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 2016, 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 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 2016. 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 has been given at the end of the Report.

Audit findings and recommendations

Fiscal position

The State continued to maintain Revenue Surplus during 2011-12 to 2015-16 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 2015-16, the State had a Revenue Surplus of ₹1,789 crore, an increase of ₹1,261 crore over the previous year. Compression of Capital Expenditure of ₹2,418 crore through an adjustment entry under Consolidated Fund of the State, revenue expenditure (₹213.37 crore) accounting as recovery of over payment, write back of ZP Fund II and Taluk Panchayat Fund balances (₹419.10 crore) and write back of ₹18.80 crore relating to unutilised funds relating to XIII FC grants had a bearing on the achievement of revenue surplus and maintaining of the fiscal indicators as per the Karnataka Fiscal Responsibility Act (KFRA). There was an increase in revenue expenditure by 13 *per cent* over the previous year, while the growth rate of revenue receipts was 14 *per cent*.

Fiscal deficit during the year was ₹19,169 crore, a decrease of ₹407 crore over the previous year. Primary deficit was at ₹7,826 crore, a decrease of ₹1,946 crore over the previous year.

Incremental non-debt receipts of ₹14,993 crore was more than the incremental primary expenditure of ₹13,047 crore and could cover the incremental interest burden (₹1,539 crore).

State’s own resources

The ratio of the State’s tax revenue to GSDP has been hovering between 10 and 11 *per cent* during 2011-12 to 2015-16. It also included book adjustment of ₹82.83 crore which increased the revenue receipts artificially during the year on account of Guarantee Commission from Mines and Geology, Karnataka Slum Development Board, Rajiv Gandhi Rural Housing Corporation Ltd and waiver of interest on delay in payment towards Electricity Tax (₹41.46 crore), waiver of tax and penalty dues in respect of KSFIC, KSIC, ESCOMs, Coffee seeds and M/s Indian Coast Guard, Mangalore (₹2.42 crore) and settlement of statutory dues of Mysugar Company Limited (₹38.95 crore). Green tax being a cess collected for a particular purpose (₹45.90 crore) remained unutilised in the Consolidated Fund without proper accounting during the period 2006-07 to 2014-15.

Ratio of non-tax revenue to revenue receipts has significantly reduced from 5.85 *per cent* in 2011-12 to 4.51 *per cent* during the year. Its ratio to GSDP (₹7,35,975 crore) was insignificant (0.73 *per cent* in 2015-16), implying the need for mobilizing non-tax revenue in the coming years by revising user charges, as recommended by Expenditure Reforms Commission.

Optimization of XIV Finance Commission Grants

During first year of award period (2015-16), there was short release of ₹30.49 crore under Basic Grants to PRIs and ₹42.00 crore under Disaster relief. Grants under Disaster relief continued at 75:25 ratio as per the recommendations of the XIII Finance Commission pending passage of GST bill in Parliament. No recommendations were made for release of grants under State Specific needs, Improving Outcome sector etc. as it has recommended that a separate institutional arrangement be introduced for the purpose.

Revenue expenditure

Expenditure under social and economic sector registered growths of 18 and 13 *per cent* respectively over the previous year, while the growth in general services was 9 *per cent*. The share of plan expenditure in total revenue expenditure increased from ₹33,831 crore in 2014-15 to ₹40,009 crore in 2015-16. Eighty three *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 81 *per cent* of revenue receipts. Explicit subsidy increased from ₹11,153 crore in 2014-15 to ₹13,149 crore during the year whereas implicit subsidy increased from ₹2,973 crore in 2014-15 to ₹3,913 crore during the year. As per the recommendation 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 current year was 15 *per cent* as against 16 *per cent* in the previous year. Funds aggregating ₹1,495 crore were blocked in incomplete projects as at the end of 2015-16. The return from investment of ₹61,356 crore as of 31 March 2016 in Companies / Corporations was negligible (₹69.40 crore). The investment included ₹25,002 crore (41 *per cent*) in Companies/ Corporations under perennial loss. During the year the Government invested ₹122 crore in these Companies and the cumulative loss had decreased by ₹213 crore.

Funds and other Liabilities

The interest accrued on the investment out of Consolidated Sinking Fund of ₹1,000 crore made in 2012-13 amounting to ₹142.86 crore did not form the part of the assets of the State Government as the transaction did not pass through the Government books. There was short transfer of ₹27.39 crore to Environment Protection Fund. Transfer of ₹2,418 crore from Consolidated Fund to Infrastructure Initiative Fund (IIF) in Public Account, write back of ZP Fund II and Taluk Panchayat Fund balances (₹419.10 crore) compressed the capital/revenue expenditure artificially. The database on Guarantees was incomplete as M/s Mysore Lamp Works Limited did not figure in the Statement on Guarantees while the guarantee fee was adjusted through book adjustment. The Guarantee Redemption Fund has not been revived.

Debt sustainability

Open Market Loans formed a predominant share (46 *per cent*) in the total fiscal liabilities of the State. The net debt available to the State during the year 2015-16 (₹16,962 crore) decreased by one *per cent* when compared to the previous year. There was delay in remittance of NABARD loans to Consolidated Fund, resulting in understatement of Public Debt receipts during 2013-14 to 2015-16.

Financial Management and Budgetary Control

Against total provision of ₹1,66,672 crore during 2015-16, an expenditure of ₹1,49,250 crore was incurred, resulting in unspent provision of ₹17,422 crore (10 *per cent*). The expenditure stood overstated as the funds released to ZP/TP funds remained unutilized to an extent of ₹1,312.74 crore. Excess expenditure over provision of ₹7.93 crore under Demand number 1, ₹44.94 crore under Demand number 5, ₹5.12 crore under Demand no 6 and ₹8.05 crore under Demand number 19 for the year 2015-16 are required to be regularized under Article 205 of the Constitution. While supplementary provision of ₹936.68 crore in 36 cases was unnecessary, re-appropriation of funds in 73 cases was made injudiciously, resulting in either unutilised provision of funds or excess over provision. In 15 grants, ₹7,343 crore was surrendered in the last two working days of the financial year.

A number of Misclassifications were noticed in the budget. Provision of ₹3,774.41 crore obtained for payment of pension to Government servants under the charged category instead of voted category in the budget estimate was rectified in Supplementary Estimate. An expenditure to an extent of ₹175.50 crore was classified under revenue section instead of capital section which affects the fiscal indicators on revenue surplus/deficit. Misclassification under the object head 059 – Other Expenses, an omnibus head to record minimum expenditure, amounted to ₹329.42 crore.

The amounts released from Contingency Fund were not justifiable as the releases were not based on circumstances but were released in a routine manner.

Payment of excess family pension continued as an amount of ₹1.80 crore in 172 cases was drawn in excess, and there was repetition of excess payment of family pension amounting to ₹1.67 crore in 98 cases.

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.

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 there were cases of persistent non-utilisation of funds, excessive provision of funds and huge provisions remaining unutilised.

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 17 *per cent* of total expenditure and 2 *per cent* of total receipts, respectively, excluding loans and advances. 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 nature of transaction, as in one case it was observed that the expenditure on secret service was merged with scholarships and incentives.