Chapter - III

3. Compliance Audit Observations

Important findings emerging from audit that highlight deficiencies in planning, investment and activities of the Management in the State Government Companies and Statutory Corporations, which had financial consequences, are included in this Chapter. These include observations on unproductive investment, violation of contractual obligations, undue favours to contractors, extra/avoidable expenditure, non-recovery of dues and cases where the intended objective of the Projects of the Government were not achieved.

Government Companies

Karnataka State Tourism Development Corporation Limited

3.1. *Implementation of Golden Chariot Project*

Due to deficiencies in operation and financial management of the Golden Chariot, and inclusion of unfavourable terms in the Service Agreement in relation to the private Management Partner, the Karnataka State Tourism Development Corporation Limited was not able to meet even its operational cost after six years of operation.

Introduction

3.1.1. With the intention to showcase unique tourist attractions and cultural heritage of Karnataka and to provide a captivating travel experience for the tourists, Government of Karnataka (GoK) conceived (2001-02) a project to operate a luxury tourist train named 'Golden Chariot' on the lines of 'Palace on Wheels' run by Rajasthan Tourism Development Corporation Limited. The project was implemented in collaboration with Indian Railways through Karnataka State Tourism Development Corporation Limited (KSTDC), an undertaking of GoK and nodal agency for promoting tourism in Karnataka.

Memorandum of Understanding with Indian Railways

3.1.2. KSTDC concluded (December 2002) a Memorandum of Understanding (MoU) with Indian Railways for implementing the project. As per the terms of the MoU, KSTDC was to act as the nodal agency for marketing, promotion, publicity and liaisoning with the Ministry of Tourism, Government of India

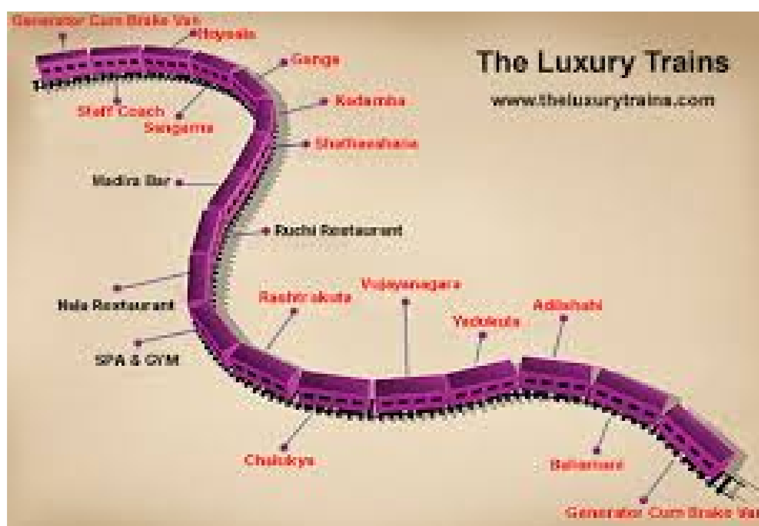
(GoI). The Railways was to provide bare shells of the coaches and to provide all facilities[60] necessary for the operation of the train, while KSTDC was to bear the cost of furnishing, provision of other coach equipment fittings and fixtures, air-conditioning of the rake *etc*. The MoU had also envisaged that Indian Railways and KSTDC should jointly finalise the revenue sharing mechanism through a Joint Working Group[61] within three months from the date of signing of the MoU.

Project feasibility and funding

3.1.3. Feasibility study was done (June 2002) by the Infrastructure Development Corporation (Karnataka) Limited (IDeCK), an agency of GoK. The financial viability was worked out by IDeCK on the assumption that the entire operational cost would be borne by the Indian Railways. However, the MoU with Indian Railways envisaged payment of haulage charges plus an element of profit. KSTDC had not revisited the viability of the project even though one of its basic assumptions *i.e.,* of the entire operational cost being borne by the Indian Railways, did not fructify.

Execution

3.1.4. The project which involved construction of eleven passenger coaches, one gym and spa coach, one bar coach, two restaurants, one staff coach and two power cars, was completed at a cost of ₹ 32.93 crore in February 2008.



Appointment of Management Partner

3.1.5. M/S Ninth Dimension Hotels & Resorts Private limited, a consortium of Ninth Dimension Hotels & Resorts Private limited and The Luxury Holidays (Marketing partner), was appointed (September 2007) as Management Partner by entering into a Service Agreement. According to the Agreement, the Management Partner should pay KSTDC a management fee every month during the management period of an amount equivalent to 10 *per cent* of

[60] Use of track, signalling, station premises, locomotives, telecommunication, train crew including maintenance staff, access to and from platforms, halts/stabling facilities.

[61] GoK constituted (April 2003/August 2007) a Joint Working Group (JWG) comprising officials/nominees of Indian Railways, GoK and KSTDC to decide matters related to operations, tariff setting, revenue collection and any other matter related to the operations of Golden Chariot.

KSTDC's Net Revenue, which is 50 *per cent* of the total net revenue with the balance 50 *per cent* being the share of Indian Railways. Besides, the Management Partner was entitled to collect and retain the other income[62]. KSTDC finalised the Service Agreement with the Management Partner, assuming revenue share of 50:50 between KSTDC and Indian Railways, without consent from Indian Railways to this effect.

Subsequently, Indian Railways informed (December 2007/January 2008) that as revenue sharing was not decided, KSTDC was to pay haulage charges to Indian Railways for running the train. A supplementary agreement was entered into (April 2008) with the Management Partner enabling KSTDC to receive 55 *per cent* of the total net revenue including management fee and the balance 45 *per cent* being payable to the Management Partner. This agreement also stipulated that KSTDC was responsible for payment of haulage charges to Indian Railways in accordance with the terms and conditions agreed between KSTDC and the Indian Railways. KSTDC, however, failed to factor in the haulage charges while finalising the revenue sharing agreement with the Management Partner, the impact of which is discussed in the subsequent paragraphs.

Undue benefit due to defective agreement

3.1.6. The Service Agreement provided for payment of commission to the Management Partner at the rate of 17 *per cent* on the gross sale value of tickets booked by them though the revenue share of the Management Partner was fixed at 45 *per cent* and contribution towards marketing fund was fixed at 2 *per cent* of the gross revenue. The necessity of offering additional commission over and above the revenue share was not justified. Moreover, as against 17 *per cent*, KSTDC paid the commission at the rates ranging from 20 to 25 *per cent* on the bookings made by them with effect from 2010-11, on par with General Sales Agents (GSA) in violation of the terms and conditions of the Service Agreement. The commission amounted to ₹ 3.27 crore during 2010-11 to 2013-14 which included ₹ 0.74 crore over and above the agreed percentage of commission.

3.1.7. Article 7.1 of the Service Agreement allowed the Management Partner to retain the entire income earned out of the services rendered[63] on board without the share of maintenance cost including haulage charges. Two out of eighteen coaches of the train were exclusively utilized for running bar/liquor sales and another for Health Club (Gym and Spa). Though, KSTDC incurred haulage cost of

[62] Other income as defined in the agreement means revenue and income derived directly or indirectly from other services including but not limited to advertising income, rental income and other receipts apart from sale of tickets/packages.

[63] Services included bar/liquor sales and gymnasium, beauty/ayurveda saloons, shops, massage parlours, and internal facilities available onboard.

₹ 1.29 crore for 75 trips operated during 2008-09 to 2010-11, the Management Partner was allowed to retain income of ₹ 1.07 crore for other services rendered and the income for the years 2011-12 to 2013-14 was not on record though KSTDC incurred haulage charges of ₹ 0.89 crore. KSTDC did not get the annual accounts of the Management Partner verified through an independent auditor, though authorized by the Service Agreement (Clause 7.2).

Extension of additional benefit to the marketing partner not envisaged in the agreement

3.1.8. KSTDC appointed (April 2008) M/s Palace Tours as exclusive worldwide marketing partner for the Golden Chariot replacing 'The Luxury Holidays', which was acting as marketing partner in the consortium of Ninth Dimension Hotels & Resorts Private Limited.

Aggrieved by this, the Luxury Holidays filed (May 2008) a case in the High Court of Delhi seeking relief from the Court to pass a decree in its favour directing that the Golden Chariot should be run in accordance with the Service Agreement. A compromise formula was arrived at (February 2010) to settle the issue out of court, entitling The Luxury Holidays to continue as exclusive marketing partner for the Golden Chariot and also to get six cabins in the Golden Chariot as complementary per year.

Audit observed that though they wanted only the enforcement of the terms and conditions of the Service Agreement for restoring its status as the marketing partner, additional six cabins were provided to the Luxury Holidays. As a result, KSTDC lost revenue of ₹ 0.69 crore during the years 2011-12 to 2013-14 from these six cabins, thereby extending undue benefit to the marketing partner. In addition, KSTDC would lose further revenue of ₹ 0.81 crore for the period from April 2014 to September 2017 calculated at the rates paid during 2013-14.

Operations

Loss in Operations

3.1.9. The commercial operations of the train commenced in March 2008. The itinerary of the train included two trips *viz.*, 'Pride of South' and 'Southern Splendour'. The 'Pride of South' covers places in Karnataka and Goa with a total distance of 1,891 kms for each round trip (seven nights). The 'Southern Splendour' trip of seven nights introduced in March 2010 covers places in Karnataka, Tamilnadu, Puducherry and Kerala for a distance of 2,111 kms. Despite running 131 trips[64] during 2008-09 to 2013-14, KSTDC incurred losses until 2012-13. There was marginal dip in loss during 2013-14 (provisional). Though, GoK released grants of ₹ 13.22 crore during 2009-10 to 2013-14 to partly compensate the haulage charges, yet the operations were under loss.

[64] Excluding one trip for trial run made during March 2008.

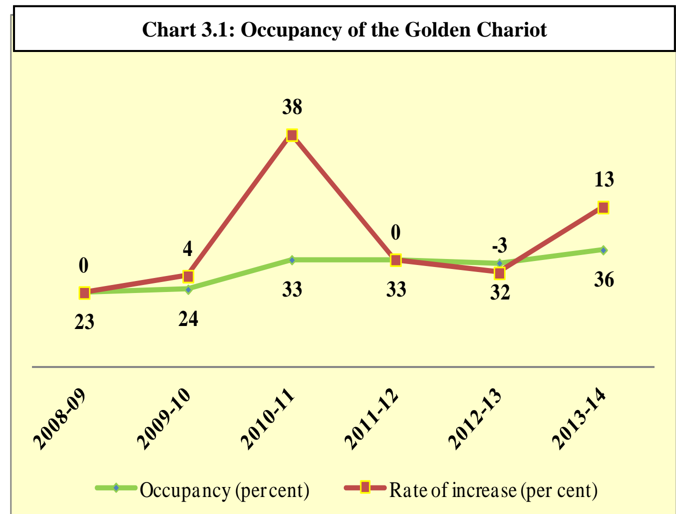
Undue benefit to Management Partner by not apportioning Haulage Cost

3.1.10. During 2008-14, KSTDC earned gross revenue of ₹ 43.24 crore from 131 trips. Considering total haulage cost of ₹ 37.20 crore for this period, the net loss was ₹ 27.08 crore, which could have been reduced to ₹ 10.34 crore, had the haulage charges been apportioned with the Management Partner proportionate to its revenue share of 45 *per cent*. As the service agreement did not provide for share of haulage cost in proportion to revenue share, the Management Partner was allowed to benefit by ₹ 16.74 crore[65] over a period of six years of operations.

Occupancy rate

3.1.11. Though the overall occupancy increased from 23 *per cent* in 2008-09 to 36 *per cent* in 2013-14, the rate of increase in occupancy was very erratic and not indicative of improvement of operations. The steep increase in occupancy rate in 2010-11 was due to operation of less trips (26 trips) as compared to 2009-10[66]. Despite exclusive marketing fund and provision of six cabins per year earmarked for promotions to the marketing partner, the occupancy rate was not encouraging as KSTDC had not formulated any marketing strategy for improving occupancy. There were no effective advertisements through print and digital media. Also, familiarization trips arranged for people primarily hailing from print and electronic media, travel writers, journalists *etc*., had not achieved the desired results with regard to occupancy.

Chart 3.1: Occupancy of the Golden Chariot



3.1.12. Full occupancy in all the 11 coaches was 88. As per policy of KSTDC, minimum number of passenger occupancy for operating a trip was ten. If the number of passengers was less than 10 in any particular trip, the trip had to be cancelled. We observed that the KSTDC had run 18 trips during 2008-09 to 2013-14, where the number of passengers was less than ten. In respect of 4 out of 18 trips, the train was operated with just one or two passengers. KSTDC, by operating uneconomical trips, incurred a loss of ₹ 4.03 crore.

[65] The difference amount of ₹ 16.74 crore (₹ 27.08 crore - ₹ 10.34 crore) is benefit to the Management Partner.

[66] The train was operated throughout the year in 2008-09 and 2009-10. As the occupancy was low, the operations were restricted to one season of the year (October to March) with effect from 2010-11. Hence, the rate of increase was abnormal in 2010-11.

Operation of excess coaches than required

3.1.13. The Golden Chariot consists of 11 passenger coaches with a capacity of eight passengers each and seven coaches for services which have to invariably run in every trip irrespective of the number of passengers travelling. However, KSTDC had the option to run either eleven or nine passenger coaches depending on occupancy. As the Indian Railways fix haulage charges in proportion to the number of coaches run in a trip, it was advantageous for KSTDC to opt for lesser number of passenger coaches when there was lower occupancy.

We observed that the KSTDC had operated all the 11 passenger coaches in respect of 85 trips during 2008-09 to 2013-14, though the occupancy ranged from 1 to 68 passengers, for which running of nine passenger coaches would have been sufficient. Thus, KSTDC had ended up paying additional haulage charges of ₹ 0.86 crore as a result of running coaches in excess of requirement. Further, KSTDC did not explore the possibility of operating the train with less than nine passenger coaches, when the occupancy was much less, so as to take advantage of paying reduced haulage charges.

Passengers travel on Familiarization and Complimentary passes

3.1.14. Familiarization[67] Trips (FAM) were arranged for people primarily hailing from print and electronic media, travel writers, journalists *etc*., from India and various parts of the world for showcasing the Golden Chariot across the globe and in turn to attract people to travel in the train. Similarly, passengers treated as VIPs on case to case basis were allowed to travel on complementary passes on behalf of KSTDC, Management Partner and GSA.

As per policy of KSTDC on FAM/Complimentary guests, the Complimentary guest would not be levied any charges for travel on the Golden Chariot but charges on use of other facilities such as bar, business centre, health club would be levied and such expenditure would be shared equally between KSTDC and the Management Partner. The policy also stipulated that a maximum of five members per trip would be allowed on complimentary basis.

We observed that

- against 155 passengers for 31 trips to be allowed, 286 passengers were allowed in 2008-09 and against 130 passengers to be allowed for 26 trips, 153 passengers were allowed this facility in 2009-10.
- in 10 trips operated between 7 April 2008 and 10 October 2011, the number of FAM/Complementary guests outnumbered the paid passengers. A loss of ₹ 1.30 crore[68] was incurred by KSTDC for operating these 10 trips after meeting haulage cost. In 4 cases, the

[67] Generally people from media such as BBC, National Geographic channel *etc*., and also people from print media are allowed to travel in the Golden Chariot so as to publicize the train across the globe. The request for such trips normally comes from the media themselves. These passengers are called FAM.

[68] Excluding loss on trip no.2, 3, 35 and 70 commented in paragraph no.3.1.12.

number of passengers was less than the minimum stipulated and there was no justification for operating these trips.

- the prescribed conditions in respect of those travelling on FAM trips were not fulfilled. The profiles of individuals and the company/media represented by the individuals and post tour reports/write-ups on the travel experience were not on record. Thus, there was nothing on record to indicate that the individuals on the FAM trips were professionals in the area of tourism to give wide publicity about the Golden Chariot so as to improve occupancy.

- during 2008-09 to 2010-11, KSTDC reimbursed ₹ 0.45 crore to the Management Partner towards on-board and off-board expenses incurred on FAM/Complementary passengers. Since there was no explicit condition for sharing of expenditure on FAM/Complementary travel, the decision of KSTDC to share this expenditure resulted in extending undue favour to the Management Partner in violation of the service agreement. Such an arrangement has been made without considering the expenses towards haulage in the operational costs.

Further, for off-board transport expenses, KSTDC collected ₹ 65,000 per trip for Pride of South and ₹ 1,50,000 per trip for Southern Splendour from the Management Partner. The charges per trip were fixed during 2008-09 and continued at the same rates even in 2013-14 without any revision although the operating costs such as fuel, maintenance and other administrative expenses had increased.

General Sales Agents

3.1.15. KSTDC appointed (2008-09) General Sales Agents (GSA), both in India and abroad for the purpose of arranging booking of tickets for the tourists travelling in the Golden Chariot. KSTDC had also entered into agreements with the GSAs setting out the terms and conditions. The agreements were being renewed as and when the term expired.

Extension of benefit in violation of terms of agreement

3.1.16. The terms of the agreement with GSAs provided that for every booking of fifteen passengers in a single trip, one complimentary seat shall be provided to the GSA. On a test check, we observed that KSTDC violated this condition on five occasions.

Though, the terms of the agreement with GSAs provided for a commission of 17 *per cent* on the value of tickets booked, KSTDC had paid commission at the rate of 20 to 25 *per cent*, extending additional benefit of ₹ 0.38 crore.

Providing Complementary/Familiarization trip passes

3.1.17. We observed that 29 passengers were allowed to travel on Complementary and Familiarization (FAM) trips on behalf of GSAs though they were not entitled for any such facility as per the agreements entered into

with KSTDC. This placed additional financial burden of ₹ 0.52 crore on KSTDC.

Non-confirmation of Bank Guarantees

3.1.18. The terms of the agreements required GSAs to furnish performance security of ₹ 4 lakh in the form of security deposit or irrevocable bank guarantee in favour of KSTDC for a period of two years to be extended for further one year. As of 31 March 2014, the agreements with eight GSAs were in currency.

We observed that KSTDC had not obtained independent confirmation of the bank guarantees furnished by GSAs from the respective banks for their validity and genuineness. Further, bank guarantees in respect of three GSAs[69] were not kept on record.

We also observed that KSTDC had neither obtained security deposit nor bank guarantee from the Luxury Holidays, who also arranged ticket booking for the train similar to other GSAs. The cheques issued by the Luxury Holidays against the bookings had bounced in many instances resulting in non-recovery of dues. The Luxury Holidays owed ₹ 0.29 crore against bookings as on 31 March 2014.

Fund management

Acceptance of bookings without receipt of money

3.1.19. The tariff structure of the Golden Chariot stipulated that 20 *per cent* of the ticket value should be paid at the time of confirmation of booking and the remaining 80 *per cent* to be paid thirty days prior to departure.

The Management Partner, the Luxury Holidays and GSAs who arranged booking of tickets for the train remitted ticket value after the departure of the train with delay up to 6 months. The value of delayed remittance for 2009-10 to 2013-14 amounted to ₹ 9.80 crore.

We observed that KSTDC had to pay haulage charges to the Indian Railways fifteen days prior to the departure of the train for each trip of the Golden Chariot. The amount of haulage charges payable per trip ranged from ₹ 0.19 crore to ₹ 0.40 crore, which was paid out of funds drawn from Over Draft account of KSTDC. As a result, KSTDC had to bear the interest on haulage charges paid until the ticket value was remitted. This indicated lack of proper fund management.

Absence of internal controls leading to possible temporary misappropriation of funds

3.1.20. The passengers travelling in the Golden Chariot could book their tickets directly through KSTDC or GSAs or through Travel Agents. The

[69] The India Experience, SDU Travel Pvt Ltd, Royal India Train Journeys.

amount so realised from the ticket booking was to be remitted directly to the Axis Bank Account opened exclusively for the Golden Chariot operations.

An instance was observed in which Lions Club, Bangalore, had booked 59 tickets for the trip conducted on 1 November 2012 and ₹ 43.45 lakh was remitted through cash and cheques to KSTDC. An amount of ₹ 17.28 lakh out of ₹ 43.45 lakh received (October 2012 and November 2012) in cash was remitted to the bank after six to 21 days of receipt.

There was no system in place to reconcile the amount received and remitted to the bank against the ticket sales on a day-to-day basis. The recorded reasons for non-remittance on the same day or on the next day of receipt of money were not available. This reflected absence of internal controls. Delayed remittance is fraught with the risk of possible temporary misappropriation of funds.

Violation of tariff policy

3.1.21. As per the tariff structure of the Golden Chariot, different rates were charged depending upon various factors *viz.*, nationality (Indian or Foreigner), occupancy (single, double, triple), and itinerary (Pride of South, Southern Splendour).

During 2013-14, KSTDC operated Pride of South trip (120th/25.11.2013) wherein 68 passengers of Japanese nationality had booked tickets as a group. KSTDC charged a lump sum amount of ₹ 0.75 crore, which included service tax, against ₹ 1.37 crore as per the prevailing tariff of the Golden Chariot with applicable discounts. By this act, KSTDC had foregone a revenue of ₹ 0.62 crore.

Payment of Service tax and TDS through the Management Partner

3.1.22. KSTDC was collecting Service tax at prescribed rates on the sale value of the tickets booked by GSAs and other travel agents. Similarly, it had deducted tax at source (TDS) on the Commission payable to GSAs and travel agents. During the period 2008-14, KSTDC collected service tax of ₹ 1.13 crore and deducted tax at source to the extent of ₹ 0.72 crore.

We observed that KSTDC deposited the taxes collected with the Management Partner and did not ensure remittance of taxes to the Government account within the prescribed time.

Comparative study

3.1.23. On similar lines of operations of the Golden Chariot, Rajasthan Tourism Development Corporation (RTDC) and Maharashtra Tourism Development Corporation (MTDC) have also been operating Royal Rajasthan on Wheels and Deccan Odyssey respectively.

A comparative study of important parameters incorporated in the Service Agreements entered into by the three Tourism Development Corporations with the Management/Hospitality Partner showed the following:

Table 3.1: Comparative study of important parameters in service agreements entered by three Tourism Development Corporations

Sl. No	Parameter	KSTDC	RTDC	MTDC
1	Tenure of agreement	10 years extendable for further 5 years	-	Three years extendable for further three years at the sole discretion of MTDC
2	Revenue share	55:45 between KSTDC and Management Partner	-	75:25 between MTDC and Management Partner. In addition, management fee of ₹ 65 lakh for one operational year escalated by 5 *per cent* every year payable to the Management Partner
3	Other income (Gym, Spa and bar sales)	Management Partner was entitled to retain entire 'other income'. No license fee	A separate agreement was entered in to for the purpose. Licensee should pay license fee of ₹ 1.06 lakh to RTDC. The revenue should be shared between RTDC and Licensee in the ratio of 48:52	No such arrangement/ Sharing
4	Haulage charges	KSTDC should bear the entire cost of haulage. Revenue shared between KSTDC and Management Partner without factoring haulage cost.	-	Haulage cost met from gross revenue of operations and the balance shared between MTDC and Management Partner.
5	Profitability 2008-14	Operations incurred cumulative loss.	Operations running on profits from 2011-12. Profit earned (2011-12 to 2013-14) was ₹ 4.52 crore.	Operations running on profits except in 2008-09 and 2012-13. Profit earned (2008-09 to 2013-14) was ₹ one crore.

We observed that

- as the tenure of agreement for 10 years was unreasonably long, KSTDC did not have any option to revise the terms of agreement until the lapse of the agreement, though the present arrangement of revenue sharing was not favourable to it. This being a new venture, KSTDC should have fixed shorter tenure like MTDC to have reasonable assessment of operations.

- the revenue share fixed by KSTDC was not linked to the haulage cost, which was a major operational expenditure. On the other hand, MTDC had paid fixed management fee and share of revenue after meeting haulage cost. As KSTDC finalised (September 2007) the Service Agreement much after (December 2003) MTDC, this should have been taken into cognizance.

- in the Golden Chariot project, the 'other income' derived from services such as Gym, Spa and Bar sales *etc*., were allowed to be retained by the Management Partner. RTDC was collecting fixed license fee and share of revenue and MTDC had not envisaged revenue sharing for such services.

The matter was brought to the notice of Government in June 2014; their reply is awaited (November 2014).

Conclusion

The objective of the Golden Chariot project to promote tourism and showcase unique tourist attractions was not achieved as the project had not been well thought out and planned. The Company also paid excess commission to the Management Partner and the General Sales Agents. The longer tenure of the Service Agreement with the Management Partner meant that the Company had no option but to continue until the expiry of the term of agreement, even though the terms were unfavourable for the Company. Operational deficiencies included running of more coaches than required, resulting in unnecessary haulage charges, operating the train even when occupancy was less than that stipulated for running it *etc*. The various deficiencies contributed to the Company not even recovering its operating cost despite receiving financial assistance of ₹ 13.22 crore from the Government.

The result was a loss of ₹ 27.11 crore (March 2014) sustained by the Company.

Recommendations

- **The Company should renegotiate with the Management Partner for sharing the haulage charges in proportionate to its revenue share thereby driving the partner to improve the occupancy rate. A fixed amount out of 'other income' earned by the Management Partner should also be shared by the Company.**

- **The commission on the sale value of tickets booked by the Management Partner and the Marketing Partner should be paid in accordance with the terms of Service Agreement.**

- **The Company should adhere to the tariff policy on ticket bookings and the discount allowed on bulk ticket bookings should be rational and uniform.**

- **The conditions attached to the Familiarisation trips on the maximum number of passengers and post tour write-ups should be strictly adhered to so that the Company realises not only fair revenue, but also facilitate promotion of heritage tourism.**

- **The Company should institute a reporting mechanism for getting inputs of marketing and publicity expenditure incurred by the Management Partner before release of his share of marketing fund.**

- **The Service Agreement should be renewed every three years and the terms and conditions reassessed at the time of renewal based on the performance of the Management Partner and considering the financial interest of the Company.**

Karnataka State Tourism Development Corporation Limited

3.2 *Non-utilisation of infrastructure created*

Infrastructure facilities created at Kemmangundi hill station at a cost of ₹ 19.41 crore could not be utilised for over a year due to non–payment of contractor's pending bills. Moreover, indecision regarding which agency should operate these facilities resulted in loss of revenue of ₹ 4.11 crore, besides depriving tourists of these facilities.

Karnataka State Tourism Development Corporation Limited (Company) was entrusted (November 2010) with various developmental works[70] to improve the infrastructural facilities for tourists visiting Kemmangundi, a hill station in Karnataka. The Department of Tourism (DoT) forwarded (December 2010) estimates to the Company for nine works costing ₹ 12.78 crore.

The Company invited (December 2010-April 2011) tenders for nine works and awarded the works for execution to a contractor (April-June 2011) at a total cost of ₹ 14.99 crore. The Company awarded (April/July 2012) three more works to the contractors for ₹ 4.43 crore which were entrusted by the DoT to the Company for execution. The DoT had released only ₹ 9.18 crore for the project during the year 2011-12. Since the works were suspended due to non-release of funds by DoT, the Company borrowed money from banks (July 2012 to April 2013) funds amounting to ₹ 7.23 crore[71] and paid to the

[70] Expansion and upgradation of cottages/rooms in various blocks.

[71] The interest of ₹ 0.92 crore (up to March 2014) on the borrowed funds was borne by the Company.

contractor. The interest of ₹ 0.92 crore (up to March 2014) on the borrowed funds was borne by the Company. The works were completed between February 2012 and May 2013 at a cost of ₹ 19.42 crore[72].

We observed that though the works were completed by May 2013, the possession of the assets was taken over only in July 2014 after a lapse of more than a year[73], and the balance payments of ₹ 3.35 crore was not released to the contractor (October 2014) due to non-release of funds by DoT.

We also observed that in a meeting held in October 2010, which was also attended by Director, Horticulture Department, the Principal Secretary, DoT, had directed that upon completion of works, the maintenance of three projects were to be entrusted to Horticulture Department and six projects were to be maintained by the Company. The Horticulture Department expressed inability (November 2013) to maintain the assets owing to shortage of skilled manpower and opined that the tourism facilities could be maintained by the Company through a mutual agreement. The DoT requested (February 2014) the Horticulture Department to issue necessary orders. However, it was only after the instructions of the Minister of Higher Education & Tourism at a meeting on 22 July 2014, that the assets were taken over on 26 July 2014 by the Horticulture Department. But, these assets were not made functional to generate revenue.

Thus, infrastructure created at Kemmangundi hill station at a cost of ₹ 19.42 crore could not be utilised for more than a year due to non-payment of bills to the contractor and indecision about running the operations of the assets/project. This resulted in loss of revenue of ₹ 4.11 crore[74] (June 2013 to July 2014). Importantly, the objective of providing better facilities to the tourists visiting the hill station has not been achieved so far (October 2014).

The matter was referred to the Government in June 2014; their reply is awaited (November 2014).

Karnataka State Tourism Development Corporation Limited

3.3 *Idling of assets due to ill-planning*

Improper planning for reusing the sets/components of sound and light show programme resulted in idling of assets worth ₹ 2.12 crore.

The Department of Tourism (DoT) of Government of Karnataka (GoK) directed (December 2009) the Karnataka State Tourism Development Corporation Limited (Company) to arrange temporary sound and light shows in 20 districts of the State to commemorate the 500th anniversary celebration of Sri Krishnadevaraya's coronation.

[72] Cost of work order as final payments are yet to made (August 2014).

[73] Two works (construction of fountain and allied works, and glass house) were stated (April 2014) to have been handed over to the Horticulture Department.

[74] Calculated at 60 *per cent* occupancy of rooms and income from commercial activities, as worked out by the Company.

For this purpose, the Company entered into (April 2010) an agreement with M/s. Innovative Lighting Systems Corp., (contractor), the single responsive bidder, at a cost of ₹ 3.99 crore[75]. As per Article 7 of the agreement, the contractor had to hand over the technical components, sound track and sets to the Company, on completion of the project.

The contractor conducted shows between November 2010 and March 2011. On completion of the shows, the contractor requested (April 2011) the Company to take custody of the sets and technical components. As the Company did not have any arrangements for storage of materials, it requested (April 2011) Karnataka State Warehousing Corporation for storage space, which did not materialise**.** Later, at the request of the Company (April 2011), the contractor hired (April 2011) a shed at ₹ 22,500 per month for storing the materials. The cost of storage worked out to ₹ 9.45 lakh (September 2014), which was yet to be paid.

The Company sought (May 2011) instructions from DoT for handing over of the assets created. Even after a lapse of three years, the Company is yet to take possession of the sets and technical components (September 2014).

It was observed that the Company did not have any plan to re-use the sets and technical components valued at ₹ 2.12 crore. Incidentally, it was observed that the Company invited tenders in December 2011 for setting up of a sound and light show at Srirangapatna Fort. As the technical components used were identical, the same valued at ₹ 0.80 crore could have been utilised in this show, thus reducing the project cost to that extent. Further, the Company did not plan for usage of materials returned by the contractor.

The Company replied (May 2014) that inspite of repeated requests, no action has been initiated by the DoT regarding handing over of the assets created. However, it is observed that besides having no plan for reuse of the assets, the Company also did not take any measures for ensuring usage of these assets for the sound and light show at Srirangapatna fort.

Thus, lack of planning for reuse of the materials resulted in idling of assets worth ₹ 2.12 crore with possible deterioration in value and condition over the last three years.

The matter was referred to the Government in July 2014; their reply is awaited (November 2014).

[75] Comprised of ₹ 1.32 crore for supply of sets, ₹ 0.80 crore for technical components, ₹ 0.57 crore for creative component and ₹ 1.30 crore for associated infrastructure.

Karnataka State Tourism Development Corporation Limited

3.4 *Unfruitful expenditure*

The Karnataka State Tourism Development Corporation Limited spent ₹ two crore on creating infrastructure to run a sound and light show at Kittur Fort, Belgaum but failed to operate the completed project, defeating the objective of promoting tourism.

The Department of Tourism (DoT) of Government of Karnataka (GoK) directed (January 2010) the Karnataka State Tourism Development Corporation Limited (Company) to implement a project for sound and light show at Kittur Fort in Belgaum district for promoting tourism in the state.

The Company invited (July 2010) short term tenders and awarded (August 2010) the work to M/s. Innovative Lighting Systems Corp. (contractor) for ₹ 1.95 crore. The contractor completed the project in December 2011, however the project was not in operation as of September 2014.

We observed that there was no power supply to the project to run the shows regularly. The source of power was not mentioned in the project report nor its cost included in the estimates. It was only in March 2012 that the Company invited tenders for supply and erection of 180 kV Diesel Generation (DG) set, which was installed in July 2012 at a cost of ₹ 13.10 lakh and was cleared for operation by the Electrical Inspectorate in September 2012. It is pertinent to mention here that at the request of the Company, the contractor had conducted *temporary* sound and light show for three days each in October 2010 and October 2011 during Kittur *Utsav* (festival) and for this purpose, a 180 kV and 160 kV DG set had been hired. This indicated that though the Company was aware that a DG set was necessary to run the shows, action to procure the DG set was initiated only after completion of the project. The contractor was asked to take care of the entire set up awaiting the decision as to which authority should manage the project including the manpower and operating costs.

The Company replied (May 2014) that after obtaining approval from the authority concerned, the facility would be handed over to the Kittur Authority. However, Government order for handing over of the project was not issued (September 2014).

The above facts along with the Company's reply indicate that the project had not been properly planned as no provision was made for power supply manpower and running costs.

Thus, the infrastructure created at a cost of ₹ two crore remained idle from September 2012 and the objective of promoting tourism was not attained.

The matter was referred to the Government in July 2014; their reply is awaited (November 2014).

Karnataka State Tourism Development Corporation Limited

3.5 *Inappropriate acquisitions and inaction on court pronouncements*

The Karnataka State Tourism Development Corporation Limited acquired lands using the power vested with the sovereign Government only to transfer them for the benefit of private parties. In spite of the Court quashing the acquisitions, the Company has not taken any action to annul the transfers and take possession of the lands. No action has been initiated against the Officers in the Company and the State Government for the unlawful actions ignoring the directives of various courts including the Apex Court.

The Hon'ble Supreme Court of India in its judgment (September 2011) dismissed the Special Leave Petition (SLP) filed by the Karnataka State Tourism Development Corporation Limited (Company) against the judgment (April 2005) of the Hon'ble High Court of Karnataka, quashing the land acquisition for the purpose of establishing Golf-cum-Hotel Resort near Bangalore Airport. The Hon'ble Supreme Court of India had observed that the Company diverted the land acquired for public purposes and handed over the same to private individuals and accused the Company of indulging in fraudulent activity.

We observed that

- the State Government had issued (December 1981) notification under Section 4(1) of Land Acquisition Act for acquisition of land in Kodihalli and Challaghatta Villages, in Bangalore South Taluk for public purposes, for the Company to establish a Golf-cum-Hotel Resort near Bangalore Airport. The Company took possession of land (at a cost of ₹ 45.54 lakh) to the extent of 23 acres and 36 guntas, against 39 acres and 27 guntas for which notification was issued. The Land Acquisition Officer passed the award in 1986. The possession of the acquired land was taken in July 1987. The Company had obtained a loan of ₹ 45.54 lakh from Canara Bank in 1987 for acquiring the land, which was repaid.

- instead of utilizing the land for the purpose specified in the notifications or for any other public purpose, the Company transferred the land to private parties for their possession and enjoyment in spite of Court orders (September/October 1991) quashing the notifications issued under Section 4(1) and declaration under Section 6 of the Act as detailed below:

  - Sold (March 1988) 14 acres and 8 guntas for ₹ 8.51 lakh to Sri Dayananda Pai, a private developer implementing private housing as decided (January 1987) in a meeting by Bangalore Development Authority (BDA) and the Company.

- Leased 5 acres and 9 guntas to M/s Universal Resorts Ltd., initially for 30 years (August 1992), which was later amended (August 1997) to 60 years.

➢ between 1987 and 1995 many owners of different parcels of the land filed writ petitions alleging illegal transfer of land and misuse of the Land Acquisition Act with the sole intention of favouring private persons and therefore demanded re-delivery of possession of land.

➢ the fifty-second report of the Committee on Public Undertakings on the working of the Company, presented before the Karnataka Legislature (February 1992), had recommended a thorough investigation into the fiasco in relation to the projects in the Challaghatta area, fixation of responsibility for the consequences and losses within six months and quick action against those found guilty.

➢ in August 2007, the Hon'ble High Court of Karnataka had ordered the State to take action in accordance with the law for the recovery of public property and to file necessary report.

We conclude that

➢ the Company did not adhere to either COPU's directions or Court orders.

➢ eminent domain, an attribute of sovereignty, the right of a Government or its agent to expropriate private property for public use, with payment of compensation, was used to acquire land from owners for use by private parties. The Company, thus, indulged in inappropriate actions to help private parties. The Company defied the verdict of the Hon'ble High Court of Karnataka quashing the award passed by the Land Acquisition Officer, which was upheld by the Apex Court in September 2011. Only land measuring 1 acre and 3 guntas in Kodihalli Village, Bangalore was transferred back (February 2012) in view of the judgment in a case filed by the owner of the property.

➢ prime land valued at ₹ 147.00 crore[76] continued to be in possession and enjoyment of the private parties. The Company has not taken any action to annul all the agreements and transfers and take possession of the land, in spite of court judgments quashing the acquisition.

➢ the beneficiaries to whom land was sold or leased for possession and enjoyment constructed commercial complex, apartments, luxurious star hotel, *etc*. As the land was transferred to private parties through deeds and agreements declaring marketable titles, compensation payable to them for taking back possession as per Supreme Court judgment is not assessable.

[76] At the rate of ₹ eight crore per acre as per the valuer's valuation for 18 acres and 14 guntas.

- neither the Company nor the State had initiated action against the officers of the Company and the State Government for their unlawful actions and for ignoring the directives of various courts, including the Apex Court.

- the objective of promoting and maximizing Golf tourism by offering catering, lodging, recreational, picnic and other facilities was not achieved.

The matter was referred to the Government in August 2014; their reply is awaited (November 2014).

Karnataka Power Transmission Corporation Limited

3.6 *Non-synchronisation of substation and associated line works*

Inspite of being aware of the fact that line works would encounter right of way problems, the Karnataka Power Transmission Corporation Limited awarded the work of construction of only the substation and delayed awarding the line works. As a result, the substation constructed at a cost of ₹ 32.04 crore is lying idle since January 2012 for want of transmission lines.

With a view to ensure all the intended benefits are derived as a result of execution of projects, there should be proper synchronisation of various components of works. The transmission lines should be planned to sychronise with the completion of substation works to achieve the objective of establishing a substation.

The Karnataka Power Transmission Corporation Limited (Company) undertakes the construction of substations alongwith the transmission lines to evacuate power. The Company approved (December 2009) the Detailed Project Report (DPR) for establishing a 220kV substation at Yelahanka with the objective of reducing the load on the existing substations at Peenya, Hebbal and Doddaballapura, besides providing alternate source of power supply to nearby substations[77]. The source of power to the substation at Yelahanka was from the substation at Singanayakanahalli of Power Grid Corporation of India Limited (PGCIL).

The work of construction of the substation at Yelahanka awarded (June 2010) to M/s Larsen & Toubro Limited was completed in January 2012, at a cost of ₹ 32.04 crore[78]. We observed that the substation at Yelahanka is idling till date (August 2014) due to lack of synchronization of the work of construction of lines connecting Yelahanka substation to PGCIL substation and substation at Yelahanka to nearby substations.

[77] Yelahanka, Rajanukunte, Kanasawadi, Sahakarnagar and Soladevanahalli and Substations dependent on the 66 kV lines between Peenya DG Plant 1,2,3 and 4.

[78] Including civil works of ₹ 4.40 crore.

The DPR (December 2009) did not envisage the construction of 220 kV transmission lines to synchronise the evacuation of power from the substation as 'Right of way'[79] was considered as a main constraint for evacuation lines. The DPR for the lines (five) was prepared only in June 2010 and tenders invited in March 2011. Attempts on five occasions (March 2011 to August 2013)[80] to tender the line works did not materialize. The work had not been awarded as of June 2014. As of August 2014, only two lines out of five have been awarded and estimates for the remaining three works were under preparation.

Government replied (October 2014) that in order to avoid the idling of the station, the two works had been awarded (July 2014) for construction of 220/66 kV lines.

Thus, even though the Company was aware of the right of way problems while approving the work of the substation in December 2009, the Company went ahead with awarding the work for substation without ensuring its synchronisation with the award of contract for line works. The instances of power interruptions in Peenya, Hebbal and Doddaballapura substations during 2012-14 also continued, affecting the quality of power supply and resultantly having an economic cost due to its effect on a largely industrial belt.

Thus, failure to synchronise construction of the transmission lines with the substation at Yelahanka resulted in the substation constructed at a cost of ₹ 32.04 crore, lying idle due to ill-planning.

Karnataka Power Transmission Corporation Limited

3.7 *Lacuna in the system of procurement of cables and usage of cables returned to stock*

Despite having decided to use cables of higher capacity in the Bangalore Urban Area, the Karnataka Power Transmission Corporation Limited invited tenders and procured cables of lower capacity. Moreover, inspite of the conditions in the contract providing for use of cables lying in stock, new work orders were issued allowing procurement by the contractor to supply the cables.

Karnataka Power Transmission Corporation Limited (Company) awards contracts for the work of laying Underground (UG) cables for its transmission network on total turnkey basis[81], through private contractors.

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[79] Right of way refers to path through which the power lines pass.

[80] All the five line works were tendered in March 2011 but tender was rejected due to defective methodology of evaluation; tender for two (of the five) line works were invited October 2011, which was cancelled as it was a single offer; tender for two works were called for in November 2012 but no offers were received; tender for five line works (in two separate notifications) were invited in February 2013, but was cancelled as it was single offer; tender for five line works (in two separate notifications) were invited in August 2013 was cancelled.

[81] Including design, testing, supply of material, civil and erection works and commissioning.

The conditions in the turnkey contracts *inter-alia* provided that the contractor should return the excess quantity of UG cables to the stores of the Company after completion of the works. The conditions in the contracts also provided that the Company could supply available material from its stores and the scope of supply of material by the contractor would be reduced in the contract to that extent.

During 2009-2014, the contractors returned 32.754 kms of 630 sq. mm of excess UG cables, which was stored at the Peenya stores of the Company at Bangalore. Of this quantity, during the same period, the stores issued 14.365 kms of cable for other works leaving a balance of 26.48 kms[82] of cable in the stores (March 2014).

We observed the following system failures in the procurement and utilisation of cables:

Failure to procure materials as per approved specification

- The Technical Advisory Committee (TAC) of the Company decided (July 2006) to use 1,000 sq mm cables in the Bangalore Urban area considering the concentrated load growth in Bangalore and for transfer of load in case of stations trouble to avoid load shedding. Despite this decision of TAC, the Company placed Detailed Work Awards in June 2007 for three evacuation line works of lower capacity (630 sq mm) from Vrushabhavathi valley (Bangalore Urban area) to various locations, with a combined length of 31.860 kms for ₹ 79.90 lakh which lacked justification. The materials so procured were returned to stores in November 2009, as it was decided to utilize 1,000 sq mm in place of 630 sq mm in this work.

- The Company subsequently failed to utilise the cables, which were lying in stores since November 2009, for other works. It is pertinent to mention that the Central Purchase Committee, had noted in December 2007 itself that there were chances of sabotage and mechanical damage to cables from water entering into the conductor during the monsoon period, which would lead to failure of cables. However, cables (valued at ₹ 17.11 crore) were lying in the open yard of the Peenya stores since the last four years, and its condition could not be ascertained.

The Government replied (October 2014) that cable to the extent of 5.22 kms (630 sq mm) has been drawn and utilised for the work between National College and Victoria sub stations. The reply further stated that balance cables had been allotted for two other works/spares and the same was yet to be drawn from the stores, as road cutting permission for the work was awaited.

[82] Including 8.088 kms of cables, which were in stock prior to 2009.

Failure to utilise 1,000 sq mm cables lying in stock

- During 2009-14, contractors had returned 10.134 kms of 1,000 sq mm[83] of UG cable to the stores at Peenya. The stores had issued 0.28 kms cables leaving a balance of 9.86 kms (valued at ₹ 12.53 crore) lying in stores (March 2014).

- We observed that the Company could have utilized the cables in the work orders issued (10 numbers) during the period 2011-14, at least to the extent it was available in stores by issuing partial turnkey contracts, wherein the Company would supply the cables.

The Government replied (October 2014) that in order to obtain guarantee/warranty benefit in the partial turnkey tenders, entire cable required was to be supplied by the Company. Further, it was replied that it was now proposed to utilise 4.75 kms of cable for the work between Kondasapura and Hosakote line and the balance was proposed to be utilised for maintenance works.

The reply does not consider the fact that during February 2013, the Company had issued letter of intent for new work of laying cable for length of 3.5 kms and though 9.26 kms[84] of cables (valued at ₹ 12.66 crore) was available in stock, it was not utilised.

Thus, purchase of 630 sq mm cables despite decision to use only 1,000 sq mm cables in the Bangalore Urban area and absence of a system to utilise surplus stock of cables available in stores when new works were executed, resulted in idling of stock worth ₹ 29.64 crore. After being pointed out in audit, the cables lying in stock were proposed to be allotted / issued for new works.

Karnataka Power Transmission Corporation Limited

3.8 *Undue benefit to the contractor*

The Karnataka Power Transmission Corporation Limited accepted the tender in US Dollars overlooking the bid conditions, which stipulated quoting in Indian Rupees for the services performed in India, resulting in undue benefit of ₹ 7.23 crore to Deepak Cables (India) Limited.

Karnataka Power Transmission Corporation Limited (Company) invited tenders (April 2007/January 2008) for design, engineering, supply, installation, testing and commissioning of 220 kV 1,000 sq mm Underground

[83] The length of UG cable in each drum ranged from 310 meters to 425 metres, and the cables are joined together using cable joints.

[84] Position of stock of cables as at beginning of February 2013. Subsequently, 0.70 kms of cable was received between February 2013 to March 2014.

(UG) cable for a total route length of 33.016 kms at six work sites[85] of the Company. The contracts involved supply of both indigenous and imported materials. The works were awarded (January 2008/April 2008/May 2009/July 2009) in four packages (TL-287, 288, 322 & 323) to Deepak Cables (India) Limited (Contractor).

Instructions to Bidders (ITB), which formed part of tender/bid document, stipulated *inter-alia* that bidders should quote the prices of imported goods in United States Dollars (USD) or Indian Rupees (INR) and the indigenous materials were to be quoted in INR only. ITB further stipulated that the cost of services to be performed in India such as clearance and handling at port, inland transportation, insurance, unloading, storage, handling at site, installation, testing and commissioning should be quoted in INR.

We observed that the Contractor had quoted (August 2007/February 2008) in USD for the services to be performed in India *viz.,* Import duty, Transport to site and Loading and unloading, which was not as per ITB which stipulated that indigenous materials and services to be performed in India should be quoted in INR. The Company also failed to indicate while awarding the work that USD prevalent at the time of opening of bids would be admitted.

The Contractor claimed bills for these services in USD and the Company admitted (between 2008-09 and 2013-14) the bills at the prevalent rates of USD[86]. The company atleast while admitting the bills, should have adopted rates of USD prevalent at the time of opening of the bids which ranged from INR 39.93 and INR 41.34. Instead, the Company adopted rate of USD prevalent at the time of payment of bills which ranged from INR 41.92 to INR 48.20.

The action of the Company in accepting the tender in USD in contravention of the bid conditions and adoption of the rates prevalent while making payment of bills resulted in undue benefit of ₹ 7.23 crore to the Contractor.

While admitting the audit observation, the Government replied (October 2014) that on receipt of final bills, the variation would be worked out and recovered, subject to verification.

[85] 220 kV East division compound substation to 220 kV ‘A station’ and 220 kV East division compound substation to 220 kV NIMHANS substation (TL:287- 8.97 kms); 220 kV East division compound substation to 220 kV substation at HAL (TL:288- 7.9 kms); 220 kV NRS Rajajinagar to 220 kV Anand Rao circle station and Cable terminating tower point to 220 kV HSR layout station (TL:322- 5.466 kms); 220 kV HSR layout station to NIMHANS station (TL:323- 10.68 kms).

[86] As per Clause 13.0 of ITB, the payment for imported goods quoted in US$ should be made in equivalent Indian rupees at the TT Buying card exchange rate notified by the State Bank of India on the date of dispatch, scheduled or actual, whichever is the least.

Karnataka Power Transmission Corporation Limited

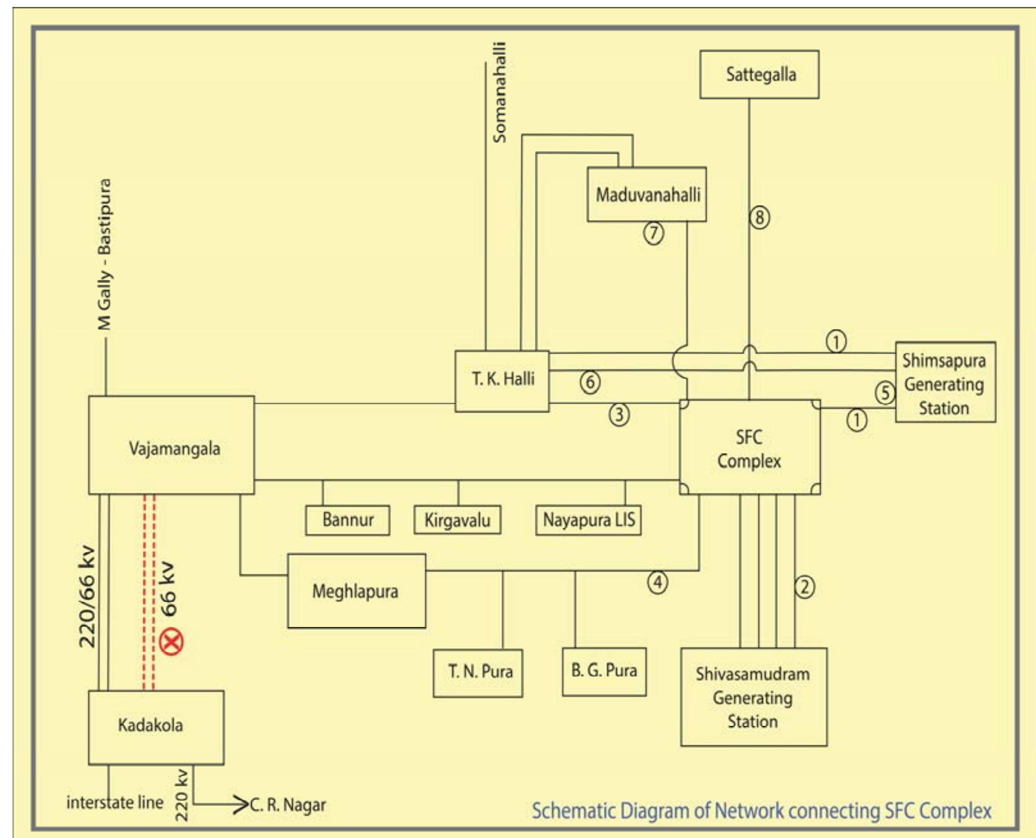
3.9 Creation of excess infrastructure

The Karnataka Power Transmission Corporation Limited created infrastructure at a cost of ₹ 3.57 crore, which was not need based.

The Karnataka Power Transmission Corporation Limited (Company) approved (February 2007) the Detailed Project Report for construction of a 66 kV double circuit line (*i.e.,* two lines) between Vajamangala and Kadakola substations with an objective to evacuate power from Static Frequency Converter[87] (SFC) complex and provide stand by line in case of exigency.

The work of constructing the double circuit line was awarded (August 2009) to Sharavathy Conductors Private Limited at a cost of ₹ 3.60 crore with scheduled completion date of February 2010. As of September 2014, expenditure of ₹ 3.57 crore had been incurred by the Company, but work had not been completed due to Right of Way problems.

The schematic diagram of the network connection around SFC complex is given below:



[87] Static Frequency Convertor was used for converting power evacuated from Shivanasamudram and Shimshapura hydro generating stations into required frequency levels before pumping the power to the grid.

We observed that

- the SFC station was designed to evacuate power from two Hydro power generating stations *viz.*, Shimshapura (17.2 MW) and Shivasamudram (42 MW). Power from Shimshapura could be evacuated to T.K Halli substation also (refer diagram at 1).

- the power generated (maximum of 59.2 MW) by the two hydro generating stations and received at SFC complex was further transmitted through the following lines to other connected substations:

Table 3.2: Transmission lines at SFC complex

Lines	Substations connected to the line	Refer diagram at
SFC-Vajamangala	Kirgavalu, Bannur, Nanjapura Lift Irrigation Scheme pumps, Vajamangala	3
SFC-Meghlapura	BG pura, TN Pura, Meghlapura	4
SFC-Shimsapura	Shimsapura	5
SFC -TK Halli	TK Halli	6
SFC -Madhuvanahalli	Madhuvanahalli	7
SFC -Sattegala	Sattegala	8

The combined peak load on the substations (mentioned in table above) in 2008-09*, i.e.,* before the work was awarded, was 70 MW[88], which far exceeded the available power of 59.2 MW generated by the two hydro generating stations. Obviously, there was enough demand for the power in these lines/stations and in case of exigency in one line, the load could be distributed to other lines/stations (mentioned in the table). Hence, there was no need for a stand by line as envisaged.

In view of the above, the decision to construct a double circuit line between Vajamangala and Kadakola substations (marked as X in the diagram) with the objective of '*evacuating power from SFC complex'* was not justified.

Government replied (October 2014) that the line was proposed for providing a standby line in case of exigencies, as a security condition required for maintaining specific degree of reliability and to facilitate evacuation of power from SFC complex.

The reply is not acceptable as the combined peak load on the existing substations as indicated in the above table far exceeded the available power from SFC complex. There existed other lines/stations, as indicated in the diagram, to distribute the load in case of exigency, for maintaining reliability. The amount of ₹ 3.57 crore spent on the infrastructure was, therefore, not need based, which calls for fixing of responsibility.

[88] Peak load was 88 MW in 2013-14.

Electricity Supply Companies

3.10. *Purchase of Power in the State*

The ESCOMs had not prepared annual load forecasts to assess the demand-supply gap, which would have facilitated the planning for purchase of power. There was no optimum utilisation of power generated from the thermal generating stations in the State. The terms and conditions of PPAs were not adhered to resulting in additional financial burden to ESCOMs. The State had not implemented the intra-state Availability Based Tariff (ABT) mechanism for maximization of power generation during peak hours.

Introduction

3.10.1. Electricity is essential for overall development of the economy. In Karnataka, the Karnataka Power Transmission Corporation Limited (KPTCL) manages transmission of power and five Electricity Supply Companies (ESCOMs)[89] manage distribution in the State. Power Company of Karnataka Limited (PCKL) facilitates the establishment of various power generation projects and coordinates procurement of power from different sources for allocation among distribution companies (ESCOMs), facilitates trading and related activities and prepares Power Purchase Agreements (PPAs) on behalf of ESCOMs. The Karnataka Electricity Regulatory Commission (KERC) regulates the power sector in the State.

The State is dependent upon Central and State Public Sector power generating companies, which together contributed 60.74 *per cent* in 2012-13 of the total power supply for the State. The shortfall is met by purchasing power from independent power producers (IPPs) including traders, power generators from renewable energy sources, *etc*., on long, medium and short term basis.

Audit findings

Power generation

3.10.2 The table below summarises the peak hour demand of the State and the power purchased from different sources during the five years up to 2012-13.

Table 3.3: Peak hour demand of the State and the power purchased from different sources.

Particulars	2008-09	2009-10	2010-11	2011-12	2012-13
Peak hour demand (MW)	6,892.00	7,942.00	8,430.00	10,545.00	10,124.00
Peak hour availability (MW)	6,548.00	6,897.00	7,815.00	8,549.00	8,761.00
Power deficit (MW)	(344.00)	(1,045.00)	(615.00)	(1,996.00)	(1,363.00)

[89] Bangalore Electricity Supply Company Limited (BESCOM), Mangalore Electricity Supply Company Limited (MESCOM), Gulbarga Electricity Supply Company Limited (GESCOM), Hubli Electricity Supply Company Limited (HESCOM) and Chamundeshwari Electricity Supply Corporation Limited (CESCO).

Particulars	2008-09	2009-10	2010-11	2011-12	2012-13
Power purchases (MUs)					
Central Sector Generators	9,789.80	10,420.30	10,397.27	11,228.28	11,771.19
State Sector Generators	23,843.37	24,728.19	21,473.17	26,823.17	22,944.88
Independent Power Producers					
Renewable Energy Sources	3,961.20	5,205.44	4,917.71	5,733.72	5,411.73
UPCL, GMR, Tata and Rayalseema Alkalies and Chemicals Company Limited	720.71	532.68	2,020.00	3,419.92	6,107.99
Traders					
Medium term, Short term basis and IEX/PXIL	1,218.94	1,548.16	7,248.66	5,702.68	10,253.05
Section 11 and Others	2,298.59	874.26	1,229.79	781.91	666.61
Total	**41,832.60**	**43,309.03**	**47,286.60**	**53,689.67**	**57,155.45**

(Source: Details furnished by GoK)

3.10.3. The State Load Despatch Center (SLDC) obtains the details of cost of power (fixed and variable cost) and short/medium term agreements from ESCOMs every month. Based on the fixed cost and short term/medium term commitments, dispatch instructions are issued. Priority is given to the dispatch of power from private parties since PPAs/Letters of Intent (LsOI) are entered/issued.

We observed that the power deficit in 2008-09 was 344 MW, which increased to 1,363 in 2012-13. The drawal of energy from State Generating Stations reduced from 23,843.37 MUs to 22,944.88 MUs in 2012-13. At the same time, purchase of medium and short term power from traders steadily increased from 1,218.94 MUs in 2008-09 to 10,253.05 MUs in 2012-13 indicating increased dependence on procurement from private sources as against the power available from State Generating stations.

The reasons for shortdrawal of energy from State Generating Stations were reviewed. We observed that the energy available as per the availability declared by the State Generating Stations (BTPS-Unit 1 and RTPS Units 1 to 8) was not fully utilised by the ESCOMs. The energy available for ESCOMs as per the declaration by the State Thermal Generating Stations for the period from 2009-10 to 2012-13 was 54,435.695 MUs. Against this the drawal was 46,605.227 MUs, resulting in under drawal of available energy to the extent of 7,830.468 MUs.

Thus, not purchasing cheaper power from the State Generator to the extent available, and resorting to purchase at higher costs from other sources, resulted in extra expenditure of ₹ 1,434.13 crore[90] to ESCOMs, which was passed on to the ultimate consumers. Even considering 50 *per cent*, the extra expenditure worked out to about ₹ 700 crore.

[90] The energy available in respect of RTPS Unit 8 was not considered as PAF was very low.

The Government replied (November 2014) that loss of generation attributable to KPCL was due to generation system constraints which include equipments/process problems, wet coal, poor quality of coal, trip loss due to grid disturbances, boiler tube leakage, latent defects noticed in the units, delay in commissioning of units, *etc*., and back down instructions issued by LDC.

The reply is not acceptable due to the fact that the capacity was declared by the generating stations after taking into account all factors and the reasons stated by the Government, which was not fully utilised.

3.10.3.1. As per Karnataka Electricity Regulatory Commission (Condition of License for ESCOMs) Regulations 2004, the Licensee has to prepare the load forecast on annual basis:

We observed that

- the annual load forecast was not prepared in any of the years by ESCOMs. The Government replied (November 2014) that annual load forecast as per KERC Regulations, was prepared periodically by KPTCL for planning the transmission line network for every 10 years. Further, Central Electricity Authority (CEA) also conducted annual load forecast. The reply is not acceptable as KPTCL's forecast was for construction of transmission lines while CEA's forecast was for the country as a whole. Annual load forecast has to be done by ESCOMs to assess the demand supply gap which would facilitate the planning for purchase of power to mitigate the shortages. No load forecast has been done by the ESCOMs as envisaged in the KERC Regulation, for analysing the demand in their area of supply.

- GESCOM stated (March 2011) that assuming the existing generating units of State Generating Stations, Central Generating Stations and other long term PPAs and with the present regime of hours of supply of power and energy requirement for High Tension (HT) industrial consumers based on HT growth in the last three years, there was no shortage of energy in any month except during March 2012 and January to March 2013 and there was no need for it to go in for Round the Clock (RTC) purchase of any power from June 2011 onwards. GESCOM also requested that it need not be included in any short term or medium term RTC procurements until the end of the financial year 2013-14.

Government replied (November 2014) that GESCOM's views were not correct as it had overdrawn the power from other ESCOMs during 2011-12 and 2012-13.

The reply is not acceptable as the demand supply gap analysis was not done by GESCOM. The ESCOMs did not have any contracted capacity and scheduling of power with State Load Despatch Centre (SLDC). The drawal of power by ESCOMs depended on allocation made by Government and not as per its requirement. Hence, the over drawal and under drawal of power cannot be determined.

Purchase of power from State Sector Generators

3.10.4. On a review of the Power Purchase Agreements entered into with State Generation Stations during the last four years, the following observations are made.

Non-adoption of Gross Calorific Value as per PPA

3.10.4.1. Article 1.1 (an) of PPA in respect of 7 units of 210 MWs at Raichur Thermal Power Station (RTPS), defined 'Gross Calorific Value' (GCV) as the weighted average gross calorific content of one kilogram of primary fuel *received at RTPS* for a particular billing month in respect of primary fuel for the purpose of calculating energy charges for each billing month.

We observed that KPCL preferred the claim for energy charges based on GCV of the coal on *'as fired'* basis in violation of the terms of PPA which was on the basis of GCV *'received at RTPS'* This resulted in extra expenditure of ₹ 523.91 crore[91] by all ESCOMs for the period from 2009-10 to 2012-13.

The Government did not offer any comments on the mention about the term 'received at RTPS' in the PPA. The fact remains that by not billing as per the terms of the PPA, the extra expenditure was passed on to the consumers.

Excess payment of Capacity Charges towards O&M Expenses

3.10.4.2. The KERC (Terms and Condition of Generation Tariff) Regulations 2009 provided the normative operation and maintenance expenses for Coal based generating stations. Further, for stations with more than seven units, only 85 *per cent* of the normative expenses are allowed. We observed that O&M expenses for RTPS Unit 8 were paid at 100 *per cent* resulting in excess payment of capacity charges of ₹ 12.21 crore for 2011-12 and 2012-13.

The Government replied (November 2014) that the tariff application for RTPS Unit 8 filed (October 2013) was still pending with KERC. The reply is not acceptable as application was filed only for fixation of tariff and RTPS Unit 8 being additional unit of RTPS and that the tariff regulations provided for payment of O&M expenses at 85 *per cent* only.

Capacity Charges without considering Plant Availability Factor (PAF)

3.10.4.3. As per Regulation 22 (2)(a) of KERC Regulations, 2009, where PAF achieved during a financial year (PAFY) was less than 70 *per cent*, payment of total capacity charges for the year shall be arrived by a certain formula[92].

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[91] In the absence of actual data on GCV of coal as received basis, we derived the GCV as received basis by applying the Dulong's formula, where the difference between gross and net calorific value for typical bituminous coal with 10 *per cent* moisture and 25 *per cent* of volatile matter was worked at 260 kcal/kg.

[92] AFC x (0.5 + 35 / NAPAF) x (PAFY / 70) (in Rupees), where:
- -AFC is annual fixed cost specified for the year in Rupees;
- -NAPAF is normative annual plant availability factor in percentage;
- -PAFY is Plant availability factor achieved during the year, in *per cent*.

The PAFY achieved by the RTPS Unit 8 in the years 2010-11 to 2012-13 was less than 70 *per cent*[93], but failure of ESCOMs to restrict the capacity charges as per formula resulted in excess expenditure of ₹ 153.83 crore. Government replied (November 2014) that KPCL had filed Tariff application before KERC in October 2013 and the matter was pending. Reply is not acceptable as application was filed only for fixation of tariff and the claim was not as per the Regulations for payment for PAFY less than 70 *per cent*.

Excess claim of Income Tax

3.10.4.4. As per PPAs, Minimum Alternate Tax (MAT)/Income Tax (IT) to be considered as a pass-through shall be restricted to tax on ROE or on actuals.

We observed that while the actual income tax of KPCL for the period 2009-10 and 2012-13 was ₹ 327.10 crore, tax on ROE worked out to only ₹ 154.27 crore. However, ESCOMs had paid an amount of ₹ 462.77 crore to KPCL, resulting in excess payment of ₹ 308.50 crore.

Government replied (November 2014) that as against the actual expenditure incurred towards O&M expenses and fuel charges, there was under recovery of ₹ 1,541.89 crore, over the norms stipulated in the PPAs. It was also stated that if the entire actual O&M expenditure and fuel costs were recovered in tariff mechanism, the revenue would increase and KPCL would have paid Corporate tax.

The reply is not acceptable as O& M expenses and fuel charges incurred beyond the norms of PPA had to be borne by KPCL and should not be passed on to consumers. Further, as IT was a pass-through in PPA, only the applicable tax incurred by KPCL should be admitted.

Purchase of power from other sources

3.10.5. The details of purchase of electricity from various other sources for the last five years ended March 2013 are given in **Annexure-9.**

The rates at which power was purchased from other sources had declined from ₹ 6.76 per kWh in 2008-09 to ₹ 4.38 per kWh in 2012-13. The reduction from 2011-12 onwards was partly due to purchase of power on medium term basis. However, we observed that PPAs were not entered into between ESCOMs and the suppliers/traders. Purchases up to September 2011 were made only on the basis of LOI. Audit observations in respect of purchases on medium and short term are given below:

Purchase of Power on medium term

3.10.6. Procurement of power for a period up to seven years but exceeding one year is termed as medium term Procurement. ESCOMs purchased 16,140.14 MUs on three occasions during 2008-09 to 2013-14 (December 2013) by entering into nine PPAs.

[93] 37.6, 42.91 and 28.41 *per cent*.

The MoP stipulated 120 days from zero date for bidding process for Case I. As per Central Electricity Regulatory Commission (CERC) Regulation 19 (2), application for medium term open access, the start date of the medium-term open access shall not be earlier than five months and not later than one year from the last day of the month in which application has been made.

We observed that PCKL decided (June 2011) to procure 500 MW of RTC power for the period from 1 September 2011 to 15 June 2013, for the requirement of BESCOM. Tender was issued in July 2011. LsOI were placed (August/September 2011) on four firms at rates ranging from ₹ 4.10 per unit to ₹ 4.39 per unit (at KPTCL periphery).

Bidders did not get the required corridor for full quantity. Against 3,816 MUs to be supplied, only 2,441 MUs was supplied by suppliers outside the Southern Region.

We observed that the main reasons for short supply of power were constraints in obtaining the corridor. This had arisen as there was delay in initiating the tender process. For the supplies to commence from September 2011, the tender process should have been completed by February 2011, so as to enable the bidders to apply for corridor *i.e.,* transmission lines for supply of power by March 2011, as the applications for medium term open access would be processed on first come first served basis. However, the tender process started only in May 2011.

The Government replied (November 2014) that PCKL initiated bidding process for 700 MW in December 2010 for three years from June 2011 to June 2014. Since the rates received were substantially higher (₹ 4.893 to ₹ 5.884 per unit), decision was taken to cancel the notification. Subsequently, in the meeting held in May 2011 under the Chairmanship of Hon'ble Chief Minister it was decided to procure 500 MW for the period August 2011 to May 2013[94].

We observed that sufficient time was not available for the successful bidders to apply for corridor (as they required five months time) and this contributed to the non-supply of power.

Procurement of power under short term

3.10.7. The PCKL tendered (January 2010) for requirement of 500 MW for February and March 2010. Four offers were received. Orders were placed on JSW Power Trading Company Limited (JSWPTCL) for 200 MW at ₹ 4.50 per kWh for February 2010 and March 2010 while orders were placed with Tata Power Trading Company Limited (TPTCL) for supply of 95.3 MW at ₹ 4.48 and ₹ 4.50 per kWh for February 2010. As TPTCL had quoted ₹ 5.422 for March 2010, it was decided to negotiate with the firm for supply of power at the same rate for March 2010. Other two suppliers did not agree for reduction in quoted rates (₹ 5.161 per kWh to ₹ 6.445 per kWh) and hence orders were not placed. JSWPTCL supplied the quantum of power, but TPTCL did not

[94] This was revised to meet the requirement from 1 September 2011 to 15 June 2013.

schedule the power as its request to amend the conditions regarding deletion of compensation clause was not agreed to.

In order to meet the shortage, PCKL again invited tender (February 2010) for supplies during February and March 2010. Against this, two quotes were received. But, LOI was placed only on Reliance Energy Trading Limited (RETL) for 100 MW of power for the period from 12.02.2010 to 28.02.2010 at ₹ 5.10 per kWh. The other quotes of RETL at ₹ 5.65 per kWh for supply (100 MW) and PTCIL at ₹ 6.56 per kWh (200MW) for supply in March 2010 were not accepted as the rates were found to be higher than the offered rates of another tender by JSWPTCL. During negotiation, the bidders did not agree to reduce the rates.

The requirement of the State for February and March 2010 was not met even after the second tender of February 2010. Consequently, the company contacted (21.02.2010) several bidders over telephone for supply of power during the remaining days of February and March 2010. Based on the offers received, eight LsOI were placed on two suppliers (PTCIL and NTPC-VVNL) for February and March 2010 at rates ranging from ₹ 5.629 per kWh to ₹ 6.588 per kWh. The offer of RETL, which had followed tender conditions was rejected with the reasoning that its rates were too high. Thus, emergent purchase in March 2010, became inevitable which was made at much higher rates than that offered by RETL. The extra expenditure paid for supplies made during March 2010 worked out to ₹ 4.85 crore.

Inadmissible payment

3.10.8. For supply of power between September 2010 and March 2013, ESCOMs entered into one PPA under Medium Term Procurement and three Letters of Acceptance (LsOA) on short term procurement with JSWPTCL.

As per PPAs under Medium Term Procurement, there existed a clause for variation in injection of power between scheduled energy and actual energy supplied at the interconnection point. The clause stipulated the accounting of variation through UI as per the provisions of the Grid code and Availability Based Tariff (ABT).

On the other hand, LsOA on short term procurement did not contain such stipulation for accounting the variation through Unscheduled Interchange (UI). The SLDC had fixed ₹ 2.85 per unit for the over injection of power.

We observed that the variation in injection by JSWPTCL in supply was accounted as UI considering it as supplies under Medium Term Procurement. As there were both Medium Term Procurement and LsOA of short term procurement, considering the entire supplies under UI of Medium Term and making payment of ₹ 14.08 crore was not in order.

The Government replied (November 2014) that provisions of Grid code and Standard bidding documents *inter alia* provides for UI charges whenever there were variations. The reply is not acceptable as it was against the terms and conditions of LsOA on short term procurement.

Impact of Audit

3.10.9. Government informed (November 2014) that based on the audit observations, BESCOM had recovered ₹ 15.83 crore on account of adjusted recoverable capacity charges, Operation and Maintenance expenses and disincentive charges.

Monitoring of purchase and distribution

3.10.10. KERC has nominated (June 2006) KPTCL for its implementation of intra-state Availability Based Tariff (ABT) in the State. Owing to non implementation of intra-state ABT the following benefits did not accrue:

- Maximization of generation during peak hours with incentives and discouragement of same during off peak hours with penalties were not achieved.

- Optimum utilization of available resources and generation capacities were not achieved.

- Encouraging backing down of generation as per merit order during off peak hours.

Government replied (November 2014) that intra-state ABT was not yet formulated by KERC. The reply is not acceptable as KERC had already formulated (June 2006) the action plan for intra-state ABT.

3.10.11. As per Section 31 of the Electricity Act, 2003, the State Government shall establish a State Load Despatch Centre operated as a Government Company or any authority or corporation established or constituted by or under any State Act, for the purpose of optimum scheduling and despatch of electricity within a State, to monitor grid operations, keep accounts of the quantity of electricity transmitted through the State grid, supervising and controlling the intra-state transmission system and carrying out real time operations for grid control and dispatching electricity within the state through secure and economic operation. Even after 11 years of the Electricity Act, 2003, coming into existence, State Load Despatch Centre (SLDC) was still working under the State Transmission Utility (KPTCL) which affected the autonomy of SLDC for optimum operation and control of the intra-state transmission system.

Government replied (November 2014) that establishment of independent SLDC is under consideration of Government.

Conclusions

We concluded that

- **annual load forecast was not done by ESCOMs to assess the demand supply gap which would facilitate the planning for purchase of power to mitigate the shortages.**

- **optimum utilization of available resources and generation capacities were not achieved.**
- **the terms and conditions of PPAs were not implemented, resulting in additional financial burden.**
- **intra-state Availability Based Tariff (ABT) has not been implemented in the State for maximization of generation during peak hours with incentives.**

Recommendations

- **Government should ensure that ESCOMs assess the demand supply gap by annual load forecast in their jurisdiction of supply to facilitate advance planning to address the shortages and for transmission network for procurement of power from other regions.**
- **Government should take action to implement the intra-state ABT mechanism as per the action plan approved by KERC.**
- **Government should ensure the optimum utilisation of available power from State and Central generators to reduce the burden due to power purchases from other sources.**
- **Government should establish a State Load Despatch Centre as envisaged under the Electricity Act, 2003.**

The Mysore Paper Mills Limited

3.11 *Idle investment and failure to comply with the Charter on Environmental protection*

The Mysore Paper Mills Limited took up a project to install a Rotary Kiln plant to comply with the directions of Karnataka State Pollution Control Board and the Charter on Environmental protection issued by the GoI. The project, which was scheduled to be completed by July 2011, has been lingering for the last three years without any concrete action plan, rendering the investment of ₹ 33.36 crore idle.

The Mysore Paper Mills Limited (Company) operates a Paper and Sugar mill at Bhadravathi in Karnataka. In the pulp and paper mill, Rotary Lime Sludge Re-burning Kiln (Rotary Kiln) was to be installed to convert the calcium carbonate back into burnt lime for reuse to overcome the problems faced in solid waste disposal. The Board of Directors (BoD) approved (October 2002) the proposal for installation of the Rotary Kiln and to seek approval of the Government of Karnataka (GoK) for incurring the capital expenditure.

The Ministry of Environment and Forests, Government of India (GoI), formulated (March 2003) a Charter on Corporate Responsibility for Environmental Protection (CREP), mandating installation of Lime Kiln projects in all large pulp and paper mills in the country within four years (by

2007). Further, the KSPCB issued (May 2004) show cause notice to the Company for non-compliance with the Water[95] and Air[96] Acts.

The Managing Director informed (August/November 2006) the GoK that it was the only paper industry in the country which was yet to comply with the Charter. GoK approved the project in January 2007. The KSPCB issued (December 2007) a consent refusal order for operating the plant for 2007-09, as Rotary Kiln was not installed, implying that the Company should stop discharge of effluents and emissions and any violation would attract penalty.

The Company invited (July 2008) tenders and issued (July 2009) Letter of Intent (LoI) to FLSmidth (supplier) for design, engineering, manufacture, supply, erection, commissioning and performance testing of Rotary Kiln for ₹ 25.47 crore[97]. The supplier had to complete the supply of the equipment within 18 months from LoI, so as to commission the plant by March 2011.

In order to synchronise the erection of equipment with the civil works, the Work Order for civil works was issued (August 2010) to High Parra Constructions Pvt. Ltd (L2 bidder)[98] for ₹ 5.40 crore, with the stipulation to complete the work by July 2011.

The Company raised (October 2009) ₹ 35 crore by issue of bonds to finance the project. The amount was to be redeemed in four installments from October 2013 onwards. The GoK released (October 2013) ₹ 10 crore for redemption of the first instalment of ₹ 8.75 crore. Company paid interest on bonds amounting to ₹ 13.81 crore up to 15 October 2014 and ₹ 1.50 crore as guarantee commission on bonds. Further, funds of ₹ 17.52 crore raised through bonds for the project were diverted to other maintenance works of sugar mill and boiler without necessary regulatory approvals, affecting payments to suppliers.

The Supplier supplied (March 2010 to October 2012) the equipment (parts) valued at ₹ 17.14 crore against which the Company made payments of ₹ 15.34 crore. The balance equipment had not been supplied (October 2014) as the Company did not make payments.

The civil works were also delayed due to formation of sludge in the excavated area and failure of the contractor to mobilize the required resources. The contractor suspended the work in November 2012 due to disputes regarding payments of statutory dues. The contractor had been paid ₹ 4.21 crore.

We observed that the equipment valued ₹ 17.14 crore was dumped in the open yard for the past three years and had started rusting[99]. The Board approved (June 2014) ₹ 10 lakh for cleaning the area and equipment and for properly

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[95] The Water (Prevention and Control of Pollution) Act, 1974.

[96] The Air (Prevention and Control of Pollution) Act, 1981.

[97] Equipment valued at ₹ 23.93 crore and erection and commission of works at ₹ 1.54 crore.

[98] The contract placed (April 2010) on M/s. Ssivana Developers (L1 bidder) to be completed by February 2011, was cancelled (June 2010) as the documents submitted were found to be fabricated.

[99] Joint Inspection Report by Audit and Management.

storing the equipment received. The Civil works were also pending completion and the Company was pursuing with the contractor to resume the work (October 2014).

Thus, the project, which was scheduled to be completed by July 2011, has not been completed till date and is lingering for the last three years without any concrete action plan for its completion. Moreover, the investment of ₹ 33.36 crore has yielded no output and is idle, nor has it achieved its objective of Environmental Protection as the discharge of effluents has not been stopped or reduced.

The matter was referred to the Government in July 2014; their reply is awaited (November 2014).

Karnataka Renewable Energy Development Limited

3.12 *Failure to comply with provisions of Service Tax Act*

The Karnataka Renewable Energy Development Limited failed to take timely action to register itself under the Service Tax Act, collect the tax from developers of renewable energy and remit it to Service Tax Department. This resulted in the Company bearing the avoidable liability of ₹ 6.70 crore.

The Karnataka Renewable Energy Development Limited (Company) was a nodal agency of the Government of Karnataka (GoK) for development of renewable energy sources in the State. The Company collects application fee, Draft Project Report (DPR) processing fee, transfer fee *etc*., from developers of renewable energy as per the Government orders issued from time to time.

The Company received (July 2010) a notice from the Additional Commissioner of Service Tax, Anti Evasion, to register itself with the Service Tax Department and to remit the service tax for the services rendered. Though the Company had appointed a tax consultant (February 2010) for expert advice on tax matters, it sought legal opinion from another advocate (June 2010) about the applicability of service tax for the Company. No decision, however, was taken on payment of service tax by the Company.

The Commissioner, Service Tax Department, issued (October 2011) a show cause notice for failure to pay service tax for the period 2006-11, contending that the activities of the Company were included under the definition of 'Business Auxiliary Services' as per the provisions of Section 65(19) of the Finance Act 1994. The notice was referred to the tax consultant, who advised (January 2012) that the Company, being a service provider, should get itself registered with the service tax authorities and also collect service tax for all future transactions as otherwise liability would be cumulative in nature.

Instead of acting on the advice of tax consultant, the Company decided (March 2012) to seek exemption from paying service tax and took up (July 2012) the matter with GoK. The matter was referred by GoK (September 2012) to the Ministry of New and Renewable Energy, Government of India (GoI), to take

up the matter with the Ministry of Finance, GoI, seeking exemption. The response of the Ministry was not received (August 2014). The Service Tax Commissioner (Adjudication) issued (November 2012) demand notice for failure to pay service tax during 2006-07 to 2010-11, and levied tax of ₹ 4.94 crore. The tax consultant again informed (February 2013) that the Company would come under the ambit of service tax. The Company however, filed an appeal before the service tax appellate authorities (February 2013) against the demand of November 2012, contending that it did not share the relation of principal and agent and the fees collected were essential for the development of renewable energy projects. While the appeal was still pending, the Service Tax Commissioner again issued (October 2013) demand notice to pay ₹ 2.38 crore as service tax for 2011-12.

The Company decided (December 2013) to register with Service Tax Department and again filed an appeal in December 2013 against the tax demand. Accordingly, the Company registered and remitted (February 2014) service tax of ₹ 11.64 crore[100] for the period 2006-14. It also started (May 2014) correspondence with the developers for recovering the service tax paid.

Timely action to register with the Service Tax Department, collection of taxes from developers and its remittance to the Service Tax Department, would have saved the company from bearing the liability of ₹ 6.70 crore for the period 2011-14.

The Government replied (July 2014) that the Service Tax Department had issued the show cause notice classifying the activities of the Company under 'Business Auxiliary services' without specifying under which sub-clause the classification was done and hence liability did not evolve. Further, the Government replied that ₹ 31.31 lakh (out of ₹ 11.64 crore) has been recovered so far from the developers and orders have been issued in June 2014 to collect fee *plus* service tax.

The reply is silent on the issue as to why the Company did not act on the advice of the tax consultant in January 2012 who had advised the Company to get itself registered with Service Tax Department to pay service tax to avoid cumulative tax liability.

Failure to take timely action by the Company despite receipt of the advice of expert tax consultant, resulted in the Company bearing a liability of ₹ 6.70 crore for the period 2011-14, which was avoidable.

[100] ₹ 4.94 crore (2006-11) and ₹ 2.38 crore (2011-12) and ₹ 4.32 crore for 2012-14. This excludes interest and penalty, which is yet to be intimated by the Service tax Department.

Karnataka Forest Development Corporation Limited

3.13 *Faulty tender evaluation*

The Karnataka Forest Development Corporation Limited awarded the work of aerial spraying of its rubber plantations to a firm, which did not meet the technical criterion specified in the tender, resulting in loss of revenue of ₹ 6.30 crore.

The Karnataka Forest Development Corporation Limited (Company) invited (December 2010) tenders for carrying out aerial spraying (by helicopter) of its rubber plantations for the year 2011-12, at Sullia and Puttur taluks, covering an area of 2,742.69 hectares (ha). The tender stipulated that the tenderer was to furnish a copy of the operator's permit[101] to undertake aerial spraying operations. The spraying was to commence on 10th May to be completed by 25th May 2011 before the onset of monsoon.

M/s. Pushpaka Aviation Private Limited (PAPL), which had quoted ₹ 1,603.67 per ha (L1) was awarded (April 2011) the contract, though they did not furnish a copy of the operator's permit to undertake aerial spraying operations along with the bid documents. Hence PAPL's bid should have been rejected as it was not fulfilling the basic eligibility conditions prescribed in the tender.

PAPL did not undertake the work within the laid down time schedule as it had failed to obtain the requisite operator's permit resulting in abnormal leaf fall in the rubber plants, leading to shortfall in yield. The Company could not take up the work later as rainy season had already set in by June 2011. The Company attached (June 2011/February 2012) the proceeds of PAPL's security deposit and earnest money deposit totalling ₹ 3.36 lakh, but could not recover penalty of ₹ 4.40 lakh, for which it had filed (November 2012) a civil suit in the Court.

The Board of Directors (BoD) directed (July 2012) to constitute a sub-committee[102] to analyse the reasons for reduction in production of rubber during 2011-12. The sub-committee attributed (November 2012) loss of 350 Metric Tonnes (MTs) of yield of rubber due to failure to carry out aerial spraying.

Audit observed (February 2013) that the tender evaluation had not been done properly, as PAPL had been awarded the contract inspite of the fact that it was not even eligible for award of work. Therefore, lack of due diligence in scrutiny of tender documents resulted in loss of yield of ₹ 6.30 crore[103].

The Company replied (March 2014) that during tender evaluation the Management had thought that obtaining operator's license was only a minor

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[101] Refers to permission from Director General of Civil Aviation, Government of India.

[102] Joint Managing Director of the Company, Executive Director (Rubber) of the Company and a Scientist from the Rubber Board.

[103] Considering the then prevailing selling price of rubber ₹ 180 per kg for 350 MTs (₹ 180*350 MTs=₹ 6.30 crore).

technical matter. The BoD, however, noted (March 2014) that Officers and field staff have to share the blame for shortfall in yield and the Company had initiated (September 2014) disciplinary proceedings against the officials concerned.

The matter was referred to the Government in June 2014; their reply is awaited (November 2014).

Karnataka Silk Industries Corporation Limited

3.14 *Extra expenditure*

The Karnataka Silk Industries Corporation Limited procured gold lace with varied terms and conditions in different years, which resulted in extra expenditure of ₹ 6.01 crore.

Gold lace is one of the raw materials for manufacturing silk sarees. It contains gold, silver, copper and silk in different proportions[104]. The Company procures gold lace through open tenders for supply an annual basis. Prior to 2004-05, the Company procured gold lace on quarterly basis. The Company floated tenders (May 2005) for procurement of gold lace incorporating price variation clause. The price variation clause in the agreements *inter-alia* included increase in the overheads and profit based on the increase in price of raw materials. This was objected to by Audit contending that increase in price of gold did not have bearing on the overheads and profits.

The Company changed the terms and conditions of tender (April 2012) citing pressure from the suppliers and objection by Audit. Accordingly, the suppliers were allowed to quote lumpsum amount of overheads separately.

We observed that

- introduction of a clause for increase of overhead and profit commensurate with the increase in cost of raw materials was not justified, as the price variation clause was to meet the increase in price of raw materials. Between July 2005 and May 2012, 90,412 marcs of gold lace were supplied at increased prices. The extra expenditure due to allowing increase in overhead and profit for every variation in price of gold and silver, worked out to ₹ 1.17 crore.

- the change in terms and conditions of tender from April 2012 asking the bidders to quote for 'manufacturing and handling cost' separately resulted in substantial increase in the price of gold lace. The bidders quoted lump sum amount for manufacturing, transportation, handling, *etc*., without giving details for each element of cost. The rates were agreed to without assessing the impact of the change on cost of gold lace with reference to the earlier method of arriving at prices. The lump sum amount towards 'manufacturing and handling cost' quoted

[104] The standard content of the gold, silver, copper and silk in gold lace is 0.65 *per cent*, 65 *per cent*, 10.35 *per cent* and 24 *per cent*.

separately against the tender enquiry floated in April 2012 was on the higher side compared to March 2012 prices. Between June 2012 and July 2014, 41,900 marcs of gold lace were supplied. The extra expenditure on this quantity worked out to ₹ 4.84 crore.

The Government replied (November 2014) that their ability to negotiate the price was limited as the number of suppliers was few. The increase was dependent on the variation in the price of the basic raw material. The change in the terms and conditions in the subsequent tender asking the bidders to quote for 'manufacturing and handling cost' separately was effected due to frequent demands of the vendors for increase in overheads and profit. The Government also stated that a Technical Committee of experts from Private and Public Sectors would be formed to determine the actual wastages and reasonable prices.

The reply is not tenable as the change in rates in the bullion market should not affect overheads and profit. Instead of negotiating these terms, the Company accepted lump sum manufacturing and handling cost without analysing the impact on prices which resulted in extra expenditure of ₹ 6.01 crore.

Hubli Electricity Supply Company Limited

3.15 *Avoidable payment of interest*

The Hubli Electricity Supply Company Limited had to bear avoidable interest burden of ₹ 4.28 crore due to wrong projections in RAPDRP works.

Government of India (GoI) approved (December 2008) the Restructured Accelerated Power Development and Reforms Programme (RAPDRP) during the XI plan with revised terms and conditions. The main objective was reduction of Aggregate Technical and Commercial (AT&C) losses to below 15 *per cent* over a period of five years covering urban areas, towns and cities having more than 30,000 population.

Hubli Electricity Supply Company Limited (Company) prepared (April 2010) a Detailed Project Report (DPR) covering 31 towns with a project cost of ₹ 278.36 crore which was approved (June 2010) by the RAPDRP Steering Committee. The Company availed (May 2011) loan of ₹ 41.75 crore from Power Finance Corporation (PFC).

Central Power Research Institute (CPRI), nominated by the Ministry of Power (MoP) as a Third Party Independent Agency, found (December 2011) that six towns with less than 15 *per cent* AT&C losses were also included in the DPR. The project estimate was, therefore, reduced to ₹ 115.96 crore after deducting the estimated cost by ₹ 162.40 crore relating to these six ineligible towns. While consolidating the town-wise quantities, as the DPR quantities were

found to be abnormal, the estimated project cost for 24 towns[105] was further reduced to ₹ 56.53 crore.

PFC directed (August 2012) the Company to refund the loan amount with interest for the ineligible towns. The Company refunded (November 2012) the principal amount of ₹ 24.36 crore pertaining to the six towns and also paid (February 2013) interest of ₹ 3.41 crore. PFC further requested (April 2014) the Company to refund the loan amount of ₹ 8.91 crore with interest of ₹ 2.42 crore due to reduction in the project cost.

We observed that

- as per the RAPDRP guidelines, losses of three billing cycles of the base year were to be considered while computing the AT&C losses according to the specified formulae[106]. But, the Company had calculated the loss by considering the billing of the entire year instead of three billing cycles. There was no justification on record for deviation from the procedure prescribed.

- wrong projection of six towns with less than 15 *per cent* AT&C loss and inflated estimates resulted in avoidable interest dues of ₹ 4.28 crore[107] on refund of loan amount of ₹ 33.27 crore.

The Government replied (September 2014) that

(i) the AT&C losses were calculated on yearly basis to have realistic aggregate value by considering different seasonal consumption and sales;

(ii) the estimates were prepared based on the then existing network and requirements in the year 2009. Based on the action taken in each town to reduce AT&C loss, the estimated cost was revised to avoid duplication of works.

The reply establishes the fact that

(i) the Company did not adopt the RAPDRP guidelines to compute the AT&C losses;

(ii) the Company failed to consider the regular action being taken to improve the network and reduce AT&C losses while preparing the estimates and noticed the abnormal variations only while consolidating the town-wise quantities.

Thus, non-adoption of RAPDRP guidelines while computing the AT&C losses and failure to prepare realistic estimates resulted in avoidable interest burden of ₹ 4.28 crore for which responsibility of the persons concerned may be fixed who did not follow prescribed parameters while preparing DPR.

[105] 31 towns were revised to 29 towns treating Hubli-Dharwad and Rabkavi-Banahatti as two towns instead of four as considered in DPR. After rejection of five ineligible towns (including Hubli-Dharwad), total number of towns became 24.

[106] AT&C loss = 1- (Billing efficiency x Collection efficiency) x 100 where Billing efficiency is arrived at by dividing 'Total units sold' with Total input; and Collection efficiency is calculated by dividing 'Revenue collected' with 'Amount billed'.

[107] ₹ 5.83 crore - ₹ 1.55 crore, being the interest earned on RAPDRP funds.

Karnataka State Coir Development Corporation Limited

3.16 *Unfruitful investment*

The Karnataka State Coir Development Corporation Limited set up a production unit to manufacture moulded trays at a cost of ₹ 33.50 lakh. Inspite of the fact that the Company was not able to sell similar products in the past, the Project was approved and implemented without conducting market survey. Poor sales of the product, even after a lapse of four years, has rendered the investment unfruitful.

The Karnataka State Coir Development Corporation Limited (Company) proposed (July 2007) to the Government of Karnataka (GoK), to establish a Needle Felt[108] and Moulded Tray Unit in Gandasi, Hassan District. The Company invited (November 2007) tenders for the work of supply, erection, installation, commissioning of coir moulded tray machine and the contract was awarded (February 2008) to M/s.2M Enterprises (contractor) at a cost of ₹ 33.50 lakh. The amount was released by GoK in August 2007 and February 2008. The contractor completed the work and the trial production was successfully conducted in January 2009.

We had observed (February 2011) that the Unit was non-functional from March 2009. In response to our observation, the Management had stated (May 2011) that due to non-availability of raw materials and lack of working capital, the production activities could not continue. The Management added that the machinery would be utilised to produce trays and other products such as fibre, yarn, mats, curled rope, coco poles, hanging baskets *etc.,* and the Company was making all efforts to make the unit profitable and viable.

The operation of the unit was reassessed (February 2014) for the period after March 2011. We noticed that the Units were not operational from August to December 2011 and again from May to September 2013, which the Company attributed to defects in machinery. The production of moulded trays and coasters commenced in October 2013 but no efforts were made to produce more marketable products such as yarn, mats *etc*., as was stated to have been planned by the Company, in its reply of May 2011.

The cumulative sales (₹ 2.42 lakh) was only two *per cent* of sales projections in the last four years made in the Project Report (refer table alongside).

Table 3.4: Projected and Actual sales
(₹ in lakh)

Year	Projected sales	Actual sales (*per cent*)
2010-11	20.40	0.05 (0.25)
2011-12	24.48	0.06 (0.25)
2012-13	28.56	0.93 (3.26)
2013-14	32.64	1.24 (3.80)
2014-15 (up to July 2014)	11.56	0.14 (1.21)
Total	117.64	2.42 (2.06)

We observed that even before setting up of the project, the Company had procured (2007-08) moulded trays from other

[108] Coir fibre (made from husk) is first cleaned and made in the form of web. The webs are needle punched and made in the form of sheet which is called Needle Felt, which is then utilised for manufacture of moulded trays.

agencies valued at ₹ 1.48 lakh, of which trays worth ₹ 0.27 lakh remained unsold (February 2011). Marketing surveys for the product (as a substitute for plastic trays) was not conducted. Evidently, the project was ill-conceived as the sales projected in the Project Report was not realistic, resulting in unfruitful investment of ₹ 33.50 lakh.

The Government replied (August 2014) that there was no dearth of raw material for engaging the tray unit for full production capacity and working capital was sanctioned by GoK as and when required for continuous production. It was further replied that the assets created were utilised and it planned to enlarge the market base to increase the turnover of moulded tray unit.

The reply of the Government is not tenable as observed from its sales record. Moreover the Company could not even recover its variable cost of ₹ 3.70 lakh (up to July 2014) since the introduction of its products. Therefore, due to the Company's failure to assess the market demand for the products, the ill-conceived project rendered the investment of ₹ 33.50 lakh largely unfruitful.

Statutory Corporations

Karnataka State Road Transport Corporation

3.17 *Additional burden*

Delay by the Karnataka State Road Transport Corporation in acting on its decision to shift the Divisional Office to Ramanagara resulted in additional burden of ₹ 80.28 lakh.

The Karnataka State Road Transport Corporation (Corporation) decided (March 2010) to shift its Bangalore Rural division situated at Deepanjalinagar, Bangalore to Ramanagara, a newly carved district and renamed it as Ramanagara Division effective from March 2010. The Bangalore Rural division comprised a Divisional office, workshop, stores and six bus depots[109].

The workshop and stores were shifted to Ramanagara in April 2010, but the Divisional office is yet to be shifted (August 2014) even after four years. The Corporation had its own bus station at Ramanagara, where they could have constructed the Divisional office, however no action was taken.

The workshop undertakes minor and major repairs for complying with the requirements for issue of Fitness Certificates, reconditioning of vehicles and accident cases. These works were done either departmentally or through contracts which involved drawal and accountal of stores and spares, diesel accounting and payments, emergent purchases, accident/ insurance claims. In addition the division is also responsible for other personnel issues. Functioning of the Divisional office at Bangalore, which is 40 kms away from the associated workshop, stores and six bus depots, for a period of four years is not in the interest of logistical and efficiency issues, as such an adhoc arrangement would certainly impact the working of the division.

We observed that there are about 80 employees working in the Divisional office who are being paid House Rent Allowance (HRA) at 30 *per cent* of basic pay[110] and City Compensatory Allowance (CCA) of ₹ 350 to ₹ 400 per month. Those working at Ramanagara are eligible for HRA at 10 *per cent* only with no CCA. Failure of the Corporation to shift the Divisional Office to Ramanagara has resulted in additional burden on HRA and CCA amounting to ₹ 80.28 lakh for 2011-12 to 2013-14.

The Corporation replied (July 2014) that shifting was delayed due to non availability of building space and as decision was taken (April 2014) to construct the Divisional Office on the existing bus station at Ramanagara, works had been entrusted (July 2014) to a contractor at ₹ 99.40 lakh and was scheduled to be completed by March 2015. The Government endorsed the same reply in November 2014.

Thus, the delay by the Corporation to act in a timely manner on its decision to shift the Division resulted in an additional expenditure of ₹ 80.28 lakh.

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[109] At Ramanagar, Channapttana, Kanakapura, Harohally, Magadi and Anekal.
[110] 25 *per cent* of Basic pay up to September 2013 and at 30 *per cent* thereafter.

Follow-up action on Audit Reports

3.18 Explanatory notes outstanding

3.18.1 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 various offices and departments of the Government. It is, therefore, necessary that they elicit appropriate and timely response from the executive. The Finance Department, Government of Karnataka, had 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 2011-12 and 2012-13 were presented to the State Legislature in February 2013 and February 2014 respectively. As of October 2014, one of the departments[111], which was commented upon, had not submitted explanatory notes for one out of the 20 Paragraphs which appeared in the Audit Reports.

Compliance with reports of Committee on Public Undertakings (COPU)

3.18.2 As per the instructions, the compliance (Action Taken Notes-ATN/ Action Taken Report - ATR) with recommendations of COPU was required to be furnished within six months of placement of the Report in the Legislature. Replies to five Reports[112] of the COPU presented to the State Legislature between December 2011 and November 2013 have not been received as on October 2014.

Response to Inspection Reports, Draft Paragraphs and Reviews

3.19 Audit observations noticed during audit and not settled on the spot are communicated to the head of PSUs and concerned departments of State Government through Inspection Reports. The heads of PSUs are required to furnish replies to the Inspection Reports through respective heads of departments within a period of one month. Department-wise break-up of Inspection Reports and audit observations outstanding as on 31 March 2014 is given in **Annexure-10.**

Draft Paragraphs and Reviews on the working of Public Sector Undertakings are forwarded to the Principal Secretary/Secretary of the Administrative Department concerned demi-officially, seeking confirmation of facts and figures and their comments thereon. Two Performance Reviews and seventeen Compliance audit paragraphs were forwarded to various departments during June to September 2014. Government had furnished replies in respect of both the Performance Reviews. However, reply in respect

[111] Department of Women and Child Development.
[112] Report Nos. 125 to 129 of COPU.

of seven compliance audit paragraphs pertaining to Department of Tourism, Department of Commerce and Industries and Department of Forest, Ecology, and Environment has not been received. Both the Performance Reviews have been discussed in the Exit Conferences with the Government. The views of the Government/Department have been taken into consideration while finalising the Reviews/Paragraphs, wherever replies have been received.

It is recommended that the Government may ensure that a procedure exists for taking action (a) against officials who fail to respond to Inspection Reports/Compliance audit paragraphs and to take action on the ATNs to the recommendations of COPU, based on the reports of Audit Monitoring Cell constituted by the Government and (b) to recover loss/outstanding advances/ overpayment is taken within prescribed time.

Bengaluru **(L. Angam Chand Singh)**
The **Principal Accountant General**
Economic and Revenue Sector Audit
Karnataka

Countersigned

New Delhi **(Shashi Kant Sharma)**
The **Comptroller and Auditor General of India**