Chapter 3

Financial Reporting

A sound internal financial reporting system based on compliance with financial rules is one of the attributes of good governance. This Chapter provides an overview and status of compliance of the departments of the State Government to various financial rules, procedures and directives during the current year.

3.1 Non-receipt of information pertaining to institutions substantially financed by the Government

To identify the institutions which attract audit under Sections 14 and 15 of the CAG's (Duties, Powers and Conditions of service) Act, 1971, heads of the Government departments are required to furnish to Audit every year information about the institutions to which financial assistance of ₹ 25 lakh or more was given, the purpose of assistance granted and the total expenditure of the institutions.

Fifteen departments did not furnish the information pertaining to 333 institutions receiving grants aggregating ₹ 25 lakh or more for the period ranging from one year to more than 10 years, as detailed in **Appendix 3.1.**

3.2 Status of submission of accounts of autonomous bodies and placement of audit reports before the State Legislature

Several autonomous bodies have been set up by the State Government in the field of village and small industries, urban development, etc. The audit of accounts of nine bodies in the State has been entrusted to the CAG. These are audited with regard to their transactions, operational activities and accounts, conducting regulatory compliance audit, review of internal management and financial control, review of systems and procedures, etc.

Separate audit reports of two autonomous bodies for the year 2007-08 and five autonomous bodies for the year 2008-09 were yet to be placed before the State Legislature.

The status of entrustment of audit, rendering of accounts, issuance of audit reports and their placement before the State Legislature are indicated in **Appendix 3.2**.

3.3 Departmental commercial undertakings

The departmental undertakings of certain Government departments performing activities of commercial and quasi-commercial nature are required to prepare *pro forma* accounts in the prescribed format annually showing the working results of financial operations so that the Government can assess their working. The finalized accounts of departmentally managed commercial and quasi-commercial undertakings reflect their overall financial health and efficiency in conducting their business. In the absence of timely finalization of accounts, the investment of the Government remains outside the scrutiny of the Audit/State Legislature.

Consequently, corrective measures, if any required, for ensuring accountability and improving efficiency cannot be taken in time. Besides, the delay in all likelihood may also open the system to risk of fraud and leakage of public money.

The heads of departments in the Government are to ensure that the undertakings prepare and submit such accounts to Accountant General for audit within a specified time frame. Out of the nine undertakings which have been closed/transferred to co-operative federation, *pro forma* accounts in respect of two undertakings were due from 1969-70. The position of arrears in preparation of *pro forma* accounts by the undertakings is given in **Appendix 3.3.**

3.4 Misappropriations, losses, etc.

There were 217 cases of misappropriation, losses, etc. involving Government money amounting to ₹ 10.07 crore as at the end of 2009-10 on which final action was pending. The department-wise break up of pending cases and age-wise analysis is given in **Appendix 3.4** and nature of these cases is given in **Appendix 3.5.** The age profile of the pending cases with the number of cases pending in each category - theft and misappropriation is given in **Table 3.3.**

Table 3.3: Profile of pending cases of misappropriations and theft

(₹ in crore)

Age-profile of the pending cases					
Range in years	Number of cases	Amount involved	Nature of the cases	Number of cases	Amount involved
Above 25	62	0.30	Theft	34	0.17
21 - 25	10	0.03			
16 - 20	40	1.61	Misappropriation	183	9.90
11 - 15	77	6.21			
06 - 10	25	1.65			
0 - 05	3	0.27			
Total	**217**	**10.07**	**Total**	**217**	**10.07**

Around 76 *per cent* of the amount involved pertained to departments of Forest, Environment and Ecology (₹ 2.70 crore), Water Resources (₹ 2.56 crore) and Public Works (₹ 2.40 crore).

3.5 Non- receipt of stores and stock accounts

The annual accounts of stores and stock are required to be furnished by various departments to Audit by 15 June of the following year. The half yearly accounts of Public Works, Water Resources and Minor Irrigation Departments are due to be received by 15 December of the year and 15 June of the following year. Delay in receipt of stores and stock accounts were commented upon in successive audit reports. The Public Accounts Committee in its first report (sixth Assembly) presented in February 1980 had also emphasised the importance of timely submission of accounts by the departments. The submission of stores and stock accounts by 82 officers of 10 departments were in arrears for period ranging from six months to eight years as of September 2010, as detailed in **Appendix 3.6**.

3.6 Unadjusted Abstract Contingent bills

Under rule 36 of the Government of Karnataka Manual of Contingent Expenditure 1958, the Controlling and Disbursing Officers are authorized to draw sums of money by preparing AC bills by debiting service heads, and they are required to present detailed contingent bill (vouchers in support of final expenditure) to the Accountant General (A&E) through treasuries. Detailed bills for an aggregate amount of ₹ 111.21 crore drawn on 14,091 AC bills were pending as at the end of November 2010 as detailed in **Table 3.4.**

Table 3.4 Pending Abstract Contingent bills

(₹ in crore)

Year	Abstract Contingent bills drawn		Detailed Contingent bills rendered		Outstanding bills as of November 2010	
	No. of Bills	Amount	No. of bills	Amount	No.	Amount
Up to 2006-07					5,313	26.20
2007-08	6,934	36.34	4,539	24.02	2,395	12.32
2008-09	7,262	69.25	4,760	42.76	2,502	26.49
2009-10	9,348	93.51	5,467	47.31	3,881	46.20
Total					**14,091**	**111.21**

Source : *AG (A&E)*

3.7 Personal deposit accounts

The Karnataka Financial Code provides for opening of Personal Deposit (PD) accounts with permission from Government in cases where the ordinary system of accounting is not suitable for transactions. PD accounts created by debit to the Consolidated Fund of the State should be closed at the end of the financial year. Administrators of the accounts should intimate the treasury officer, the balance to be transferred to the Consolidated Fund. For continuation of PD accounts beyond the period of its currency, administrators are required to seek the permission of the Finance Department. Periodical reconciliation of PD accounts with treasury accounts is the responsibility of the administrators concerned.

3.7.1 Funds kept in PD Accounts

The position of deposits, withdrawals and balances in PD accounts during the period 2007-10 is given in **Table 3.6**

Table 3.6: Funds in PD accounts

(₹ in crore)

Year	Opening balance	Receipts/Deposits	Withdrawals	Closing balance
2007-08	754.94	1,381.60	1,445.25	691.29
2008-09	691.29	1,593.31	1,438.29	846.31
2009-10	846.31	3,491.10	3,123.18	1,214.23

3.7.2 Unspent balances in PD Accounts

Position of deposits, withdrawals and balances in PD accounts of five Deputy Commissioners[1] during the period 2005-10 revealed that the balance had steadily increased nine fold from ₹ 15 crore at the beginning of 2005-06 to ₹ 134.50 crore at the close of 2009-10 as detailed in the **Table 3.7**.

Table3.7 Unspent balances in PD Accounts

(₹ in crore)

Year	Opening balance	Receipts/Deposits	Withdrawals	Closing Balance
Revenue Department				
2005-06	15.00	63.12	47.83	30.29
2006-07	30.29	100.76	58.34	72.70
2007-08	72.70	294.31	261.05	105.96
2008-09	105.96	153.29	113.18	146.06
2009-10	146.06	132.21	143.77	134.50

3.7.3 Reconciliation of balances

As of March 2010, the administrators did not reconcile the balances in PD accounts with those in the books of the treasury. There was a difference of (-) ₹ 27.53 crore in seven accounts and (+) ₹ 0.11 crore in one account which remained un-reconciled (**Appendix 3.7).**

3.8 Reconciliation of expenditure and receipts

To enable the controlling officers to exercise effective control over expenditure to keep it within the budget grants and to ensure accuracy of their accounts, expenditure recorded in their books have to be reconciled by them every month during the financial year with that recorded in the books of the Accountant General (Accounts and Entitlement).

Even though non-reconciliation of departmental figures is being pointed out regularly in Audit Reports, lapses on the part of controlling officers in this regard continued to persist during 2009-10 also. Out of 194 controlling officers, 31 controlling officers reconciled the expenditure of ₹ 3,318.71 crore (26 *per cent* of the total expenditure of ₹ 12,954 crore incurred by them) and 28 controlling officers had not reconciled the expenditure of ₹ 17,106.02 crore (100 *per cent*) incurred by them.

Further, controlling officers should arrange to obtain from their subordinates, monthly accounts and returns in suitable form claiming credit for the amount paid into the treasury or otherwise accounted for and compare these with the statements of treasury credits furnished by the Accountant General to see that the amounts reported as collected have been duly credited to Government account. Also, the disbursing officers and subordinate officers should reconcile their departmental figures with the treasury figures. Out of 79 controlling officers, 52 had reconciled their receipts amounting ₹ 48,784.37 crore, 10 had reconciled partially and 17 did not reconcile receipts amounting to ₹ 822.47 crore as of October 2010. In respect of loans and advances, none of the controlling officers had reconciled their expenditure figures.

[1] Deputy Commissioners –Bangalore Urban, Mandya, Ramnagaram, Hassan and Bangalore Rural

3.9 Comments on Accounts

The fiscal indicators *viz.,* surplus / deficit on revenue account and fiscal deficit (net debit in the Consolidated Fund excluding borrowings) are calculated after taking into account all the transactions as per the accounting principles. In other words, the fiscal indicators flow from accounts. The revenue surplus and fiscal deficit of the State for the year 2009-10 was ₹ 1,619 crore and ₹ 10,875 crore respectively. The transactions which were not according to principles of accounting and which affected the said indicators by overstating or understating as the case may be, are discussed in the succeeding paragraphs.

3.9.1 Non-transfer of receipts/expenditure from the Consolidated Fund to earmarked Reserve Funds

- ✓ *Infrastructure Initiative, Bangalore Metro Rail Corporation Limited and CM's Rural Road Development Funds*

Budget provision of ₹ 3,187.86 crore was provided by the State Legislature for the year 2009-10 for transfer of expenditure related to these Reserve Funds from the Consolidated Fund to the Public Account. Against the actual expenditure of ₹ 2,849.03 crore during the year only ₹ 385.51 crore was transferred based on the Government order issued.

On transfer of ₹ 1,850 crore and ₹ 2,100 crore from general revenues during 2008-09 and 2009-10 respectively, the balances at the credit of these reserve funds as on 31 March 2010 were IIF – ₹ 5,284 crore, BMRCL – ₹ 1,316 crore and CMRRD ₹ 666 crore. Despite ₹ 7,266 crore at the credit of these reserve funds, the entire expenditure of ₹ 2,849 crore (initially debited to the Consolidated Fund) was not transferred to Public Account. This resulted in understatement of revenue surplus and overstatement of fiscal deficit by ₹ 187 crore and ₹ 2,276 crore respectively.

The State Government replied (November 2010) that funds created from out of general revenues being basically reserve funds are intended to provide reserve for expenditure out of the fund and that accretion to and expenditure from the fund need not be in the same year. It was also stated that since the actual expenditure within the budgetary approval given by the legislature depends on over-all fiscal position managed by the executive, the decision to not to transfer the expenditure to the Public Account was due to late surge of receipts.

However, a reserve fund which is created for specific purpose to account for transactions of a particular character should record all the transactions in complete form. Exclusion of a particular set of transactions (transfer of debit from consolidated fund to the Public Account) distorts the fiscal indicators of the Government.

Rural Road Development Cess (RRD) collections (other than infrastructure cess) *viz.*, conversion fee, market fee, transportation of forest produces, toll on roads and bridges and the related expenditure were not transferred to the earmarked Reserve Funds.

The State Government, in its reply (November 2010), stated that RRD Cess collections on conversion fee, market fee, toll on roads and bridges and cess on transport of forest produce were not transferred to the earmarked reserve funds because while RRD Cess collections on conversion fee, market fee, toll on roads and bridges were not operationalized in 2009-10, the cess on transport of forest produce was refunded due to judicial pronouncement. However, there were receipts to the tune of ₹ 26.54 lakh during 2009-10 under conversion fee and toll on roads and bridges which had to be transferred to the Public Account.

✓ *Consumer Welfare Fund*

Expenditure of ₹ 93 lakh relating to Consumer Welfare Fund was not transferred from Consolidated Fund to Public Account. Non carrying out of the book adjustment resulted in inflation of expenditure of ₹ 93 lakh in the Consolidated Fund and reduction of revenue surplus.

✓ *Fiscal Management Fund*

The Fiscal Management Fund was created during 2006-07 in terms of Section 4(p) of the Fiscal Responsibility Act, 2002, to discharge the liabilities arising during the course of the year out of general revenue of the State. However, no rules had been framed regarding its administration. A sum of ₹ 150 crore had been transferred from the Consolidated Fund during the year. The balance at the end of the year was ₹ 857 crore. Transfers from the Consolidated Fund inflated the revenue expenditure and reduced revenue surplus to that effect.

The State Government replied (November 2010) that the fund was created to take care of demands arising due to contingent liabilities on account of Government guarantees, contribution to pension scheme etc.

The Government had created the fund for discharging liabilities arising on account of Government guarantees but is inoperative and the pension contribution scheme had not yet been implemented.

The procedure adopted for accounting of transactions pertaining to the Reserve funds was not in accordance with the principles mentioned in Para 3.4 of the General Directions contained in the 'List of Major and Minor Heads'.

3.9.2 Book adjustments resulting in fresh adverse balance/ increase in the amount of adverse balance in Public Account

✓ *Central Road Fund*

Expenditure of ₹ 205.30 crore was transferred from Consolidated Fund [HOA-5054-80-902-deduct amount met from Central Road Fund] to Central Road Fund in Public Account [HOA-8449-103] in excess of balance (₹ 165.30 crore) at the credit of the fund resulting in adverse balance of ₹ 40 crore.

The State Government in its reply (November 2010) stated that the adverse balance was on account of initial expenditure being met out of the State funds which was to be reimbursed subsequently. However, as per the accepted principle of accounting, the adjustment of expenditure should be only to the extent of revenue received from Government of India.

✓ *Sinking Fund Investment Account*

The balance in the sinking fund became adverse during 2008-09. During the current year the adverse balance increased by ₹ 15 lakh [HOA 8222-02-101].

In reply, the State Government stated (November 2010) that the adverse balance is being examined.

3.9.3 Incorrect accounting

₹ Ten crore sanctioned for construction of super speciality hospital at Bellary, out of the Consolidated Fund [HOA 4210-01-110-1-01-139], was ordered to be transferred by the Government to Reserve Fund in Public Account [HOA 8229-00-102-0-002] instead of to the deposit account. The said transaction had been reflected in the accounts as such.
The State Government replied (November 2010) that the transaction was on account of administrative exigency and that as there was no provision under revenue account, re-appropriation was not possible and hence the amount was released from capital head of account.

Reserve funds are to be credited from general revenues only as no fund for the purpose had been created under the Public Account to account for the said transaction.

3.9.4 Bookings under Minor Head 800 – 'Other Receipts' and 'Other Expenditure'

An amount of ₹ 7,771.61 crore constituting about 12.81 *per cent* of the total expenditure (Revenue, Capital and Loan) was classified under the Minor Head '800 – Other Expenditure' under the respective Major Heads of Account. Several schemes/programmes/activities such as Equities and Investment in Companies, Road Works, Basic Urban Services Programme – Urban Infrastructure, Sewerage and sanitation scheme –'Suvarna Grama'. Rashtriya Krishi Vikas Yojana, Power infrastructure improvement, etc., had huge bookings under the Minor Head '800'. These Schemes/Projects are not depicted distinctly in the Finance Accounts, though the details of this expenditure are depicted at the sub-head (scheme) level or below in the Detailed Demands for Grants and corresponding head-wise Appropriation Accounts forming part of the State Government Accounts.

Similarly, on the receipts side, ₹ 3,132.29 crore constituting about 6.29 *per cent* of the total receipts (Revenue, Capital and Loan) was classified under the Minor Head '800 Other Receipts' under the respective Major Heads of Account. Several receipts such as Special Problem Grants (compensation for loss suffered by the State on account of phasing out of the Central Sales Tax and on account of introduction of VAT), Loans written off, Cess collected, etc., have huge receipts booked under the Minor Head '800'. These receipts are not depicted distinctly in the Finance Accounts, though the details of these receipts are depicted at the sub-head (scheme) level or below.

3.10 Conclusion

The Government's compliance towards disposal of cases of losses, misappropriations, etc. was deficient. Detailed bills against abstract bills were awaited since long and amount was retained in PD Accounts against the principle of Legislative financial control. Non-reconciliation of expenditure ranging from 26 to 100 *per cent* was also noticed. Out of 79 controlling officers, 17 did not reconcile the receipt figures at all and 10 reconciled the figures partially.

3.11 Recommendations

Departmental enquiries in all the cases of misappropriations, losses, defalcations, etc., should be expedited to bring the defaulters to book. For this purpose, the internal controls in various departments should be strengthened to prevent recurrence of such cases.

BANGALORE **(D.J. BHADRA)**
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(Civil and Commercial Audit)

COUNTER SIGNED

NEW DELHI **(VINOD RAI)**
The **Comptroller and Auditor General of India**