CHAPTER III

3. TRANSACTION AUDIT OBSERVATIONS

Important audit findings noticed as a result of test check of transactions made by the State Government companies are included in this Chapter. These paragraphs have been discussed with the respective Administrative Department and the Management of the companies. Their views have been taken into consideration while finalising the paragraphs.

GOVERNMENT COMPANIES

Karnataka Neeravari Nigam Limited

3.1 Non-utilisation of excavated hard rock

Failure to utilize the hard rock available from excavation of canal for dam and allied works resulted in extra expenditure of Rs.2.18 crore.

The construction of dam across Tunga river near Gajanur village and allied works was awarded (October 1999) to Mysore Construction Company. As at April 2005, the contractor executed 2.34 lakh cubic metre (cum) of concrete work using 2.57 lakh cum rubble. Audit observed that during the period of concrete work in the dam (April 2000 to July 2004), excavation works in canal of the Upper Tunga Project were in full swing and large quantity (more than 28 lakh cubic metre in all) of excavated hard rock was available for use. Even though the contract contained a provision for issue of rubble from excavation at the rates as per schedule of rates (Rs.90 per cum), the Company did not issue the rubble to the contractor for utilisation in the work.

Failure to issue the rubble excavated during canal excavation to the contractor by the Company in the dam works resulted in an extra expenditure of Rs.2.18 crore.

The Government stated (June 2005) that utilization of excavated hard rock of canal works was not considered at the time of estimation as it was not available at the time of entrustment and that the excavated hard rock was not suitable for concrete work.

The reply of the Government is not acceptable because, though the excavated hard rock was not available at the time of entrustment of work it was available during execution of concrete work. Further, the contractor purchased (October 2001) 1,09,715 cum hard rock in public auction from the Company and utilized it in the concrete work of the dam.

3.2 Avoidable expenditure

Avoidable delay by Company resulted in payment of higher rates for work done during extended period and a resultant extra expenditure of Rs.1.28 crore.

The work of Dasanal tunnel of Ghataprabha Right Bank Canal estimated to cost Rs.5.74 crore was awarded (November 1997) to a contractor for Rs.4.31 crore, with a stipulation to complete the work in 20 months time i.e., by July 1999. The work was completed only on 28 February 2002 and the final bill is yet to be paid (August 2005). During the delayed period of 31 months, extension was given thrice with a condition that no extra rate or claims would be paid for the work executed during the extended period.

The contractor, however, claimed (February 2001) compensation of Rs.7.22 crore for the delay in work. The Chief Engineer recommended (January 2002) for revision of rates for work executed beyond the original contract period. The Technical Sub-Committee (TSC) which examined the proposal observed (June 2002) that out of a total delay of 31 months, 17 months delay was attributable to the Company and 14 months delay to the contractor. The TSC recommended that for the period of delay attributable to the contractor, no claim or compensation was payable. For the period of delay attributable to the Company, it was decided to make payment at reasonable rates as the claims of compensation by the contractor were not easily verifiable. It was decided that payment for the work done beyond 1 October 2000 at Schedule of Rates of 1999-2000 would be just and fair. Accordingly, the Company paid (November 2002) Rs.1.28 crore to the contractor.

The following were the reasons for delay attributed by TSC to the Company:

- Delay in payment of Running Account bills - two months.
- Delay in supply of blasting material - three months.
- Delay in deciding the side slopes at the exit - five months.
- Delay in shifting the transmission lines - four months.
- Other reasons - two months.

All the above reasons attributed to the Company were avoidable. Failure of the Company to avoid such delays, thus resulted in extra expenditure of Rs.1.28 crore.

The Government while admitting the facts stated (August 2005) that the Officers of the Company have been instructed to avoid such delay in completion of work in future.

3.3 Undue benefit to contractor

The Company failed to deduct the full cost of rubble supplied/used for the work and the element of profit thereon from the rates payable to the contractor, resulting in undue benefit of Rs.59.09 lakh to the contractor.

The construction of dam and allied works of Markandeya project estimated at Rs.84.70 crore was entrusted (March 1998) to Karnataka State Construction Corporation Limited (KSCC) at 12 per cent premium over the schedule of rates of the year of execution. The project is in progress and the total expenditure incurred upto March 2005 was Rs.131.59 crore.

The rates for completed items of work in the schedule of rates included the cost of all materials and an element of contractors profit (considered at 10 per cent) on the materials supplied by him. In order to arrive at the rate payable to the contractor when material is supplied by the Company, cost of material and the element of contractor's profit thereon is required to be reduced from the completed item rates. As per terms of the contract, the rubble (excavated hard rock) was to be issued at the rates mentioned in the Schedule of Rates. Even though the hard rock excavated from foundation, etc., was used for construction work, there was no record of actual quantity issued to the work. The rate of excavated hard rock as per schedule of rates was Rs.61 per cubic metre. The Company deducted only Rs.53.68/51.85 per cubic metre of concrete work and Rs.61 per cubic metre of rubble and murrum filling, as against Rs.71.13/73.81[♥] and Rs.67.10[♣] deductible towards cost of rubble required for the work and the element of contractors profit thereon.

Non-deduction of the cost of actual quantity of rubble required for the work, and the element of contractors profit thereon, resulted in undue benefit of Rs.59.09 lakh in execution of 2.12 lakh cubic metres of concrete work and 1.08 lakh cubic metres of rubble and murrum filling using the excavated hard rock upto March 2005.

As against the above, the Government agreed (September 2005) to recover Rs.56.15 lakh at Rs.68.32 per cubic metre. The particulars of recovery is awaited (November 2005).

3.4 Defective estimation

Payment of higher rates for additional quantities due to defective estimates resulted in extra-expenditure of Rs.40.43 lakh.

Consultancy services for the works of investigation, survey, preparation of designs, drawings, etc. and estimates for Upper Tunga Project (UTP) main canal from km 124 to 297 was awarded (June 2000) to a private consultant for

♥ One cubic metre of concrete work requires 0.85/0.88 cum of graded jelly. The wastage in crushing the rubble into jelly is 20 per cent. Therefore rubble required to execute one cum of concrete is 1.06/1.10 cum. Cost of rubble @ Rs.61 per cum and contractors profit at 10 per cent =Rs.71.13/73.81 per cum

♣ One cubic metre of rubble and murrum filling requires one cubic metre of ruble. Cost of one cum of rubble at Rs.61 per cum and contractors profit at 10 per cent = Rs.67.10 per cum.

Rs.75 lakh. The consultant finalised estimates for two packages of canal works in km.124 to 128 and km.133 and 135 falling under the jurisdiction of UTP Division, Rattihalli. Works on these two reaches were awarded to the lowest tenderers for their quoted price of Rs.1.26 crore and Rs.1.74 crore respectively, which were 52.06 per cent and 54.37 per cent respectively of the cost put to tender.

The quantities of canal excavation/embankment work increased during execution due to:

- variation in ground level from the Consultant's estimates,
- variation in soil strata from the Consultant's estimates,
- controlled blasting not provided for in the estimates anticipating shut down of power transmission at the time of blasting, which was not agreed to by the Karnataka Power Transmission Corporation Limited.

Consequent to these deviations from the estimates, the probable cost of completion of the works increased to Rs.1.68 crore and Rs.2.49 crore respectively. Audit observed that in the agreement with the consultant for the job of estimation, neither indicated any criteria as to how the estimation was to be done nor how accurate it should be. The payment of higher rates for quantities beyond 125 per cent of the estimated quantities resulted in extra-expenditure of Rs.40.43 lakh to the Company, which could have been avoided if the estimates were more accurate.

The Government stated (May 2005) that the consultant only prepares estimates based on normally accepted methodology of estimation; that while the over all quantities of excavation might not show significant variation, the actual quantities of individual strata might vary significantly due to practicable methodology adopted for sampling of strata for preparation of estimates.

The reply is not acceptable as due to defective estimates, the rates derived for higher quantities as per the contractual provisions were higher than the quoted rates, resulting in the extra expenditure.

3.5 Deviations from tender conditions

The Company incurred extra expenditure of Rs.18.73 lakh due to rejection of lowest tender in deviation of tender conditions.

The Company invited (January 2002) tenders for the work of raising of embankment in mile no.6 to 11 of Nargund Branch Canal, estimated to cost Rs.1.83 crore. The tender notifications issued both in Kannada and English required all the tenderers to enclose the additional performance bank guarantee, while submitting the tenders itself for the amount of difference between the cost as per quoted rates and 75 per cent of the estimated rates, in case their quoted rates fall below 75 per cent of the estimated rates and also stated that other wise the tender would be rejected. This was in deviation from the formal tender notice enclosed with the tender documents, according to which only the successful tenderers were required to furnish the additional performance security in the form of bank guarantee.

Out of six tenders received, four tenders including the lowest tender of Rs.1.15 crore were not considered as they had not furnished additional performance bank guarantee along with the tender as per the condition of tender notification and the work was awarded to V.I.Shetty, the second highest tenderer, who had enclosed the bank guarantee, at quoted price of Rs.1.34 crore.

Audit observed that the decision to reject four tenders including the lowest tender on the ground that additional performance guarantee was not submitted as per tender notification, was not correct as formal tender notification, which was a part of tender documents, required submission of additional performance bank guarantee by successful tenderers. This resulted in extra expenditure of Rs.18.73 lakh.

The Government while confirming the ambiguity stated (August 2005) that V.I.Shetty was the lowest eligible tenderer satisfying the conditions of tender notification. The reply is not acceptable as the tender notification was in deviation of condition contained in the tender document and as per the condition of tender document all the four rejected tenderers were also otherwise eligible.

Krishna Bhagya Jala Nigam Limited

3.6 Avoidable expenditure

Defective estimation and difference in standard adopted for measurement for estimation and work executed, resulted in an avoidable expenditure of Rs.53.37 lakh.

The work of construction of km.80 of Narayanpur Right Bank Canal estimated to cost Rs.2.05 crore, based on Schedule of Rates of 1996-97, was awarded (October 1998) to a contractor at his bid price of Rs.1.18 crore. The completed cost of the work was Rs.4.19 crore, which was settled in October 2003.

The major reason for increase in cost was increase in quantities of excavation in hard rock from the estimated 54,462 cubic metre to 2,00,652.50 cubic metre. i.e., an increase of 1,46,190.50 cubic metre.

Audit observed that out of above, 58,374.69 cum of extra quantities were due to:

- easening of Service road and inspection path as the slope originally proposed in the estimate was not considered safe in the hilly terrain, at the time of execution (20,831.47 cum),
- taking working levels at every 10 metre interval longitudinally and at five metre interval laterally as against the estimates prepared with only centre line levels taken at every 30 metre interval only (37,543.22 cum).

The above extra quantities could have been avoided had the Company conducted survey and investigation properly as prescribed in the design manual. Failure to do so resulted in extra expenditure of Rs.53.37 lakh due to payment at higher rates.

The Government stated (June 2005) that easening of service road and inspection path was purely in the interest of adequate safety to vehicular traffic on tricky hilly terrain; the procedure followed while determining quantities of earth work excavation at the time of estimation and payment was in conformity with the standard procedures prescribed in the design manual and the contract stipulations. It further stated that if all the essential technical provisions were made earlier, the estimate could have been on the higher side and therefore, the expenditure could not be treated as extra-expenditure.

The reply is not acceptable as the hilly terrain was known at the time of estimation and therefore the service road and inspection path could have provided adequate slope at the time of estimation itself and payment of higher rates for extra quantities above 125 per cent of the estimated quantities could have been avoided. Further, the design manual provided for taking trial pits for estimation at intervals closer than 30 metres if there was any appreciable change in soil strata.

3.7 Excess payment

Adoption of market rates instead of the rates specified in the schedule of rates for payment for additional quantities, in contravention of the terms of the agreements, resulted in excess payment of Rs.40.54 lakh.

As per clause 13(b) of contracts entered into by the Company, the additional quantity which exceeds 125 per cent of the tendered quantity shall be paid at the rates entered into or derived from the schedule of rates prevalent at the time of executing additions and alterations plus or minus the overall percentage of the original tendered rates, over the current schedule of rates of the year in which the tender was accepted.

Audit observed, that while deriving the rates payable for additional quantities in excess of 125 per cent of the tendered quantities of concrete works and hard rock excavation in respect of nine works executed by Rodalbanda Division during 1997-2003, the division adopted market rates instead of the rates specified in the schedule of rates for cement and blasting materials.

The payments were made, accordingly, between September 2002 and March 2004, which resulted in excess payment of Rs.40.54 lakh.

The Government stated (May 2005) that the Company has decided to recover the amount from the future bills of the contractors. The particulars of recovery are still awaited (August 2005).

3.8 Incorrect projection of tender conditions

Incorrect projection of tender condition resulted in additional financial burden of Rs.18.76 lakh.

The Company invited (June 2003) tender for 22 works of Field Irrigation Channels at an estimated cost of Rs.4.34 crore. The tender documents contained a 'Brief tender notification' in Kannada and a 'Formal tender notice' in English. As per item 13 of the Brief tender notification (Kannada), *"if any contractor quoted his rates below 75 per cent of the estimated cost, then the contractor should furnish an additional performance security along with bid document in the form of demand draft for an amount equivalent to the difference between the cost as per quoted rate and 75 per cent of the estimated cost, else the tender will be rejected."*. The Formal tender notice, in English, however, did not mention about any demand draft and specified only that the contractor shall furnish an additional performance security in the form of bank guarantee in such cases. There was no mention as to when the bank guarantee was to be furnished, and there was no mention about rejection of tender in the absence of bank guarantee, in the formal tender notice.

Audit observed (June 2004) that lowest bids for eight works were rejected as non-responsive for the reason that 'difference amount not furnished' in the form of demand draft as required under 'Brief tender notification' in Kannada. The rejection of lowest tenders resulted in additional financial burden of Rs.18.76 lakh.

The Government admitted (May 2005) the fact of difference in Kannada and English versions and assured to ensure similarity in Kannada and English versions in future.

Karnataka Soaps and Detergents Limited

3.9 Sale of 'All Fair' fairness cream

Failure of the Company to conduct market survey, resulted in loss of Rs.1.76 crore in sale of 'All Fair' fairness cream.

The Company entered (July 2001) into an agreement with Vale Exports Private Limited, Chennai ('firm'), for marketing of "All Fair" fairness cream being manufactured by the firm for five years. The agreement, interalia, provided that;

- the firm was to finalise advertising strategies, media plans for canvassing the products,
- the firm was to give post dated cheques to safeguard the company against premature closure of the agreement or very low level of sales,
- in case products remain unsold and consequently warrant sales return, the firm was to accept such returns.

The Company received (January and October 2002) a blank cheque and another post dates cheque of Rs.10 lakh from the firm. Audit observed that the Company decided (March 2002) to carry out advertisement by spending

Rs.50 lakh, on the products as the firm expressed its inability to do so even though it was firm's responsibility as per the agreement. The decision to spend on advertisement was taken after the firm accepted the conditions of increasing credit period from 60 days to 90 days and assigning the brand name to the Company.

Audit observed that though the Company was aware of the stiff competition for the product in the market, it did not conduct any market survey before venturing into this transaction and relied on the claims made by the firm. The Company procured (August 2001 to September 2002) 21,35,544 tubes of cream costing Rs.2.01 crore and paid Rs.1.43 crore through letter of credit. The Company stopped further procurement, thereafter, due to accumulation of stock. The Company was able to sell only 6,21,515 tubes (including 47,791 tubes issued as 'scheme' -free of cost with the product), leaving 15,14,029 tubes costing Rs.1.52 crore unsold. The Company was able to realise margin of Rs.8.58 lakh on the sale of tubes. Audit observed that the Company did not return the unsold tubes to the firm as envisaged in the agreement and instead issued these tubes as 'free' with the sale of its own products.

The Company could also not recover Rs.82.35 lakh (Rs.90.93 lakh minus margin of Rs.8.58 lakh) spent on the advertisement. Audit noticed that the Company did not encash the blank cheque and another post dated cheque of Rs.10 lakh available with it. This resulted in a loss of Rs.1.76 crore (after adjusting an amount of Rs.58 lakh not paid) to the Company.

The Government stated (November 2005) that due to diversion of its products from sandalwood based to non-sandalwood, the offer of the firm was accepted. The Government further stated that the sales promotion expenses cannot be treated as a financial loss. The reply is not acceptable since, as per the agreement the firm was responsible for sales promotion. Further, the Company failed to return the unsold tubes to the firm as provided under the agreement and encash the blank and post dated cheques available with it.

3.10 Avoidable extra expenditure

Hasty decision of the Company in placing the second order before the expiry of delivery period of first order resulted in avoidable extra expenditure of Rs.1.56 crore.

Palm Fatty Acid Distillate (PFAD) is the main raw material in the manufacture of soaps. The Company assessed (May 2003) a requirement of 2,000 metric tonne (MT) of PFAD for 2003-04 and floated (May 2003) limited tender enquiries. After negotiations (June 2003) with the two tenderers (who had only quoted against enquiry), the Company obtained revised offers for Rs.19,075 per MT (all inclusive) from Olivia Impex Private Limited, Mumbai, a new supplier and Rs.19,085 per MT from General Food Limited, Mumbai, who was a regular supplier. The Company placed (June 2003) order on lowest tenderer i.e. Olivia Impex (P) Limited, (firm) for the entire quantity. As per the conditions of the purchase order, the firm was to complete the supplies in two consignments of 1,000 MT each in September 2003 and November 2003.

The firm supplied the first consignment of 994.130 MT, as per the schedule and sought (2 December 2003) extension of time up to January 2004, to supply the balance quantity. The Company, however, extended the delivery schedule up to December 2003 only. The firm failed to supply within December 2003 due to non availability of ship and again sought extension (29 December 2003) up to 15 February 2004 for which the Company agreed (3 January 2004).

As the stock position became critical, which could hamper the production, the Company floated (31 January 2004) tender enquiry and placed (13 February 2004) order on General Food Ltd. for supply of 1,000 MT at the price of Rs.27,600 per MT with delivery schedule of March 2004 at the risk and cost of Olivia Impex (P) Ltd. As new tender was floated and finalised before the expiry of the extended period of first order, the first supplier refused to supply the balance quantity and the Company could not enforce risk purchase clause. In addition to this, the Company was forced to procure (21 February 2004) 500 MT of soap noodles, an alternative raw material to PFAD, at an additional cost of Rs.70.39 lakh, (after deducting savings of Rs.11.73 lakh in use of soap noodles for which caustic soda lye is not required).

The hasty decision to float fresh tenders and place order for 1,000 MT of PFAD on General Food Limited even before the expiry of extended supply period of Olivia Impex Pvt. Limited, resulted in avoidable extra expenditure of Rs.1.56 crore.

The Government stated (November 2005) that inspite of extending the delivery period the firm failed to supply. As the stock position was critical the Company was forced to procure at higher rates while finalising the second tender. The reply is not acceptable, as the Company placed the second order before the expiry of extended delivery period, which forced the supplier to back out. Moreover, the supply period for second supplier was in March 2004 only and as such the Company could have waited till. The reply indicated lack of proper planning in procurement by the Company.

3.11 Heavy damaged stock

Failure of the Company to monitor the stock held at various branches resulted in accumulation of damaged stock of Rs.1.31 crore.

As per Stores Manual, the Company is to review the stock once in six months and take action for their disposal through the disposal committee. Audit observed that the Company did not review the stock for the last six years which resulted in accumulation of damaged stock of Rs.1.31 crore at various branches/depots. In order to liquidate the damaged stock, the Company invited offers in 2003 and 2004, without any response. The damaged stock of Rs.1.31 crore is still lying with the Company (August 2005).

Failure of the Company to follow the prescribed procedure as laid down in the Manual resulted in accumulation of damaged stock of Rs.1.31 crore.

The Government stated (October 2005) that the damaged stock was more than five years old and it would be disposed off for the best price possible. The fact remains that the Company failed to follow the internal control mechanism to monitor the movement of finished stock held at various branches/depots.

3.12 Avoidable expenditure

The decision of the Company to procure sandalwood oil instead of resorting to in-house production resulted in extra expenditure of Rs.34.83 lakh.

The Company is having sandalwood oil production units with installed capacity of 114 tonnes per annum. The Company has been producing sandalwood oil mainly for its in-house consumption in the manufacture of soaps. The Company decided (November 2003) to procure 1 to 1.5 tonnes of sandalwood oil on the ground that procurement of sandalwood oil from outside was cheaper compared to in-house production, cost of which was worked to Rs.35,300 per kg. Accordingly, the Company procured 1.750 tonnes of sandalwood oil from outside at Rs.30,817.48 per kg (for 1000 kgs) and at Rs.34,008 per kg (for 750 kgs).

Audit observed that the in-house cost of production of sandalwood oil in 2003-04 was Rs.30,194 per kg as compared to the procurement rate of Rs.30,817 per kg. and Rs.34,008 per kg. As such the in-house production was cheaper compared to the cost of procurement.

The decision of the Company in procuring sandalwood oil at higher rates instead of resorting to in-house production, which was cheaper, thus, resulted in extra expenditure of Rs. 34.83 lakh.

The Government stated (November 2005) that no extra expenditure was incurred as the procurement cost of sandalwood oil was Rs.30,817.48 per kg. and Rs.34,008 per kg as the in-house manufacturing cost would work out to Rs.35,300 per kg considering the prevailing market rate of the sandalwood. The reply is to be viewed in the light of the fact that in-house cost of production of Rs.30,194 per kg. has been taken from the cost sheet prepared by the Company and certified by the Chartered Accountants.

The Mysore Sugar Company Limited

3.13 Loss of export incentive

The Company failed to claim export incentive of Rs.1.71 crore from the State Government for settlement of dues to farmers.

The Government announced (September 2003) an incentive of Rs.1,000 per tonne payable on export of sugar made from the date (10 September 2003) of the Government order, with a view to ensure early settlement of cane dues to farmers. The Government order, interalia, provided that the beneficiary (sugar mill) should have unsettled cane dues for the season 2001-02 and 2002-03, and the export realisation should be utilised for settling the dues of farmers. The details thereof were required to be submitted to the Commissioner of Cane Development. The incentive was applicable only till 31 March 2004.

The Company entered (August 2003) into an agreement with an exporter for export of 20,000 tonnes of sugar at Rs.9,000 per tonne, with a view to settle its dues of Rs.17 crore to farmers. The Company exported 17,086 tonnes of sugar from 17 September 2003 to 14 November 2003, entitling it for the export incentive as per the Government Order. The Company, however, did not claim for export incentive of Rs.1.71 crore from the Government. The Company lodged (June 2005) a claim for Rs.1.48 crore upon being pointed out by Audit in October 2004.

The Government stated (August 2005) that the claim of Rs.1.48 crore has been lodged for 14,771 tonne lifted by exporter after Government order as the balance quantity was lifted before the Government order. It was further stated that the claim of the Company was under consideration of the Government. The reply in respect of amount of claim is not acceptable as the entire quantity was actually exported after the date of Government order, as per the records made available to audit, and as such was eligible for incentive.

3.14 Bonds raised in anticipation of budgetary support

Raising bonds without prior consent of the Government for budgetary support resulted in locking up of the funds so raised and consequential loss of interest of Rs.86.84 lakh.

The Company decided (February 2001) to raise bonds by private placement for Rs.15 crore, with the guarantee of the State Government, in order to part finance the co-generation project. After receiving the approval of the Government for the guarantee in August 2001, three arrangers were appointed (October 2001), who could raise Rs.1.18 crore only up to February 2002.

The Company, therefore, appointed (February 2002) Investment Credit Rating Agency (ICRA) as the rating agency for the issue, who while assigning the credit rating to the bond put a condition (May 2002) that a tripartite agreement has to be executed between the Company, the Government and the Trustees (Canara Bank) to the bond holders; the amount of interest and/or principal payable by the Company to the bond holders shall be declared by the State Legislature by law as an expenditure charged to the Consolidated Fund of the State and shall also pass an Appropriation bill each year for appropriating the said expenditure out of the Consolidated Fund of the State. The Company forwarded (July 2002) the draft tripartite agreement to the Government for approval. The Company went ahead with raising the funds without awaiting the approval of the Government, even as the said condition of budgetary support was not in accordance with the concept of guarantee and could not be fulfilled without the approval of the Legislature. The Company raised Rs.15 crore through arrangers up to December 2002. The Government directed (April 2003) the Company to drop the condition of budgetary provision.

In the mean time, ICRA withdrew the rating (March 2003) for non-fulfilment of rating conditions and the trustees asked the Company to refund the proceeds of the issue with interest. The Company got (July 2003) the bond issue re-rated by Credit Analysis and Research Limited without budgetary support from the Government as decided in the meeting of the investors, ICRA, Trustees and the Government. It was also agreed to enhance the interest rate by half-a-per cent at the request of major investors and to refund Rs.16 lakh to small investors. Accordingly, the tripartite agreement was concluded on 7 October 2003 and the Company could draw the funds only on 15 October 2003.

The decision of the Company to raise funds on conditions not under its control and without awaiting the approval of the Government resulted in a extra payment of interest of Rs.86.84 lakh to the bond holders (net of interest earned on the funds kept in fixed deposits), for the period from February 2002 to October 2003.

The Government while confirming the facts stated (September 2005) that the loss of interest was due to unreasonable insistence of the credit rating agency for budgetary support for repayment of principal and payment of interest in State budget, and the circumstances was beyond the control of the Company. The reply is not acceptable as the decision to raise funds without obtaining the consent of the Government was not correct.

3.15 Loss due to irregular procurement

The procurement of non-oppige cane during the initial stages of crushing operations & consequent diversion of oppige cane due to shortage of water and poor follow up of dues resulted in a loss of Rs.85.36 lakh.

The cane procurement of the Company is based mainly on the annual agreement (oppige) entered into with the farmers in advance. While the Company is obliged to purchase the oppige cane, there is no such obligation to purchase cane from non-oppige farmers.

The Government of Karnataka had ordered (February 2003) for diversion of cane from Cauvery basin to nearest factories so as to avoid it drying up before crushing due to closure of various irrigation canals in Cauvery basin. As per the order, the respective sugar factories were to enter into agreement with the receiving factories and make all the necessary arrangements for transportation of the cane. The receiving factory was required to pay through the sending factory, the price for the cane at the rates they were paying to their own farmers.

During the crushing season 2002-03, as against total oppige quantity of 5.47 lakh tones of sugar cane, the Company procured 9.33 lakh tonnes of cane The Company stopped cane crushing from 7 April 2003 due to non-availability of water and diverted 17,723 tonnes of cane procured after March 2003 (after the end of crushing season in March) to other three private sugar mills without entering into any agreement with them. As against the procurement cost of Rs.1.60 crore and cost of transportation of Rs.13.38 lakh incurred on the cane so supplied, the Company received only Rs.87.53 lakh from the receiving factories. There was no further correspondence with the receiving factories after December 2003.

Audit observed that

- non-oppige cane was supplied in the guise of oppige cane by removing the control system in the computer;
- procurement of non-oppige cane in the initial stages of crushing forced the Company to purchase oppige cane even after end of crushing season, which was diverted to other sugar factories due to stoppage of crushing operations;
- the receiving factories paid Rs.87.53 lakh only as against Rs.148.40 lakh payable as per the Government order as there was no agreement with them regarding the price of the cane so diverted;

The procurement of non-oppige cane in the name of oppige cane during the initial stages of crushing operations and consequent diversion of oppige cane due to shortage of water and poor follow up of dues resulted in a loss of Rs.85.36 lakh.

The Government confirmed (August 2005) the facts and stated that the Company has initiated enquiries against the concerned officers and staff, which is in progress.

Karnataka State Industrial Investment and Development Corporation Limited

3.16 Implementation of Rajajinagar IT/BT park

The civil works contract for the project was awarded without obtaining prior approval of the Government. The work was stopped by the Government, for want of formal approval. This resulted in avoidable delay and consequential extra expenditure of Rs.4.20 crore.

A joint venture agreement as well as a lease agreement was entered into (March 2001) between the Company and Karnataka State Small Industries Development Corporation Limited (KSSIDC) to establish an information technology/bio-technology park at Rajajinagar Industrial Estate, Bangalore on a vacant land measuring 1.6 acres owned by KSSIDC. As per the agreement, the entire project was to be promoted, marketed, maintained and managed by the Company and the profit/cash accruals after all expenses was to be shared between the Company and KSSIDC in the ratio 70:30 during the initial lease period of 30 years.

As per the Articles of Association of the Company, the Board of Directors would reserve for the decision of the Government any programme of capital expenditure exceeding rupees three crore. The Board, however, without waiting for the approval of Government decided (July 2002) to award the contract for civil works to the lowest bidder, at Rs.29.30 crore. The work order was issued on 20 August 2002. The Government, however, directed (28 August 2002) the

Company not to proceed with the project in any manner including sanction /disbursal of any advance to the contractor, till such time further instructions are received from the Government. Inspite of this, the Company paid (September 2002) mobilisation advance of Rs.2.93 crore. The Government again directed (November 2002) the Company not to commence the construction work and to get back the advance paid to the contractors. The contractor was directed to stop the work only in March 2003.

The Government directed (March 2003) the Company to undertake market survey to assess the demand and viability and to explore the possibility of raising the required funds based on the project viability and securities offered by the Company and without insisting on Government guarantee, by engaging a consultant. Based on the feasibility report prepared by the consultant, the Government permitted (February 2004) the Company to take up the project subject to availability of funds without Government support/guarantee.

Due to delay in implementation of the project, the contractor demanded (May 2004) an escalation of 31 per cent over the original contract price. The architect of the project recommended an escalation of 14.3 per cent, which was approved by the Company. Thus not seeking approval of the Government in the first instance not only resulted in delay of the project (the construction has reached only the basement level as at July 2005) but also resulted in an extra-expenditure of Rs.4.20 crore due to cost escalation.

The Government while narrating (August 2005) the factual sequence of events did not reply to the specific points raised by audit.

Karnataka Forest Development Corporation Limited

3.17 Infructuous expenditure

Improper planting operations and failure to protect the agave seedlings resulted in the failure of the plantation raised at a cost of Rs.1.14 crore.

The Company raised (1995-96) agave plantations over 701 hectares. The expected life of the plant was 10 years with an annual yield per plant of 12-13 leaves from fourth year onwards.

Audit observed (October 2004) that the Company did not harvest the leaves as envisaged in the project report. It was reported (June 2003) that the project was a total failure due to (i) heavy wild boar attack on tender shoots soon after planting, (ii) adverse climatic conditions and other biotic interferences; and (iii) the agave plant was found only in helter skelter so that collection of leaves was not economical. It was also stated that there was no demand for agave leaves in the area. The Company instituted an inquiry on being pointed out by Audit.

The enquiry into the failure of the plantations by the Additional Principal Chief Conservator of Forest revealed (April 2005) that;

- the Company was not well equipped to execute the plantation works during 1995-96;
- the plantation pattern was not in accordance with the site conditions;
- the reason attributed for failure that "casting of shadow by the eucalyptus growth on the newly planted agave suckers" does not have logical support as the site was cleared of the growth before plantation and pruning of coppice growth was permitted;

Thus improper planting operations and failure to protect the agave seedlings resulted in infructuous expenditure of Rs.1.14 crore on the plantation.

The Government stated (August 2005) that the Company has been advised to submit an evaluation report highlighting the internal control system, reasons for failures and fixing of responsibility etc. The Company is yet to submit an evaluation report (November 2005).

Karnataka State Tourism Development Corporation Limited

3.18 Non-compliance of the recommendations of COPU

The Company not only failed to take action on the recommendations of COPU but extended similar benefit to another organisation.

The Government of Karnataka leased (May 1980) 124 acres of land at Chellaghatta tank bed to the Company for a period of 30 years at a nominal rent to enable the Company to develop and maintain a golf course in association with Karnataka Golf Association (KGA). The Company in turn leased the land to KGA for a period of 30 years in August 1980. As per the agreement the Company was entitled to the entire revenue and was required to meet the revenue deficits, if any. The lease rent was to be decided later on.

The agreement was revised on 25 July 1986 and according to which the lease rent was fixed at Rupee one per acre per annum. The revised agreement, however, deleted the clauses relating to entitlement of the Company to the income from the golf course and other amenities.

COPU in its 52nd Report of 1991-92 recommended that the inclusion of one sided provision favouring KGA in the agreement and deletion of provisions favouring the Company may be probed and necessary follow-up action taken against those found responsible.

Audit observed that even after a lapse of more than 13 years, the Government/Company has not taken any action to comply with COPU recommendations. The Company, however, leased (March 2001) 167 acres and 35 guntas of land on a long-term lease (50 years) basis to the Belgaum Golf Association for development of a golf course of international standards and its subsequent running and maintenance with the same terms and conditions as that of KGA.

The Company, thus, not only failed to take action on the recommendation of COPU but extended the similar benefit to another organization.

The Government stated (July 2005) that, it has constituted a sub-committee consisting of the Government nominees on the KGA and would submit a report on this aspect to the Government. The Committee's report and action taken thereon is awaited (August 2005).

General

3.19 Corporate Governance in State Government companies

Introduction

3.19.1 Corporate Governance is the system by which companies are directed and controlled by the management in the best interest of the shareholders and others ensuring greater transparency and better and timely financial reporting. The Board of Directors are responsible for governance of their companies.

3.19.2 The Companies Act, 1956 was amended in December 2000 by providing, *inter alia*, Directors' Responsibility Statement (Section 217) to be attached to the Director's Report to the Shareholders. According to Section 217 (2AA) of the Act, the Board of Directors has to report to the shareholders that they have taken proper and sufficient care for the maintenance of accounting records; for safeguarding the assets of the company and for preventing and detecting fraud and other irregularities.

Further, according to Section 292A of the Companies Act, 1956, notified in December 2000, every public limited company having paid up capital of not less than rupees five crore shall constitute an Audit Committee, at the Board level. The Act also provides that the Statutory Auditors, Internal Auditors, if any, and the Director in charge of Finance should attend and participate in the meetings of the Audit Committee, without any voting rights.

A similar concept has also been introduced through clause 49 of the listing agreements for listed companies as issued by Securities and Exchange Board of India (SEBI), which envisages that the Board of Directors shall have an optimum combination of executive and non-executive Directors with not less than fifty per cent of the Board of Directors comprising non-executive Directors. It also provides that listed companies having paid up capital of rupees three crore and above should have a qualified and independent Director in the Audit Committee.

3.19.3 The main components of Corporate Governance are:

- matters relating to the Board of Directors;
- Directors' Report; and
- constitution of the Audit Committee.

3.19.4 Out of 59 working Government Companies (PSUs), Audit reviewed 3* listed companies and 12♦ other companies, selected based on equity and turnover.

Listed Companies

Composition of the Board of Directors

3.19.5. As per clause 49 of the listing agreement of the Securities and Exchange Board of India (SEBI), the Board of listed companies should comprise at least one-third of independent Directors and the Chairman should be non-executive. In case of executive Chairman at least half of the Board should comprise of independent Directors. SEBI also clarified that Government nominee (official) Directors are not independent Directors.

KNNL has 12 Directors on its Board (September 2005). Except the Managing Director, all other Directors were non-executive Directors, who were nominees of the Government. The composition of the Board was, therefore, not in accordance with SEBI requirement.

Absence of Functional Directors

3.19.6. MPML and KNNL did not have any functional directors on its Board.

Deficiencies in Director's Responsibility Statement

3.19.7. In compliance with Section 217 (2AA) of the Companies Act, 1956, all the three listed companies had given a general statement that all applicable Accounting Standards have been followed while finalising the Annual Financial Statements of the companies (2002-03 and 2003-04) and proper/ sufficient care for the maintenance of adequate records was taken.

There was, however, non-compliance of various Accounting Standards (AS)♦ noticed by Audit in all the three listed companies.

* **Mysore Paper Mills Limited (MPML), Karnataka Neeravari Nigam Limited (KNNL), Krishna Bhagya Jala Nigam Limited (KBJNL).**

♦ **Mysore Sugar Company Limited (Mysugar),Karnataka Soaps and Detergents Limited (KSDL),Karnataka Land Army Corporation Limited (KLACL),Karnataka Vidyuth Karkhane Limited (KAVIKA),Karnataka Silk Industries Corporation Limited (KSIC),Mysore Sales International Limited (MSIL),Karnataka Handloom Development Corporation Limited (KHDC),Karnataka State Industrial Investment and Development Corporation Limited (KSIIDC),Karnataka Power Corporation Limited (KPC),Karnataka Power Transmission Corporation Limited (KPTCL), Hubli Electricity Supply Company Limited (HESCOM) and Hutti Gold Mines Company Limited (HGMCL).**

♦ **AS-2, AS-10 in MPML, AS-2, AS-9, AS-10 and AS-15 in KBJNL and AS-2, AS-9 and AS-10 in KNNL**

Audit Committee

Role and functions

3.19.8. The main functions of the Audit Committee are to assess and review the financial reporting system, to ensure that the financial statements are correct, sufficient and credible. It follows up on all issues and interacts with the statutory auditors before finalisation of annual accounts. The Committee also reviews the adequacy of Internal Control System and holds discussion with Internal Auditors on any significant finding and follow up action thereon. It also reviews the financial and risk management and evaluates the findings of internal investigation where there is any suspected fraud or irregularities or failure of Internal Control System of material nature and reports to the Board.

Composition

3.19.9. As per the provisions of the listing agreement, all the members of the Audit Committee should be non-executive Directors and atleast one Director should have expertise in financial and accounting knowledge. In KNNL, none of the Directors had expertise in financial and accounting knowledge and hence the composition of the Audit Committee was defective.

Meetings

3.19.10. Though KNNL had a Finance and Audit Committee from September 2001, a separate Audit Committee, in pursuance to Section 292(A), was constituted only during August 2003 and it held only two meetings (on 29 January 2004 and 8 July 2004) so far (March 2005) as against three meetings to be held.

3.19.11. In MPML, neither external auditors nor internal auditors attended the last 17 Audit Committee meetings held between January 2001 to August 2004. Though, the Audit Committee expressed its displeasure repeatedly (from January 2001 onwards) regarding the quality of the Internal Audit reports and recommended specific guidelines/areas to improve the quality of such reports, no corrective action was initiated till date (July 2005). Further the Board was also not appraised about the facts in this regard.

3.19.12. In respect of KBJNL, Audit Committee held three meetings in 2002-03 of which two meetings were held within a span of 42 days (13 February 2003 and 27 March 2003). In 2003-04, only two meetings were held as against three meeting per annum. Statutory Auditors did not attend the Audit Committee meetings held on 27 March 2002 and 5 November 2003.

Attendance of the Chairman of the Audit Committee in the AGM

3.19.13. As per Section 292(A) of the Companies Act, the Chairman of the Audit Committee invariably has to attend the Annual General Meeting (AGM) to answer the queries of the shareholders, if any, and to make any representation to clarify the position. The Chairman of the Audit Committee, however, did not attend AGM in KBJNL (2003-04) and KNNL (2002-03 and 2003-04).

Non-compliance of listing agreement

3.19.14. As per the provisions of the listing agreement, the Company should hold Board Meetings within a maximum gap of four months between the two meetings, whereas there was a gap of more than five to six months between two meetings (on two occasions) in 2001-02 and 2002-03 in KBJNL and on three occasions during the last three years ending 31 March 2004 in KNNL.

3.19.15. KBJNL and KNNL did not disclose the following mandatory requirement in their Directors' Report during the last three years ending 31 March 2004:

- Brief resume of all the Directors and their expertise in specific functional areas.

- Names of the companies in which the person also holds the directorship and the membership/chairmanship of the committees in other companies taken up by the Directors of the Company.

3.19.16. As per Section 292(A) of the Companies Act 1956 and clause 49(III)B of listing agreement of SEBI, the Audit Committee has to examine and suggest corrective action on the report submitted to it on Internal Audit/Internal Control Systems. But, the Audit Committee of KNNL did not review/discuss the adequacy of Internal Control Systems and Internal Audit with Management, External and Internal Auditors and the follow-up action taken on Internal Audit reports.

3.19.17. The accounts of all the listed companies were not discussed with external/statutory auditors before commencement of audit about the nature and scope of audit as well as the post audit discussions to ascertain any area of concern to suggest for corrective actions. It is also not clear whether any letter was issued by the auditor to management covering any area which they could not verify/weakness.

General/other issues

3.19.18. As a part of Corporate Governance, MPML in its Director's Report during the last three years ending 31 March 2004 stated that an action plan was drawn for *risk's and concerns and outlook, opportunities and threats* to reduce the cost and improve the quality of products and to face challenges of increasing trend in the international paper prices, supply and demand under "Management Discussion Analysis". A review of the working results of the Company, however, revealed that no concrete steps were taken in respect of the action plan and the Company continued to rely for its survival only on Government support, indicating lack of commitment and poor social responsibility on the part of its Board.

Unlisted Companies

Board of Directors

Meeting of Board of Directors

Board meetings were not held regularly.

3.19.19. Section 285 of the Companies Act, 1956, provides that "in the case of every company, a meeting of its Board of Directors shall be held at least once in every three months and at least four such meetings shall be held every year".

Audit revealed that there was a gap of more than five to six months between two meetings in HESCOM and KLAC during the period 2001-04.

Attendance of Directors in the meetings of the Board

Directors' participation in Board meetings was absent.

3.19.20. The attendance of the directors in the Board Meetings of KSDL, KSIIDC, MSIL, HGML and HESCOM was not regular and some of the Director's absence was continuous in more than five to six Board Meetings. As the Directors are the nominees of the Government to the Board, their continuous absence, defeated the very purpose of the nomination.

Vacancy position and frequent changes of Managing Directors and vacancies of Directors

3.19.21. The Board of KSDL had only seven Directors during 2001-02 and 2002-03 against the maximum strength of 12 directors.

3.19.22. Frequent changes of the top executives always adversely affect smooth functioning of the Company. Audit noticed that there were frequent changes in the post of Managing Director (in respect of KAVIKA) and there were four Managing Directors during April 2001 to December 2002. Further, the Company had an in-charge Managing Director during August 2002 to December 2002. This indicates the poor commitment to the principles of Corporate Governance.

Directors' Report to shareholders

3.19.23. The Companies Act, 1956 {Section 217 (2AA)} requires that a report of the Board of Directors including a Directors' Responsibility Statement is to be attached to every balance sheet laid before a company in Annual General Meeting. Audit noticed that except HGML and KPCL, in all the companies there was non-compliance of certain Accounting Standards which was contradictory to the statement given under Directors' Responsibility Statements in the respective Directors' Report.

3.19.24. Mysugar had not conducted the Annual General Meeting within the stipulated time during the last three years and its Director's Report for last three years ending 31 March 2004 is silent about the progress of its co-generation plant wherein a substantial investment of over Rs.76 crore was involved. As such, the share holders were not kept informed of the position of the co-generation plant.

Audit Committee

Composition

3.19.25. Out of 33 companies which have paid up capital of rupees five crore and above as on 31 March 2005, 26 companies have constituted the Audit Committee and seven• companies have not constituted Audit Committees. Following deficiencies were observed in the composition of Audit Committees.

Constitution of Audit Committee delayed in many cases.

- Though the provisions of Section 292(A) was effective from December 2000, there was delay in constitution of Audit Committee in respect of KAVIKA (May 2002), KHDC (September 2002), KSDL (April 2002) and MSIL (September 2003).

- The composition of the Audit Committee was not disclosed in the annual reports of KAVIKA and Mysugar as required by the Act.

Meetings

- Companies have to hold at least two meetings of the Audit Committee in a year. KSDL and MSIL did not hold any meeting from March 2003 and September 2003 respectively up to January 2005. Mysugar also failed to conduct any meetings between November 2001 to January 2005.

- In the Audit Committee meetings of KHDC (15 September 2004), KAVIKA (31 August 2002) and KSDL (five meetings held on 26 April 2002, 28 June 2002, 31 August 2002, 3 March 2003 and 2 December 2004) the Statutory Auditors and Internal Auditors were absent, though the attendance was mandatory. In these meetings, the issues relating to need to put in concerted efforts for the recovery of dues, to formulate a clear policy in respect of check bouncing and disproportionate inventory at unit offices were discussed in KSDL. In KHDC, the Committee recommended to take appropriate action for the improvement of internal controls. As these issues were directly related to internal auditors, their absence in audit committee meetings deprived the value addition.

- The Chairmen of the Audit Committee of KSIC, KSIIDC and Mysugar did not attend their Annual General Meetings.

Terms of reference

3.19.26. The Board of KSIC and KHDC had not framed any terms of reference/duties and responsibilities of the Audit Committee up to January 2005. Further, the terms of reference of Mysugar, KPTCL and KSDL did not

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• **Karnataka Scheduled Castes and Scheduled Tribes Development Corporation Limited; Karnataka Togari Abhivridhi Mandali Limited; Karnataka Land Army Corporation Limited; The Karnataka Minorities Development Corporation Limited; Karnataka Forest Development Corporation Limited; Karnataka State Women's Development Corporation and The Karnataka Backward Classes Development Corporation Limited.**

contain Financial and Risk Management Policies and Fraud and Fraud Risks which are to be addressed. Thus, it could not be ensured that the committees had specifically dealt with frauds and fraud related risks.

Discussion by the Audit Committee

3.19.27. The Act (Section 292(A) (6)) requires that the Audit Committee should have discussions with the auditors periodically about the internal control systems , the scope of audit including the observations of the auditors and review the half yearly and annual financial statements before submission to the Board and also ensure compliance of internal control systems.

Audit scrutiny revealed that:

- The Audit committee did not review the accounts of KHDC (2003-04), KAVIKA (2002-03), KSDL (2002-03 and 2003-04) and Mysugar (2001-02 to 2003-04), before submission to the Board.

- Audit Committees in KSIC, KAVIKA, KLAC, KSDL, Mysugar, KHDC, KPTCL, KPC and KSIIDC failed to review the adequacy of the Internal Control System and Internal Audit periodically and no corrective action was, therefore, taken.

These irregularities were brought to the notice of the Government (April 2005). The Government stated (September-November 2005) that corrective action would be taken.

Sum up

- **The Government have not appointed independent directors in most of the companies.**

- **The attendance of the directors in the Board meetings was not regular in five companies, and the number of Board meetings were not held as required under Companies Act in four companies. Seven companies have not constituted Audit Committees. In most of the companies, the Audit Committee meetings were not held regularly associating the Statutory/Internal Auditors which indicated that the functioning of the Audit Committees were not effective.**

3.20 Implementation of pollution control measures in The Mysore Paper Mills Limited and The Mysore Sugar Company Limited

3.20.1. The Government of India has enacted various Acts to enforce effective environmental protection and established regulatory bodies to monitor and enforce the provisions of the Acts viz.,

- The Water (Prevention and Control of Pollution) Act, 1974,
- The Air (Prevention and Control of Pollution) Act, 1981,
- The Environment (Protection) Act, 1986,
- The Hazardous Waste (Management and Handling) Rules 1989.

3.20.2. The disposal of waste/effluent in to the atmosphere/water from paper and sugar industry is considered as a major source of pollution. In Karnataka, there are two State Government Undertakings viz., The Mysore Paper Mills Limited (MPML) at Bhadravathi and The Mysore Sugar Company Limited (Mysugar) in Mandya which are engaged in the manufacture of paper and sugar. These companies have been selected for detailed audit.

3.20.3. The nature of effluents from the pulping, washing, bleaching and soda recovery plants of MPML are highly coloured, alkaline in nature and have large amount of solids whereas effluent from paper machines are on the acidic side, less coloured but having large amount of suspended solids. The sugar mill effluents have low level of solids, but high level of Bio Chemical Oxygen Demand (BOD) and Chemical Oxygen Demand (COD) contents. The waste generated during the course of production activities viz., waste oil and other chemical waste like, sugar press mud, fly ash, lime sludge, effluent sludge, chemical waste and wood/bamboo dust are classified as hazardous waste. The waste oil and wood/bamboo dust are being used as fuel in the boilers, sugar mill press mud and fly ash are being disposed to outsiders for use as manure and to manufacture bricks; lime sludge and effluent sludge are being used for land fill and chemical waste are being released to the river after treatment.

3.20.4. The environmental policy formulated by MPML and Mysugar, compliance to the various legislations and regulations prescribed by the regulatory bodies, the existing environmental management practices, significant environmental issues and concerns arising from operations and activities in the plants, waste prevention/control and waste management for the last four years up to 2004-05 were reviewed (March/ April 2005) in audit.

The findings of the Audit are discussed in succeeding paragraphs:

Water Pollution

The Mysore Paper Mills Limited

Abnormal variance in the analysis reports of treated effluents

3.20.5. As mandated by Central Pollution Control Board directions, the Company is having a self-monitoring system to analyse the treated effluents in its own laboratories on a day to day basis. The State Pollution Control Board (SPCB) also conducts random sampling and analyses the trade effluents on a regular basis to verify and to confirm that the chemical contents in the effluents are with in the permissible limits.

A test check of such reports of the Company as well as PCB revealed that there were abnormal variances in respect of certain parameters. As against the prescribed norm of BOD of 30 mg/ltr, the actual reported by SPCB during 2004-05 varied from 34 to 111 mg/ltr. Similarly as against the prescribed norm of COD of 250 mg/ltr, the actual reported by PCB varied from 278 to 453 mg/ltr, between August 2002 to March 2005. The chlorides and conductions reported by the PCB were also on higher side at 261 to 512 mg/ltr as against the prescribed norm of 350 mg/ltr, and 1,720 to 2,800 µmho/cm as against the prescribed norm of 2,250 μmho/cm respectively. This indicates that the Company failed to take remedial measures to adhere to the regulations.

Water Management

Failure to take action to recycle water resulted in foregoing the savings of Rs.3.10 crore.

3.20.6. One of the consultants suggested for recycling and reuse of waste water in March 1990 to reduce water consumption. SPCB also insisted for the same. The Company, however, took action only in September 2002 to recycle the water and to reuse it. Failure to recycle the waste water during the years 2000-01 to 2002-03 resulted in forgoing the savings of Rs.3.10 crore due to use of excess water.

Failure to avail rebate on Water Cess

3.20.7. As per the Water (Prevention and Control of Pollution) Cess Act, 1977, water cess is being levied on the Company by the SPCB for consuming water for carrying on the industrial activity. Section 7 of the Act provides for a 25 per cent rebate on the cess payable to those industries who consume water within the quantity prescribed for that category of industries and also to comply with the effluents standards prescribed under the Water Act and the Environment (Protection) Act.

Though the Company is having the Effluent Treatment Plant and sewage treatment plant, failure to comply with the specified parameters and using the water more than the prescribed limit, resulted in foregoing the rebate of Rs.36.98 lakh for the years 2001-02 to 2004-05.

Ground water contamination

The Company has failed to take remedial measures to avoid pollution by dumping of solid waste in an unscientific manner.

3.20.8. The Company is dumping its solid wastes like lime sludge, fly ash, sludge of ETP, press mud and bio sludge, etc., which contain harmful chemicals, in its own land out side the factory premises as land fill. This results in the leaching of effluents in to the ground, contaminating the water. The PCB has been repeatedly warning the Company that the above solid wastes were dumped in the open field in unscientific manner, without covering them with fresh earth. Repeated notices and adverse analysis reports indicates that the Company had not taken remedial measures in this regard (August 2005).

Upgradation of Effluent Treatment Plant

3.20.9. The Central Pollution Control Board declared (1991-92) Bhadravathi as one of the highly polluted towns in the country. This prompted the Company to appoint a consultant (Ramky Engineers Limited, Hyderabad) to study the system and suggest measures for up gradation of ETP to meet the pollution norms. The consultant submitted (July 1996) detailed tender specifications for the upgradation of ETP. After obtaining the State Pollution Control Board's approval, the Company invited (August 1996) tenders for the complete upgradation of the plant on turnkey basis. The work was awarded to Degermont India Limited on lowest offer basis for Rs.8.36 crore with a completion schedule of 10 months i.e., June 1998. Due to change in design, the scheduled completion date was revised (June 1999) to September 1999 with a revised price of Rs.9.31 crore. The work, however, was completed and put to trial run with full load in April 2000.

During trial runs the ETP failed and the operations of ETP were totally disrupted (July 2000). The ETP was put back into service only during January 2001 without meeting the stipulated norms for discharge of effluents.

A Sub-committee appointed (March 2001) by the Company after a Public Interest Litigation petition filed in the High court of Karnataka noticed (April 2002) that the consultants as well as the turnkey contractor did not possess the required exposure in paper industry, and suggested short term and long term measures to improve the efficiency of ETP to meet the norms. For carrying out the short term/ long term measures, the Company appointed another consultant at a fees of Rs.12.50 lakh. The Company carried out the modification as suggested by the consultant at Rs.1.42 crore except installation of CSRMP anaerobic digester costing Rs.1.50 crore.

The Company has not been able to meet the requirement of State Pollution Control Board even after investing Rs.14.46 crore.

Audit observed that even after huge investment of Rs.13.04 crore (capitalized cost of upgradation) towards up-gradation of ETP and additional expenditure of Rs.1.42 crore towards short term capital works to rectify/improve the system, the Company was not able to meet the requirements of State Pollution Control Board and continued to discharge effluents containing higher percentage of COD and BOD.

3.20.10 Further, it was envisaged in the upgradation plan to make use of Biological Sludge and ETP Sludge generated as fuel in the boiler to save coal consumption. As the performance of press deg system designed and erected by Degermont India Limited continues to be unsatisfactory and the dryness of the solids from the discharge is only around 18 to 19 per cent against 35 per cent specified, the sludge generated could not be burnt in the boiler resulting in additional expenditure on coal of Rs.5.60 crore for the last four years ending March 2005. In addition, the Company incurred extra expenditure of Rs.1.22 crore towards transportation of sludge from the plant to waste pit outside the factory.

Air pollution

The Mysore Sugar Company Limited

Non renewal of license in respect of air pollution

3.20.11. The PCB did not renew the industrial license of the Company for the years 2001 to 2004 as the percentage of suspended particulate matter (SPM) level in the emission of boilers was around 399.50mg/m^3 as against the permissible norm of 150mg/m^3 [ϕ] and causing air pollution. Pending renewal of the license, the Company however, continued the industrial operations during the period.

[ϕ] mg/m^3 means milligram per cubic metre.

Non conduction of air emission tests

3.20.12. Audit observed that neither the Company nor the Pollution Control Board attempted to check the air effluents green house gases released to the atmosphere from the boilers between February 2002 to March 2005. In the absence of these reports, the content of injurious items in the effluents released against specified norms could not be ensured. Further, as against the specified height of the chimney at 16.5 metres above the ground level, the actual height of the chimney was only six metres above ground level.

Waste Management

The Mysore Paper Mills Limited

Installation of Bagasse Anaerobic Digester to dilute the treated effluents

3.20.13. The Company, in order to meet the gap between the actual and specified parameters in respect of Bio Chemical Oxygen Demand (BOD) and Chemical Oxygen Demand (COD) in the bagasse effluent decided (March 2002) to install Bagasse anaerobic digester at an estimated cost of Rs.96 lakh. The work of design, engineering, supply, erection and commissioning of the equipment was awarded (December 2002) to the lowest tenderer at Rs.93.81 lakh with a stipulation to complete/commission the system by December 2003.

Even after the delay of over 20 months from the targeted date of completion (December 2003), the digester is yet to be commissioned (August 2005). The trial runs, however, conducted during March 2005 revealed that the plant could cater only at about 35-40 per cent of capacity. The State Pollution Control Board has also felt that there may be some serious problems in the design or in the operation of the plant.

Non-commissioning of Bagasse Anaerobic Digestor has resulted in foregoing savings of Rs.84.25 lakh besides non-compliance to statutory requirements.

Apart from meeting the standard prescribed in respect of BOD and COD, the cost benefit analyses of the project envisaged generation of the minimum guaranteed gas of 0.5 m^3 per kg of COD or 600 cum/day to be used as fuel to save coal consumption. Due to non-commissioning of the Bagasse Anaerobic Digester, the Company not only failed to comply with the statutory requirement but also foregone the benefit of Rs.84.25 lakh towards the anticipated fuel savings.

Lime Sludge Reburning Plant

3.20.14. The Company consumes about 80 to 100 tonnes per day (TPD) of burnt lime in the process of caustisizing and in Hypo Plant to prepare chemicals for pulping operations. At caustisizing plant, green liquor from chemical recovery boiler is slaked[∉] with burnt lime to produce white liquor, which is used for pulping process. In this process, lime sludge is generated which is presently being disposed off as solid waste material. The lime sludge generated at caustisizing plant contains Calcium Carbonate, which can be recovered by

[∉] **Slake means mixing of quicklime with water to produce Calcium hydroxide.**

burning with make up limestone or seashell in a lime sludge-reburning kiln. Apart from minimizing the environmental pollution in the solid waste disposal, the installation Lime Sludge Reburning Plant envisaged savings of Rs.1.02 crore in the cost of burnt lime, in addition to savings in the cost of transportation of lime sludge.

The installation of the Lime Sludge Plant before the financial year 2006 is committed to PCB, the Board accorded (October 2002) approval for the implementation of the project at an approximate cost of Rs.12 crore. The Company had invited (December 2002) global tenders for supply and erection of 100 TPD lime sludge re-burning plant. However, the tenders were not finalised due to paucity of funds.

Pending commissioning of the plant, the Company continued to dispose the lime sludge by transporting the same outside the factory. Thus, delay in installation resulted in continued discharge of solid waste to the environment. This not only resulted in additional expenditure but also defeated the aim of waste management.

These were brought to the notice of the Government (June 2005). The Government stated (July/October 2005) that corrective action would be taken.

3.21 Follow-up action on Audit Reports

Explanatory note outstanding

3.21.1. The Comptroller and Auditor General of India's Audit Reports represent culmination of the process of scrutiny starting with initial inspection of accounts and records maintained in the various offices and departments of Government. It is, therefore, necessary that they elicit appropriate and timely response from the executive. Finance Department, Government of Karnataka issued instructions (January 1974) to all Administrative Departments to submit explanatory notes indicating a corrective/remedial action taken or proposed to be taken on paragraphs and reviews included in the Audit Reports within three months of their presentation to the Legislature, without waiting for any notice or call from the Committee on Public Undertakings (COPU).

Though the Audit Reports for the years 2000-01 and 2003-04 were presented to the State Legislature in March 2002 and July 2005 respectively, six out of 11 departments, which were commented upon, did not submit explanatory notes on 21 out of 56 paragraphs/reviews as on November 2005, as indicated below:

Year of the Audit Report (Commercial)	Total paragraphs and reviews in Audit Report	No. of paragraphs and reviews for which explanatory notes were not received
2000-01	32	1
2003-04	24	20
Total	**56**	**21**

Department wise analysis is given below:

Name of the department	2000-01	2003-04
Commerce and Industries	-	2
Energy	-	5
Food Civil Supplies and Consumer Affairs	-	1
Water Resources	-	10
Finance	-	1
General	1	1
Total	**1**	**20**

Department largely responsible for non-submission of explanatory notes was Water Resources Department.

Compliance to reports of Committee on Public Undertakings (COPU) outstanding

3.21.2. The replies to paragraphs were required to be furnished within six months from the presentation of the Reports. Replies to 113 paragraphs pertaining to 11 Reports of the COPU, presented to the State Legislature between April 1998 and July 2005, had not been received as on November 2005, as indicated below:

Year of the COPU Report	Total number of Reports involved	No. of paragraphs where replies not received.
1997-1998	3	56
1998-1999	1	06
1999-2000	2	23
2001-2002	1	01
2002-2003	1	13
2003-2004	1	02
2004-2005	2	12
Total	**11**	**113**

3.22 Response to inspection reports, draft paragraphs and reviews

Audit observations noticed during audit and not settled on the spot are communicated to the head of PSUs and concerned departments of State Government through inspection reports. The heads of PSUs are required to furnish replies to the inspection reports through respective heads of departments within a period of six weeks. Inspection reports issued up to March 2005 pertaining to 70 PSUs disclosed that 4,675 paragraphs relating to 1,125 inspection reports remained outstanding at the end of September 2005; of these, 18 inspection reports containing 198 paragraphs were pending due to non-receipt of even first replies. Department wise break-up of inspection reports and audit observations outstanding as on 30 September 2005 is given in **Annexure 16.**

Similarly, draft paragraphs and reviews on the working of Public Sector Undertakings are forwarded to the Secretary of the Administrative Department concerned demi-officially seeking confirmation of facts and figures and their comments thereon within a period of six weeks. All the reviews have been discussed in the Audit Review Committee on Public Sector Enterprises. The paragraphs have also been discussed with the respective Administrative Department and the Management of the companies/corporations. Their views have been taken into consideration while finalising the reviews/paragraphs.

It is recommended that (a) the Government should ensure that procedure exists for action against the officials who failed to send replies to inspection reports/draft paragraphs and ATNs to recommendation of COPU, as per the prescribed time schedule, (b) action to recover loss/outstanding advances/overpayment is taken within prescribed time, and (c) the system of responding to the audit observations is revamped.

BANGALORE **(K.P.LAKSHMANA. RAO)**
The **Principal Accountant General**
(Civil and Commercial Audit)
Karnataka

COUNTERSIGNED

NEW DELHI **(VIJAYENDRA N. KAUL)**
The **Comptroller and Auditor General of India**