EXECUTIVE SUMMARY

Background

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

Though, the Comptroller and Auditor General (C&AG) has been commenting upon the State's Finances, the comments formed part of the civil audit report and remained camouflaged in the large body of audit findings on compliance and performance audits. In recognition of the need to bring State finances centre-stage, a stand-alone report on State Government finances was considered appropriate. Accordingly from the report year 2008-09 onwards, the C&AG has decided to bring out a separate volume titled "Report on State Finances".

The Report

Based on the audited accounts of the Government of Karnataka for the year ending March 2010, this report provides an analytical review of the annual accounts of the State Government. This report is structured in three chapters.

Chapter 1 is based on the audit of Finance Accounts and makes an assessment of Government of Karnataka's fiscal position as at 31 March 2010. It, *inter-alia*, provides an insight into trends in committed expenditure, borrowing pattern besides, a brief account of Government of India funds transferred directly to the State implementing agencies through off-budget route.

Chapter 2 is based on the audit of Appropriation Accounts, gives description of appropriations and the manner in which the allocated resources were managed by the service delivery departments.

Chapter 3 is an inventory of Karnataka Government's compliance with various reporting requirements and financial rules.

The report also has an appendage of additional data collated from several sources in support of these findings.

Audit findings and recommendations

Fiscal position

In 2009-10, the State was on the road to recovery from the effects of economic slow-down. Decrease in revenue surplus was contained, if not reversed. The increase in fiscal deficit in 2009-10 was less pronounced than the increase in fiscal deficit in 2008-09. The increase in primary deficit was also contained in 2009-10. Despite increase in revenue and non-debt receipts by ₹ 6,253 crore in 2009-10 over the previous year, primary deficit increased by ₹ 1,462 crore as the incremental non-debt receipts were short of incremental primary expenditure by ₹ 1,462 crore.

Primary deficit of ₹ 5,622 crore at the end of the year implied that non-debt receipts were sufficient for meeting primary revenue expenditure and that the State had to depend on borrowed funds for meeting 10 *per cent* (₹ 5,622 crore) of its primary expenditure. *This underlined the need for augmentation of own revenue for fiscal correction and consolidation.*

Revenue expenditure

Non-plan revenue expenditure (NPRE) was 74 *per cent* of revenue expenditure during 2009-10. It included devolutions to PRIs and ULBs, interest payments, subsidies, pension payments, salaries and maintenance expenditure.

Merit subsidy constituted around seven *per cent* of the total subsidy expenditure of the State during the year. *Subsidies will not meet the aims of social policy unless the beneficiaries are properly identified and targeted. The delivery of product or service at subsidized price results in large scale corruption, diversion and misuse. The Government should take action to implement the purchaser-provider model proposed in 2005 and ensure that beneficiaries are properly identified and targeted.*

Quality of capital expenditure

Capital expenditure of the State included certain items of expenditure which either do not qualify as capital expenditure or which do not involve any cash outflow.

Funds aggregating ₹ 1,015 crore were blocked in incomplete projects as at the end of 2009-10.

Investment to the end of 2009-10 included ₹ 16,993 crore (52 *per cent*) to four companies/corporations under perennial loss. Investment of ₹ 981.40 crore in respect of five Companies / Corporations was lying in Public Account to the end of March 2010. The State Government should also review the working of State Public Sector Undertakings incurring huge losses and work out either a revival strategy or close down such units. *The State Government should formulate guidelines for quick completion of incomplete projects and strictly monitor reasons for time and cost over-runs with a view to take corrective action.*

Position of Cash Balance

The cash balance of the State at the end of the year increased by 25 *per cent* over the previous year. *Since, maintaining idle cash balance is not prudent cash management, a shelf of projects should be ready and techno-economic feasibility should have been appraised and approved so that mismatch between timing of borrowings and channeling it towards productive investment is considerably reduced.*

Oversight of funds transferred directly from the Union to the State implementing agencies

The Central Government transferred a sizeable quantum of funds (₹ 7,594 crore during 2009-10) directly to the State implementing agencies for implementation of Central plan schemes. Funds flowing directly to the implementing agencies through off-budget routing inhibits FRA requirements of transparency and therefore, escape accountability. There is no single agency monitoring its use and there is no readily available data on the amounts spent in any particular year on major flagship and other important schemes. *A system has to be put in place to ensure proper accounting of these funds and the updated information should be validated by the State Government as well as the Accountant General (Accounts & Entitlement).*

Financial management and budgetary control

There was an over-all unspent provision of ₹ 10,962.72 crore off-set by an excess expenditure of ₹ 915.42 crore over provision during 2009-10. The excess expenditure requires regularisation under Article 205 of the Constitution of India. Large unspent provisions were in areas viz., urban development, water resources, debt servicing, public works, finance, agriculture and horticulture, etc. There were also instances of inadequate provision of funds and unnecessary/excessive re-appropriations. Besides, there was a rush of expenditure at the end of the year. In many cases, the anticipated unspent provisions were either not surrendered or surrendered on the last two days of the year leaving no scope for utilizing these funds for other development purposes. Cases of non-drawal of Contingency Fund sanctioned, were noticed. *Budgetary controls should be strictly followed to avoid such deficiencies in financial management. Last minute fund releases and issuance of re-appropriation/surrender orders should be minimised.*

Financial reporting

There were instances of losses and misappropriations. *The departmental enquiries in such cases should be expedited to bring the guilty to book.* Internal controls should be strengthened to prevent such cases in future.