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. Karnataka was the first State to enact (September 2002) the Karnataka Fiscal Responsibility Act (KFRA), 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 for 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 2017, 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 KFRA, budget documents, Fourteenth Finance Commission Report (XIV FC) and other financial data obtained from various Government departments and organisations. 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 on 31 March 2017. It provides an insight into trends in committed expenditure and borrowing pattern and certain accounting adjustments that have a bearing on the fiscal parameters.

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.

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 is given at the end of the Report.

Audit findings and recommendations

Fiscal position

The State recorded Revenue Surplus during 2012-13 to 2016-17 and maintained the fiscal deficit relative to Gross State Domestic Product (GSDP) below the limit laid down under KFRA, as amended from time to time. During 2016-17, the State had a Revenue Surplus of ₹1,293 crore, a decrease of ₹496 crore over the previous year. There was an increase in revenue expenditure by 13 *per cent* over the previous year, while the revenue receipts increased by 12 *per cent* during the year.

Fiscal deficit during 2016-17 was ₹28,664 crore, increase of ₹9,495 crore (50 *per cent* in terms of amount) from ₹19,169 crore in 2015-16. Primary deficit was ₹15,814 crore, an increase of ₹7,988 crore over the previous year. Incremental non-debt receipts of ₹14,112 crore was less than the incremental primary expenditure of ₹22,101 crore.

State's own resources

The ratio of the State's tax revenue to GSDP was between 7.3 and 7.8 *per cent* during 2012-13 to 2016-17. It also included book adjustment of ₹344.30 crore, which increased the revenue receipts artificially during the year on account of Guarantee Commission (₹52.91 crore) from Karnataka State Co-operative Marketing Federation Limited, Karnataka Slum Development Board, Rajiv Gandhi Rural Housing Corporation Limited, Karnataka Road Development Corporation Limited, Karnataka State Police Housing and Infrastructure Development Corporation and adjustment of motor vehicle tax dues of transport corporations adjusted as subsidy (₹291.39 crore).

Ratio of non-tax revenue to revenue receipts reduced significantly from 5.07 *per cent* in 2012-13 to 4.35 *per cent* during the year. Its ratio to GSDP (₹11,17,334 crore) was insignificant (0.52 *per cent* in 2016-17), implying the need for mobilising non-tax revenue in the coming years by revising user charges, as recommended by Expenditure Reforms Commission.

Optimisation of XIV Finance Commission Grants

During 2016-17, there was short release of ₹20.41 crore under Basic Grants to PRIs. Grants under Disaster relief continued at 75:25 ratios as per the recommendations of the XIII Finance Commission, pending passage of Goods and Service Tax bill in Parliament. The release of Performance Grants to Panchayat Raj Institutions (PRIs) and Urban Local Bodies (ULBs) commenced from 2016-17 onwards. There was short release of ₹2.70 crore under Performance Grants to PRIs. The XIV FC Commission made some other recommendations especially on professions tax, setting up of water regulatory authority and State Electricity Regulatory Commission Fund etc.

Revenue expenditure

Expenditure under social and economic sector registered growth of 18 and 19 *per cent* respectively over the previous year, while the growth in general services was two *per cent*. The share of plan expenditure in total revenue expenditure increased from ₹40,009 crore in 2015-16 to ₹47,962 crore in 2016-17. Eighty *per cent* of revenue expenditure consisted of committed expenditure on salaries, devolutions to local bodies, interest payments, pensions, subsidies, administrative expenses, grants-in-aid and financial assistance. The committed expenditure consumed 79 *per cent* of revenue receipts. Explicit subsidy increased from ₹13,149 crore in 2015-16 to ₹14,387 crore during the year, whereas implicit subsidy decreased from ₹3,913 crore in 2015-16 to ₹3,714 crore during the year. As per the recommendations of the XII 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 year 2016-17 was 19 *per cent* (₹28,150 crore) as against 15 *per cent* (₹20,316 crore) in the previous year. Funds aggregating to ₹2,027 crore were blocked in incomplete projects at the end of 2016-17. The return from investment of ₹63,115 crore as on 31 March 2017 in Companies/Corporations was negligible (₹82.50 crore). The investment included ₹24,474 crore (39 *per cent*) in Companies/Corporations under loss. During the year, the Government invested ₹123 crore in these Companies and the cumulative loss decreased by ₹45 crore.

Funds and other Liabilities

The interest accrued on the investment out of Consolidated Sinking Fund of ₹2,070 crore amounting to ₹317.45 crore did not form the part of the assets of the State Government as the transaction did not pass through the Government books. Green Tax Cess of ₹57.89 crore along with relevant expenditure was not transferred to Green Tax Fund. Transfer of ₹4,621.53 crore from Consolidated Fund to Infrastructure Initiative Fund (IIF), Bangalore Metro Rail Corporation Limited (BMRCL) fund and Chief Minister Rural Road Development (CMRRD) fund in Public Account, write back of Zilla Panchayat Fund II and Taluk Panchayat Fund II balances (₹1,086.28 crore) artificially inflated revenue expenditure. The Guarantee Redemption Fund was not revived.

Debt sustainability

Open Market Loans had a major share (49 *per cent*) in the total fiscal liabilities of the State. The percentage of debt to GSDP in 2016-17 was 19.81 *per cent*, which was within the limit of 25 *per cent* as mandated under KFRA 2002. The net debt available to the State during 2016-17 (₹23,736 crore) increased by 40 *per cent* when compared to the previous year. The interest relief of ₹192.42 crore on National Small Savings Fund (NSSF) loans as recommended by XIII FC was short released.

Financial Management and Budgetary Control

Against total provision of ₹1,86,052 crore during 2016-17, an expenditure of ₹1,73,045 crore was incurred, resulting in unspent provision of ₹13,007 crore (seven *per cent*). Release of money from Consolidated Fund to the implementing agencies should be based on requirement of funds rather than to avoid lapse of budget grants. It was revealed that expenditure stood overstated to an extent of ₹5,898 crore mainly due to release of funds to ZP/TP remaining unutilised to an extent of ₹1,381 crore, transfer of only the revenues of ₹4,622 crore to fund account, ₹260 crore related to scholarships to minority students released to Directorate of Minorities kept in PD account etc. Excess expenditure of ₹1,085.41 crore (₹176.75 crore under Demand No.1, ₹55.37 crore under Demand No.5, ₹632.06 crore under Demand No.14, ₹59.81 crore under Demand No.20 and ₹161.42 crore under Demand No.29) over provision for the year 2016-17 are required to be regularised under Article 205 of the Constitution. Supplementary provision of ₹2,047.40 crore in 26 cases was unnecessary, re-appropriation of funds in 62 cases was made injudiciously, resulting in either un-utilised provision of funds or excess over provision. In 15 grants, savings in excess of rupees five crore amounting to ₹1,789.36 crore was surrendered in the last two working days of the financial year.

In four cases under three grants, the executive orders of ₹1.03 crore for incurring the expenditure not covered in the budget initially were issued as 'additionalities', which were not regularised subsequently, in the supplementary estimates, resulting in excess expenditure of ₹0.44 crore.

In five cases, involving five grants, excess expenditure amounting to ₹124 crore, which should be treated as 'New Service/New Instrument of Service' was incurred without the approval of the Legislature.

An amount of ₹45.69 crore was misclassified under the capital/revenue section affecting the fiscal indicators. Misclassification under the object head 059 – Other Expenses, an omnibus head, to record minimum expenditure, amounted to ₹1,265.77 crore.

Supplementary budget was not 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.

Payment of excess family pension continued, as an amount of ₹1.39 crore in 151 cases was drawn in excess, and there was repetition of excess payment of family pension amounting to ₹1.23 crore in 79 cases.

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

The budget/expenditure suffered from 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

Non-payment Detailed Contingent (NDC) bills, against Abstract Contingent (AC) bills, were pending over a long period and large sums of money were retained in Personal Deposit (PD) accounts against the principle of Legislative financial control. Non reconciliation of expenditure was to the extent of 19 *per cent* of total expenditure. There were adverse balances under certain Debt, Deposit and Remittance (DDR) heads, which required remedial action for their clearance. Suspense accounts needs speedy clearance by taking up the matter with the concerned authorities as they have a bearing on the cash balance of the Government. The transaction of the Government account should be transparent to exhibit the correct head of account as there were instances of provision/ expenditure made under defunct object heads of account. Drawal of money from Consolidated Fund unless required for immediate use should be avoided, as it was noticed that in certain cases, the money was drawn and deposited in PD account/bank accounts of the implementing agencies.