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, enhancing 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 and greater transparency in fiscal operations by the use of medium-term fiscal framework.

The Report

Based on the audited accounts of the Government of Karnataka for the year ending March 2012, the report provides an analytical review of the annual accounts of the State Government. The financial performance of the State has been assessed based on the FRA, budget documents, Thirteenth Finance Commission Report (XIII FC) and other financial data obtained from various Government departments and organizations. The 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 2012. It, *inter-alia*, provides an insight into trends in committed expenditure and 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 and 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 includes appendices of additional data collected from several sources in support of these findings. A glossary of selected terms has been given at the end of the Report.

Audit findings and recommendations

- ### Fiscal position

The state continued to maintain revenue surplus during 2007-12 and kept fiscal deficit relative to GSDP below the limit laid down under FRA as amended from time to time. During 2011-12, the State had a revenue surplus of ₹ 4,521 crore, an increase of ₹ 349 crore over previous year. This was on account of increase in revenue receipts by 20 *per cent* over previous year. Further, compression of expenditure on account of delay in government sanctions, limiting transfers to fund accounts, non release of funds etc., also contributed to increase in revenue surplus over previous year.

Fiscal deficit during the year was ₹ 12,470 crore, an increase of ₹ 1,782 crore over previous year. Primary deficit increased by ₹ 819 crore during the year from ₹ 5,047 crore in 2010-11.

Incremental non-debt receipts of ₹ 11,697 crore was less than the incremental primary expenditure of ₹ 12,346 crore and could not cover the incremental interest burden (₹ 963 crore). The State Government got relief of ₹ 170.14 crore under debt waiver wherein all Central loans contracted by the State Government with the Central Ministries, other than those relating to Finance Ministry and outstanding as at 31 March 2010, were waived.

- ### State's own resources

The ratio of the State's tax revenue to GSDP which had shown an increasing trend since 2009-10 was at 10.70 *per cent* during the year.

Ratio of non-tax revenue to GSDP was insignificant, implying the need for mobilizing non-tax revenue in the coming years by revising user charges, as recommended by Expenditure Reforms Commission.

- ### Revenue expenditure

There was 14 and 29 *per cent* growth under social and economic services sectors of expenditure over the previous year, while the growth in general services was 17 *per cent.* The share of plan expenditure in total revenue expenditure increased from ₹ 15,188 crore in 2010-11 to ₹ 18,567 crore in 2011-12. Fifty *per cent* of revenue expenditure consisted of committed expenditure on salaries, pensions, interest payments and subsidies. Total subsidy of ₹ 7,390 crore presented a partial picture as it excluded implicit subsidy of around ₹ 4,204 crore during 2011-12. As per the recommendation of TFC, expenditure forming implicit subsidy should be brought out for transparency.

- ### Quality of expenditure

The share of capital expenditure to total expenditure during the current year was 21 *per cent* which was one percentage point less than the previous year. Funds aggregating ₹ 1,047 crore were blocked in incomplete projects as at the end of 2011-12. The return from investment of ₹ 44,295 crore as of March 2012 in companies / corporations was negligible (₹ 60.56 crore). The investment included ₹ 18,924 crore (43 *per cent*) in Companies/ Corporations under perennial loss.

The State Government should review the working of State public sector undertakings incurring huge losses and take suitable decisions. The State Government should formulate guidelines for quick completion of incomplete projects and strictly monitor time and cost over runs with a view to taking corrective action.

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

The Central Government transferred a sizeable quantum of funds (₹ 7,140 crore during 2011-12) directly to the State implementing agencies for implementation of Central plan schemes. Funds flowing directly to the implementing agencies through off-budget route inhibit 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.

Though a system has been proposed to ensure accounting of these funds a system is required to validate this information by the State Government.

- **Funds and other Liabilities**

Reserve funds of the State viz., corpus fund of Consumer Welfare Fund, Guarantee Redemption Fund etc., were not created/ revived through contributions from general revenues/earmarked revenues. No rules have been framed regarding administration of Fiscal Management Fund.

Rules with regard to administration and investment pattern of various reserve funds require to be framed.

- **Debt sustainability**

The repayment obligation of the State would increase enormously from 2018-19 onwards, due to huge market borrowings in 2008-10. Further, repayment obligations of the borrowings made in 2011-12 (₹ 7,500 crore) would become due from 2021-22.

The Government should consider reviving the sinking fund as it would help to meet the sudden increase in the amount of debt servicing from 2018-19 onwards.

Financial Management and Budgetary Control

Against total provision of ₹ 99,744.66 crore during 2011-12, an expenditure of ₹ 86,829.62 crore was incurred. This resulted in an unspent provision of ₹ 12,915.04 crore (13 *per cent*). Excess expenditure of ₹ 4,793.28 crore relating to the period 1989-90 to 2010-11 required regularization under Article 205 of the Constitution. Expenditure aggregating ₹ 430.13 crore in 43 cases which should have been treated as 'New Service/New instrument of service' was incurred without the approval of the Legislature. While, supplementary provision of ₹ 165.79 crore in 23 cases was unnecessary, re-appropriation of funds in 60 cases was made injudiciously, resulting in either un-utilised provision or excess over provision. In 25 grants, ₹ 4,830.68 crore was surrendered in the last two working days of the financial year. Contingency Fund drawals sanctioned in one case for ₹ 4.50 crore was utilized to the extent of 30 *per cent* during the year 2011-12.

Budgetary control should be strengthened in all departments to avoid cases of provision remaining unutilized. The departmental budgets should be more realistic and cases of persistent non-utilisation of funds, excessive provision of funds should be avoided.

- **Financial Reporting**

Detailed bills, against abstract contingent bills, were wanting since long and large sums of money were being retained in PD Accounts against the principle of Legislative financial control. Non-reconciliation of expenditure and receipts was to the extent of 34 *per cent* of total expenditure and two *per cent* of total receipts, respectively. There were adverse balances under certain DDR heads which required remedial action for their clearance.

The internal controls in various departments should be strengthened to prevent recurrence of misappropriation/losses. Accounting reforms are required to capture salary expenditure (PR Institutions), implicit subsidies as recommended by the Finance Commission. Review of suspense heads needs to be done to bring the transactions to the final heads in the year of accounts itself.