-structure and superstructure has remained idle. • The Contractor had stopped the work in December 2012. • During a joint-inspection by the audit team and Management, it was noticed (June 2013) that the area was abandoned with no security and personnel at the Project site.
8	Bridge at Sagara-Pattaguppa	• Wrong assumptions in the DPR.	• The bridge was designed considering Full Reservoir Level of 565.397 metres as	• Cost of the work increased by ₹ 6.59 crore. • The work was delayed by 3 ½

Sl. No	Name of the work	Factors which affected the construction	Consequential events	Audit Remarks
Major Roads (Sl No. refers to Sl No. in Annexure No.8)				
	Road.		against 566.380 metres, resulting in increase in height of the bridge by 0.983 metres. • Deck slab width of 7.5 metres was considered in DPR, against the required width of 8.5 metres.	years.
9	Bridge across Krishna River.	• Changed the design after award of work. • Land not acquired in time.	• Raised the height of the bridge by 1.20 metres (considering the proximity of Almatti Dam) to maintain a safe clearance at abutments / bearings. • The land was handed over to the Contractor only (March 2012) after 609 days[23] from the award of contract.	• The cost has increased from ₹ 38.99 crore to ₹ 43.29 crore. • The work was to be completed by January 2013. Extension of time has been demanded up to July 2014.
10	Bridge at Honnalli.	• Contractor abandoned work.	• During discussions with the officials of the Company, it emerged that the contractor had stopped the works since January/February 2013. • During site visit (June 2013), we noticed that the work site was inundated	• The physical and financial progress of bridges on Hospet Shimoga Road (Honnalli) as on the date of stoppage (February 2013) was 13.36 *per cent* and ₹ 2.91 crore respectively, and that of Hariahara-Ranebennur Road (Harihara) (January 2013) was 6.34 *per cent* and ₹ 1.26 crore respectively.
11	Bridge at Harihara.			

Non imposition of Liquidated damages

2.1.11.1 The work of widening and improvements to Mysore-Bantwal Road (Package C), awarded in December 2009, was scheduled to be completed in June 2012. Similarly, the works of construction of bridges on Hospet-Shimoga Road and Harihara-Ranebennur Road, awarded in June 2011, were scheduled to be completed in June 2013.

Bridge on Hosepet -Shimoga Road at Honnali (June 2013)

These works were still in progress (December 2013). The Company failed to levy liquidated damages (LD) on the contractors, though the terms of contract provided for levy of LD for delay in completion of works. The LD for the three works worked out to ₹ 12.54 crore[24].

[23] The extra days to be given to contractor were considered as 263 days.

[24] Mysore-Bantwal Road (Package C) - ₹ 8.38 crore; Bridges on Hospet-Shimoga Road and Harihara-Ranebennur Road - ₹ 4.16 crore.

Phase bridges

2.1.12 The Government of Karnataka (GoK) approved (February 2005/January 2006/April 2007) the construction of 1,185 bridges in three phases[25] (Phase II, III, IV) at an estimated cost of ₹ 691.40 crore. As per the decision of the BoD (April 2006/February 2007) and Government order (April 2007), the Company transferred those works (385 out of 1185 bridges), whose estimated cost was less than ₹ 25 lakh individually to Public Works, Port and Inland Water Transport (PWP&IWT) Department. The Company, had, however, approved the estimate of ₹ 557.21 crore (including tender premium) for execution of only 496 bridges. The Company did not obtain consent/approval of the Government for incurring ₹ 557.21 crore for construction of significantly lesser number of bridges. The details of works in Phase II, III and IV are given under.

Table 2.1.3: Details of works of Phase bridges

(Figures in brackets indicate cost - ₹ in crore)

Phase	Number of bridges approved by Government and cost	Number of bridge works tendered and awarded	Number of bridges under execution and estimated cost	Number of bridges completed and actual expenditure as at March 2013
II	366 (197.40)	262	256[26] (243.84)	254 (211.00)
III	360 (210.00)	218	169 (224.67)	167 (193.08)
IV	459 (284.00)	320	71 (88.70)	70 (83.92)
Total	**1,185 (691.40)**	**800**	**496 (557.21[27])**	**491 (488.00)**

(Source: Monthly Monitoring Reports, Government orders, Running bills)

Award of works

2.1.13 The Company invited (February 2005/January 2006/June 2007) tenders for taking up of 800 bridge works in four packages representing 27 districts[28] of the State, in each of Phase II, Phase III and Phase IV. Each phase was divided into four packages, consisting of districts according to the Revenue Divisions of the State. The details of the tendering, quotations and award of works are indicated in **Annexure-9.**

The BoD of the Company, after the award of works, decided (October 2009) to reduce the scope of contract to 496 bridges and also decided to withdraw the 304 un-started bridges and transfer them to the PWP&IWT Department.

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[25] Phase I was completed in November 2001.

[26] This figure is taken as per Running Account bills submitted by the contractors. However, as per MMR, it was reported as 255 bridges.

[27] The estimated cost included tender premium as submitted by the contractors and approved by the Company.

[28] Package 1: Bidar, Gulbarga, Raichur, Yadgir, Bellary, Koppal.
Package 2: Bagalkot, Bijapur, Belgaum, Dharwad, Haveri, Gadag, Chickodi, Uttara Kannada.
Package 3: Bangalore, Kolar, Tumkur, Chitradurga, Davenagere, Shimoga.
Package 4: Mysore, Mandya, Kodagu, Hassan, Dakshina Kannada, Chikmangalore, Chamarajnagar.

Irregularities in calling tenders and award

2.1.13.1 We observed that:

- The Government, while entrusting the works, had directed (February 2005/January 2006/April 2007) the Company to prepare detailed estimates for construction of bridges. However**,** the Notices Inviting Tenders were issued (February 2005/January 2006/June 2007) without detailed estimates and without designs and drawings. The amounts put to tender[29] were not determined by the Company; they were based on line estimates by PWP&IWT Department. Consequently, the Company had no knowledge of exact cost of the works. The Letters of Intent (LoI)/ Agreements, which were issued /entered, were without designs and drawings and Bill of Quantities (BOQ).

- In the absence of design and drawings, estimated quantities and the exact amount put to tender, the contracts were finalised based on the premium quoted by the contractors (percentage tender). There were no benchmarks against which the bids could be compared.

- The designs and drawings and estimates were prepared by the contractors after award of works.

- The Government Order on the bridge works did not specify adoption of National Highway Schedule of Rates (NHSR) for their execution. The Company, however, invited the tenders with a condition that the rates should be quoted based on the NHSR. Over and above this, the contract terms also provided for payment of price variation for Cement, Steel and Bitumen.

The Government replied (November 2013) that the number of bridges in each phase was more and the bridges were scattered and located in remote places. Owing to non availability of staff, the design and estimates were also to be got done by contractors only. In order to avoid delays these works were also entrusted to the contractor. As regards adoption of NHSR for estimates and payments, the Company stated that the Government had given their approval.

The fact remained that the Company had no role in preparation of the estimates and certification of their correctness. Those were done by the construction contractors themselves, after award of the contracts. Allowing the NHSR for construction of bridges in rural roads and located in remote places had only escalated the cost of construction without benefits.

[29]Total amount put to tender for 800 bridges (Phase II - ₹ 178.88 crore; Phase III - ₹ 183.17 crore; Phase IV - ₹ 219.79 crore).

Violation of Government notification

2.1.14 Government issued (January 2005) an order stipulating that in respect of works contracts of value more than ₹ 25 lakh, the contractors should be made responsible for submitting bills supported by hard copies of detailed measurements of works. It further stipulated that the Assistant Engineer in direct charge of the work should take independent measurements of the works and enter the same in the electronic spreadsheets and make computations thereof. The provisions contained in the Government Order were to be incorporated in the conditions of contract of tender documents.

We observed that:

- The Company had not incorporated the provisions of the Government Order in the tender conditions of the bridge works taken up in phases, even though BOQ was not mentioned in the work award. Contrary to the Government Order, the terms of contract provided for interim payment based on the completion of milestones as specified in the contract.

- The Running Account Bills were certified by the Project Management Consultants and the Project Engineers of the Company. The bills were admitted without taking measurements independently by the Divisional Engineer concerned. Payments were made based on certification without check measurement by the Company, on the approval of the Managing Director. The Company paid[30] (March 2013) an amount of ₹ 475.43 crore for works and ₹ 12.57 crore towards survey and soil investigation so far based on running bills submitted, based on percentage of completion.

The Government stated (November 2013) that measurements as recorded in the site book would be submitted along with final bill.

The reply is not acceptable as the contractors had not submitted (December 2013) final bills for any of the packages, though the works were completed. As a result, the Company had no mechanism to ensure the actual quantities executed in respect of completed bridges until final bills together with measurement books are submitted by the contractors.

Non-adherence to the terms of contract

2.1.15 The agreements stipulated that the rates as stated under Schedule of items of BOQ and approved by the Company should be firm and binding during the tenure of the contract and should not be subject to any escalation, whatsoever, notwithstanding any changes in the list of materials, labour and/or quantity variation.

[30] As per the bills passed for payments.

It was also stipulated that the contractors should submit the estimated cost for each bridge based on actual site survey and soil investigation and design and approval to be obtained from the Company within three months of the effective date of contract.

We observed that the estimates were to be submitted by August 2005 for Phase-II, November 2006 for Phase-III, January/March 2008 for Phase IV. The contractors, however, submitted estimates spread over a period of four years adopting the NHSRs relevant to the years in which the estimates were prepared, taking advantage of the rate increases. In all, submission of designs and estimates were delayed in case of 160 bridges.

The Government stated (November 2013) that the estimates were prepared and approved based on the NHSR of the contract period of three years and no estimates were approved beyond the contract period.

The reply is not acceptable as the contracts had stipulated that the estimates were to be prepared and got approved within 3 months from the dates of the contracts. The contracts did not make any allowance for delays in preparation of estimates. Therefore, application of the rates of the periods in which the estimates were prepared was in violation of the contracts.

Reduction in scope of contracts

2.1.16 The Company awarded the works for construction of 800 bridges in three phases (split into four packages in each phase) with a stipulation to complete them within 36 months from the date of agreement. The BoD, while reviewing the progress of works, noted that progress shown by the contractors was very slow and they were not making any effort to complete the works and hence decided (October 2009) to withdraw bridges, which were not started, from the scope of the contract in all the three phases. The unstarted bridges (304 numbers) were transferred (November 2009) to PWP&IWT Department. As on the date of withdrawl of bridges (October 2009), the contractors had completed 347 out of 800 bridges[31] in all the three phases.
We observed that:

- The contractors should have completed 262 bridges in Phase II and 218 in Phase III as of May 2008 and August 2009 respectively. Against which the contractors had completed only 214 in Phase II and 123 in Phase III respectively as on the date of withdrawl (October 2009). The Company, therefore, dropped 55 of balance 143 bridges taken up in both the phases.
- In respect of Phase IV, as on the date of withdrawal (October 2009) the contractors had completed only 10 out of 320 bridges. The Company, therefore, dropped the construction of 249 bridges and the balance 71 bridges (including 10 completed bridges) were retained.

[31] **214 of 262, 123 of 218 and 10 of 320 bridges in Phase II, III and IV respectively.**

- As a result of withdrawing the 304 bridges from the scope of the contract, an expenditure of ₹ 5.67 crore paid towards survey and soil investigation in respect of 268 bridges had become infructuous.

  The Government stated (November 2013) that the soil and survey investigation reports were handed over to PWP&IWT Department to use the data when they take up these bridges.

  The soil and survey investigation was done by the contractor to whom works were awarded, immediately after the award of works between 2005 and 2007. There is no evidence to suggest that these reports were handed over and were being considered for use.

- Clause 4.38.1 and 4.38.3 of General Condition of Contract provided for levy of liquidated damages at 0.5 *per cent* of the balance work for every month of delay till its completion, subject to maximum of 7.5 *per cent* of the contract price.

  Though only 345[32] out of 496 bridges were completed in phase II, III and IV within the stipulated contract period and the delay in construction of balance bridges were attributable to contractors, the Company had not levied penalty as per the contract terms. The value of balance works as at the stipulated date of completion was ₹ 176.77 crore[33] and the liquidated damages at the rate of 7.5 *per cent* amounting to ₹ 13.26 crore should have been levied.

  The Government stated (November 2013) that action would be taken to levy the penalty in the final bills as per the terms of contract.

Curtailment of competition

2.1.17 The GoK issued (August 2005) a Standard Tender Document (STD), for adoption from September 2005 for tendering and award of works. According to which, the works valuing between ₹ 50 lakh and above but less than ₹ 1 crore should be executed through an open tender on Item Rate Basis adopting two cover tender system, without allowing price adjustment. The prequalification criteria of tenderers should be in accordance with Clause 3 of the STD.

We observed that:

- Out of 496 bridge works taken up, the value of 324 bridges individually cost less than ₹ 1 crore. The minor bridge works were however, clubbed together and made into packages in each phase.

- The price adjustment was not to be allowed if the value of work was less than ₹ 1 crore. As the value of each package was more than ₹ 1 crore, the Company allowed price adjustment giving undue advantage to the contractors.

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[32] 212 bridges as of April 2008 in phase II (progress as of May 2008 not available); 123 bridges as of August 2009 in phase III; 10 bridges as of October 2010 in phase IV.

[33] The cost represents average estimated cost of bridges in each phase which were not completed within the contract period.

- A comparison of pre-qualification criteria fixed by the Company *vis-à-vis* the STD is as under.

Table 2.1.4: Pre-qualification criteria fixed by the Company *vis-à-vis* the STD

Sl. No	Criteria	As per Clause 3 of STD for the works valued less than ₹ one crore	As fixed by the Company
1	Minimum financial turnover.	Two times of estimated annual payments of the contract in at least two financial years.	Average annual construction turnover of ₹ 100 crore in any two years of the last five financial years.
2	Work experience.	Satisfactory completion of at least one similar work (90 *per cent* of contract value) as prime contractor.	Should have completed atleast 25 bridges in single contract with a total value of ₹ 30 crore or more.
3	Execution of minimum quantities of similar works.	80 *per cent* of the peak annual rate of contract.	Excavation : 80,000 cum Concrete: 15,000 cum Pre-stressed concrete: 2,000cum

- Consequent to fixation of high prequalification criteria, all the 5,346 (approximate) Class-I contractors who were registered with Karnataka Public Works Department became ineligible for participation and the competition was curtailed. Only three contractors *viz*., L&T Limited, Gammon India Limited and Nagarjuna Construction Company Limited (NCCL) qualified for the tenders in all the three phases.

- The provisions of the Competition Act, 2002 as amended by the Competition(Amendment) Act, 2007 (the Act) states that bid rigging means agreement between enterprises which has the effect of eliminating or reducing competition for bids.

  Only two firms bagged all the packages in the Phases II[34], III and IV. Gammon India Limited bagged Packages 1 and 4 and NCCL Packages 2 and 3. The facts suggest that there existed bid rigging.

The Government stated (November 2013) that the main reasons for taking up the bridges in packages was to avoid delay in preparation of individual estimates and tender processing and to enable completion of all the bridges within the stipulated period of three years. The reply is not acceptable as there were delays in preparation of estimates and completion. Further, there is no evidence to suggest that works would be delayed if they were entrusted to individual Class-I contractors.

[34] **Detailed records were not made available to audit.**

Bridges not completed

2.1.18 We noticed that two bridges were not completed, a bridge had no approach road and another one was not constructed as per requirement. These cases are discussed below:

Bridges on old National Highway at Bellur cross and on Madikeri-kutta road across Lakshmantheertha River

(Bridge on Madikeri-Kutta road across Lakshmantheertha river- photo dated May 2013)

We observed that the works of two bridges *viz.*, a bridge on old National Highway at Bellur cross and a bridge on Madikeri-Kutta road across Lakshmantheertha river was entrusted (August 2006/December 2007) to Gammon India Limited under Phase III and IV respectively at an estimated cost of ₹ 3.10 crore. The construction of the bridge on old National Highway at Bellur cross should have been completed by August 2009 and bridge on Madikeri-kutta road across Lakshmantheertha river by October 2010. The progress achieved was 41 *per cent* and 35 *per cent* respectively (June 2013). The Company had incurred an expenditure of ₹ 1.15 crore on these works (November 2013).

Bridge on Shirahatti - Belvanike road

Photo dated June 2013

2.1.19 The bridge located on Shirahatti - Belavanike Road at Km.1.00 was completed (June 2011) at a cost of ₹ 0.60 crore. However, the bridge had no approach road. The PWP&IWT Department agreed (February 2009) to construct the approach road. To a communication from the Company the PWP&IWT Department confirmed (August 2011) that they had received an amount of ₹ 0.50 crore from the District Commissioner for the approach road.

The approach roads were, however, not taken up for construction (November 2013) even after a lapse of four years.

Bridge on Guttal – Itagi road

2.1.20 The bridge was completed (September 2008) under Phase II at a cost of ₹ 1.54 crore. The Divisional Engineer of the Company reported (October 2008) that the existing bridge would be submerged during the flood and cause inconvenience to the road users to cross the bridge. The technical opinion obtained (October 2008) from Civil Technologies (India) Private Ltd stated that the existing deck slab needed to be raised by two metres to facilitate the flood discharge. Since the deck slabs have not been raised the bridge will be inundated during floods.

The Government replied (November 2013) that the proposal for raising the structure was dropped as it was uneconomical. Further, it was replied that only during heavy floods, the bridge would submerge.

The reply is not acceptable as the Divisional Engineer had stated that during flood in October 2008 the villagers were unable to cross the bridge and the vehicular traffic had stopped. Further, it was also mentioned that there was pressure from local MLA and villagers to raise the level of the bridge.

Execution of projects under Public Private Partnership

Policy framework

2.1.21 The Government of India formulated (January 2006) the policy on Public Private Partnership (PPP) in infrastructure projects recognizing the concept of Viability Gap Funding (VGF). The scheme aims at supporting infrastructure projects that are economically justified but fall short of financial viability. The quantum of financial support to be provided under this scheme shall be in the form of capital grant at the stage of project construction. A catalytic grant assistance up to 20 *per cent* of capital cost was envisaged. Apart from this, an additional grant up to 20 *per cent* can be provided by the sponsoring Ministry or the State Government. In line with this, the New Infrastructure Policy 2007 of the GoK was pronounced.

Formulation and implementation

2.1.22 In the Budget Speech 2005-06, the Deputy Chief Minister announced improvements to three roads - Wagdhari to Ribbanpally Road, Dharwad-Alnavar-Ramnagar Road and Chikkanayakanahalli-Tiptur-Hassan Road - through the Company under tolling/BOT system.

The Company proposed (June 2006) to float special purpose vehicle (SPV) with Infrastructure Leasing & Financial Services (IL&FS) for executing the above mentioned project on BOT/BOOT basis. The SPV would raise the resources from commercial borrowings, the State Government would fund viability gap, if any and SPV would be permitted to collect toll.

We observed that:

- The Government issued orders (August 2006) for construction of roads through PPP on BOT basis, without forming SPV.

- The private partner was allowed to toll and appropriate the entire revenue to themselves for 30 years.

We further observed that:

- The actual implementation of the projects took almost five years from the year of announcement. There had been delays at every stage: conception of the projects, approvals, clearances from State Level Committee and Planning Commission and tendering.

- The cost of ₹ 722.11 crore, submitted for final approval of the Planning Commission for the above three projects was far higher than the initial cost of ₹ 610.20 crore proposed for in-principle approval of the Planning Commission. The increase in cost was ₹ 111.91 crore, which resulted in higher outflow of ₹ 44.76 crore by way of Viability Gap Funding (VGF), which is an additional burden on the budget of both Central and State Government.

- Wagdhari to Ribbanpally Road has since been completed (August 2012), Dharwad-Alnavar-Ramnagar Road is facing forest clearance issues. Chikkanayakanahalli-Tiptur-Hassan Road was abandoned by the contractor and is under litigation.

The Government replied (November 2013) that though the projects were announced in budget speech 2005-06, the preliminary preparations relating to pre and final feasibility studies, traffic studies, revenue model *etc*., in the implementing institution levels were not done and hence, the delay.

We observed that the preparation of DPRs of all the three projects executed was completed between September 2006 and July 2007, yet the finalization of tenders took place only in 2009-10.

Selection of Concessionaires

2.1.23 Tender notification was issued in September 2006 by inviting applications to select qualified contractors to invite bids for the works of Dharwad-Alnavar-Ramnagar Road and in August 2007 for Chikkanayakanahalli-Tiptur-Hassan and Wagdhari-Ribbanpally Road. No qualified firms submitted their financial bids.

The Company failed to attract bidders for its projects even after updating the prices of the estimate to the latest schedule of rates, *albeit*, many firms qualified for bidding.

We observed that

- GVR-RMN-Prathyusha, the successful private partner for both Wagdhari-Ribbanpally Road and Dharwad-Alnavar-Ramnagar Road, and Abhijeeth Infrastructure Limited for Chikkanayakanahalli-Tiptur-Hassan Road were not RFQ participants.

- Lack of adequate land, perceived difficulty in getting forest clearance and the hesitation of financial institutions to lend for such projects were the reasons attributed for poor response.

Critical elements of financial viability

2.1.24 The critical elements that determine the financial viability of a PPP project are traffic volumes, concession period and capital costs.

Traffic volume, growth and concession period

2.1.24.1 Long term forecasting of traffic on a project road is required for design of highway and assessing the economic and financial viability of the proposed investment. Further, the Model Concession Agreement finalized by the Planning Commission, states that the guiding principle for determining a project specific concession period is the carrying capacity of the respective highway at the end of the proposed concession period. As such, the concession period is determined on a project-specific basis depending on the volume of present and projected traffic.

The table below indicates the growth estimates, number of lanes proposed and the level predicted for the three roads over the concession period.

Table 2.1.5: Growth estimates and level of service of PPP projects

Particulars	Wagdhari-Ribbanpally Road		Dharwad-Alnavar-Ramnagar Road	Chikkanayakanahalli-Tiptur-Hassan Road	
Traffic growth estimate projected in financial module (per cent)	7		6	5	
Number of lanes	2		2	2	
Concession period (in years) and year up to which concession agreement will be in force.	30 (2041)		30 (2041)	30 (2042)	
Year in which the level of service (LOS) reaching 'D' or 'E'	Section-1	2015	Estimate remains within LOS 'C' throughout concession period.	Section-1	-
	Section-2	2020		Section-2	2022
	Section-3	2020		Section-3	2019
	Section-4	-			

We observed that:

- As per the Planning Commission the acceptable traffic growth rate was 5 *per cent,* whereas the traffic growth projection in case of Wagdhari-Ribbanpally Road was 7 *per cent* and Dharwad-Alnavar-Ramnagar Road was 6 *per cent.*

- Level of Service (LOS) is defined as a qualitative measure describing operational conditions within a traffic stream and their perception by drivers/passengers, such as speed, travel time, freedom to manoeuvre traffic interruptions, comfort, convenience and safety. The Indian Road Congress (IRC) Code 64-1990 recommends under normal circumstances, use of LOS 'B' is adequate for design of rural highway. At LOS 'B' level, volume of traffic will be around 0.5 times the maximum capacity and this is taken as design service volume for the purpose of adopting design values. However, in the PPP projects, the Consultants had proposed to adopt the LOS as 'C'. Under LOS 'C', traffic would experience congestion and inconvenience during peak hours.

- Even LOS 'C' was not maintained for the entire period of the concessionaire agreement. As could be seen from Table 2.1.5 above, three of the four sections of Wagdhari-Ribbanpally Road would cross LOS 'C' between 2015 and 2020 and become LOS 'D'/LOS 'E'. Similarly, two of the three sections of Chikkanayakanahalli-Tiptur-Hassan Road would become LOS 'D'/LOS 'E' between 2019 and 2022. The concession periods for the above roads extend till 2041 and 2042. The projects would experience conditions close to unstable flow. Owing to high density of traffic, the drivers would be severely restricted in their freedom to select desired speed, maneuvering traffic would be extremely difficult, comfort and convenience extremely poor and driver frustration generally high.

- Even though the DPR of Chikkanayakanahalli-Tiptur-Hassan Road provided for construction of additional lanes in two sections of the road in the years 2018 and 2021 to mitigate traffic congestion, the same was not incorporated in the Concession Agreement. The DPR of the other two roads did not have provision for addition of lanes.

Capital costs and concession period

2.1.24.2 The table below shows the estimated cost of the PPP projects, VGF, Investment by the Developer and period of tolling allowed.

Table 2.1.6: Financial parameters of PPP projects

₹ in crore

Name of the project	Wagdhari-Ribbanpally Road	Dharwad-Alnavar-Ramnagar Road	Chikkanayakanahalli-Tiptur-Hassan Road
Total investment required – estimated cost of the project	238.58	230.29	238.45
Viability Gap Funding by Company	90.66	82.90	92.99
Developer's contribution	50.60	69.58	92.99
Debt portion of the private partner	97.32	77.81	52.47
Investment by the Developer	147.92	147.39	145.46
NPV of the net revenue from the investment (*Per cent* adopted for discounting in brackets)	208.15 (10)	61.01 (12)	616.51 (12)
Period of tolling allowed to private partners as per Concessionaire Agreement	30 years	30 years	30 years

(Source : Financial module submitted to Planning Commission)

We observed that:

- The Net Present Value (NPV) of net operating income after tax of the projects would be ₹ 208.15 crore, ₹ 61.01 crore and ₹ 616.51 crore for Wagdhari-Ribbanpally Road, Dharwad-Alnavar-Ramnagar Road and Chikkanayakanahalli-Tiptur-Hassan Road respectively. This is indicative of high returns and Company should have insisted for shorter concession period, especially in respect of Chikkanayakanahalli-Tiptur-Hassan Road, where the NPV was very high.

- The initial investment projected for Wagdhari-Ribbanpally Road was ₹ 276.64 crore with concession period of 30 years. The project cost was scaled down to ₹ 242.75 crore by the Planning Commission. However, the Company did not reassess the concession period.

- For Chikkanayakanahalli-Tiptur-Hassan road, the BoD of the Company resolved to adopt rigid pavement option of ₹ 210.74 crore towards capital cost. The Consultants had agreed to suggestions of Technical Committee for a concession period of 20 years. The BoD decided to offer the construction of the road with rigid pavement with concession period of 30 years, in contravention of the suggestion. This is discussed in detail in Paragraph 2.1.30.

2.1.25 Concessionaire raising loans from the banks far in excess of project cost

Table 2.1.7: Details of project cost *vis-à-vis* funding by Financial institutions.

(₹ in crore)

Particulars	Wagdhari-Ribbanpally Road	Dharwad-Alnavar-Ramnagar Road	Chikkanayakanahalli-Tiptur-Hassan Road
Project cost approved by Planning Commission	238.58	230.29	238.45
Upfront VGF component	45.33	41.45	92.99
Proposed Developer's equity	50.60	69.58	92.99
Debt portion of the Developer	142.65	119.26	52.47
Cost projected to bankers by private partners for securing loan	314.31	270.84	318.98
VGF projected to bankers by private partners	49.98	48.34	92.99
Amount of loan sanctioned	213.73	152.92	133.00
Excess sanction	71.08	33.66	80.53
Financial Institution	SBI and consortium banks	Canara Bank and consortium banks	SBI and Infrastructure Finance Company Limited

(Source: Common loan agreement with financial institutions)

We observed that:

- The private partners had projected the project cost to the bankers much higher than the cost approved by the Planning Commission for all the three projects. This had facilitated the private partners to avail more loan (₹ 185.27 crore for three projects).

  In the event of the private partner defaults in the payments of loan, the bankers would take over the tolling as per the loan agreement, with the concomitant effect of increasing the tolling beyond the concession period of 30 years.

- Further, in respect of Chikkanayakanahalli-Tiptur-Hassan road, the concessionaire had projected the cost of the project as ₹ 318.98 crore to the Financial Institutions though the cost of the project was ₹ 238.45 crore. The Chartered Accountant appointed by the concessionaire had certified (November 2012) that the expenditure incurred till November 2012 was ₹ 144. 65 crore. This represented 45.35 *per cent* of the total projected cost (₹ 318.98 crore). However, as per records of the Company, the physical progress achieved was only 17.92 *per cent and* as per Audit Report of the Auditor (M/s. Mott MacDonald,) appointed by the Financial Institution, the overall progress achieved was 19.90 *per cent*. In the absence of monitoring of physical progress *vis-à-vis* the drawal of funds from the banks, the possibility of diversion of funds by the concessionaire cannot be ruled out.

Acquisition of land

2.1.26 As per the Article 4 (Clause 4.1 and 4.2) – Conditions precedent of the Concession Agreement the Government shall have provided to the Concessionaire the 'Right of way' to the site to the extent of 90 *per cent* of the total area of the site prior to appointed date. In the event the Government does not fulfill the condition, the Government shall pay to the Concessionaire damages at the rate of 0.1 *per cent* of the performance security for each day's delay subject to maximum of 20 *per cent*.

As per Article 10 (Clause 10.3) of the Concession Agreement, the Government shall provide and grant the Right of Way to the concessionaire in respect of all land included in the Appendix (10 *per cent* of the area of the site) within 90 days of the appointed date[35]. In the event of delay it shall pay the concessionaire damages at the rate of ₹ 50 per day for every 1,000 sq.mtrs or part thereof.

The lands are to be acquired under Land Acquisition Act 1894. Preliminary notifications under Section 4(1) are issued duly notifying the land proposed to be acquired. Final notifications for acquisition of land are issued under Section 6(1) of the Act. Generally, the time period between the preliminary notification and final award is about three years.

We observed that:

- The preliminary notification for acquisition of Land for Dharwad-Ramnagar Road was issued (October 2011) after a delay of six months from the appointed date (March 2011). The final notifications under Section 6(1) of the Act were still under issue, for land in some villages.

- Similarly, in respect of Chikkanayakanahalli-Tiptur-Hassan Road notification under Section 4(1) was issued (March 2012) after two months of appointed date (January 2012). Final notifications under Section 6 (1) are yet to be issued (December 2013).

[35] **Appointed date refers to date of financial closure.**

- Though it takes three years on an average for completion of the acquisition process, the Government had issued preliminary notifications after delays as stated above. The areas of the sites as specified in the designs have not been handed over to the concessionaires till date (September 2013). As a result, the liability of the Government to the concessionaire as on December 2013 is ₹ 4.96 crore in case of the two roads.

The Government stated (November 2013) that the Company was depending on the respective revenue departments for acquiring the land and the process of land acquisition is very much elaborative. It was also stated that the Company was planning to create an exclusive cell for expediting the land acquisition process.

Financial Closure

2.1.27 As per Article 24 of the concession agreement entered, the financial closure has to be achieved within 180 days from the date of the Agreement and in the event of delay, the concessionaire shall be entitled to a further period not exceeding 120 days subject to an advance payment of damages to Government in a sum calculated at the rate of 0.1 *per cent* of the performance security for each day of delay by the concessionaire.

- The Concession Agreement with the Concessionaire GVRMP Whagdhari-Ribbanpally Tollway Private Limited was executed in June 2010. The Concessionaire achieved the financial closure on 7 January 2011 after a delay of 32 days for which a penalty of 3.2 *per cent* of Performance Guarantee of ₹ 12.39 crore amounting to ₹ 39.65 lakh had to be levied. The claim has not been preferred on the concessionaire till date (December 2013).

- The Concession Agreement with the Concessionaire GVRMP Dharwad Ramnagar Tollway Private Limited was executed in June 2010. The Concessionaire achieved the financial closure on 16 March 2011, with a delay of 100 days for which a penalty of 10 *per cent* of Performance Guarantee of ₹ 11.88 crore amounting to ₹ 1.19 crore has to be levied. The claim has not been preferred on the concessionaire till date (December 2013).

The Government stated (November 2013) that the financial closure for both the projects was achieved in December 2010, which was within six months of concession agreement (June 2010).

The reply is factually incorrect as the mere sanction of loan does not convey financial closure. Financial closure is stated to happen only when financial documents have been executed, which in case of these two projects was done in January 2011 and March 2011 respectively.

Wagdhari-Ribbanpally Road Project

Granular Sub Base of the road

2.1.28.1 As per the provisions of the Concession Agreement (Part II Schedule B Annexure I Clause 2.3) the detailed pavement design of carriageway shall be done in accordance with the standards mentioned in Schedule-D. Accordingly, the thickness of the Granular Sub Base (GSB) for carriageway, approaches of all structures, paved shoulders, *etc*., from Km. 0 to Km.141.34 shall be 200 millimetre (mm).

However, the Concessionaire had provided only 100 mm of GSB material in the earthen shoulder portion. A review meeting was chaired by the Managing Director of Company in August 2011 and after discussion it was decided that the GSB work executed till then was not to be disturbed. It was also agreed that further GSB work in the remaining chainage (93.51 to 141.34 Kms) should be executed with 200 mm thick for full width.

We observed that the Concessionaire had changed the composition of pavement without prior approval of the Government. The Company had thus, failed to ensure the quality of the road (up to 93.50 Kms) and the reduction in this project cost.

The Government stated (November 2013) that DPR provided for 100 mm GSB for shoulders and accordingly project cost was calculated. The reply is contrary to the facts. The concession agreement stipulated provision of 200 mm GSB for the entire stretch of the road.

Modified Bitumen in the wearing course

2.1.28.2 Use of Modified Bitumen for wearing course was specified in the Concessionaire Agreement. The Concessionaire was asked to use Polymer Modified Bitumen (PMB)-40 for bituminous concrete works as per IRC SP-53. The Developer refused to use PMB-40 as it was not in line with the contract conditions.

As per MoRTH (Government of India) use of modified bitumen was compulsory for wearing courses. The wearing course executed was not as per the scope of work, as the concessionaire used the lower grade '60/70 grade' bitumen (VG30), which is less expensive. The approved project cost was ₹ 238.58 crore. The VGF was 40 *per cent* of the approved cost. With the reduction in cost, the corresponding VGF should have been lesser. Also it had resulted in compromising the quality of carriageway.

The Government stated (November 2013) that there was an anomaly in the provisions of concession agreement on specification of bitumen for wearing course and the Technical Committee took a decision to leave the matter to the Independent Engineer. The reply is not in order as the concessionaire had used 60/70 grade bitumen without obtaining opinion of Independent Engineer and the use of this grade was not in line with provisions of concession agreement as well.

Dharwad- Ramnagar Road

Change in design and scope of work

2.1.29 The 'in principle' approval by Government of India to the proposal to improve the Dharwad-Alnavar-Ramnagar Road (SH-34) was accorded in March 2008, at a cost of ₹ 193 crore (SR 2007-08). The cost of the project was revised to ₹ 237.60 crore (including shifting of utilities) based on then current SR (2009-10).

In the project, road having a length of 60.4 kilometers was proposed to have a minimum two lane carriageway with one metre wide paved shoulders. The road was designed with curve improvements to attain a speed of 100 Kilometre per hour (Kmph). A new bypass of 3.7 Kms length from Km.9.050 to Km. 12.750 was also proposed. The main carriage way was to be of seven metres, paved shoulders of two metres, earthen shoulders of three metres and foot-path-cum-drain of three metres. The proposed Right of way as per Concession agreement for road of this measurements was 30 metres.

The proposed road passed through Nagargali Reserve Forest and it was anticipated that there would be impact on flora and fauna. The road also passed through water bodies like tanks and seasonal streams.

Though the project report was ready by 2006 the concession agreement was signed in June 2010 and the Company requested for diversion of forest land five years later in May 2011, after notice inviting tenders was issued (September 2006). The Forest Department refused (November 2011) to part with land.

The matter of construction of road in the forest reaches was discussed in the meeting held in November 2011 convened by the Additional Chief Secretary, Forest Ecology and Environment, Department, GoK. It was resolved to recommend black topping of a width of 5.5 metre in 25 Kms stretch of the road passing through forest areas in Dharwad and Belgaum. The State Government approved (November 2011) black topping of 5.50 metres with 60 centimetre concrete drain without shoulders.

SNC-LAVALIN Infrastructure Private Limited, the Independent Engineers, in their letter (December 2011), comparing the DPR alignment and actual execution alignment, pointed out that there could be variations of quantities and actual length of the project, as the reaches in the reserved forest area were still undecided. Therefore, variations of quantities would attract Article 16 of the agreement dealing with change in scope of work after finalization of the project corridor.

Article 16 stipulated that if Government decided to proceed with the change of scope, it should convey its preferred option to the Concessionaire, and the parties should with assistance of the Independent Engineer, thereupon make good faith efforts to agree upon the time and cost for implementation thereof. This procedure was not followed though the changes were known to the Company. The Concessionaire was allowed to undertake the work though there was reduction in scope at the originally estimated cost.

The Company has so far released ₹ 35.60 crore, the share of the Central Government, inspite of reduction in scope of work. The financial interest of the State was not safeguarded as estimate of cost of the road as per the alignment now under implementation was not prepared, the VGF was not revised and the concession period was not adjusted.

The Government stated (November 2013) that action would be taken after completion of works, as per the provisions of concession agreement.

Tolling not possible on account of restricting the road width

2.1.29.1 A 5.5 metre road without shoulders does not come within the scope of Development of State Highways and Major District Roads user fee Notification (May 2009) and subsequent corrigendum (February 2011). The user fee rates notified under the above order were applicable only to roads with a width of 7.0 metre carriage way with 2 metre paved shoulder and 2 metre soft shoulder.

Therefore, only reduced toll rates are applicable for the road[36] (60.40 Kms), which would have significant impact on the project's financial viability. This would lead to increase in concession period. The Concessionaire has completed the road in the forest reaches with 5.5 metre carriageway with varying soft shoulders.

Shifting of water supply pipelines and sewage drains

2.1.29.2 The Divisional Engineer of the Company had requested (February 2010) the Karnataka Water Board, Dharwad for shifting the water supply pipelines away from the width of the road. The Company deposited (June 2010) an amount of ₹ 62.45 lakh with the Karnataka Water Board, Dharwad. The work of shifting the pipelines was executed at a cost of ₹ 44.41 lakh. When the work of RCC open drain was taken up, it was noticed most of the pipeline length was below RCC drain and inside the road width. The entire pipeline was removed and re-laid at a cost of ₹ 28.20 lakh. Thus, the faulty work carried out by the Karnataka Water Board resulted in an extra cost of ₹ 28.20 lakh to the Company.

[36] Dharwad-Alnavar-Ramnagar Road - Toll will be applicable for 35.40 Kms (60.40 Kms–25.00 Kms)

Chikkanayakanahalli –Tiptur - Hassan Road

Selection of design and concession period

2.1.30 The Technical Committee of the Company in its meeting held in May 2006 while deliberating the feasibility report prepared by the Consultants (Consulting Engineering Services (India) Private Limited, Bangalore) for Chikkanayakanahalli-Tiptur-Hassan road asked the Consultants to work out the initial cost of the road with flexible and rigid pavements for design life periods and concession periods. The Report of the Technical Committee of the Company had the following options, which were placed before the BoD Meeting in August 2006.

- Road with Flexible pavement was ₹ 171.81 crore 'with shoulders'. The concession period was proposed to be 20 years after construction period.

- Road with Rigid pavement was ₹ 210.74 crore 'with shoulders'. The concession period was proposed to be 20 years after construction period.

The BoD of the Company resolved to adopt rigid pavement option with shoulders amounting to ₹ 210.74 crore with concession period of 30 years. It was approved by the Government (October 2007).

The decision of the BoD to offer the construction of the road with rigid pavement with concession period of 30 years, in contravention of the suggestion of the Technical Committee had resulted in foregoing the revenue from the 21st year to 30th year to the concessionaire.

Exemption from Customs duty

2.1.30.1 Abhijeet Toll Roads (Karnataka) Limited stated (April 2012) that the EPC (Erection, Procurement, and Commissioning) of Chikkanayakanahalli-Tiptur-Hassan road executed by it was awarded to Abhijeeth Projects Limited. Abhijeeth Projects Limited imported a paver equipment[37] from Germany at ₹ 4.79 crore and requested the Company to issue letter to them for exemption from payment of customs duty[38]. The amount of exemption to be claimed was ₹1.24 crore.

The Company issued a letter to Deputy Commissioner of Customs, Chennai port to release the equipment without payment of duty, though the import of such equipment by the Construction Company was not part of the contract and the fact of import was not intimated by the bidder at the time of negotiations. This had resulted in loss of revenue to the GoI, in the form of Customs duty.

[37] Slip Form Paver with self loading DBI along with central Tie-Bar Inserter equipments.
[38] As per Notification of March 2002- Condition – 40.

Milestones penalty

2.1.30.2 The Concessionaire for the Chikkanayakanahalli-Tiptur-Hassan road was contracted in January 2012 and completion of construction of road was fixed for January 2014. The progress achieved by the Concessionaire for the first and second mile stones as on December 2012 is given in table below.

Table 2.1.8: Progress achieved by the Concessionaire in Chikkanayakanahalli –Tiptur - Hassan Road

Sl. No.	Project Milestone	Mile Stone I (July 2012)		Upto Milestone II (January 2013)	
		Required	Achieved	Required	Achieved
1	Project Road (Kms)	15.244	2.283	38	2.283
2	Bridges and Cross Drainage structures	20	32	49	32

We observed that as per the audit report of Mott Macdonald, the Auditor for Consortium of Banks led by State bank of India (SBI), the overall progress achieved was 19.9 *per cent,* against the milestone of 76.5 *per cent*. Milestone penalty to be levied from 6 July 2012 to 10 June 2013 (delay of 337 days) worked out to ₹ 3.99 crore.

The Government stated (November 2013) that there was a litigation in the court against the forfeiture of the performance security.

Fee and expense to the Independent Engineers

2.1.31 As per Clause 2 (Schedule-P of Part II) of Concession Agreement, the Company shall endeavour that payments to the independent engineer on account of fee and expenses do not exceed two *per cent* of the total project cost. Payments not exceeding such two *per cent* shall be borne equally by the Company and the Concessionaire, and any payments in excess thereof shall be borne entirely by the Company.

We observed that:

- While inviting tenders for availing the services of Independent Engineer, the Company did not include the limiting clause for fee and expenses. Consequently, Consulting Engineering Services (I) Private Limited was appointed (May 2011) as Independent Engineer for Wagdhari- Ribbanpally Road for a fee of ₹ 5.50 crore, which was in excess of two *per cent* of TPC by ₹ 72.84 lakh,

- Similarly, Span Consultants Private Limited was appointed (May 2011) as the Independent Engineer for the Dharwad – Ramnagar road, at an amount of ₹ 5.71 crore, which was ₹ 1.10 crore more than the ceiling amount of two *per cent* of TPC.

The excess cost of ₹ 1.83 crore fixed over and above the ceiling limit for both the projects had to be borne by the Company.

The Government replied (November 2013) that it was not mandatory to limit the Independent Engineers' charges to two *per cent.* The reply is not acceptable as the Company should have endeavoured as a prudent financial measure to limit the payment to two *per cent* so as to minimize the expenditure.

Monitoring of the projects

2.1.32 We observed that:

- The Planning Commission had prescribed the two tier monitoring mechanism for overseeing the implementation of the agreed terms in and delivery of specified services of the concessionaire agreement. This has not been implemented.

- As per the Concession Agreement (Article 23.1) the Government shall appoint a consulting engineering firm to be independent engineer not later than 90 days from the date of the agreement. The Independent Engineers for supervising the works of the Wagdhari – Ribbanpally road and Dharwad – Ramnagar road were appointed in May 2011 after the delay of 7 months. The delayed appointment resulted in lack of supervision of works in the initial period of the contracts.

- The Concession agreement (Article 22.4) states the Concessionaire shall install, operate and maintain a computer system with round-the-clock connections to the networks of the Government and other related entities for exchange of data and information useful or necessary for efficient and transparent regulation and management of traffic. For this purpose, it shall follow such protocol for Electronic Data interchange as the Government may specify. No such interchange was provided nor insisted upon by the Company (December 2013).

Resource mobilization

Sources

2.1.33 The sources of funding as envisaged by the Government and the present position are detailed below:

Table 2.1.9: Sources of funding envisaged and their present position

Envisaged sources	Present position
1. Budgetary provisions for specific projects.	The Company is in receipt of funds for various projects through fund allocated to Karnataka Public Works Department (KPWD).
2. Grants in aid received from the State Government.	Company was in receipt of Grant-in-aid from various departments to execute specific works
3. Loans from market and financial institutions.	The Company takes loans from HUDCO for execution of projects and the repayment is made through budgetary allocations of the Government.
4. Toll collection on roads transferred to the Company by the Government.	The Company has not been allowed to collect toll from any road.

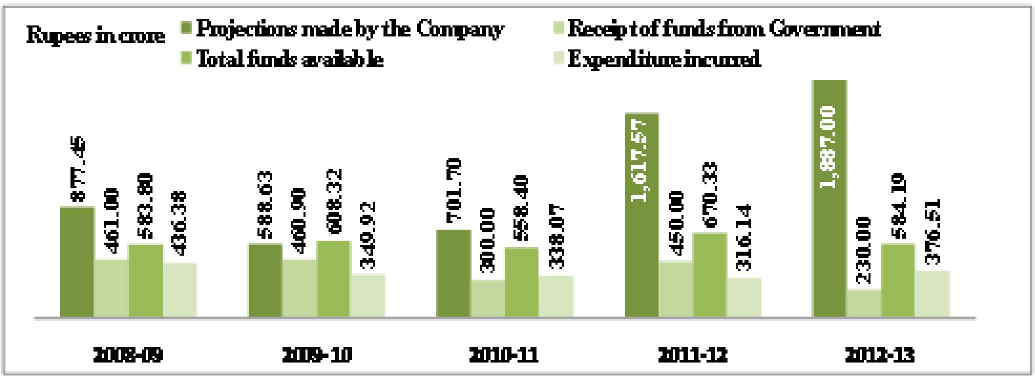
Envisaged sources	Present position
5. Income from land adjacent to the road projects.	No such lands were allocated.
6 Commercial exploitation of the lands transferred to the Company	No such lands were allocated.
7. Levy of tax/duty for provision of infrastructural facilities.	No such levy charges are collected.

We observed that the Company has not been able to generate funds from the envisaged sources and was entirely dependent on the budgetary support of the Government.

It is pertinent to note that the Expenditure Reform Commission, GOK in its Third Report (May 2011) had reiterated the recommendations made by it in its First Report (Jan 2010), wherein it questioned the relevance of the Company and its continuance in the context of its failure to mobilize funds independently. The Commission deliberated that the Company was established as a Special Purpose Vehicle (SPV) for the purpose of raising money from HUDCO and other sources and was supposed to service the same through imposing toll on roads. In reality, the borrowings of the organization were serviced by the Government.

Budgets

2.1.34 The Company prepares annual action plan for each year detailing the ongoing works and fresh works proposed to be taken up and likely expenditure for that year and sends it to KPWD for budgetary allocation. The funds projected by the Company, funds received from KPWD and the expenditure incurred during the five years ended in 2012-13 are illustrated graphically below:



We observed that:

- ➢ The budgetary allocation and actual expenditure were not commensurate with the projections. Even the allotted funds were not fully utilized in any of the years, because of works lingering, as commented in Paragraph 2.1.11 *infra*.

- In addition to the regular works, the Company also undertook works for Departments of the Government receiving special grants. The Company received a total of ₹ 739.32 crore as grants[39] during the last five years and spent only ₹ 418.85 crore, as at end of March 2013.

- The Company kept the unutilized funds of ₹ 649.49 crore in term deposits in nationalized banks as at the end of March 2013. Despite parking money in fixed deposits, the Company availed (November 2012) a loan of ₹ 189.20 crore at an interest of 11 *per cent* from HUDCO for funding two road projects[40]. The Company had drawn ₹ 23.20 crore and paid interest on borrowings in excess by ₹ 42.53 lakh[41] (up to December 2013) of the interest accrued on term deposits.

Karnataka Road Fund

2.1.35 The GoK constituted a High-level Task Force (HLTF) in 1999, which recommended setting up of a dedicated and non-lapsable Road Fund (the Karnataka Road Fund) to be administered by an autonomous Road Fund Board.

The Government of Karnataka created Karnataka Road Fund only in March 2009 and contributed ₹ 250 crore to a Personal Deposit Account. Mysore Minerals Limited[42] was to contribute ₹ 250 crore to the Road Fund. Instead, Mysore Minerals Limited contributed ₹ 50 crore in the equity of the Company as at June 2013.

The Company withdrew ₹ 240 crore from Personal Deposit account for meeting PPP expenses after obtaining approval of the GoK. The Company accounted the same as specific grants received from the Government. The expenditure out of this grant upto June 2013 was ₹ 25.31 crore and the balance was held in term deposits by the Company.

Acknowledgements

2.1.36 We acknowledge the co-operation extended by the Departments of the Government of Karnataka and the Company in facilitating the conduct of audit.

Conclusions

We concluded that:

- **There were many instances of faulty preparation of estimates, design changes, delay in land acquisition and getting forest clearances, which resulted in time and cost overrun, in execution of road and bridge works.**

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[39] For Tourism Projects, PPP Projects, Mangalore Airport road Projects, Special Development Plan.
[40] Sandur-Hospet and Kudlagi-Sandur-Tornagal roads.
[41] Calculated at 2 *per cent* for twelve months (December 2012 to December 2013) on ₹ 23.20 crore.
[42] A Public Sector Undertaking held by the Government o f Karnataka.

- **For Phase bridges, the estimates and the designs were prepared by the executing contractors that too after award of contracts, instead of the Company preparing them. The conditions in the contracts were changed subsequent to award of the contract resulting in undue advantage to the contractors. The pattern of quotations indicated bid rotation.**

- **The Company was entirely dependent on the budgetary support of the Government. It did not generate funds from the envisaged sources though the primary purpose of setting up the Company was independent mobilization of funds.**

- **The Company proposed (June 2006) to float special purpose vehicle (SPV) for executing the road projects on BOT/BOOT basis by raising resources through commercial borrowings and to collect toll. However, the Government issued orders for construction of roads through PPP on BOT basis, without forming SPV, allowing the private partner to toll and appropriate the entire revenue to themselves for 30 years. The opportunity for the Government to obtain a return on investment has been lost.**

- **The PPP Projects attracted a lukewarm response. Of the three projects taken up till date (December 2013), two are lingering on after 2 to 3 years.**

- **There were changes in design and use of materials after the three PPP projects were awarded and such expenditure was not factored in the cost of the project. We observed that in view of the likelihood of tolling being reduced on Dharwad- Ramnagar Road, on account of restriction of the road width, there would be significant impact on the project financials.**

- **The decision of the Board of Directors to offer the construction of the Chikkanayakanahalli- Hassan Road with rigid pavement with concession period of 30 years, in contravention of the suggestion of the Technical Committee, had resulted in the Company foregoing revenue from the 21st year to 30th year to the concessionaire.**

- **The two tier monitoring mechanism as envisaged by the Planning Commission has not been put in place. Independent Engineers for supervising the projects were appointed seven months after the stipulated date.**

- **Electronic Data interchanges for analyzing traffic census and sampling are yet to be created.**

Recommendations

We recommend that:

- **As the Company was set up as a Special Purpose Vehicle, it should function accordingly and should generate and expend its own funds for achieving its objectives.**

- **Estimates and design of the roads and bridges projects prepared by Consultants and Contractors did not match with actuals. Therefore, these need to be examined and evaluated independently before approval.**

- **The practice of entrusting the task of designing and estimating the projects after award of works should be eschewed.**

- **Survey of land and the process of acquisition should be started in advance, once Detailed Project Reports are finalised. An institutional mechanism to co-ordinate the entire process of land acquisition and various clearances is required to be put in place to avoid delays and overruns.**

- **The possibility of executing projects under Joint Venture model through a revenue sharing mode between Company and private partner needs to be explored.**

- **The two-tier monitoring mechanism suggested by the Planning Commission for overseeing the implementation of the agreed terms and delivery of specified services of the concessionaire agreement needs to be implemented at the earliest.**

- **The Electronic Data Interchange for efficient and transparent regulation and management needs to be put in place at the earliest.**

2.2 Performance Audit on '*Procurement, storage and release of essential commodities by Public Sector Undertakings*'.

Executive Summary

Introduction

Food management in the State Sector has three basic components: procurement of food grains from farmers affording them remunerative prices, distribution of food grains particularly to the vulnerable sections of the society at affordable prices and maintenance of food buffers for food security and price stability. The Decentralised Procurement Scheme (DCP), empowering the States to procure food grains, was introduced in 1997-98. The State of Karnataka came into the scheme in the year 2004-05. The Public Sector Undertakings which undertake the procurement, storage and distribution of food grains in the State are Karnataka Food and Civil Supplies Corporation Limited (KFCSC) and Karnataka State Warehousing Corporation (KSWC).

Profiles of the institutions involved

KFCSC is responsible for procurement of paddy and other coarse grains through Minimum Support Price (MSP) operations and from Central Pool; maintaining the Targeted Public Distribution System(TPDS) and implementing other allied schemes of the Governments such as Sampoorna Grameena Rojgar Yojana, Flood Relief Scheme and Mid-day Meal Scheme.

KSWC is the agency to store food grains and other commodities. KSWC also acts as a procuring agency under the MSP operation as and when directed by the Government of Karnataka. KFCSC is the major user of the storage facilities.

Objectives of the Performance Audit

The performance audit was conducted to ascertain whether estimation of requirements of food grains and its procurement, allotment and off-take were adequate and as per the policies; the activities were efficient and effective; essential commodities were released in time and as per the directions/orders of Government/agencies; and monitoring and internal control systems were adequate, appropriate and efficient.

Requirement of essential commodities

The GoI allotted food grains to the State for 31.29 lakh Below Poverty Line (BPL), including Anthyodaya Anna Yojana (AAY) families. The allotment was at the rate of 29 Kgs of rice for every family.

The GoK, however, had identified BPL cardholders (including AAY) by adopting its own criteria and the number of cardholders determined was 106.13 lakh cardholders as at end of March 2009 and 98.34 lakh cardholders as at end of March 2013. The GoK supplied food grains to the cardholders who were not in the BPL category (as defined by the Planning Commission), categorizing them as 'Extra BPL' (EBPL).

GoK reduced the quantity of supply of rice to BPL card holders (excluding AAY families) from 29 Kgs per cardholder to a maximum of 20 Kgs.

Procurement of rice

Production in the State *vis-à-vis* procurement

The performance of KFCSC, the sole agency vested with the responsibility of MSP operations and procurement of levy rice was poor. It succeeded in procuring only 4.712 (2.37 *per cent*) lakh MTs, against the production of 198.45 lakh MTs in the years from 2008-09 to 2012-13. This situation had resulted in drawing bulk of the requirements from the Central Pool of food grains for supplying to the families coming under BPL and AAY. The production in the State was sufficient to meet the requirement of TPDS.

Procurement of Custom Milled Rice

Hulling and distribution

Hulling was never completed within the dates prescribed by GoI in any of the last four years ended 2012-13. The delays in hulling ranged from 5 months in 2009-10 to 13 months in 2011-12. Hulling for 2012-13 was yet to be

completed (December 2013). The distribution of rice to the TPDS after receipt of rice was also delayed.

Economic cost *vis-a-vis* actual

One of the objectives of the DCP was to reduce the cost of procurement and thereby, reduce the subsidy burden on Governments. Our analysis indicated that the procurement of paddy by KFCSC was not economical.

Compared with the economic cost fixed by the GoI of ₹ 18.34 for 2009-10 and ₹ 18.38 for 2010-11 for a Kg of rice for procurement in the State, the actual cost at the point of release to TPDS was ₹ 22.30 and ₹ 28.79 respectively. The increase in cost was on account of high interest charges incurred for holding stock and excessive charges paid for transportation, milling and storage. The MSP operations in the decentralised set up had only increased the subsidy burden.

The FCI had booked the cost of procurement and distribution of rice as ₹18.27 and ₹ 19.83 per Kg in 2009-10 and 2010-11.

Mill Point Levy Rice

Poor collection

A quantity of 58.70 lakh MTs of paddy was milled in the year 2011-12 and 56.42 lakh MTs in 2012-13, assessed on the basis of the quantum of electricity consumed. In terms of extant of the Levy Order, the millers and dealers were required to make available 13.03 lakh MTs and 12.11 lakh MTs of rice for levy in the two years, which is 33.33 *per cent* of the quantity milled.

The GoK lowered the target for supply of Levy rice to 3 lakh MTs for 2011-12 and 3.5 lakh MTs for 2012-13. The GoK reduced (December 2012) the target for 2012-13 further to 1.5 lakh MTs. The Levy Order, however, did not have a provision to reduce the targets for levy collection.

The actual collection of rice from millers during 2011-12 was only 2.03 lakh MTs and in 2012-13, it was even lesser at 0.59 lakh MTs. There were no initiatives to ensure compliance with the Levy order in terms of the rice procurement from the dealers, in any of the years.

Extra cost on account of failure to meet the levy target

Procurement of targeted quantity of levy rice would have made the State less dependent on the Central Pool (FCI) and reduced the cost of TPDS.

The total quantum of mill point levy rice not collected and/or not offered was 22.52 lakh MTs in 2011-12 and 2012-13. The additional cost incurred for procurement of this quantity from Central Pool was about ₹ 948.61 crore.

Procurement of Maize

Cost of transportation of maize

KFCSC procured 4.22 lakh MTs of maize directly from farmers during 2008-09 and 2009-10 and KSWC procured 1.30 lakh MTs during 2009-10. The quantity of maize procured was sold by FCI through tenders.

The transportation charges paid by KFCSC were 45 *per cent* more than the rates fixed by GoI in 2008-09 and 311 *per cent* in 2009-10. The excess cost incurred worked out to ₹ 9.09 crore.

The cost of transportation incurred by KFCSC in 2009-10 was very high (₹ 56.94 per quintal) in comparison to costs of KSWC and KSCMF (₹ 29.73 and ₹ 46.90 per quintal respectively) who were also involved in similar operations in the same year.

Storage

Storage in private godowns

KFCSC had not been initiating action to reserve space in Government owned warehouses for storage of their procurements. KFCSC hired private godowns for storing the food grains.

Distribution

Determination of eligible families for supply of food grains

The State supplied food grains to the cardholders, who were not coming under the BPL category as per the Planning Commission, categorizing them as 'Extra BPL category' (EBPL).

The GoK identified 31.24 lakh cards as excess or fictitious in January 2011. Prior to 2011 these cards were part of the BPL/EBPL categories.

The number of APL cardholders identified by GoK in the State ranged between 52.98 lakh during 2008-09 and 34.99 lakh during 2012-13. While GoI had been supplying rice for supply to APL families as per their assessment on regular basis, those supplies did not reach the APL families.

Supply of Rice, Wheat and Sugar

The GoI had allotted food grains for distribution to BPL and AAY cardholders approved by them at the rate of 35 Kgs per family per month (29 Kgs rice and 6 Kgs wheat per family per month) from April 2002 onwards. GoK had, however, adopted different parameters for distribution of food grains. This system restricted the eligibility of BPL families to a maximum of 23 Kgs.

Electronic weigh bridges at wholesale points

The Commissioner (FCS&CA) directed (June 2010) all the wholesale nominees of the state to install electronic weigh bridge within a period of three months; otherwise, their wholesale trade license was liable to be cancelled. KFCSC has not installed so far stating (June 2013) that no fund was released by the GoK for the purpose.

System lapses in procurement, storage and distribution

We observed that there were system deficiencies in the procurement, storage and distribution processes, which resulted in misappropriation of stock and shortages of food grains. The Company had no system of monitoring the quantity received at procurement centres, quantity handled, quantity of stock/bags loaded in trucks at procurement centres and reconciliation of quantities received at storage point with loaded quantities. The system of checking the quality of food grains procured was also deficient.

Internal Control and Internal Audit

The KFCSC has not devised appropriate Management Information System to generate and disseminate reliable consolidated information of its activities. There were no manuals relating to procurement, accounting and audit. Physical verification of stock procured under MSP Operations was not conducted periodically.

Our conclusions and recommendations are given at the end of the Performance Audit Report.

Introduction

2.2.1 Food management in the State Sector has three basic components: procurement of food grains from farmers affording them remunerative prices, distribution of food grains particularly to the vulnerable sections of the society at affordable prices and maintenance of food buffers for food security and price stability. The instruments for food management are the Minimum Support Price (MSP), fixing of quota for compulsory procurement of food items – the levy and Central Issue Price (CIP). The Decentralised Procurement (DCP) Scheme empowering the States to procure food grains was introduced in 1997-98. The State of Karnataka came into the scheme in the year 2004-05. The Public Sector Undertakings (PSUs) which undertake the procurement, storage and distribution of food grains[43] in Karnataka are Karnataka Food and Civil Supplies Corporation Limited (KFCSC) and Karnataka State Warehousing Corporation (KSWC).

Profiles of the institutions

2.2.2 KFCSC was incorporated in September 1973 as a wholly owned Government Company with the primary objective of procuring, lifting and distributing food grains under the Targeted Public Distribution System (TPDS) and implementing other allied schemes of the Governments such as Sampoorna Grameena Rojgar Yojana (SGRY), Flood Relief Scheme, and Mid-day Meal Scheme. Market intervention to stabilize the prices so as to provide protection to the growers of paddy and other coarse grains through Minimum Support Price (MSP) operations was also the responsibility of the KFCSC. The management of the KFCSC is vested in a Board of Directors (BoD) with Chairman and nine Directors. KFCSC has 29 District Offices (DOs), 194 Wholesale Points (WSP) and 178 retail points.

KSWC was established to store food grains and other commodities and consequent on enactment of the Warehousing Act, 1962, KSWC was deemed to have been established under Section 2 (k) of the said Act. KSWC also acts as a procuring agency under the MSP operation as and when directed by Government of Karnataka (GoK). The Management of the KSWC is vested in a BoD with Managing Director, Chairman and nine Directors. KFCSC is the major user of the storage facilities.

Scope of Audit

2.2.3 The present performance audit, conducted between April and September 2013 covered the procurement and distribution activities carried out by the KFCSC and the activities relating to storage undertaken by KSWC, during the period 2008-09 to 2012-13.

[43] **Essential commodities for the purposes of this Performance Audit are paddy, rice, maize, wheat and sugar dealt by the two Public Sector Undertakings and intended primarily for Targeted Public Distribution System.**

In KFCSC, we perused the records in Head Office at Bangalore and in 9[44] of the 29 District Offices, as also the records in 14 of 74 wholesale points coming under the selected districts. The selection for test check district officers was done applying stratified method based on turnover. The wholesale points were selected on random basis. In KSWC, 5 of the 7 Regional Offices were selected linking them to the utilization of the storage capacity and which are in the districts subjected to audit in KFCSC. In these regional offices, 19 of the 36 warehouse centers were selected for check based on pre-set criteria[45].

Audit Objectives

2.2.4 The performance audit was conducted to ascertain whether the:

- Estimation of requirements of essential commodities in the State and its procurement, allotment and off-take were adequate and as per the policies, procedure and directions of GoI/GoK.
- Operational activities of the godowns were efficient and effective and as per rules, procedures and guidelines.
- Essential commodities were released in time and as per the directions/orders of Government/agencies.
- Financial management was effective.
- Manpower Management, Monitoring and Internal Control System were effective.

Audit Criteria

2.2.5 The Audit criteria were derived from the following sources:

- Policies of the Governments, Acts, Orders and Guidelines of the GoI/GoK for procurement and allotment of food grains;
- Projections by the Government and other agencies;
- Annual targets fixed for procurement and milling of paddy; and
- Purchase orders, Agreements for handling, hulling and transportation.

Audit Methodology

2.2.6 We examined the files/records related to procurement including MSP operations, storage and distribution of food grains and the relevant orders and guidelines issued by the GoI/GoK.

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[44] Shimoga, Davanagere, Gulbarga, Yadgir, Mandya, Bellary, Haveri Hassan and Bangalore.

[45] MSP Operations, capacity, stock of KFCSC and misappropriations noticed by the management.

An Entry conference was held in May 2013 to appraise the GoK and the Management of the objectives of the Performance Audit. The audit findings were reported to the GoK/Management and discussed in an exit conference held on 6 November 2013. The Exit conference was attended by the Principal Secretary to the Government, Food, Civil Supplies and Consumer Affairs (FCS&CA) Department and the Commissioner (FCS&CA), and the Principal Accountant General.

Overall position of procurement and releases of food grains

2.2.7 The procurement and release of food grains made by KFCSC and KSWC for the period 2008-09 to 2012-13 were as follows:

Table 2.2.1: Procurement and release of food grains

(Quantity in lakh MTs)

Food grains	Opening Stock (April 2008)	Purchase/ transfers during 2008-13	Total	Releases / transfer during 2008-13	Closing Stock (31 March 2013)
Rice	0.15	79.68[46]	79.83	79.63	0.20
Wheat	0.05	13.26[47]	13.31	13.23	0.08
Maize	0.00	5.52	5.52	5.47	0.05
Ragi	0.00	0.37	0.37	0.37	0.00
Sugar	0.01	3.54	3.55	3.48	0.07

(Source: Annual accounts of KFCSC. Note: Quantity less than 1,000 MTs ignored.)

Audit Findings

2.2.8 The audit findings are discussed under three major headings: procurement, storage and release.

Requirement of essential commodities

2.2.9 In order to cater to the requirement of beneficiaries under Targetted Public Distribution System (TPDS), the State had to procure food grains under DCP Scheme (Custom Milled Rice and Mill Point Levy rice). The FCI supplied the balance quantity from the Central pool.

The GoI allotted food grains to the State for 31.29 lakh Below Poverty Line (BPL), including Anthyodaya Anna Yojana (AAY) families[48]. The allotment was at the rate of 29 Kgs of rice for each family every month. In addition, specific quantity was allotted every month to meet the requirement of Above Poverty Line (APL) cardholders.

The number of BPL families (including AAY) as per the Planning Commission, number of cardholders as per the GoK, and the requirement of food grains are given below:

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[46] **Includes CMR, Mill point levy rice and allotment by FCI.**

[47] **Represents procurement from FCI.**

[48] **Beneficiaries belonging to Scheduled Caste, Scheduled Tribe, agricultural labourers, families headed by widows, and persons above 60 years of age not having social security.**

Table 2.2.2: BPL cardholders and requirement of food grains

(Card holders in lakh numbers. Quantity in lakh MTs)

Year	No of BPL families (including AAY) as per Planning Commission	No of BPL cardholders (including AAY) as per GoK	Rice		Wheat		Sugar	
			Require-ment for BPL families including AAY as per GoI norms[49]	Require-ment for BPL families including AAY as per GoK norms[50]	Require-ment for BPL families including AAY as per GoI norms	Require-ment for BPL families including AAY as per GoK norms	Require-ment for BPL families including AAY as per GoI norms[51]	Require-ment for BPL families including AAY as per GoK norms
2008-09	31.29	106.13	36.93	26.77	7.64	4.25	2.55	1.27
2009-10	31.29	98.43	34.25	24.92	7.09	3.98	2.36	1.18
2010-11	31.29	96.34	33.53	24.34	6.94	3.87	2.32	1.16
2011-12	31.29	96.01	33.41	24.34	6.91	3.89	2.30	1.15
2012-13	31.29	98.34	34.22	24.81	7.08	3.94	2.36	1.11

The GoK, however, had identified BPL cardholders (including AAY) by adopting its own criteria and the number of cardholders varied between 106.13 lakh cardholders as at end of March 2009 to 98.34 lakh cardholders as at end of March 2013. The GoK supplied food grains to the cardholders who were not coming under the BPL category (as defined by the Planning Commission). These additional cardholders were categorized as 'Extra BPL category' (EBPL).

GoK reduced the quantity of supply of rice to BPL Card holders (excluding AAY families) from 29 Kgs. per cardholder to a maximum of 20 Kgs per month.

Considering the BPL (including EBPL) category beneficiaries identified by the State, the requirement is given in the above Table 2.2.2. The distribution of rice and other foodgrains are brought out in paragraph 2.2.16 *infra*.

Procurement

Procurement of Rice

2.2.10 The procurement of rice in the State is effected in two different ways. These are Custom Milled Rice (CMR) through MSP operations and Mill Point Levy of rice.

Custom Milled Rice: In order to ensure availability of Minimum Support Price[52] (MSP) to farmers and to maximise procurement, GoI introduced

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[49] Considering 29 Kgs for BPL (including AAY) cardholders.

[50] Considering 29 Kgs for AAY cardholders and maximum of 20 Kgs for BPL cardholders as fixed by the GoK

[51] Considering four members per card at 500 grams per member as fixed by GoI.

[52] MSP is fixed by the GoI based on rates recommended by the Commission for Agricultural Costs and Prices (CACP), which takes into consideration cost of cultivation and remunerative prices to farmers on their products. While determining MSP, the CACP considers the cost of production, trends in domestic and international market prices, stock position, changes in agricultural terms of trade, inter-crop price parity, prices fixed in previous years *etc*.

(1997-98) Decentralised Procurement (DCP) Scheme. GoK had been a DCP state since Khariff Marketing Season (KMS) 2004-05. The main objectives of the DCP were to eliminate the over-dependence on Food Corporation of India (FCI) for public distribution of food grains, to free FCI from the task of procurement of food grains and to reduce the subsidy burden, as the economic cost of rice procured directly by the States would be lower than the economic cost of FCI.

As per directions of GoK, KFCSC (sole agency) procures paddy. KFCSC formulates operational guidelines for procurement of paddy and coarse grains before commencement of each KMS. KFCSC opens procurement centers in various districts, mainly at APMC yards, giving wide publicity. The paddy is procured after certification by the graders appointed by the Agriculture Department. KFCSC then invites tenders for milling the paddy and the resultant rice is termed as Custom Milled Rice (CMR). The CMR is accounted as part of the Central Pool.

Mill Point Levy rice: As per the Karnataka Rice Milling Regulation and Rice and Paddy Procurement (Levy) Order, 1999, every miller or dealer shall sell to the GoK or its designated agent 33.33 *per cent* of the quantity of each variety of rice conforming to specifications, obtained from hulling of the paddy on its account every day. Alternatively, the miller/dealer could sell a fixed quantity of rice in such installments as agreed with the Department by giving an Undertaking in writing setting out the quantity, variety *etc.*

Production in the State *vis-à-vis* procurement

2.2.10.1 The details of production, requirement, procurement, and allotment of rice for public distribution are tabulated below:

Table 2.2.3: Details of production, requirement, procurement and allotment of rice

(Quantity in lakh MTs)

Year	Production of rice in the State	Requirement of rice in the State for public distribution[53]	Procurement of CMR and Mill point levy rice by KFCSC	Allot-ment of GoI from FCI	Total procurement available for distribution
2008-09	40.31	33.04	0.002	17.52	17.52
2009-10	38.76	33.50	0.10	19.91	20.01
2010-11	42.97	32.66	0.45	20.60	21.05
2011-12	39.53	33.37	3.50	19.64	23.14
2012-13	36.88	31.25	0.66	22.08	22.74
Total	**198.45**	**163.82**	**4.712**	**99.75**	**104.46**

(Source : Agriculture Department, Allotment Orders, Procurement Section Records of the KFCSC, Economic Survey and Workings by Audit,).

We observed that:

- The performance of KFCSC, the sole agency in the State vested with the responsibility of MSP operations and procurement of levy rice, was poor. The KFCSC succeeded in procuring only 4.712 lakh MTs, as

[53] **Considering 29 Kgs each for AAY cardholders, 20 Kgs each for BPL cardholders (maximum) and actual allotment by GoI for APL card holders.**

against the production of 198.45 lakh MTs in five years from 2008-09 to 2012-13, which was mere 2.37 *per cent* of the requirement.

- This situation had resulted in drawing bulk of the requirements of food grains from the Central Pool to feed the families coming under BPL and AAY, though the State had sufficient production to meet the requirement of public distribution system. This had resulted in additional costs towards transportation of rice from various other States to Central Pool and for onward transfer to the State, which is brought out in Paragraph 2.2.11.1 in detail.

Procurement of Custom Milled Rice

2.2.10.2 The Purchase Manager in charge of procurement centre undertakes the procurement operation and was required to maintain stock register at the time of procurement and enter daily transaction into stock register with name of the persons from whom procurement was made, date of procurement and quantity procured. The procurement officer should enter the number of bags and quantity in the truck chit while sending the stock to storage centers and the details were to be recorded at unloading ends as well. The details of paddy procured and CMR obtained for the procurement seasons 2008-09 to 2012-13 are given below:

Table 2.2.4: Details of paddy procured and CMR received

(Quantity in MTs)

Procure-ment season	Procure-ment	Paddy sent for hulling	Shortage of paddy	Quantity of CMR received	Shortfall in receipt of CMR considering the norm of 67 *per cent* [54] of the quantity of paddy
2008-09	367	367	0	246	0
2009-10	15,454	15,327	127	9,963	0
2010-11	34,811	34,627	184	23,200	0
2011-12	2,29,451	2,20,007	9,445	1,47,249	156
2012-13	21,764	19,865	Hulling was not completed.	12,908	Hulling is in progress

(Source: Records of Procurement Section of KFCSC; Fully revised estimates of area, production and productivity of agricultural crops of the Department of Economics and Statistics, Agriculture Department).

On a test check of the records[55] during KMS 2011-12 when maximum procurement of paddy was made in procurement centers, we observed that:

- The number of bags and quantity were not entered immediately in the daily transaction stock registers at the procurement centers. The details were recorded based on truck chits received back from the storage points.
- The number of bags received at the storage points varied from the number of bags loaded to the trucks from the procurement centers.

[54] **Since the quality of paddy procured during Rabi Marketing Season (RMS) was not of the Fair Average Quality (FAQ), test hulling was conducted in six districts (Bellary, Koppal, Raichur, Shimoga, Davangere, Yadgir) and conversion rate fixed (May 2010) at 65 *per cent,* as against 67 *per cent* for Khariff Marketing Season 2009-10.**

[55] **Stock receipts, transport bills, truck chits and related documents.**

In Hirekerur and Hanagal procurement centres of Haveri District, the quantity loaded (March 2012) in 51 trucks was 17,112 bags as per the truck chits. Whereas, the quantity recorded at unloading points (storage centre) was 16,075 bags. The short receipt of 1,037 bags was not explained.

In Shimoga District, the quantity loaded (January 2012/April 2012/March 2013) in 52 trucks was 11,823 bags as per the truck chits. Whereas, the quantity recorded at unloading points (storage centres) was 11,463 bags. There was a short receipt was 360 bags.

- In three District Offices[56], test check of payment to farmers during 2011-12 revealed that payments (₹ 75.63 lakh) to farmers in 69 cases were made after delays ranging from 10 to 45 days from the date of procurement, which was in contravention of the guidelines. The guidelines issued in October 2011 stipulated that payment had to be made the next day after day of procurement.

Hulling and distribution

2.2.10.3 KFCSC entered into agreements with rice mills for hulling paddy procured under the DCP Scheme. The mills were required to deliver the Custom Milled Rice (CMR) at the pre-determined quantity of 67 *per cent* of paddy hulled.

We observed that the terms of the hulling agreements, entered into by the District Offices (Shimoga, Davanagere, Yadgir and Mandya) with rice mills, were not uniform. The agreement of each district had different terms and conditions regarding number of days allowed for hulling and levy of penalty for non-delivery of CMR within the stipulated period.

The details of season-wise procurement of paddy, actual date of completion of hulling and month of final release to TPDS are tabulated below:

Table 2.2.5: Details of procurement of paddy, its hulling and final release to TPDS

Season	Procurement period	Quantity of paddy Procured (in MTs)	Due dates for completion of hulling as per GoI directives	Actual dates of completion of hulling	Delay in hulling (months)	Month of final release to TPDS
KMS	October 2008 to March 2009	366.65	No date fixed	July 2009	-	April 2011
RMS and KMS	June 2009 March 2010	15,454.28	October 2010	March 2011	5	November 2011
KMS	October 2010 to March 2011	34,810.74	August 2011	July 2012	11	October 2012
KMS	October 2011 to March 2012	2,29,451.46	July 2012	August 2013	13	August 2013
KMS	October 2012 to March 2013	21,764.32	September 2013	Hulling not completed (December 2013)	-	Still under issue

(Source: Compiled from the procurement section records)

[56] **Davanagere, Yadgir and Mandya.**

We observed that:

- The hulling was not completed within the due dates as prescribed by GoI, in any of the last four years (2009-10 to 2012-13). Though the procurement season was October to March of every year, the KFCSC had finalised the tenders only between March and November every year during 2009-10 to 2012-13. Finalization of tender and entering into hulling agreements delayed delivering CMR within the stipulated time. The delays ranged between 5 months (in 2009-10) and 13 months in 2011-12. Hulling for 2012-13 is yet to be completed (December 2013).

- Even after hulling, releases of rice to the TPDS were delayed by seven months in 2009-10 and two months in 2010-11.

- In Yadgir and Mandya Districts, registers were not maintained to monitor the release of paddy for hulling and delivery of CMR.

The Government replied (December 2013) that KFCSC provided stock position of rice every month and on the basis of the declared stock, food grains were allotted in the following month. The reply is a statement of the procedure followed in issue of rice and does not address the specific issues of delays in hulling and issue to TPDS.

Economic cost *vis-a-vis* actual

2.2.10.4 *Economic cost:* The provisional rate of Custom Milled Rice delivered to the Central Pool during each season in respect of each State (or its agencies) consists of Minimum Support Price, incentive bonus, statutory charges, 'mandi' labour charges, custody and maintenance charges, interest charges, milling charges and cost of gunny bags and administrative charges. This is issued by the Department of Food and Public Distribution, GoI. The rates for Raw rice (Common, Grade A) and Par-boiled rice are separately fixed and intimated by GoI.

Data on cost of procurement: Once the entire rice for the season is issued under TPDS, the accounts of procurement, storage, transportation and other incidentals are audited by a Statutory Auditor and forwarded to GoI for settlement.

The actual cost of procurement has been determined only for the years 2008-09 to 2010-11[57]. The compilation of data relating to costs of 2011-12 and 2012-13 are not prepared yet (December 2013) as the rice procured in these years are yet to be fully distributed under TPDS. The procurement in 2008-09 was minimal at 246 MTs only and therefore not considered for our analysis.

[57] The figures for 2010-11 are yet (December 2013) to be audited by the Statutory Auditor appointed for this purpose.

The details of economic costs for interest, milling and storage fixed by GoI *vis-à-vis* the actuals for the two years 2009-10 and 2010-11 are given below:

Table 2.2.6: Details of economic cost of rice *vis-à-vis* actuals

	2009-10			2010-11		
Total paddy procured (MTs)	15,424.90			34,810.70		
Total rice procured (MTs)	9,963.40			23,199.80		
	Economic cost	**Actual**	**Increase**	**Economic cost**	**Actual**	**Increase**
	Rate per Kg of rice (₹)			**Rate per Kg of rice (₹)**		
MSP for the Custom Milled Rice	14.93	15.49	0.56	15.04	15.41	0.37
Cost towards interest charges on acquisition and distribution	0.92	2.65	1.73	0.84	9.90	9.06
Milling charges including transportation, handling and gunny bag charges	1.22	3.01	1.79	1.27	2.07	0.80
Storage, custody and maintenance charges	0.21	0.30	0.09	0.23	0.50	0.27
Other costs	1.06	0.85	(-) 0.22	1.00	0.91	(-) 0.09
Total	**18.34**	**22.30**	**3.96**	**18.38**	**28.79**	**10.41**
Cost incurred by FCI	**NA**	**18.27**	**NA**	**NA**	**19.83**	**NA**

(Source: Records of claim preferred by KFCSC; Annual accounts of FCI. NA=Not available)

We observed that:

- The GoI had factored interest charges for six months considering two months for storage and four months for distribution. The limit fixed for interest charges for acquisition was ₹ 0.92 (per Kg of rice) in 2009-10 and ₹ 0.84 per Kg in 2010-11. Against this, the KFCSC had incurred ₹ 2.65 per Kg in 2009-10 and ₹ 9.90 per Kg in 2010-11.
- The storage, custody and maintenance charges per Kg of rice incurred by KFCSC were ₹ 0.30 and ₹ 0.50 against ₹ 0.21 and ₹ 0.23 fixed by the GoI for 2009-10 and 2010-11 respectively.

Consequently, the actual costs of procurement were ₹ 22.30 and ₹ 28.79 for a Kg. of rice respectively for 2009-10 and 2010-11, compared with the total (economic) cost of ₹ 18.34 and ₹ 18.38 fixed by the GoI for respective years. The total increase in cost in excess of the limit fixed by the GoI, for procurement of 3.32 lakh MTs in 2009-10 and 2010-11 was ₹ 28.10 crore. The excess cost was due to delay in hulling of paddy and distribution of rice as brought out in the Table 2.2.5.

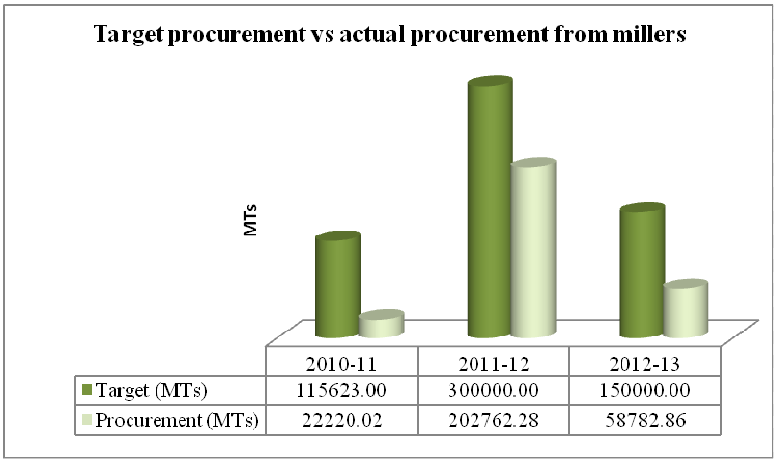
We reviewed the costs incurred by the FCI in the same periods (2009-10 and 2010-11) for purposes of comparison. The FCI had booked a cost of ₹ 18.27 and ₹ 19.83 per Kg in their accounts for procurement and distribution of rice in 2009-10 and 2010-11 respectively. It could be seen that these costs were much lesser than the costs incurred by the KFCSC in the corresponding years, which were ₹ 22.30 and ₹ 28.79 per Kg respectively.

Thus the procurement of paddy under DCP Scheme by the KFCSC was not economical, leading to increasing the subsidy burden on GoI. The objective of reducing the burden of subsidy through decentralized procurement was defeated.

Procurement of Mill Point Levy rice

2.2.11 As per the Karnataka Rice Milling Regulation and Rice and Paddy Procurement (Levy) Order, 1999, every miller or dealer shall sell to the GoK or its designated agent 33.33 *per cent* of the quantity of each variety of rice conforming to specifications, obtained from hulling of the paddy on its account every day. The quantum was to be fixed on the basis of electricity consumed by the millers in the previous year. Alternatively, the miller/dealer could also sell a fixed quantity[58] of rice in such installments as agreed with the Department by giving an Undertaking in writing setting out the quantity, variety *etc*. The rice was procured at the rates fixed by GoI.

Up to 2010-11, FCI was collecting levy rice from the millers. GoK appointed (April 2011) KFCSC as agency for procurement of levy rice from the licensed millers and dealers in the State.



The targets fixed by the GoK for mill point levy and actual procurement for the period 2010-11[59] to 2012-13 are given in the graph alongside.

We observed that:

- GoK had not taken any action to ensure procurement of rice from the dealers the quantity as provided in the Levy Order, in any of the years.
- The Levy Order stipulated that the miller had to make available 33.33 *per cent* of the quantity of each variety of rice obtained from hulling of paddy. In the year 2010-11, 58.70 lakh MTs of paddy was milled and in the year 2011-12 a total of 56.42 lakh MTs, computed on the basis of the quantum of electricity[60] consumed. The millers had to make

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[58] As per circular of November 1999, 18 *per cent* of estimated production was considered as target for 1999-2000, and the same has not been modified since. The Commissioner, Food Department had clarified (September 2013) that the applicable percentage of rice to be supplied was 18 *per cent*, in case an 'Undertaking' was provided as per Levy Order.

[59] Prior to 2010-11, FCI was the agency for collection of levy rice in Karnataka. Further, target fixed for 2010-11 was 2.50 lakh MTs, out of which FCI collected 1.34 lakh MTs and balance was to be collected by KFCSC. During the years 2008-09 and 2009-10 FCI collected 1.07 lakh MTs and 0.69 lakh MTs respectively.

[60] The norm for assessment of rice milled is consumption of electricity at the quantum of 40 units for milling a MT of paddy.

available[61] 13.03 lakh MTs and 12.11 lakh MTs of rice respectively in these two years.

The GoK, however, lowered the target to 3 lakh MTs for 2011-12 and 3.5 lakh MTs for 2012-13 in line with a decision taken in the Food Secretaries' meeting. Conceding to the representations of the Karnataka State Rice Millers Association, the GoK reduced (December 2012) the target of 2012-13 further to 1.5 lakh MTs. There was no provision in the Levy Order to reduce the targets for levy collection.

- Even these reduced targets were not achieved. The collection of levy rice in 2011-12 was only 2.03 lakh MTs and 0.59 lakh MTs in 2012-13.
- The Commissioner (FCS&CA) informed (August 2013) the Government that the approximate additional cost for non-collection of the 0.90 lakh MTs (1.5 lakh MTs-0.59 lakh MTs) was ₹ 45 crore and requested (September 2013) the Government for orders regarding recovery at 33.33 *per cent* for 2012-13. But no orders were issued by the GoK.
- The Deputy Director of Food of the respective districts was empowered to take possession of the stocks in the premises of millers to the extent of shortfall plus ten *per cent* thereof; but these powers were never invoked. There were no records to indicate that action was initiated against defaulting millers and dealers in accordance with the Levy Order.

Extra cost on account of failure to meet the levy target

2.2.11.1 Procurement of targeted quantity of levy rice would have made the State less dependent on the Central Pool (FCI) and reduced the cost of Targeted Public Distribution System. The table below gives the difference in cost of levy rice and the average cost of procurement of FCI during 2011-12[62].

Table 2.2.7: Economic cost of levy rice *vis-à-vis* cost of procurement of FCI

Description	₹ per Kg
Economic cost of levy rice from millers in Karnataka	19.07
Average cost of procurement of rice by FCI *plus* additional cost of transportation[63] for supply to Karnataka	23.28
Extra cost	4.21

(Source: Provisional economic cost sheet of GoI for levy rice of Karnataka; Annual Report of FCI for average cost of procurement of rice; Confirmation received from FCI for transportation cost from point of origin to Karnataka.)

[61] After adjustment for custom milled paddy of 0.35 lakh and 2.20 lakh during 2010-11 and 2011-12 respectively and considering 33.33 *per cent* of paddy (or 22.33 Kgs rice of every 100 Kgs paddy milled) as millers had not entered into agreements.

[62] The accounts of FCI for 2012-13 was yet to be uploaded on their website.

[63] The average cost of transportation of FCI was ₹ 79.47 per quintal (Source: Annual Reports of FCI), whereas, the cost of transportation from State of Origin to Karnataka by FCI was ₹ 285 per qtl (Source : As provided by FCI).

The additional cost incurred for procurement of 22.52 lakh MTs[64] from Central Pool during 2011-12 and 2012-13 was about ₹ 948.61 crore.

Depriving beneficiaries of superior variety of rice

2.2.12 As per Rice Levy Order 1999, every miller or dealer shall sell to the State Government or its designated agent 33.33 *per cent* of the quantity of *each variety of rice* conforming to specifications, obtained from hulling of the paddy on his account, every day. KFCSC was receiving Grade-A and Common varieties of rice, which satisfied the 'Fair Average Quality' specified by FCI, under levy.

We observed that more than ninety[65] *per cent* of the land under rice cultivation in the State produces high yielding/hybrid varieties (non-traditional). Yet, KFCSC succeeded in procuring only a quantity of 2.28 lakh MTs of Grade-A rice, while the quantity of Common Grade rice procured was 3.57 lakh MTs during 2008-13. This demonstrated the failure of the Government to make available better quality of rice to the poor under TPDS.

Procurement of Maize

2.2.13 On the directions of GoI the GoK also carries out operations for procurement of maize under MSP scheme. The economic cost of procurement of maize is fixed by GoI. The agencies involved in the procurement process in the State are two Public Sector Undertakings and an agency in co-operative sector. The PSUs conducting the operations for procurement of maize are KFCSC and KSWC. Karnataka State Cooperative Marketing Federation (KSCMF) is the agency in the co-operative sector.

The KFCSC was entrusted with the procurement operations in 2008-09 and 2009-10. KSWC also procured maize in 2009-10. The maize so procured was stored in the godowns of KSWC and also in that owned by private agencies.

KFCSC procured 4.22 lakh MTs of maize directly from farmers during 2008-09 and 2009-10 and KSWC procured 1.30 lakh MTs during 2009-10. The quantity of maize procured was sold by FCI through tenders.

System lapses in procurement of Maize

2.2.13.1 KSWC procured (2009-10) maize at Harapanahalli in Davanagere District and stored a quantity of 7,514.60 MTs valued at ₹ 6.39 crore in godown at Hospet. FCI could lift only 6,444.82 MTs and shortage of 1,069.78 MTs was reported. The KSWC filed (December 2012) a complaint with the police and initiated a departmental enquiry against the erring employee, which was in progress (October 2013).

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[64] **13.03 lakh MTs *less* 2.03 lakh MTs for 2011-12 *plus* 12.11 lakh MTs *less* 0.59 lakh MTs for 2012-13. 22.52 lakh MTs x 421.23 per qtl = ₹ 948.61 crore.**

[65] **Source: Fully Revised Estimates of area, production and yield by Department of Economics and Statistics; Agriculture Department.**

On a test check of 200 truck chits produced to audit, we observed that :

- In 52 cases, against the loaded quantity of 9,957 bags of 95 Kgs each, only 9,135 bags were shown as stored at godowns resulting in shortage of 822 bags.
- In 7 cases, as against the loaded quantity of 1,251 bags of 95 Kgs, 1,688 bags were shown as receipt resulting in excess of 437 bags.
- Trucks had arrived at Hospet (85 Kms) after a delay of 4 to 20 days of loading from Harapanahalli.

The KSWC had no system of monitoring the quantities received at procurement centres, quantity handled and quantity of stock/bags loaded to trucks at procurement centres. There was no system of reconciliation of quantities received at storage point with loaded quantities. These system failures paved the way for misappropriation of stocks.

Cost of transportation

2.2.13.2 One of the elements of the economic cost was the cost incurred for transporting the maize from procurement centres to storage points.

The rates fixed by the GoI and the actual cost incurred by KFCSC, KSWC KSCMF for transportation of maize during 2008-09 and 2009-10 are detailed under:

Table 2.2.8: Actual cost towards transportation of maize by various agencies

(Rate per quintal in ₹)

Year	Rate fixed by GoI	Actual charges of		
		KFCSC	KSWC	KSCMF
2008-09	22.16	32.04	-	47.89
2009-10	13.85	56.94	29.73	46.90

(Source: Economic cost sheet and final claims of PSUs)

We observed that:

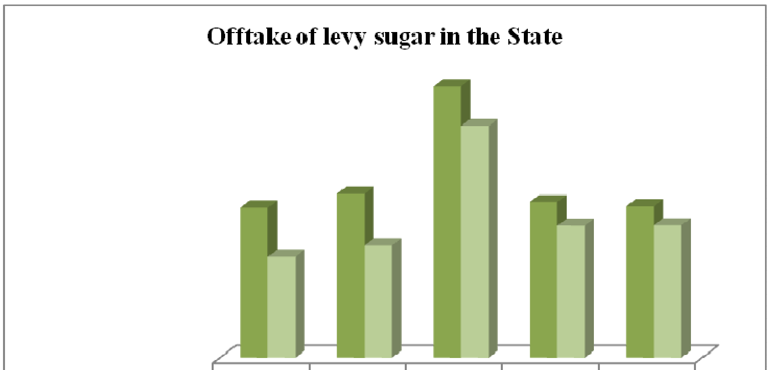
- The charges paid by KFCSC were 45 *per cent* more than the rates fixed by GoI in 2008-09 and 311 *per cent* in 2009-10. The excess cost incurred worked out to ₹ 9.09 crore[66].
- The cost of transportation of KFCSC in 2009-10 was very high (₹ 56.94 per quintal) in comparison to costs of KSWC and KSCMF (₹ 29.73 and ₹ 46.90 per quintal respectively) also involved in similar operations in the same year.

[66] **2.74 lakh MTs x (₹ 32.04-₹ 22.16 per MT) for 2008-09 *plus* 1.48 lakh MTs x (₹ 56.94-₹ 13.85 per MT) for 2009-10= ₹ 9.09 crore.**

Procurement of Sugar

2.2.14 In terms of the Essential Commodities Act, 1955, the domestic producer of Sugar should supply certain fixed percentage of Sugar produced at a price determined by GoI, fixed from time to time. The GoI issues district-wise allotment orders for procurement of levy sugar every month.

The procurement in the State was undertaken by the KFCSC and the Taluk Agricultural Produce Co-operative Marketing Societies. The details of allotment and actual procurement of Sugar are given alongside.



	2008-09	2009-10	2010-11	2011-12	2012-13
Allotment (MTs)	108714	118659	196330	112696	109630
Offtake (MTs)	73389	81301	167740	95549	95863

As against the target of 6.46 lakh MTs during 2008-13, only 5.14 lakh MTs was only collected/offered resulting in short procurement of 1.32 lakh MTs. The shortfall in procurement included 0.39 lakh MTs of KFCSC. The shortfall in procurement was mainly due to stock of Sugar being unavailable in factories for lifting (79 cases), non-release by factories (119 cases) and non-lifting by wholesalers (36 cases)[67].

As per Section 7 of Essential Commodities Act, 1955, default attracted penalty in the form of fine and imprisonment. The Commissioner (Cane Development) had not initiated any action against the defaulting mills for not depositing the levy sugar as per the target fixed.

Non-procurement of levy sugar as per the target not only resulted in violation of levy order by the sugar mills but also defeated the objective of providing sugar at subsidized rates to ration card holders.

Storage

2.2.15 The food grains procured by the KFCSC/KSWC are stored in godowns owned and operated by KSWC, CWC and Private agencies. For release under TPDS, the Commissioner allocates food grains and sugar to each district. On the basis of allotment order, the District Managers obtain release orders from FCI. These grains are stored at the wholesale points of KFCSC.

KFCSC had not been initiating action to reserve space for storage of their procurements in advance. This resulted in requests for godown space being made to KSWC when the actual procurement was underway by which time KSWC had allotted most of its available space to other clients. Failure to

[67] **Data related to the period July 2009 to March 2013.**

initiate action in advance to reserve space in Government owned godowns resulted in KFCSC hiring private godowns.

System lapses and other related issues

2.2.15.1 Instances of shortages when food grains were stored are given below:

Paddy stored in private godown

2.2.15.2 The KFCSC procured 1.05 lakh MTs of paddy in Shimoga district during KMS 2011-12. The KFCSC hired private godowns to store the paddy, stating non-availability of KSWC/CWC godowns. 72,841 MTs (69.22 *per cent*) of paddy was under the control of one private agency[68]. A quantity of 15,000 MTs was stored in Covered and Plinth (CAP) storage (open yard) on the recommendations (February 2012) of DC, Shimoga. The Private Warehousing Agency had given (January 2011) an undertaking to store this quantity under CAP storage without any storage loss. KFCSC had instructed them to follow the guidelines prescribed by FCI for CAP storage.

The paddy was being issued for hulling. During an inspection in March 2013, shortage in quantity of paddy stored was noticed and it was estimated at 8,500 MTs. The total shortage as at end August 2013 as per the hulling statement was 7,757.61 MTs valued at ₹ 11.03 crore.

We observed that in view of the delay in finalising agreement for hulling and to prevent the likely damage due to impending monsoon rains, the private agency was instructed to shift the grains from CAP storage to inside the godowns. The private agency claimed a bill for shifting only for 11,988.83 MTs though 15,000 MTs was stored in CAP storage. Raising of bills for a lower quantity was a conspicuous indication of shortage. This was not given adequate attention by KFCSC. This issue of shortage was brought to the notice of the BoD only in December 2013.

Receipt and storage of maize

2.2.15.3 KFCSC procured 29,541.62 MTs of maize at Bellary procurement centre (2008-09). A quantity of 5,224.36 MTs was stored in private godowns. Against this only 2,861.21MTs was released and the balance quantity of 2,363.16 MTs valued ₹ 2.10 crore was found not available (August 2010). A fact finding team, which investigated the issue found (August 2010) that 2,363.16 MTs of maize was not procured at all. Payments were made based on bogus grain vouchers in certain cases. Payments were admitted without signatures of farmers/ procurement in-charge in certain other cases. The case was referred to Lokayukta (March 2011) and was pending (December 2013).

We observed that a team of officers of the KFCSC which visited the procurement centre in June 2009 had reported about absence of details of payment to farmers in the payment register, non-obtaining certificate from

[68] **Suraksha Warehousing Corporation Limited.**

SWC/CWC for the quantity stored, absence of periodical physical verification of stocks and non-reconciliation of bank accounts, during compilation of accounts related to MSPO. Inspite of lapses in system being reported, KFCSC failed to initiate action until August 2010, by which time huge shortages had occurred.

2.2.15.4 KFCSC procured 1,48,388.85 MTs of maize and stored in KSWC and CWC godowns. FCI was to call tenders for sale of this quantity through open auction. FCI issued (September 2010 and December 2010) release order for the entire quantity of maize to parties, against which only 1,41,532.01 MTs was released and the balance 6,856.84 MTs valued ₹ 5.24 crore was shown as storage loss.

CWC, while furnishing the explanation to the KFCSC for the shortage stated (September 2011) that the stocks were not up to the mark, there was excess percentage of damaged grains, and that damaged grains became powder. FCI, in a letter to the Food , Civil Supplies and Consumer Affairs Department, GoK complained (September/October 2010) that maize procured in Shimoga and Davangere (approximately 1 lakh MTs) were found to be beyond rejection limit of GoI's specifications and fetched the lowest rates in the market because of poor quality.

We observed that the system of checking the quality of food grains procured was deficient as is evident from the reports of Central Warehousing Corporation (CWC) and FCI.

We further observed that KSWC preferred (September 2011) claim with the insurer an amount of ₹ 1.15 crore[69] being the loss incurred on account of misappropriation. The insurer rejected the claim stating (December 2011) that there was delay in preferring the claim by the Company. Civil case has been filed against the agencies for recovery of shortage, which is under progress (December 2013).

Non-preference of claims in time with the insurer

2.2.15.5 The KSWC had procured maize up to March 2010 and releases were completed only in July 2011. The total shortage of maize was 5,224.77 MTs.

A quantity of 2,565.72 MTs was misappropriated by the Warehousing Managers of KSWC. 1,069.78 MTs in Harapanahalli (as brought out in paragraph 2.2.13.1) and 1,495.94 MTs in the Davanagere during storage of maize. KSWC had initiated a Departmental enquiry, which was in progress (December 2013).

We observed that KSWC preferred (September 2011) claim with the insurer[70] for an amount of ₹ 1.26 crore being the loss incurred on account of misappropriation at Davanagere. The insurer rejected the claim stating (December 2011) that there was delay in preferring the claim by the Company.

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[69] 1,306.46 MTs of procured by KFCSC and stored KSWC godowns at Shimoga.
[70] Fidelity Floater Policy.

The Company failed to prefer claims with insurer within the admissible time (14 days).

Distribution

2.2.16 The GoI makes allocation of food grains to the GoK at Central Issue Price (CIP)[71] for Targeted Public Distribution System (TPDS) and Other Welfare Schemes (OWS), after considering the CMR/Levy rice. The CMR and Levy rice procured by the State are stored in the warehouses and are part of the Central Pool.

The allocation of food grains under TPDS is made on the basis of 1993-94 poverty estimates of the Planning Commission and the population estimates of the Registrar General of India as on 1 March 2000 or the number of such families actually identified and ration cards issued to them by the GoK, whichever is less. The number of BPL cardholders (including AAY) in the State as per Planning Commission was 31.29 lakh, for which allocation was made. GoI allotted food grains to APL families also.

Determination of eligible families for supply of food grains

2.2.16.1 The GoI envisaged review of BPL and AAY list every year for deletion of ineligible families and inclusion of eligible families. The GoI prescribed certain norms for identification of BPL families. The GoK had, however, identified BPL cardholders (including AAY) by adopting its own criteria. The number of BPL cardholders in the State varied between 106.13 lakh cardholders as at end of March 2009 and 98.34 lakh as at end of March 2013.

We observed that:

- The State supplied food grains to the cardholders, who were not coming under the BPL category as per the Planning Commission, categorizing them as 'Extra BPL category' (EBPL).
- The GoK identified 31.24 lakh cards as excess or fictitious in January 2011. Prior to 2011 these cards were part of the BPL/EBPL categories.
- The number of APL cardholders identified by GoK in the State ranged between 52.98 lakh during 2008-09 to 34.99 lakh during 2012-13. While GoI had been supplying rice for APL families as per their assessment on regular basis, APL families had not got any food grain.

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[71] **Rate at which the GoI sells the food grains to the State, for issue under TPDS.**

Supply of rice, wheat and sugar

2.2.16.2 The allotment and offtake of rice, wheat and sugar for TPDS in the State during the five years 2008-09 to 2012-13 are given below:

Table 2.2.9: Allotment and offtake of rice, wheat and sugar.

(Quantity in lakh MTs)

Food grain	Description	2008-09	2009-10	2010-11	2011-12	2012-13
Rice	Total Allotment	**17.52**	**20.01**	**21.05**	**23.14**	**22.73**
	BPL families	10.86	10.87	11.93	13.44	12.35
	APL families	6.66	9.14	9.12	9.70	10.38
	Total Offtake	**17.13**	**19.44**	**20.24**	**22.47**	**21.97**
	BPL families[72]	14.86	16.80	17.13	19.31	18.38
	Supplies to other Schemes/APL families	2.27	2.64	3.11	3.16	3.59
Wheat	Total Allotment	2.95	3.47	3.73	2.92	3.84
	Total Offtake	2.88	3.21	3.46	2.87	3.76
Sugar	Total Allotment	1.09	1.19	1.96	1.13	1.10
	Total Offtake	0.73	0.81	1.68	0.96	0.96

(Source : Workings by Audit, Allotment Orders, Procurement Section Records of the KFCSC/Department, Economic Survey).

- Though the GoI had allotted food grains for distribution to BPL and AAY cardholders approved by them at the rate of 35 Kgs per family per month (29 Kgs rice and 6 Kgs wheat per family per month), from April 2002 onwards, the GoK had adopted a 'unit' system for distribution restricting the eligibility of BPL families to a maximum of 23 Kgs[73].

- The GoI supplied the quantities allotted to AAY and BPL families at the Central Issues Prices (CIP). The GoK supplied the food grains to AAY and BPL families (as per the Planning Commission's allotment) at State Issue Price, which is lower than the CIP. Supplies to BPL beneficiaries termed as EBPL which were not recognized by the GoI, were also supplied at the State Issue Price. The difference between the Central Issue Price and State Issue Price for issues to EBPL category during the period 2008-09 to 2012-13 amounted to ₹ 1,661.20 crore[74] which was an extra burden on the State Exchequer.

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[72] **Offtake under BPL and AAY and diversion from APL to EBPL category.**

[73] **The scale of issue of rice and wheat as per the Gok**

Rice	Wheat
AAY : 29 Kgs per card	**AAY : 6 Kgs per card**
BPL : 1 person = 1 unit **1 unit = 4 Kgs; 2 units = 8 Kgs** **3 units = 12 Kgs; 4 units = 16 Kgs** **5 units and above = 20 Kgs**	**BPL : 1 person = 1 unit** **1 and 2 units = 1 Kg** **3 units = 2 Kgs** **4 and above = 3 Kgs**

[74] **Being difference between CIP and rate issued to beneficiaries for five years (2008-13) on 27.05 lakh MTs of rice and 2.65 lakh MTs of wheat.**

- As per the norm of GoI, the minimum per head per month quantum of levy sugar to be distributed was 500 grams, with effect from February 2001. The State, however, was issuing 1 Kg per card per month irrespective of the number of members in the family.

  The KFCSC was not lifting the entire quantity of sugar allotted from the sugar mills. Thus, even the reduced quantum of sugar specified by the GoK was not supplied to the beneficiaries.

- The food grains procured under various schemes were lying with the Company for unusually long periods of time, as per its books of accounts. There was reportedly a balance of 999.22 MTs of rice and 168.43 MTs of wheat not utilised under Sampoorna Grameena Rojgar Yojana (SGRY) scheme. This scheme was closed in 2007-08. 448.94 MTs of rice and 25.64 MTs of wheat meant for flood relief in 2009-10; 45.49 MTs of rice and 8.48 MTs of wheat at DO, Mandya meant for Zilla Panchayat; 15.32 MTs of rice meant for distribution under schemes such as Food For Work, Jawahar Rojgar Yojana, and Employment Assurance Scheme were not issued, though schemes were closed.

The Commissioner informed (December 2013) that supply of rice to a category known as EBPL with the rice allotted for APL category families was done by the GoK from December 1997 onwards. The Department/ GoK, however, did not furnish any records to show the basis for creation of a new category (EBPL) and has the approval of competent authorities to provision of APL rice to them at BPL rates. The rationale for adoption of reduced entitlement and connected records were also not made available to audit.

System lapses in distribution

2.2.16.3 Instances of lapses in the system when food grains were given for distribution are given below:

Sl.No	Facts of the case	System lapses / Our observations
1	There was illegal sale of TPDS rice in *Chikkanayakanahalli WSP* and the Depot Manager was caught by Lokayukta (September 2012). Stock verification revealed that there was shortage of stock of 95.62 MTs of rice, 8.81 MTs of wheat and 0.57 MTs of Sugar. A show cause notice was issued (December 2012) directing the official to repay ₹ 15.57 lakh, but the amount has not been paid so far (December 20013)	• As per the guidelines issued (November 2010) by KFCSC, the District Managers were bound to visit all wholesale, retail and other Depots twice in a month, and submit reports. In this case the District Manager had visited the wholesale deport only twice (April and August 2012) after the delinquent Depot Manager took over charge (January 2012). • The Depot Manager concerned was earlier dismissed (May 2006) from service. The Board of Directors reinstated him in June 2006 with a condition that the official should not be Depot Manager. It was, however, seen that as per the orders of the Chief Minister he was transferred (September 2010) to Arasikere WSP and posted as Depot Manager.

Sl.No	Facts of the case	System lapses / Our observations
2	In *Mysore WSP,* there was shortage of stock of rice (March 2013), wheat and Sugar valued at ₹ 78.24 lakh. Criminal cases were lodged in April 2013 against the godown manager. Departmental enquiry was yet to start (October 2013).	• Depot Manager of the Mysore WSP in his monthly tour diary had not recorded any difference between the book balance and the physical stock. • Internal Auditors, who had conducted audit for each month failed to report it.
3	In *Sandur WSP* there was shortage (November 2012) of stock (TPDS and Mid Day Meal rice *etc.*) of ₹ 41.33 lakh[75]. Departmental enquiry, started in March 2013, was yet to be finalised (December 2013).	• The official was working as Depot Manager at Sandur, WSP for more than four years in violation of the guidelines (April 2006), which limited the tenure to a maximum of one year. • The misappropriation that took place over a period of six months was not reported. Shortages were not reported in the tour diary of the District Manager.
4	In *Siraguppa WSP* during stock verification, shortage was noticed and the value of shortage was assessed at ₹ 22.06 lakh[76].	

Wholesale points

2.2.17 The KFCSC had 194 wholesale points. The KFCSC lifted food grains allotted under TPDS by 10th of every month. The retail outlets, which distributed food grains under TPDS to the cardholders lifted the food grains before 20th of every month.

On inspection of wholesale points at Haveri, Shimoga and Hassan Districts, the following were observed:

- As per the policy of the KFCSC, the issue of stocks should be on FIFO method. In Haveri and Shimoga the truck loads were directly unloaded in the retailers' vehicles in violation of the policy. The 'First In' stocks, continued to lie in warehouses while 'Last In' stocks got transferred to retailers.

- In Hassan Rural West the stock of wheat was 336.19 quintals as per the stock register. There was excess physical stock of 10 quintals

Electronic weigh bridges at wholesale points

2.2.17.1 The Commissioner (FCS&CA) directed (June 2010) all the wholesale nominees of the state to install electronic weigh bridge within a period of three months; otherwise, their wholesale trade license was liable to be cancelled.

[75] Rice: 4,307.21 quintals, wheat: 697.15 quintals, levy sugar:81.65 quintals, 244 ltrs of palm oil, 7.81 quintals of MDM toor dal and other uncontrolled commodities.

[76] Includes other PDS items and non-remittance of sale proceeds of ₹ 16,747.

The BoD decided (June 2010) to install electronic weigh bridges in 10 own wholesale points, in addition to 39 places where construction of new godowns had been planned. The GoK was requested (August 2010) to provide financial assistance of ₹ 5.88 crore.

We observed that no progress was made to install the electronic weight bridge, in spite of reminders from GoK. KFCSC replied (June 2013) that no fund was released by the GoK for the purpose (December 2013).

Fund Management

Reimbursement of subsidy claims

2.2.18.1 Under the Decentralised Procurement Scheme (DCP), GoI determines state-specific Economic Cost[77] of food grains and the difference between the Economic Cost and sales realisation at Central Issue Price (CIP) under TPDS and Other Welfare Schemes (OWS) is passed on to the KFCSC as food subsidy.

In terms of GoI's instruction, 95 *per cent* of food subsidy claimed quarterly by the KFCSC was to be released in advance by GoI as provisional subsidy and balance five *per cent* representing final claims was reimbursable on submission of audited Annual Accounts of each KMS to GoI not later than four months after the accounts of the relevant KMS were audited by the Statutory Auditors. The position of claims in respect of CMR and Mill Point Levy rice are given below:

2.2.18.2 The details of submission of final claims for reimbursement of cost of CMR procured under MSP operations are given below:

Table 2.2.10 : Details of submission of final claims for CMR

Particulars	Date of submission of final claim	Amount receivable (₹ in crore)	Delay in submission[78]
2008-09	5.09.12	51.87	2 years 6 months
2009-10	18.02.13	61.23	2 years
2010-11	Pending	Yet to be finalised	1 year 4 months
2011-12	Pending	Yet to be finalised	4 months
2012-13	Hulling not yet completed (December 2013)		
Total		**113.10**	

(Source: As per information furnished by the Company)

There were undue delays in submission of final claims of 2008-09 and 2009-10 ranging from 2 years to 2 ½ years resulting in the Company not being able to avail of funds of ₹ 113.10 crore from GoI. Final bills of 2010-11 and 2011-12 had not been finalised till date (October 2013). The final bills were preferred only after the entire quantity of food grains procured for each season was fully released.

[77] **Acquisition cost including incidental expenses, administrative overheads, handling, storages *etc*.**

[78] **After allowing a period of one year after the completion of procurement operations.**

2.2.18.3 Cost of mill point levy rice is claimed separately. The Company had claimed ₹ 450.27 crore as per provisional costing sheet for the period 2010-11 and 2011-12. The Company received ₹ 430.73 crore, leaving a balance of ₹ 19.54 crore (December 2013).

Sugar Price Equalisation Fund (SPEF)

2.2.18.4 KFCSC lifted Sugar every month at price fixed and as per the allotment made by the GoI, from various sugar factories and transported the quantities to wholesale points for distribution under TPDS at the issue price of ₹ 13.50 per Kg. KFCSC had to initially bear the difference in the cost of sugar procured and issue price along with handling, transportation cost, *etc*. The difference was subsequently reimbursed to the KFCSC by way of subsidy from Sugar Price Equalization Fund[79] (SPEF) of GoI, through FCI.

We observed that the final audit of 2011-12 and 2012-13 is yet to be completed (October 2013) and as such, claims for this period were yet to be preferred.

Revolving Fund

2.2.18.5 The GoK had created a Revolving Fund (RF) and made available working capital for procurement operations under MSP operations 2009-10. The RF was placed under the control of Karnataka State Agricultural Marketing Board (KSAMB). The fund is available for use by KFCSC and KSWC.

KSWC had drawn funds out of the RF for its MSP operations during 2004-05, 2005-06 and 2009-10. Out of ₹ 265.33 crore drawn, KSWC had repaid only ₹ 243.33 crore and balance of ₹ 22 crore along with interest of ₹ 23.02 had not been refunded till date (December 2013).

Finance Department/KSAMB had been regularly reminding KSWC for immediate settlement of all dues to the RF. The main reason for non-payment of the amount was that the KSWC had spend excess amounts on interest, transportation and handling costs and final settlement was yet to be done by GoI.

Price Equalization and Stabilization Fund (PESF)

2.2.18.6 Based on directions (December 1995) of GoK, a Price Equalization and Stabilization Fund (PSEF) was created (November 1996). As per the Order, KFCSC had to remit the surplus income after meeting all the revenue expenditure.

We observed that between 1996-97 and 2012-13, there were 'book adjustments' to the PESF with deposits of ₹ 93.98 crore and withdrawals for an equal amount. Such adjustments did not have the approval of the PESF Committee. Though the issue of non obtaining approval of PESF committee

[79] **Established by GoI from which the differential cost of levy sugar is reimbursed to wholesale nominees.**

had been repeatedly pointed out by the statutory auditors in their reports, no action was taken to obtain the approval of the Committee (December 2013).

Manpower

2.2.19 We observed that:

- In KSWC, as against the sanctioned staff strength of 940, only 405 (43 *per cent*) were in position. The Company, while discussing this issue at the Executive Committee meetings had noted that in many centres due to non-availability of Officers, Junior clerks are placed as incharge warehouse managers and were not competent to carryout warehousing activities in a businesslike manner.

- In KFCSC, as at end of August 2013, the post of DGM (PRO/MKT/CS) was lying vacant since August 2010, DGM (L&D&IT) since February 2012 and Company Secretary since December 2002. The Sr.DGM was looking after all operations and also in charge post of General Manager since April 2013.

- The Managing Director of KFCSC was changed frequently, with tenures ranging from 8 days to 18 months. Between 2008 and 2012, ten Managing Directors served the KFCSC.

- KFCSC had issued (April 2006) guidelines for appointment of Depot Managers, which stated that appointment of any official to wholesale points was to be restricted to a maximum limit of one year, after which the official was to be posted for office work. It was observed that the Depot Managers continued to serve from 15 months to 15 years in 105 Depots in violation of the guideline. Further, Junior Assistants, though not eligible were posted as Depot Managers in the absence of sufficient number of Office Managers and Senior Assistants. This situation had arisen mainly because of a non-recruitment of required staff.

Internal Control and Internal Audit

2.2.20 Internal Control System helps the management to achieve the organizational objectives efficiently and effectively. We observed the following deficiencies:

MIS data and monitoring: The KFCSC has not devised an appropriate MIS to generate reliable consolidated information of activities.

Manuals: There were no manuals relating to procurement, accounting and audit.

Reconciliation with Bank Accounts: The Shimoga District Office did not prepare Bank Reconciliation Statements (BRS) in the last three years 2009-10 to 2011-12. The reconciliation was completed only after appointment of M/s Ramesha & Company, Chartered Accountants, who submitted their report in October 2012. Further, in the BRS of KFCSC for the year 2012-13, the bank pass sheet had shown excess debit of ₹ 1.55 crore for cheques issued by the KFCSC.

Stock verification: Physical verification of stock procured under MSPO was not conducted periodically.

Difference in stock: The closing balance of stock (quantitative details) as on 31 March 2011 was not tallying[80] with the opening balance of stock as on 1 April 2011 in the annual accounts of the KFCSC.

Delegation of Powers: A test check in seven Districts showed that the DMs had issued cheques for amounts beyond the limit prescribed under delegation of powers in 75 instances. In Shimoga, DM issued multiple cheques splitting payment usurping the powers delegated to senior officials, in 15 cases.

Computerization : An MoU[81] was signed (October 2006) between the KFCSC and FCI to implement Integrated Information System for Food Grains Management (IISFM) project, which aimed to put in place an online MIS to give the stock position of food grains kept in central pool, in any given depot at any given point of time. A simplified application of depot module was created in (September 2010). The Project has not been implemented fully (December 2013). In some districts, data was not at all entered, while in other districts, entries were made only in one or two depots.

Acknowledgement

2.2.21 We acknowledge the co-operation extended by the Departments of the GoK and the Companies in facilitating the conduct of audit.

Conclusions

We conclude that:

- **The procurement of rice by KFCSC, the sole procuring agency in the State under DCP and levy schemes, was poor. This had resulted in drawing almost the entire quantity of its requirements from the Central Pool.**

- **The cost of operations had always been on the higher side when compared with the economic cost fixed by GoI, as also with reference to the costs of procurement of FCI.**

- **Hulling and release of foodgrains were delayed. The various elements of cost such as cost of transportation, cost of carrying inventory, charges for storage and other charges exceeded the limits prescribed by the GoI substantially. There were no efforts to keep the costs in check and keep it at economic level.**

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[80] **The difference in respect of rice was (126.17 MTs), wheat (288.35 MTs), ragi (0.30 MTs) and sugar (60.30 MTs).**

[81] **Copy of MoU was not available in the file produced to audit.**

- **The targeted quantity of rice and sugar were not procured from Rice Millers, Dealers and Sugar Mills.**
- **Lack of adequate monitoring and internal control in procurement, storage and release activities resulted in misappropriation, shortage, and procurement of grains of poor quality.**
- **Management Information System in the Company was deficient. Manpower Management, Internal Control System and Monitoring by Management were also deficient.**

Recommendations

- **The KFCSC should strengthen its procurement mechanism by improving the Decentralised procurement activities to maximise the procurement of rice produced in the State. The Levy Order, 1999 should be enforced.**
- **KFCSC should control the cost of transportation, hulling, and carrying inventory. In the context of ensuring food security to the people, the abnormal increase in controllable cost is a huge burden on the exchequer.**
- **Hulling of paddy must be completed within stipulated time. The releases of food grains under TPDS should not be delayed.**
- **The system of periodical checking of the quantity and quality of food grains needs improvement. The system of monitoring the records on the arrivals at procurement centres and transfers to storage points needs to be strengthened.**
- **All eligible BPL families should get the quota of food grains as fixed by the GoI. Identification of eligible beneficiaries through a transparent verifiable mechanism and weeding out of fictitious cardholders should be a regular feature.**