Executive Summary

Background

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

The Report

Based on the audited accounts of the Government of Karnataka for the year ended 31 March 2015, the report provides an analytical review of the annual accounts of the State Government. The financial performance of the State has been assessed based on the FRA, budget documents, Thirteenth Finance Commission Report (XIII FC) and other financial data obtained from various Government departments and organizations. The report is structured in three chapters.

Chapter I is based on the audit of Finance Accounts and makes an assessment of Government of Karnataka's fiscal position as at 31 March 2015. It provides an insight into trends in committed expenditure and borrowing pattern and certain accounting adjustments that have a bearing on the fiscal parameters. A review on the compliance of the Karnataka Government to the provisions of the Karnataka Fiscal Responsibility Act, 2002 has also been brought out.

Chapter II is based on the audit of Appropriation Accounts and gives description of appropriations and the manner in which the allocated resources were managed by the service delivery departments. Issues of budgeting affecting transparency of transactions are also brought out in this Chapter. It also includes parking of funds outside of Government Accounts, by certain corporations/offices coming under the Administrative control of Social Welfare department, in violation of, fiscally prudent norms.

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

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

Audit findings and recommendations

Fiscal position

The State continued to maintain Revenue Surplus during 2010-15 and maintained the fiscal deficit relative to Gross State Domestic Product (GSDP) below the limit laid down under FRA, as amended from time to time. During 2014-15, the State had a Revenue Surplus of ₹528 crore, an increase of ₹175 crore over the previous year. During the year, though an amount of ₹500 crore was provided for transfer to the Consolidated Sinking Fund from General Revenues in the original budget estimate, this was reduced to ₹250 crore in the revised estimates. However, no investment was made in 2014-15 also. Compression of Capital Expenditure of ₹500 crore through an adjustment entry under Consolidated Fund of the State, revenue expenditure (₹151.44 crore), against the norms of Accounting principles and non-adjustment of ₹15.52 crore (net) to the Karnataka Silk Worm Cocoon and Silk Yarn Development and Price Stabilisation Fund had a bearing on the achievement of revenue surplus and maintaining of the fiscal indicators as per the Fiscal Responsibility Act (FRA). There was an increase in revenue expenditure by 16 *per cent* over the previous year, while the growth rate of revenue receipts was also 16 *per cent*.

Fiscal deficit during the year was ₹19,576 crore, an increase of ₹2,484 crore over the previous year. Primary deficit was at ₹9,772 crore, an increase by ₹707 crore over the previous year.

Incremental non-debt receipts of ₹14,497 crore was less than the incremental primary expenditure of ₹15,204 crore and could not cover the incremental interest burden (₹1,777 crore).

State's own resources

The ratio of the State's tax revenue to GSDP has shown an increasing trend since 2010-11, except during 2013-14. It increased from 9.40 *per cent* in 2010-11 to 10.20 *per cent* during the year. It also included book adjustment of ₹1215 crore which increased the revenue receipts artificially during the year.

Ratio of non-tax revenue to revenue receipts has significantly reduced from 5.77 *per cent* in 2010-11 to 4.50 *per cent* during the year. Its ratio to GSDP (₹6,85,207 crore) was insignificant (0.68 *per cent* in 2014-15), implying the need for mobilizing non-tax revenue in the coming years by revising user charges, as recommended by Expenditure Reforms Commission. Non remittance of user charges is an area that escapes the scrutiny by the Legislature. Therefore, a system for remittance/release of such money needs to be put in place for tracking the revenues/expenditure and assurance to indicate that the money generated from the sector is ploughed back into the same sector for development.

Optimization of XIII Finance Commission Grants

State Government could not avail grants amounting to ₹279 crore under the heading 'Improving Outcome Grants' as the State Government had not adhered to the GOI guidelines/requirements and their alternate proposals were disagreed to by the GOI. Further, failure to implement the schemes and non utilisation of amounts released under first instalment resulted in non-allotment of further grants.

Revenue expenditure

Expenditure under social and economic sector registered growths of 21 and 13 *per cent* respectively over the previous year, while the growth in general services was 13 *per cent*. The share of plan expenditure in total revenue expenditure increased from ₹26,970 crore in 2013-14 to ₹33,831 crore in 2014-15. Eighty four *per cent* of revenue expenditure consisted of committed expenditure on salaries, pensions, interest payments, subsidies administrative expenses, grants-in-aid and financial assistance and devolutions to Local Bodies. The committed expenditure consumed 97 *per cent* of uncommitted revenue receipts. Explicit subsidy decreased from ₹13,323 crore in 2013-14 to ₹11,153 crore during the year whereas implicit subsidy increased from ₹1,690 crore in 2013-14 to ₹2,973 crore during the year. As per the recommendation of the Twelfth Finance Commission, expenditure forming implicit subsidy should be brought out in Finance Accounts for transparency. However, this is not being done.

Quality of expenditure

The share of capital expenditure to total expenditure during the current year was 16 *per cent* as against 17 *per cent* in the previous year. Funds aggregating ₹1,144 crore were blocked in incomplete projects as at the end of 2014-15. The return from investment of ₹61,727 crore as of 31 March 2015 in Companies / Corporations was negligible (₹74.84 crore). The investment included ₹25,007 crore (41 *per cent*) in Companies/ Corporations under perennial loss. During the year the Government invested ₹2,666 crore in these Companies and the cumulative loss had increased by ₹205 crore.

Funds and other Liabilities

The interest accrued on the investment made out of Consolidated Sinking Fund of ₹1,000 crore made in 2012-13 amounting to ₹136.14 crore did not form the part of the assets of the State Government as the transaction did not pass through the Government books. The transactions relating to Karnataka Silk Worm Cocoon and Silk Yarn Development and Price Stabilisation Fund (₹15.52 crore) were not carried out during the year. Non transfer of commensurate expenditure (₹244.03 crore) to Karnataka Forest Development Fund, transfer of ₹640 crore to Karnataka Fiscal Management Fund, compressed/overstated the revenue expenditure. The Guarantee Redemption Fund has not been revived.

Compliance to the Karnataka Fiscal Responsibility Act, 2002

Accounting adjustments relating to noncash transactions, waiver of tax dues etc. had its impact on the fiscal indicators like fiscal deficit and revenue surplus being shown as within the limits. Doing away with accounting adjustments to showcase the expenditure at bloated levels, should be avoided. The figures of expenditure/receipt should flow from the normal accounting transactions with regard to the adherence to the accounting principles rather than an intervention to justify the transactions.

Debt sustainability

Sixty three *per cent* of the open market borrowings are in the maturity bracket of above seven years. The borrowing programme of the State Government has to be need based, as the accumulated borrowing has a bearing on the liabilities for future generations. Parking of funds for long periods either in bank/deposit account should be avoided as it reflects poor cash management.

Financial Management and Budgetary Control

Against total provision of ₹1,53,936 crore during 2014-15, an expenditure of ₹1,31,365 crore was incurred, resulting in unspent provision of ₹22,571 crore (15 *per cent*). As the expenditure under the revenue and capital sections fell short of even the original budget, the exercise should be made more transparent by bringing out a separate document - an explanatory memorandum detailing the reasons for enhanced provision, to be placed before the Legislature, as per the practice in the Union Government. Excess expenditure over provision of ₹189 crore under Demand number 8 and ₹0.06 crore in Demand number 10 for the year 2014-15 are required to be regularized under Article 205 of the Constitution. Expenditure aggregating ₹150.79 crore in 11 cases which should have been treated as 'New Service/New instrument of service' was incurred without the approval of the Legislature. While supplementary provision of ₹687.73 crore in 25 cases was unnecessary, re-appropriation of funds in 35 cases was made injudiciously, resulting in either un-utilised provision of funds or excess over provision. In 15 grants, ₹3,313 crore was surrendered in the last two working days of the financial year. Contingency Fund transactions were not in accordance with the rules, as it revealed that the funds were released in excess of requirement in one case while in another the release was made by bending the stipulation prescribed.

Supplementary budget could not be assessed for being fiscally neutral as it failed to 'exhibit the statement indicating the corresponding curtailment of expenditure/augmentation of revenue to fully offset the impact of the supplementary estimate in relation to the budget targets of the current year' as required under the provisions of KFRA.

In the Department of Social Welfare, the funds released for welfare schemes to implementing officers, companies/corporations, were deposited in Savings Bank/Fixed Deposit (₹2,188 crore) and these funds remained for long periods without being expended which was in contravention to prudent fiscal management practices.

Budgetary control should be strengthened in all departments to avoid cases of provision remaining unutilized as huge unutilised provisions were observed across several grants. The budgetary exercise should be more realistic as cases of persistent non-utilisation of funds, excessive provision of funds and huge provisions remaining unutilised, were observed.

The budget/expenditure suffered inadequate disclosure on account of operation of incorrect budget lines for release and accounting of Urban Local Bodies (ULB) grants. Distinct heads should be opened for accommodation of budget/expenditure of the ULB sector to ensure that the grants released to ULBs should be distinct from that of the State Sector. The budget document brought out for devolutions to ULBs should be reviewed for classification of expenditure, avoiding merger with the State budget.

Financial Reporting

Detailed bills, against abstract contingent bills, were wanting over a long period and large sums of money were being retained in Personal Deposit Accounts against the principle of legislative financial control. Non-reconciliation of expenditure and receipts was to the extent of 39.55 *per cent* of total expenditure and 1.25 *per cent* of total receipts, respectively. There were adverse balances under certain Debt, Deposit and Remittance (DDR) heads which required remedial action for their clearance.