CHAPTER IV

4. TRANSACTION AUDIT OBSERVATIONS

Important audit findings noticed as a result of test check of transactions made by the State Government companies and Statutory corporations are included in this Chapter.

GOVERNMENT COMPANIES

The Mysore Paper Mills Limited

4.1 Defective Planning

Plantation of pines without conducting proper feasibility rendered the investment of Rs.22.74 crore uneconomic.

The forest raw material requirement for the manufacture of paper was estimated by the Company at 1.75 lakh MT to 1.80 lakh MT of short fibre wood variety i.e. Acacia and Eucalyptus and 35,000 MT to 40,000 MT of long fibre wood i.e. Pine and Bamboo. While carrying out the development of captive plantation under Phase II (1990-1996) with the financial assistance of Commonwealth Development Corporation, it was decided to raise Pinewood plantations as a substitute for bamboo.

Under Phase-II, the Company raised pinewood plantations over an area of 4,498 hectare by incurring an expenditure of Rs.22.74 crore with an estimated yield of 4,22,784 MT (at 94 Air Dry MT per hectare). The matured plantations were to be harvested between 2003 and 2009 since the gestation period of the pine is 12 years from the year of plantation.

It was noticed in audit that the decision to plant pine was taken without examining the possibility of using the entire quantity of pinewood for the manufacture of paper as the total requirement of such long fibre wood was only 35,000 MT to 40,000 MT per year as against the average availability of around 70,000 MT every year from 2003 to 2009. The Company also did not carry out production trials for manufacturing paper with pinewood. Consequently, the Company has not been able to utilise the entire quantity of pinewood available with it due to technical problems. The efforts to sell the pinewood in the market to other paper manufacturers also did not yield any results.

This has rendered the total investment of Rs.22.74 crore in the plantation of pine an uneconomic investment.

The Management stated (May 2006) that the usage of pine was restricted due to technical difficulties and pinewood could not substitute bamboo fully and only a maximum of 20,000 MT could be processed leaving the balance to be sold. Further, due to its hygienic pitch content (resin), the pinewood needed to be stored for six to eight months before consumption.

It is evident from the reply that there was lack of co-ordination between the production and plantation divisions as no link between the expected yield and actual demand was established.

The matter was reported to the Government (June 2006); their reply is awaited (September 2006).

4.2 Avoidable expenditure

Unilateral deduction of the value of power supplied to KPTCL/MESCOM from the energy bills resulted in payment of interest of Rs.1.25 crore.

The Company has been drawing power from Mangalore Electricity Supply Company Limited (MESCOM). The Company also started (November 2000) to supply surplus power generated from its co-generation plant to the Karnataka Power Transmission Corporation Limited (KPTCL) grid. As per draft Power Purchase Agreement (PPA) (approved by Karnataka Electricity Regulatory Commission in June 2006) the Company was required to submit tariff invoices for supplied power from time to time to KPTCL and the same would be paid by KPTCL within 15 days. As per the procedure in vogue, MESCOM raises power bills on a monthly basis and the energy charges are payable on or before the 18th of the following month, failing which two *per cent* interest per month for the belated period of payment was leviable by MESCOM.

It was noticed (February 2006) in audit that the Company did not submit tariff invoices for supplied power to KPTCL and instead started deducting unilaterally the value of energy supplied to KPTCL from the bills raised by MESCOM. The deduction was never accepted by MESCOM and this amount was indicated as arrears and interest was charged. Consequently, the Company had to pay (June 2004) interest of Rs.1.25 crore for the period July 2002 to March 2004.

The Management stated (May 2006) that it adjusted the value of exported power out of MESCOM bills as per the approval of both KPTCL and the State Government. In the absence of adjustments of value of exported power, the Company would have lost interest to that extent as MESCOM would not have paid interest on the value of power exported not adjusted as its financial position was under tremendous strain due to continuous losses incurred between 2002-2005.

The reply is not acceptable in view of the fact that there was no such approval by KPTCL and the State Government for such adjustment. The Company was required to submit the bills for exported power to KPTCL, which was not done. Further, the financial constraints faced and the recurring losses made by the Company was not a justification for unilateral deduction from the bills of MESCOM.

The matter was reported to the Government (June 2006); their reply is awaited (September 2006).

4.3 Extra expenditure

Injudicious decision to place order only for part quantity of the total requirement resulted in extra expenditure of Rs.86.48 lakh.

The Company invited (August 2003) global tenders for procurement of 4,000 Air Dry Metric Tonne (ADMT) of Chemical Thermo Mechanical Softwood Pulp (CTMP) in two batches of 2,000 ADMT each in November 2003 and February 2004 to meet its requirement for six month from January to June 2004. OTCL, Canada was the only firm, which responded quoting US$395 per ADMT for supply of 2,000 ADMT in the 1st shipment and additional 2,000 ADMT in the 2nd shipment at US$ 415 per ADMT. After negotiations (October 2003) the rates were reduced to US$ 394 and US$ 414 per ADMT for the quantities to be supplied in the 1st and 2nd shipment respectively. The Company, however, decided to procure 2,000 ADMT against 4,000 ADMT, in view of the high price, and accordingly placed (November 2003) the purchase order for supply of 2,000 ADMT only.

The Company again invited (March 2004) global tenders for procuring 3,000 ADMT of CTMP to cover the requirement for May to July 2004. OTCL, Canada was again the only firm to respond and quoted a rate of US$ 510 per ADMT for supply of 2,000 ADMT. After negotiations, the Company placed orders (April 2004) for supply of 1,000 ADMT, which was increased to 2,000 ADMT (May 2004) at US$ 508 per ADMT.

The decision of the Company to restrict the supply to 2,000 ADMT against the initial tender in spite of limited response to its tender and being aware of the increased price for future supplies was not prudent and resulted in extra expenditure of Rs.86.48 lakh[♣].

The Management stated (April 2006) that as on the date of opening of the price bid on 27 October 2003, the confirmed supply was only for 1,000 ADMT and not for 4,000 ADMT. It further, stated that on 29 October 2003 the supplier had confirmed to supply the entire quantity but at a higher rate. The reply is not acceptable as the Company was aware of the poor response and shortage of material in the market, which was indicative of the probability of higher prices in the future.

The matter was reported to the Government (April 2006); their reply is awaited (September 2006).

♣ **US$508 - US$414 = US$94 x Rs.46 per US$ = Rs.86.48 lakh.**

Krishna Bhagya Jala Nigam Limited

4.4 Excess payment

Failure to comply with its own decision resulted in excess payment of Rs.37.52 lakh to a contractor.

The construction of common headwork of Almatti Left Bank Canal and Chimmalagi Lift Irrigation Scheme was awarded (May 1994) to Mysore Construction Company, Bangalore at the negotiated price of Rs.4.41 crore, with completion period of 36 months. Six supplementary agreements were also executed (October 2001) on account of additional/extra items of work. As the execution of work by the department was banned by the Government, the balance earthwork excavation for intake channel, jackwell was also entrusted (1994) to the same agency on extra items rate list (EIRL) basis. The work was completed in March 2004.

The Technical Sub-Committee (TSC) in its 51st and 52nd meeting held on 3 May 2000 and 3 June 2000 respectively, while recommending higher rate for escalation, increase in the quantity in excavation, embankment, concrete etc., directed to recover payment of lift charges in the earthwork and differential payments between KBJNL SR 1996-97 rates and Irrigation Department (ID) Dam SR rates 1996-97. The Board of Directors in its 38th meeting held on 14 November 2000 also approved the decision of TSC. While making final payments (March 2004) to the agency, the Company failed to recover the lift charges and difference in SR of ID Dam rates and KBJNL rates, resulting in excess payment of Rs.37.52 lakh. On this being pointed out by Audit, the Company decided (February 2006) to recover the amount from the contractor. The contractor has, however, approached the High Court of Karnataka against the order for recovery and the matter is still pending in High Court (August 2006).

The matter was reported to the Government (March 2006); their reply is awaited (September 2006).

4.5 Undue benefit to contractor

Non-deduction of shrinkage from the final measured quantities of earthwork embankment, as per contract conditions, resulted in extension of undue benefit of Rs.37.20 lakh to the contractor.

The construction of a high level bridge across Ghataprabha river near Anagawadi was awarded (May 1996) to a contractor at his quoted price of Rs.21.05 crore. As per clause 26.06.4 of the agreement, the final measurement shall be recorded only after passage of one monsoon after completion of the embankment/cohesive non-swelling layer to the design profile. For final payment, deduction of 2.5 *per cent* in quantity was to be made towards shrinkage. The work was completed during July 1999 and final payments made during October 2001.

It was noticed in audit that even though the concerned sub-division prepared the final bill in accordance with the above provisions after deduction of the shrinkage, the payment was made for the full quantities, without deduction for shrinkage. This resulted in excess payment of Rs.37.20 lakh to the contractor.

The Government stated (February 2006) that action has now been taken to recover the shrinkage amount alongwith interest from the contractor. As the Company had already settled the final bill in October 2001, the modality of recovering the amount is awaited (September 2006).

4.6 Undue payment

Payment of rates higher than the approved rates for concrete items resulted in undue benefit of Rs.35.87 lakh to contractor.

The construction of a barrage across Bhima River near Yadgir, estimated to cost Rs.20.04 crore was awarded (July 2002) to a contractor at his bid price of Rs.12.20 crore, which was 39 *per cent* below the estimated cost. The barrage was designed with 4.25 metre wide submersible operating platform meant only for operating the gates of the barrage. Subsequently, while the work was in progress, the scope of the work was modified to construct a non-submersible bridge of 7.5 metre of road width above the barrage so that it will serve as an alternate bridge to the old bridge on Yadgir-Shahapur road. The modifications increased the estimated cost of the work by Rs. 21.14 crore at the rates as per schedule of rates of the Company. The work was carried out without retendering and completed (March 2006) as per the changed scope.

The Board, taking into account the increase in scope of work, hike in cost of work etc. approved (September 2004) higher rates for increased scope of work only. The Board approved rate for concrete items of work was at a premium of five *per cent* above the schedule of rates for 1996-97 of the Company. Accordingly, a rate of Rs.2,754.41 per cubic metre was payable for the additional quantities of concrete work. The Company, however, paid a rate of Rs.2,855.63 per cubic metre, which was worked out considering Rs.128.61 per bag of cement instead of the rate of Rs.110 per bag contained in the schedule of rates for 1996-97 of the Company. Since higher rates based on percentage of premium over schedule of rates had already been sanctioned by the Board, there was no justification for adding hike in cement rates separately while making the payment then adding premium of five *per cent*. This resulted in undue benefit of Rs.35.87 lakh to the contractor.

The matter was reported to the Management / Government (March 2006); their replies are awaited (September 2006).

Karnataka State Electronics Development Corporation Limited

4.7 Delay in settlement of bonds

Delay in arranging funds for settlement of bonds on exercising the call option resulted in loss of Rs.39.06 lakh and increased liability of Rs.2.94 crore on borrowings.

The Company issued non-convertible redeemable bonds (guaranteed by the Government of Karnataka) called 'Mahiti Bonds' of Rs.60 crore by private placement during 2000-01 at a coupon rate (interest rate) of 12.75 *per cent* per annum to execute the projects entrusted under Millennium IT Policy of the Government of Karnataka. The terms of offer document stipulated that the Bond could be redeemed by exercising the 'call' and 'put' option by either of the parties at the end of fifth year i.e. before 25 January 2006.

Considering the steep reduction in the interest rate, the Company proposed (December 2004) to the Government to exercise 'call' option at the end of fifth year. The Government permitted (August 2005) the Company to exercise the 'call' option by raising necessary resources from Housing and Urban Development Corporation Limited (HUDCO). HUDCO offered (November 2005) to extend financial assistance of Rs.54 crore at fixed interest rate of 8.75 *per cent* per annum and the balance amount of Rupees six crore was to be mobilised by the Company. Notice of call option was issued in October 2005 exercising the option to redeem the Bonds on 31 January 2006.

The Company approached (November 2005) the Government for approval for arranging loan of Rs.54 crore from HUDCO and to release Rupees six crore for meeting the payment obligations, the approval for which was received only on 22 March 2006. The Bonds were finally redeemed (7 April 2006) after a delay of 66 days from the due date, by availing loan of Rs.54 crore from HUDCO and Government contribution of Rupees six crore. As a result the Company paid interest at higher rates to the bond holders till then resulting in extra payment of Rs.39.06 lakh.

Further, HUDCO also increased the rate of interest from 8.75 *per cent* to 10.25 *per cent* with effect from 1 March 2006 resulting in increased liability of Rs.2.94 crore (approximately) towards payment of interest to HUDCO.

The Government confirmed (June 2006) the facts but has attributed procedural delay in getting the funds from the Government. The reply is not acceptable since the Government had already allowed the Company to raise funds from HUDCO and immediate action could have saved both extra payment of Rs.39.06 lakh and additional liability of Rs.2.94 crore.

4.8 Undue benefit

Waiver of interest on belated payment resulted in undue benefit of Rs.46.95 lakh to a party.

The Company developed (1980) industrial plots with necessary infrastructure facilities at the Electronic City, Bangalore. During 1999-2000, Infosys Technologies Limited (Infosys) was allotted 17.6653 acre, on payment of tentative price of Rs.14 lakh per acre, pending finalisation of the cost of development charges. After finalising (September 2001) the cost at Rs.17.75 lakh per acre, including development charges, the Company asked (December 2001) Infosys to pay the differential cost of development charges of Rs. 64.58 lakh and get the land registered upto 31 December 2001.

Infosys initially refused to pay the amount on the ground that the cost was on the higher side but agreed (November 2005) to pay Rs. 64.58 lakh in one lump if the Company waived the interest. The Company accepted (November 2005) the proposal of Infosys and waived the interest of Rs. 46.95 lakh for the period from January 2002 to November 2005. It was noticed in audit that the Company had levied and collected interest for delayed payment from other companies (including some Government Companies) who were allotted industrial plots in the State. It is also pertinent to mention that the Company had utilised borrowed funds for the development of industrial plots during 1993 to 1999.

The Government stated (June 2006) that the interest was waived due to the contribution of Infosys to the overall growth of IT industries in the State. The reply is not acceptable as interest was being levied and collected from other companies, who were allotted industrial plots in the State.

The decision of the Company to waive interest of Rs.46.95 lakh to Infosys alone resulted in undue benefit to them.

Karnataka Power Transmission Corporation Limited

4.9 Extra expenditure

Error in issuing of letter of intent led to re-tendering and consequential extra expenditure of Rs.44.18 lakh.

The Company invited (August 2003) tenders for the work of installing 1x10 MVA 110/11 KV sub-station at Industrial Growth Centre, Chikkasugar and terminal bay at 110/33 KV sub-station at APMC yard, Raichur, at an estimated cost of Rs.2.76 crore. The tender was finalised in favour of Vee Vee Controls Limited (firm) on turnkey basis at Rs.2.11 crore, after taking discount of 9.5 *per cent* on the quoted price of Rs.2.33 crore. The Company, however, while issuing Letter of Intents (LOI) (January 2004) did not deduct the discount element and indicated the cost as Rs.2.33 crore. The agreements were also entered (May 2004) with the firm for the original amount of Rs.2.33 crore.

After entering into the agreements, the Company issued (June 2004) detailed work order for Rs.2.11 crore. On noticing the discrepancy in the amount mentioned in the LOI and detailed work award, the Company asked (July 2004) the firm to correct the amount of the contract as Rs.2.11 crore. The firm, however, refused (January 2005) to execute the work at the reduced cost. The Company cancelled the contract (April 2005) and forfeited the earnest money deposit (EMD) (Rs.1.84 lakh) and encashed the bank guarantee (Rs.28.98 lakh). Subsequently, the work was re-tendered and awarded (October 2005) to Omricon Engineers, Aurangabad at a cost of Rs.2.86 crore.

Thus, the error committed while issuing the Letter of Intent led to re-tendering and consequential extra expenditure of Rs.44.18 lakh.

The Government (May 2006) while accepting the error as inadvertent, stated that the contractor has gone for arbitration against the action of encashing bank guarantee and forfeiting of EMD.

4.10 Extra expenditure

Placement of order on second lowest tenderer resulted in undue favour and extra expenditure of Rs.37 lakh.

The Company invited (September 2002) bids for establishing 2x100 MVA, 220/66KV substation at Madhuvanahalli (Kollegal) and providing two terminal bays at T.K.Halli 200 KV station on turnkey basis. The estimated cost of the work, based on the Schedule of Rates of 2002-03 was Rs.15.60 crore. After evaluating (November 2002) the technical and commercial bids of the six firms who responded, the Company accepted the bids of three firms. These bids were valid till 11 May 2003. The price bids of three firms were, however, opened in March 2003, out of which Bombay Sub-urban Electricity Supply Company (BSES) was the lowest at Rs.19.92 crore, followed by L&T at Rs.21.10 crore.

While finalising the tender, the Company offered (9 May 2003) 10 *per cent* premium over and above the estimated cost of Rs.15.60 crore, which was not agreed to by BSES. The Company requested (25 May 2003) BSES for extension of the validity period, which expired on 11 May 2003. The request for extension was, however, not acceded to (July 2003) by BSES. The Board in the meantime authorised (9 May 2003) the Managing Director to conduct negotiations with the second lowest tenderer in the event of the lowest tenderer not accepting the negotiated offer. The Company finalised (September 2003) the tender in favour of the second lowest bidder-L&T by offering 10 *per cent* premium over and above the estimated cost of Rs.18.44 crore based on the Schedule of Rates of 2003-04, which worked out to Rs.20.29 crore.

It was noticed in audit (April 2005) that the Company followed two parameters in negotiating the tender - in the case of the lowest tenderer, the Company used estimate based on Schedule of Rates of 2002-03 while in case of the second lowest tenderer estimate based on Schedule of Rates of 2003-04 was used. Further, the second lowest tenderer was approached after expiry of the validity period and the validity period was got extended thereafter. Thus the Company extended undue benefits to the second lowest tenderer resulting in extra expenditure of Rs.37 lakh.

The Government stated (July 2006) that since the lowest tenderer refused to accept the offer of 10 *per cent* premium on Rs.15.60 crore and extension of validity period, L&T who was the second lowest tenderer, was elevated to the lowest position and hence the order was finalised on L&T. The reply is not acceptable as the Company negotiated with both parties using different Schedule of Rates and request for extension of validity of the offer of the second lowest tenderer was made after the expiry of the validity period.

Bangalore Electricity Supply Company Limited

4.11 Avoidable payment

Entrustment of disposal of scrap to an external agency, against its own interest, resulted in avoidable payment of service charges of Rs.37.24 lakh.

The Company was disposing of scrap departmentally. As the workload on the staff was more, which led to delay, the Company examined (June 2003) the feasibility of entrusting the work to Metal Scrap Trading Corporation Limited (MSTC). The examination revealed that entrusting the work to MSTC had the following disadvantages, viz:

- the period of tender and revenue realisation would be monthly instead of weekly/fortnightly;
- MSTC could not assure higher rates for scrap materials;
- the workload of the staff would remain the same and they could not be redeployed elsewhere;
- the revenue would be 2.5 *per cent* less due to commission payable to MSTC; and
- there would be no value addition by entrusting the work to MSTC.

In spite of the above disadvantages, the Managing Director of the Company ordered (June 2003) entrustment of the work to MSTC on the ground that it is a Government of India enterprise. Accordingly, an agreement was entered (July 2003) with MSTC initially for one year which was extended for further three years. The terms and conditions, *inter alia*, included payment of service charges at 2.5 *per cent* on the value of materials sold. The Company paid service charges of Rs.37.24 lakh for the sale value of Rs.14.85 crore during October 2003 to July 2005 and continues to incur service charges till the expiry of the agreement.

It was noticed (December 2005) in audit that the Company could not dispense with the staff, which continued to assist MSTC in arranging for the disposal of the scrap materials. Thus, the purpose of engaging the external agency i.e. reducing the workload of the Company staff has not been achieved even after spending Rs.37.24 lakh as commission.

The Government stated (May 2006) that MSTC was appointed as it has vast experience in handling scrap. Further, the realisation of higher scrap value could not be envisaged as the scrap value depends upon the market trend on the date of tender and quality of scrap. The Company was now proposing to dispense with the outside agency and revert to the old system. From the reply it is evident that entrusting the work to MSTC did not give the Company any additional advantage, while it entailed avoidable extra expenditure.

4.12 Loss of revenue

Failure to comply with its own conditions resulted in non levy of tariff minimum charges of Rs.28.35 lakh.

The Company serviced (February 2001) power to Brigade Enterprises Private Limited, Bangalore with a contract demand of 1,000 KVA (RR No:BS9HT-8).

Based on the request (April 2001) the Company sanctioned (September 2001) additional power of 1,500 KVA under self execution scheme. Terms and conditions of the sanction order *inter alia* included that the consumer was to pay tariff minimum charges from the date of commencement of supply (actual date of availment of power supply or expiry of 30 days notice period issued by the Board, whichever was earlier), even if the consumer failed to avail power supply.

After payment of initial security deposit (October 2001) and augmentation charges (February 2002) by the consumer, arranging of additional power of 1,500 KVA from the existing 11KV system was approved (May 2002). Subsequently, the consumer did not avail additional power and instead staggered the additional load by availing 500 KVA (April 2003) and 1,000 KVA (April 2004). This was also approved by the Company. During the period from June 2002 to July 2003, the Company failed to levy minimum tariff charges amounting to Rs.28.35 lakh in violation of its own terms and conditions of the sanction.

The Government stated (July 2006) that minimum tariff is applicable only after the agreement is executed and not on intimation of sanction load. Further, it stated that the Company had collected three months minimum deposit and infrastructure charges two years in advance of actual availment of additional power supply to the consumer. The reply is not acceptable as the regulation for arranging power supply stipulated that if the consumer failed to avail power within 30 days from such intimation, the installation shall be deemed as serviced on expiry of 30 days period and the consumer is liable to pay the demand charges and monthly minimum charges.

Mysore Minerals Limited

4.13 Fixation of low price

Fixation of price of iron ore to be sold to a 'marketing agent' far below the reference price of MMTC Limited resulted in loss of Rs.22.35 crore.

A reference is invited to Paragraph 2.1.24 of the Report of the Comptroller and Auditor General of India for the year ended 31 March 2004 (Commercial), Government of Karnataka, wherein it was pointed out that non-revision of selling price in terms of original agreement for sale of iron ore resulted in loss of Rs.3.27 crore.

As per the 'Marketing agreement', (October 1999 and revised in January 2002) the Company has to sell the calibrated iron ore (except iron ore fines) mined at Subbarayanahalli mines exclusively to Kalyani Ferrous Industries Limited (KFIL), for 20 years or more until the mining lease expires, at the prices determined as per the agreement. The price was fixed at Rs.250 per tonne for an initial lock-in period of three years. Thereafter, the prices were to be reviewed and re-fixed with effect from 1st of April every year taking in to consideration the revision of prices by MMTC Limited. Audit analysis revealed that the agreement was silent about the basis/formula to arrive at a price from the prices declared by MMTC Limited from time to time.

The first revision was due on 1 April 2005 as per the agreement. The Company worked out and communicated (May 2005) a selling price of Rs.902 per tonne based on the MMTC price of Rs.1,000 per tonne (tentative) after deducting transportation and handling cost. This price was not accepted by the KFIL. After several rounds of discussion with KFIL, the Company fixed (July 2005) a selling price at Rs.314 per tonne valid till 31 March 2007. The reasons for the fixation of such a low price, as compared to MMTC price and agreeing to make it valid for two years instead of one year were, however, not on record.

Fixation of price at Rs.314 per tonne instead of Rs.972 per tonne, resulted in loss of Rs.658 per tonne. During 2005-06 a total of 3,39,685 tonne of iron ore supplied at the price of Rs.314 per tonne resulted in loss of Rs.22.35 crore. The Company may continue to incur losses in the absence of any fixed basis/formula in the agreement.

The matter was reported to the Management (May 2006)/Government (June 2006); their replies are awaited (September 2006).

Cauvery Neeravari Nigam Limited

4.14 Excess payment and extension of undue benefit

Payment at rates higher than at the approved Schedule of Rates resulted in excess payment and extension of undue benefit of Rs.4.68 crore.

The balance works♣ relating to dam appurtenant works of Uduthorahalla reservoir project was entrusted (June 1998) by the Irrigation Department of the Government of Karnataka to Consolidated Enterprises (Contractor) at a cost of Rs.26 crore, at a premium of nine *per cent* over the Schedule of Rates of 1993-94. While the works were in progress, the contractor requested (May 1999) for payment at nine *per cent* above the current Schedule of Rates of 1996-97, due to failure of the Department to supply cement and steel and non-payment of monthly bills by the Department. The Government accorded (July 2001) approval, for the payment at the rates of 1996-97 in respect of the works executed after 31 May 1999. This project was transferred to the Company after its formation in June 2003.

Audit scrutiny revealed that in respect of certain critical items of works, rates other than those based upon the Schedule of Rates of 1996-97 were paid as detailed below:

- An *ad hoc* increase of 20 *per cent* over the Schedule of Rates of 1993-94 for hearting and casing of the dam embankment,
- An *ad hoc* increase of 30 *per cent* above the Schedule of Rates of 1993-94 or rate analysis, which ever is less, for concrete items of work .

These deviations, which were contrary to the rates approved by the Government in July 2001, resulted in excess payment of Rs.4.68 crore and extension of undue benefit as per the latest running account bill paid in January 2006. The work is yet to be completed (August 2006).

The Management stated (July 2006), that the rates for 1996-97 Schedule of Rates were lesser than the rates as per Schedule of Rates of KRS dam Circle. As the agency represented for revised rates, it was analysed that it would be appropriate to include derived rates for lead, loading and unloading charges based on the data break up of Schedule of Rates of 1993-94 and incorporating in it the machinery hire charges, labour charges, and oil charges of market that prevailed during 1996-97 and hence the revised rates were worked out.

The reply is not acceptable as Schedule of Rates of different circles were finalised by the Schedule of Rate Committees based on the cost of material,

♣ **The project was originally entrusted (January 1990) by the Irrigation Department to the Karnataka State Construction Corporation Limited (KSCC). The work was withdrawn (December 1994) from them and entrusted (September 1995) to the present contractor, who was the sub-contractor of KSCC. The works entrusted in September 1995 were completed and the present contract comprised the further works entrusted during June 1998.**

labour and transportation, etc., of the local market, keeping in view the directions of the Board of Chief Engineers. The rates so finalised need not be higher than the rates for the previous year, and comparing the rates with that of another circle was not justified. Giving *ad hoc* increase of 20 *per cent* and 30 *per cent* over the previous Schedule of Rates, instead of payment at the Schedule of Rates approved by the Government resulted in excess payment to the contractor.

The matter was reported to the Government (June 2006); their reply is awaited (September 2006).

Karnataka Power Corporation Limited

4.15 Idle investment

Failure to evaluate the compatibility of the software with interface equipment resulted in idle investment of Rs.4.03 crore.

In order to have comprehensive station level computer control system named as second level control system for Kadra and Kodasalli Power houses, the Company placed purchase order (August 1995) for supply and commissioning of station level computer system at Rs.1.35 crore for both the power houses on CEGELEC (now ALSTOM Systems Limited).

It was noticed that the Company did not evaluate compatibility of this software with the interface equipment (equipments purchased for interfacing between the water control system and the computer system) to be supplied by BHEL.

ALSTOM supplied the computer system along with the required software and conducted trials during 1998-2002 to integrate the system with water control system using interfacing equipments supplied by BHEL. The computer system could not be integrated due to lacunae in the system like delay in commands, system function, log issues, stability, etc.

As the supplier failed to solve the problems of the system, the Company rejected (October 2004) the system and encashed the bank guarantees of Rs.15.23 lakh. The Company also asked the supplier to make good the balance amount of Rs.1.18 crore, paid to them for supply of the system, as per the terms of the purchase order. Recovery of the amount was awaited (August 2006).

Non-availability of station level computer system not only resulted in failures to utilise the available water judiciously but also in blockage of Rs.2.85 crore in interfacing equipment. Failure to evaluate the compatibility of the software with interface equipment, thus, resulted in blockade of Rs.4.03 crore.

The Management admitted the fact of non-functioning of station level computer system and stated (August 2005) that the microprocessor based line control panel and interfacing panels have been commissioned and are in service. The reply is not acceptable as the microprocessor based line control panel and interfacing panels were to be used along with the computer system and non-availability of computer system has rendered these equipments ineffective.

The matter was reported to the Government (April 2006); their reply is awaited (September 2006).

The Mysore Sugar Company Limited

4.16 Loss due to violation of licence conditions

Production of spirit directly from sugarcane juice in violation of licence conditions resulted in loss of Rs.3.43 crore.

The Company started (September 2004) production of rectified spirit directly from sugarcane juice without obtaining the necessary permission from the Excise Department. The Excise Department consequently, confiscated (March 2005) the stock of 4,82,819 litre of rectified spirit and 30,011 litre of medium grade alcohol costing Rs.3.43 crore. The appeal of the Company against confiscation was rejected and confiscated spirit was auctioned in June 2005.

Thus, production of spirit directly from sugar cane juice in violation of licence conditions and without obtaining express permission from the Government resulted in loss of Rs.3.43 crore.

The Management, while confirming the facts, stated (April 2006) that the production of spirit directly from sugarcane juice was started as per the understanding reached with the Excise Authorities and the Cane Commissioner, with the best intention of reducing the financial loss of the Company as production of sugar was not viable due to very low cane production/crushing. The reply is not acceptable as the Company should not have gone for production of rectified spirit without obtaining necessary approval from the Excise Department.

The matter was reported to the Government (April 2006); their reply is awaited (September 2006).

The Mysore Electrical Industries Limited

4.17 Extra expenditure

Addition of a condition not stipulated in the tender/offer documents resulted in the purchase order being rejected and consequential extra expenditure of Rs.72.48 lakh.

The Company invited (June 2003) tenders for supply of ACSR Drake conductor required for the construction of 220 KV transmission line from Chickodi to Kudchi, from vendors approved by Karnataka Power Transmission Corporation Limited (KPTCL).

After negotiation, Sharavathi Conductors Private Limited (SCPL) was evaluated as the lowest tenderer. Purchase order for supply of 213.54 kilometre of Drake conductor was placed (October 2003) on SCPL with firm prices of Rs.1,48,808 per kilometre. The firm was also asked to furnish performance bank guarantee, which was not stipulated in the tender/offer documents. SCPL did not accept (November 2003) the purchase order as it varied from the offer. The attempt to get supplies from the second and the third lowest tenderers also failed. The Company, therefore, issued (May 2004) fresh enquiries to all the participants of the original tender and the purchase order was placed (July 2004) on SCPL, at the negotiated price of Rs.1,72,000 per kilometre for 215 kilometre of Drake conductor, on variable price conditions.

Addition of a condition not stipulated in the tender/offer documents resulted in the purchase order being rejected and consequential extra expenditure of Rs.72.48 lakh on the procurement of the conductors from the same firm at higher rates.

The Government stated (May 2006) that the terms and conditions of furnishing bank guarantee were not acceptable to SCPL. The reply is not acceptable as this condition was not stipulated in tender/offer documents but was added at the time of placing order.

Karnataka Road Development Corporation Limited

4.18 Avoidable expenditure

Widening the berms upto the extreme edge of the drainage on both sides of the carriage way resulted in avoidable expenditure of Rs.69.15 lakh.

The Company entrusted (April 2001) maintenance work of various State highways in Hassan district to Vishal Infrastructure Limited, Bangalore (contractor) for a period of three years on rate contract basis. The work included, among other items, two metre wide 20 centimetre thick berm works on both sides of the carriage way. During execution, the Public Works Department, Government of Karnataka, instructed the contractor to clear the high berms upto the extreme edge of the drain on both sides of the road in order to demarcate the road width to have a clear right of way. This resulted in increase in the quantity of earthwork excavation by 1,97,581 cubic metre, at a cost of Rs.69.15 lakh.

It is pertinent to mention in this connection that Indian Road Congress (IRC) has provided for standard requirement of 1.8 metre berm work on both sides of the carriage way. As such, berm works beyond two metres of the carriage way was not required and was also not envisaged in the original estimate or contract for the road maintenance work.

The Management stated (May 2005) that if the berm cutting was restricted to two metres, there was every likelihood of remaining road width being encroached upon, and also that water would not drain properly into longitudinal drains, which might result in deterioration of asphalted surface of the road. The reply is not acceptable as the problem of drainage of water could have been tackled by proper maintenance of the cross drains and encroachments cannot be prevented even by excess berm work. Further, extending the high berm upto the extreme edge of the drains was not required in view of IRC specifications also. As such, extending the high berm upto the extreme edge of the drains on both sides of the carriage ways by incurring extra expenditure of Rs.69.15 lakh was avoidable.

The matter was reported to the Government (March 2006); their reply is awaited (September 2006).

Karnataka State Industrial Investment and Development Corporation Limited

4.19 Imprudent tax planning

The Company lost the opportunity to earn additional interest of Rs.66.63 lakh due to its failure to avail of the benefit under Section 197(1) of the Income Tax Act.

The Company has been incurring losses since 1998-99 and filing Income tax returns indicating ‘loss’ from business operations. There has been ‘unabsorbed depreciation’ and ‘unabsorbed losses’ to be adjusted against future earnings.

The Company constructed (2000-01) a building ‘Khanija Bhavan’ and rented the space to various companies. The total rental income from this building was Rs.10.07 crore per annum. The tenants have been paying rent after deducting TDS in accordance with the provisions of Income Tax Act, 1961 (Act). As the Company was filing ‘loss’ returns with Income-Tax authorities, it was getting refund of tax along with interest at six *per cent* per annum after the assessment.

As per Section 197(1)[1] of the Act, the Company was entitled to get a ‘certificate’ from Income-Tax authorities to avail the benefit of non-deduction of TDS from rental income. The Company did not avail of this benefit and thereby TDS of Rs.3.77 crore was deducted by the tenants during 2001-02 to 2002-03. The Company availed the benefit of Section 197(1) in 2003-04 but the same was again not availed in 2004-05 resulting in payment of TDS of Rs.2.13 crore. Had the Company done tax planning properly it could have earned more interest by using the funds for its lending business.

The Management stated (May 2006) that as per Business Plan Resource Forecast (BPRF), it had budgeted to make ‘profit’ and as such ‘Income tax’ was paid. The reply is not acceptable since BPRF is a projection of income for the year only, whereas for payment of income tax, the ‘unabsorbed depreciation and losses’ of earlier years are also relevant. Since the Company was showing ‘loss from business operations’ since 1998-99 and was having ‘unabsorbed

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[1] Section 197(1) 1961 stipulates that when the Assessing Officer is satisfied that the total income of the recipient justifies the deduction of Income Tax at any lower rates or no deduction of income tax, the Assessing officer on an application made by the assessee on this behalf give such *certificate* as may be appropriate.

depreciation and losses' it should have considered these facts at the time of tax planning and should have availed the benefit of Section 197(1) of the Act.

Thus the Company lost the opportunity to earn additional interest of Rs.66.63 lakh (the difference between lending rate of the Company and interest paid by tax authorities) due to its failure to avail of the benefit under Section 197(1) of the Act.

The matter was reported to the Government (April 2006); their reply is awaited (September 2006).

Marketing Consultants and Agencies Limited

4.20 Supply of material and services to IT.Com

Materials supplied and services of Rs.56.70 lakh rendered by the Company to the event managers of IT.Com 2002 and IT.Com 2003 remained unpaid as there was no formal agreement with the event managers.

During 2002, the Company supplied various materials including brochures, floor plans, envelops, receipt books, compact disks, exhibition manual etc., and also rendered services in arranging to place advertisements in various news papers and magazines, to 'Cyber Expo', (Division of Cyber Media) the event managers of 'IT.Com 2002', an exhibition held at Bangalore by the Department of Information Technology and Bio-Technology. There was, however, no formal order for the material or services to be supplied/rendered from the event managers or the Department. The estimates for the materials, art works and advertisements were approved by the event managers before arranging for supply. The total value of materials supplied and services rendered were billed at Rs.34.54 lakh. The Company received payments of only Rs.2.68 lakh upto July 2006. Cyber Expo deducted Rs.7.38 lakh as 'tax deducted at source' on balance of Rs.24.48 lakh, which is yet to be received (August 2006).

In spite of the fact that payments were not made in respect of IT.Com 2002, the Company again rendered similar services and supplied materials for IT.Com 2003 organised by Cyber Expo. The invoices for the materials/services were raised in the name of IT.Com 2003 at the instance of the event managers (Cyber Expo). The total value of the materials supplied/services rendered was Rs.40.11 lakh against which payment of only Rs.7.89 lakh was received, leaving a balance of Rs.32.22 lakh (July 2006). The total amount receivable in respect of both IT.Com 2002 and IT.Com 2003 from the event managers was Rs.56.70 lakh (July 2006).

As no payment was received, the Company sent (October 2004) legal notices to the event managers to make the payment of the outstanding dues. No payment, was, however, received (July 2006) and the Company has not taken any further legal action.

The Management confirmed (May 2006) that it had not entered into a contract agreement for services rendered. It was further stated that the event managers were appointed by the Department of Information Technology and

Bio-Technology and jobs were done for the event managers on the oral instructions of the then Secretary of the Department at short notice and that the matter of payment was being pursued with the Department also.

The reply of the Company indicates that it did not take steps to safeguarding the interest of the Company. Undertaking jobs for the second event when payment for the first job had not been received was not justified.

The matter was reported to the Government (June 2006); their reply is awaited (September 2006).

Gulbarga Electricity Supply Company Limited

4.21 Delay in calibrating the meter of an HT installation

Failure to comply with the codal provisions in calibrating meter of a high tension installation resulted in loss of revenue of Rs.53.35 lakh.

Clause 26.07 of Karnataka Electricity Supply and Distribution Code required that the meters fixed to High Tension (HT) installations are to be tested/calibrated/rated once in a year in order to ascertain the accuracy of its performance. In case of any fault in meter reading, clause 27.03 of the code *ibid*, provides for maximum of six months back billing- i.e. billing for previous period on the basis of estimated consumption of energy.

The meter of Karanja Industries Limited, Bidar, an HT consumer was serviced on 2 January 2002 and as per codal provisions had to be calibrated by 2 January 2003 (i.e. after one year). The Company, however, calibrated the installation only on 16 January 2004, (i.e. after two years). The meter was found to be recording slow consumption of power by 45 *per cent* and the Company raised back billing charges for the six months period (August 2003 to January 2004) as per clause 27.03 of the code.

Audit scrutiny of records revealed that the results of calibration on 16 January 2004 indicated that the meter had been faulty for the previous 21 months. If the meter was calibrated by January 2003 (one year period, as per codal provision), the fault could have been detected and consumer back-billed for August 2002 to January 2003 and further recording of energy charges would have been on the basis of accurate billing. By not adhering to the codal provisions for annual test/calibration the fault remained undetected and meter ran slow for 21 months, whereas only six months back-billing was enforceable. This resulted in loss of revenue of Rs.53.35 lakh as the energy recorded was only 55 *per cent* of the energy actually consumed (August 2002 to July 2003).

The matter was reported to the Management/Government (January 2006/ March 2006); their replies are awaited (September 2006).

Jungle Lodges and Resorts Limited

4.22 Renovation and outsourcing of Hotel Metropole and Hotel Krishna Raja Sagar

Introduction

4.22.1 The Government of Karnataka transferred (April 2003) Hotel Metropole and Hotel Krishna Raja Sagar (KRS) at Mysore from the Tourism Department to the Company with a view to revitalising and recommencing the hotel business within a period of three months. Accordingly, the said buildings, taken over by the Company in June 2003, were renovated at a cost of Rs.4.84 crore (loan of Rs.2.50 crore from HUDCO and the balance amount of Rs.2.34 crore incurred out of internal accruals) and both the hotels were outsourced[2] to Royal Orchid Hotels Limited (ROHL).

Audit scrutiny conducted in December 2005 of the records relating to renovation and outsourcing of these hotels revealed the following:

Violation of pre-qualification criteria

4.22.2 The Notice Inviting Tenders (NIT) for the renovation work of Hotel Metropole and Hotel KRS, comprising pre-qualification requirement of the tenderers was issued in July 2003. As per this, the applicants were required to have experience in the construction and renovation of heritage/ eco-tourism hotels of minimum three-star level and a minimum turn over of Rupees two crore in the past five years. Three parties responded to the notice. The tender of one party was not considered as it did not have the required turnover of Rupees two crore. Tenders of the other two parties were considered for evaluation and since the financial offer of Manjushree Constructions was the lowest, the renovation work of both the properties was awarded to them.

Audit scrutiny revealed that Manjushree Constructions did not have a turnover of minimum of Rupees two crore and experience in the construction of three star level hotels. As such they were not eligible for evaluation. But their offer was considered only because they had executed other works of the Company earlier. Accepting the offer of Manjushree Constructions was not only contrary to the pre-qualification criteria prescribed in the NIT but was also in violation of the rules framed under Karnataka Transparency in Public Procurement Act, 2000.

Delay in awarding renovation work of Hotel KRS

4.22.3 The tenders for the renovation of both the works were invited in July 2003 and tenders were finalised in favour of Manjushree Constructions. The work order, however, in respect of Hotel KRS was issued in March 2004, only after completion of the work of Hotel Metropole for which no reason was on record. This resulted not only in payment of escalation in cost to the extent

[2] **Hotel Metropole in May 2004 and Hotel Krishna Raja Sagar in March 2006.**

of Rs.9.87 lakh to the contractor but also resulted in anticipated revenue loss of Rs.1.32 crore[∞] for the period from August 2003 to March 2006.

Outsourcing of hotels

4.22.4 The Company invited tenders (January 2004) for outsourcing the operation and management of its hotels for a period of 15 years. The NIT contained only the eligibility and evaluation criteria for financial capability and no mention was made regarding the minimum expected returns based on the prevalent return in respect of the 3-Star Hotel category.

Low rate of return- Hotel Metropole

4.22.5 Hotel Metropole was built about 100 years back during the reign of the Wodeyar dynasty. The hotel building is a classic example of colonial style of architecture and a heritage building. India Tourism Statistics-2003 had ranked Karnataka among the top five states in India in respect of tourists' inflow. Mysore, being an important tourist destination from historical, cultural, heritage and business point of view, was projected to attract tourist from all over the country and abroad.

It was noticed in audit that though the Company invited tenders for outsourcing it did not analyse the rate of return to be expected from the hotels keeping in view the huge potential because of the factors mentioned above. Considering the market value of land and building of Hotel Metropole at Rs.15.60 crore and Rs.3.19 crore spent towards the renovation cost, outsourcing of Hotel Metropole to ROHL for a period of 15 years at a licence fee of Rs.14.75 crore works out to a meagre return of 5.2 *per cent* per annum on capital invested by the Government.

The Management stated (March 2006) that considering the fact that the capital investment by the Company is only Rs.3.30 crore, the return is 347 *per cent* in aggregate and approximately 23 *per cent* on an average per annum.

The reply is not acceptable because the Company considered only the renovation cost incurred by it and ignored the total value of the property for reckoning the rate of return.

Delay in handing over of Hotel Metropole

4.22.6 The Hotel Metropole was outsourced to Royal Orchids Hotel Limited (ROHL) in May 2004 for an aggregate lease rent of Rs.14.75 crore for a period of 15 years. In addition, the ROHL was to pay 10 *per cent* of the annual revenue exceeding Rs.2.50 crore. According to the outsourcing agreement, the second instalment of lease rent was to be received on the first anniversary from the date of certificate issued by the architects of the Company about the readiness of the hotel to commence operations after renovation. This certificate was to be issued within three months from the date of agreement.

It was noticed in audit that due to delay in rectification of roof leakage, the readiness certificate in respect of Hotel Metropole could be issued only on

[∞] **total lease rent payable was Rs.7.42 crore for 15 years; proportionate lease rent payable for period August 2003 to March 2006 works out to Rs.1.32 crore.**

17 October 2004. This resulted in the postponement of the payment of second instalment of lease rent and thereby a loss of Rs.9.26 lakh, being the rental from 26 August to 16 October 2004.

The Management stated (March 2006) that the lease agreement was subject to completion of the pending works. As the rectification work of roof leakage was completed only in October 2004 and the readiness certificate was issued only on 17 October 2004, commercial operations started only from 17 October 2004 and therefore there was no loss.

The reply is not acceptable as the delay on the part of the Company to complete renovation within time resulted in foregoing the lease rental.

Extension of undue benefit – Hotel Metropole

4.22.7 The lease deed with ROHL entitled the lessee to create additional facilities including a swimming pool at their cost. The Company, however, spent (November 2003) Rs.49.28 lakh on providing a swimming pool (Rs.7 lakh), furniture (Rs.37.08 lakh) and landscaping the premises (Rs.5.20 lakh).

As the expenditure on the above items was to be met by ROHL as per the lease agreement, providing the additional facilities resulted in undue benefit of Rs.49.28 lakh.

Irregular payments – Hotel KRS

4.22.8 The tender for renovation of Hotel KRS clearly indicated that the dismantling includes carting of the debris from the site and the quoted rates should be applicable to all lead and lifts. The Company, however, admitted the claims in respect of disposal of dismounted debris away from the site as extra items (Rs.2.20 lakh) and the additional lead and lift charges (Rs.4.16 lakh) for third floor against the tender conditions. The payment of Rs.6.36 lakh was irregular and resulted in undue benefit to the contractor.

The Management stated (March 2006) that disposal of debris far away from the site only applied to removal of debris outside the premises and lead and lift applicable only upto second floor. The reply is not acceptable as there was no such mention in the tender specifications and as such cannot be considered as extra items.

To sum up

The Company did not follow the conditions prescribed in the notice inviting tender while finalising the tender. Delay in issue of work order in respect of Hotel KRS resulted in payment of Rs.9.87 lakh as escalation besides loss of revenue of Rs.1.32 crore. Delay in handing over the possession of Hotel Metropole resulted in loss of revenue of Rs.9.26 lakh. The Company gave undue benefit of Rs.49.28 lakh to ROHL.

The matter was reported to the Government (June 2006), their reply is awaited (September 2006).

STATUTORY CORPORATION

Karnataka State Warehousing Corporation

4.23 Unfruitful expenditure on construction of staff quarters

Construction of staff quarters without creating other basic amenities resulted in blocking up of funds of Rs.3.15 crore and interest burden of Rs.88.30 lakh.

The Corporation considered (July 2001) that provision of infrastructure facilities such as compound wall, office block, staff quarters, hamali sheds and water supply around the warehouses was essential to make them more functional. The Corporation decided (January 2002) to provide these infrastructure facilities at a cost of Rs.11.36 crore at 20 locations in 15 districts. The funds required were to be met with borrowings from Banks/Government. It was further decided (June 2002) to entrust the entire project to Hindustan Steel Works Construction Limited (HSCL). It was noticed in audit that the staff quarters were to be completed (both civil works and internal electrification) within nine months as per Memorandum of Understanding signed (20 June 2002) with HSCL. However, construction of Type I & II quarters were completed between April 2003 and December 2005 in 20 locations in 15 districts after delays ranging from 1 to 14 months at a total cost of Rs.3.15 crore.

As the Corporation failed to provide power connection, water supply and roads, the quarters could not be allotted to the employees so far (August 2006). This resulted in not only the unfruitful investment of Rs.3.15 crore from borrowed funds but also in un-necessary interest burden of Rs.88.30 lakh (at the rate of 12 *per cent*) per annum. The Corporation continued to incur recurring expenditure of Rs.0.17 lakh per month towards House Rent Allowance being paid to employees.

The Management stated (May 2006) that due to financial crisis, they could not provide the basic amenities such as power connection, water supply and the road to the quarters. The reply is not acceptable as the objective of the project as envisaged by the Corporation has not been achieved and the expenditure on construction has remained unfruitful.

The matter was reported to the Government (June 2006); their reply is awaited (September 2006).

General

4.24 Persistent non-compliance with Accounting Standards in preparation of Financial Statements

Accounting Standards (AS) are the accepted standards of accounting recommended by the Institute of Chartered Accountants of India and prescribed by the Central Government in consultation with the National Advisory

Committee on Accounting Standards under section 210 A of the Companies Act, 1956. The purpose of introducing AS is to facilitate the adoption of standard accounting practices by companies so that the annual accounts prepared exhibit a true and fair view of the transactions and also to facilitate the comparability of the information contained in published financial statements of companies. Under Section 211(3A) of the Companies Act, it is obligatory for every company to prepare the financial statements (profit & loss account and balance sheet) in accordance with the AS.

The Auditors are also required to report under Section 227(3) (d) of the Act, *ibid* as to whether the accounts have been prepared in compliance with AS. The extent of compliance with AS in the State Government companies was examined by audit with a view to highlight cases of persistent non-compliance of Accounting Standards in preparation of annual accounts by these companies.

A review of the financial statements and the Statutory Auditors' report thereon for the years 2001-02 to 2004-05, in respect of 80[3] Public Sector Undertakings, which finalised their previous years' accounts as of March 2006 revealed that 37 companies had persistently[4] not complied with one to six Accounting Standards as detailed in **Annexure-9.**

It would be seen from the **Annexure** that:

- nine companies[5] persistently violated AS 1, which deals with the disclosure of significant accounting policies to be followed in preparing and presenting financial statements on the basis of certain fundamental accounting assumptions viz., (a) going concern (b) consistency and (c) accrual.
- ten companies[6] persistently violated AS 2, which deals with the determination of the value at which inventories are carried in financial statements until the related revenues are realised and provides that inventories should be valued at the lower of cost or net realisable value.
- two companies[7] persistently violated AS 3, which deals with presentation of cash flow statement. The cash flow statement should report cash flows during the period classified into operating, investing and financing activities.
- two companies[8] persistently violated AS 5, which deals with net profit or loss for the period, prior period items and changes in accounting policies. The nature and amount of prior period items should be separately disclosed in the statement of profit and loss in a manner that their impact on the current profit and loss can be perceived.

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[3] **Including 59 working Government companies; 17 non-working Government companies and 4 deemed Government companies.**

[4] **Persistent non-compliance means companies that have not complied with the same AS for more than one year and continue to disclose the fact in their latest finalised accounts.**

[5] **Sl.No. 7,11,18,20,23,34 to 37 of Annexure-9**.

[6] **Sl No. 12,14,20,22,24,26 to29 and 32 of Annexure-9.**

[7] **Sl. No. 6 and 25 of Annexure-9.**

[8] **Sl.No. 11 and 32 of Annexure-9**.

- six companies[9] persistently violated AS 6, which deals with depreciation accounting. As per this Standard, the depreciation amount of a depreciable asset should be allocated on a systematic basis to each accounting period during the useful life of the asset. The depreciation method selected should be applied consistently and changes should be made only if the adoption of the new method is required by statute.
- four companies[10] persistently violated AS 9, which deals with revenue recognition. Revenue from sales or service transaction should be recognised, if at the time of performance it is not unreasonable to expect ultimate collection. If at the time of raising any claim it is unreasonable to expect ultimate collection, revenue recognition should be postponed.
- nine companies[11] persistently violated AS 10, which deals with the accounting of fixed assets. The cost of a self constructed fixed asset should comprise those costs that relate directly to the specific assets and those that are attributable to the construction activity in general and can be allocated to the specific asset. Items retired from active use and held for disposal should be stated at the lower of their net book value and net realisable value and shown separately in the financial statements.
- one company (Karnataka Telecom Limited - Sl.No.35 of **Annexure-9**) persistently violated AS 11, which deals with accounting for effects of changes in foreign exchange rates.
- eight companies[12] persistently violated AS 12, which deals with the accounting of Government grants. As per the Standard, Government grants related to specific fixed assets should be presented in the balance sheet by showing the grants as a deduction from the gross value of the assets concerned in arriving at their book value. Where the grant related to specific fixed asset equals the whole or virtually the whole of the cost of the asset, the asset should be shown in the balance sheet at a nominal value.
- two companies[13] persistently violated AS 13, which deals with the accounting of investments. As per this Standard, any reduction in the carrying amount and any reversals of such reduction should be charged or credited to the profit and loss statement.
- thirteen companies[14] persistently violated AS 15, which deals with accounting for retirement benefits to employees (viz., provident fund, pension, gratuity, leave encashment etc.) and provides that the contribution payable by the employer towards retirement benefits be charged to statement of profit and loss for the year on accrual basis and the accruing liability calculated according to actuarial valuation.

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[9] **Sl.No. 8,12,21,24,26 and 28 of Annexure-9.**
[10] **Sl.No. 11,16,17,33 of Annexure-9.**
[11] **Sl.No. 12,15,23,24,26 to 30 of Annexure-9.**
[12] **Sl. No. 2,6,8,16,18,25,27 and 29 of Annexure-9.**
[13] **Sl.No. 9 and 32 of Annexure-9.**
[14] **Sl.No. 1,3,4,9,10, 19,21,24,26,29,31, 34 and 37 of Annexure-9.**

- four companies[15] persistently violated AS 16, which deals with the accounting for borrowing costs. Borrowing costs are interest and other costs incurred by an enterprise in connection with the borrowing of funds. Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset, should be capitalized as a part of the cost of that asset.
- one company (The Karnataka Handloom Development Corporation Limited-Sl.No.6 of **Annexure-9**) persistently violated AS 17, which deals with segment reporting and establishes principles for reporting financial information about the different types of products and services and also the different geographical areas in which it operates.
- two companies[16] persistently violated AS 19, which deals with accounting of leases. As per this Standard, if a sale and lease-back transaction results in an operating lease and it is clear that the transaction is established at a fair value, any profit or loss should be recognised immediately.
- six companies[17] persistently violated AS 22, which deals with accounting for taxes. According to this Standard, the carrying amount of deferred tax assets should be reviewed at each balance sheet date. An enterprise should write down the carrying amount of deferred tax asset to the extent that is no longer reasonably certain that sufficient future taxable income will be available against which deferred tax asset can be realised.

The matter was reported to the Government (June 2006); their reply is awaited (September 2006).

4.25 Follow-up action on Audit Reports

Explanatory note outstanding

4.25.1 The Comptroller and Auditor General of India's Audit Reports represent the 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).

Audit Reports for the years 2000-01 to 2004-05 were presented to the State Legislature between March 2002 and March 2006. Seven out of nine

[15] **Sl. No. 26 to 29 of Annexure-9.**
[16] **Sl. No. 20 and 32 of Annexure-9.**
[17] **Sl. No. 3,5,13,20,26 and 32 of Annexure-9.**

departments, which were commented upon, did not submit explanatory notes on 26 out of 81 paragraphs/reviews as on September 2006, 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	2
2004-05	25	23
Total	**81**	**26**

Department wise analysis is given below:

Name of the department	2000-01	2003-04	2004-05
Commerce and Industries	-	1	9
Energy	-	1	-
Water resources	-	-	9
Forest	-	-	1
Tourism	-	-	2
Social Welfare	-	-	1
General	1	-	1
Total	**1**	**2**	**23**

Department largely responsible for non-submission of explanatory notes were Commerce & Industries and Water Resources Department.

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

4.25.2 The replies to paragraphs are required to be furnished within six months from the presentation of the Reports. Replies to 33 paragraphs pertaining to eight Reports of the COPU, presented to the State Legislature between February 2004 and August 2006, had not been furnished as on September 2006, as indicated below:

Year of the COPU Report	Total number of Reports involved	No. of paragraphs where replies not received.
2003-2004	1	2
2005-2006	5	27
2006-2007	2	4
Total	**8**	**33**

4.26 Response to inspection reports, draft paragraphs and reviews

Audit observations noticed during audit and not settled on the spot are communicated to the heads of the PSUs and concerned departments of the State Government through inspection reports. The heads of PSUs are required to furnish replies to the inspection reports through the respective heads of departments within a period of six weeks. A review of Inspection reports issued up to March 2006 pertaining to 77 PSUs disclosed that 3,681 paragraphs relating to 1,006 inspection reports remained outstanding at the end of March 2006. Of these, 38 inspection reports containing 159 paragraphs were pending due to non-receipt of even first replies. Department wise break-up of inspection reports and audit observations outstanding as on 31 March 2006 is given in **Annexure-10.**

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. However, 16 paragraphs and one review forwarded to the various departments during March 2006 to August 2006, as detailed in **Annexure-11**, had not been replied so far.

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

BANGALORE **(USHA SANKAR)**
The **Principal Accountant General**
(Civil and Commercial Audit)
Karnataka

COUNTERSIGNED

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