CHAPTER IV

4. TRANSACTION AUDIT OBSERVATIONS

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

GOVERNMENT COMPANIES

Mysore Minerals Limited

4.1 Loss of revenue

Failure to procure and sell the contractually entitled share of iron ore lumps at the fixed transfer price from Joint Venture Company resulted in loss of revenue of Rs.20.82crore.

The State Government set up (January 1997) a Joint Venture between Jindal Vijayanagar Steel Limited (JVSL) and Mysore Minerals Limited (Company) to provide adequate supply of iron ore to the steel plant of JVSL at Torangallu. A MOU was signed (January 1997) between the Company and JVSL and a Joint venture company Vijayanagar Minerals Private Limited (VMPL) was incorporated (April 1998).

As per the MOU, out of the annual capacity development of 8 million tonne (Iron ore lumps and fines), JVSL was to purchase 3.5 million tonne of fines, while the Company was to purchase 1.5 million tonne of lumps at the transfer price (lower than market price) to be decided by joint venture partners. VMPL was free to sell the quantity of lumps in excess of 1.5 million tonne and fines in excess of 3.5 million tonne with the first option of refusal by the Company. The transfer price for lumps was fixed (January 1999) at Rs.164 per tonne. JVSL and the Company also agreed (June 1999) for the premium of Rs.30 per tonne for lump payable by VMPL to the Company for using mines of the Company.

Mention was made in Paragraph 2.1.34 of the Audit Report (Commercial) of the Government of Karnataka for the year ended 31 March 2004, that the Company did not exercise the option to buy lumps at transfer price (lower than the market price) as per MOU which resulted in loss of revenue of Rs.1.58 crore on the quantity of 2.57 lakh tonne of iron ore lumps during 2001-2004.

VMPL generated iron ore lumps of 1.53 lakh tonne in 2004-05 and 2.26 lakh tonne in 2005-06. As this quantity was less than 1.5 million tonne, the entire quantity of lumps should have been purchased by the Company at the transfer price fixed as per the MOU. The Company, however, did not procure the lumps generated, despite the audit observation (*supra*) and allowed JVSL to sell the entire quantity in open market. Compared to the prevailing prices

being paid by MMTC to the Company for lumps supplied to MMTC, non-lifting of lumps by the Company resulted in loss of revenue of Rs.20.82 crore[91].

The matter was reported to the Management/Government (March 2007); their replies are awaited (August 2007).

4.2 Undue benefit

Violation of terms of agreement resulted in undue benefit of Rs.9.84 crore to the contractor.

The Company entered into a five year agreement (July 2003) with Orient Goa Limited (OGL) for sale of iron ore fines of different grades. As per agreement, the rates were to be firm for the year 2003-04. Thereafter, the prices were to be revised and re-fixed with effect from 1 April each year after mutual negotiation based on prevailing market conditions/MMTC prices. Further, as per Clause 3 of the agreement OGL was to purchase minimum of four lakh metric tonne of iron ore fines per annum against advance payment.

For the year 2003-04, the Company fixed a price of Rs.110 per dry metric tonne (DMT) and Rs.70 per DMT (excluding transportation charges) for '> 66% iron ore' and '< 65% iron ore' grade fines respectively.

It was observed (February 2006) that the prevailing prices of MMTC as on 1 April 2004 and 1April 2005 had increased as detailed below:

MMTC prices* prevailing as on	>66% grade	<65% (*i e.,*64/63%) grade
	Rs. per DMT	
1 April 2004	999.30	861.79
1 April 2005	1,551.90	1,201.90

***The above prices are net of transportation charges of Rs.98.10 per dry metric tonne (DMT).**

The Company, however, did not revise/re-fix the prices of iron ore as stipulated in the agreement. Based on the prevailing MMTC prices and giving allowance of five *per cent* on the rates of MMTC as on 1 April of 2004 and 2005 the mutually agreed price could have been settled accordingly for different grades of ore. The Company should have atleast claimed Rs.33.55 crore for supplies made during 2004-05 and 2005-06. The Company, however, claimed Rs.21.81 crore only based on old rates/rates prevailing on date of delivery/date of issue of delivery order.

The Management stated (June 2007) that instead of fixing the price once in a year (1 April) the Company adopted prevailing price of MMTC as on the day

[91] The MMTC prices during the period 2004 -06 (different months) ranged from Rs.347 to 847 per tonne, while the transfer price was Rs.164 per tonne. The loss of revenue worked out to Rs.21.96 crore. The Company, however, had received premium of Rs.1.14 crore on these lumps (Considering the actual premium received at Rs. 30 per tonne on 3.78 lakh tonne lumps). Hence, the actual loss in revenue worked out to Rs.20.82 crore.

of issue of delivery order and was able to get the benefit of upward revision of MMTC prices. It further stated that based on the above audit observation, the matter of non-fixation of prices as required under contractual terms was negotiated (August 2006) with OGL and it was mutually agreed to charge the price prevailing at the time of receipt of advance. Accordingly, the Company recovered an amount of Rs.1.90 crore.

The reply of the Company is not tenable as the agreement provided that as on 1 April of each year the price had to be revised/re-fixed based on prevailing MMTC prices and not based on the prices prevailing as on date of receipt of advance. The fact that there was a loss of Rs.9.84 crore considering the prices prevailing on 1 April of each year indicates that the adoption of MMTC prices as on date of delivery was not beneficial to the Company and such arrangement was in violation of the terms of agreement.

The matter was reported to the Government (May 2007); their reply is awaited (August 2007).

4.3 Avoidable payment

The Company failed to comply with provisions of IT Act which resulted in payment of interest of Rs.1.61 crore.

Under Sections 208 to 219 of the Income Tax (IT) Act 1961, companies are required to assess and pay advance tax in respect of the total income chargeable to tax. Any failure, short payment or delay in payment of advance tax instalments on the due dates attracts penal interest at the prescribed rates under Section 234 B&C of the, *ibid,* Act.

It was observed (May 2006) that the Company estimated (March 2006) the income tax liability of Rs.21.88 crore on the estimated total income of Rs.65 crore for the financial year 2005-06 (assessment year 2006-07). The Company, however, did not pay the first two instalments of advance tax due on 15 June and 15 September 2005, but paid Rs.10 crore and Rs.8 crore on 15 December 2005 and 16 March 2006, respectively.

As per self assessment tax return filed (30 November 2006) by the Company the total tax liability worked out to Rs.30.65 crore, out of which Rs.18.89 crore was already paid (Rs.18 crore as advance tax and Rs.0.89 crore as TDS). Accordingly, the Company deposited the balance tax of Rs.11.76 crore (November 2006). In addition, it also paid penal interest of Rs.94.08 lakh and Rs.67.28 lakh as per the provisions of Section 234B and 234C of the Act *ibid,* respectively. Thus failure to pay advance tax inspite of having surplus funds resulted in payment of penal interest of Rs.1.61 crore.

The Company stated (February 2007) that due to oversight and non-availability of tax consultants, advance income tax was not paid. The Company further stated that the interest earned out of fixed deposits would reduce the interest liability on the Income Tax. The reply is not tenable as the non-compliance of provisions of IT Act leading to payment of penal interest of Rs.1.61 crore cannot be justified by the interest earned on fixed deposits. Even after taking

into account the amount of interest (Rs.0.30 crore) that was earned on fixed deposits to the extent of instalments of advance tax due on 15 June and 15 September 2005, the company suffered a loss of Rs.1.31 crore.

The matter was reported to the Government (March 2007), their reply is awaited (June 2007).

4.4 Non-realisation of revenue

The Company failed to claim additional adhoc increase in price agreed by MMTC Limited for iron ore supplied from 27 October 2003 to 31 December 2003, resulting in loss of revenue of Rs.82.82 lakh.

The Company was supplying (2003-04) iron ore fines from its mines situated in the Bellary district of the State to MMTC. MMTC agreed (December 2003) to give additional adhoc increase over the agreed basic prices on the demand of suppliers of iron ore to share the benefit arising out of increased realisation on export of iron ore fines. Accordingly Memoranda of Settlement (MOS) was reached (December 2003) between MMTC and the Bellary-Hospet Sector Iron Ore Mine Owners' and Suppliers Association.

As per MOS, an additional adhoc price of Rs.455 per tonne for 66/66 grade fines and Rs.439 per tonne for 66/65 grade fines was payable for ore procured by MMTC during the period from 27 October 2003 to 31 December 2003. During this period, the Company supplied 18,631 tonne of iron ore fines from its Subbarayanahalli Mines to MMTC. The Company, however, made no claim in respect of the additional adhoc price on supplies made during the above period, which resulted in loss of revenue of Rs.82.82 lakh[92].

The matter was reported (April 2007) to the Management/Government; their replies are awaited (August 2007).

4.5 Donations

The Company made donations in violation of statutory regulations.

As per the Memorandum and Articles of Association, the Company can provide for contribution/assistance or to guarantee money to charitable, benevolent, religious, scientific, national, political or other institutions or objects or for any public, general or useful objects subject to provisions of Companies Act, 1956. Further, Section 293(e) of the Companies Act, 1956 provides that a Public Company shall not, except with the consent in General meeting, contribute to charitable and other funds not directly related to the business of the Company or the welfare of its employees, any amounts the aggregate of which would in any financial year exceed Rs.50,000 or

[92] **6,430.23 Metric tonne (66/66 grade) * Rs.455 *plus* 12,200.79 Metric tonne (66/65 grade) * Rs.439 = Rs.82.82 lakh.**

five *per cent* of its average net profits[93] during three financial years immediately preceding, which ever is greater.

It was noticed that the Company released (April 2004 to June 2006) Rs.4.84 crore as donations to various organisations. These donations were *prima facie* in violation of Section 293(e) of the Companies Act (*ibid*), as the Company contributed Rs.16 lakh in 2004-05, Rs.3.68 crore in 2005-06 and Rs.1 crore in 2006-07 (upto June 2006), as against the maximum amount of Rs.50,000 per year and these contributions were not directly related to the business of the Company.

It was also noticed that prior approval of the Board was taken only in eight cases[94] (Rs.1.69 crore); whereas sanctions for the majority of cases (26 cases[95] totalling Rs.3.14 crore) were obtained after disbursement (ratification). In respect of 14 cases (totalling rupees one lakh) the Board's sanction/ratification was not obtained as of August 2007. The consent of shareholder in the general meeting was, however, not obtained in all the cases as required in terms of the provisions of Section 292(e) of the Companies Act, 1956.

Thus, the Company made contributions in violation of the provisions of the Companies Act 1956; despite incurring continuous losses upto 2003-04 and having accumulated losses of Rs.39.10 crore as on 31 March 2004. The Company had secured loan of Rs.3.34 crore and unsecured loan of Rs.14.95 crore as on 31 March 2006. As such donations made were not financially prudent and priority should have been given for repayment of loans.

The matter was reported (April 2007) to the Management/Government; their replies are awaited (August 2007).

Karnataka Power Corporation Limited

4.6 Payment of ex-gratia to medically unfit employees

Introduction of a new Voluntary Exit Scheme to medically unfit employees resulted in avoidable expenditure of Rs.46.89 crore.

The Board of Directors (BoD) approved (December 2000) a Voluntary Exit Scheme (VES) for medically unfit employees. This scheme was extended upto March 2004. The scheme was approved without the approval of the State Government. The Company approached (February 2006) the Government for ratification, which is yet to be received (August 2007).

A total number of 928 medically unfit employees were allowed VES from March 2001 to March 2004 and a total payment of Rs.46.89 crore was made on account of ex-gratia in addition to normal cessation benefits.

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[93] as determined in accordance with provisions of Section 349 and 350 of Companies Act, 1956.
[94] Date of payment was between 18 May 2004 and 31 March 2006.
[95] Date of payment was between January 2005 to June 2006.

It was observed that the VES scheme was in violation of Cadre and Recruitment Rules of the Company, which provides as follows:

- an employee, who by bodily or mental infirmity, is permanently incapacitated for service in the Company, is entitled for an invalid pension;
- such employees were eligible only for the normal cessation benefits;
- the Company is empowered to cause a medical examination at any time on a workman by any qualified medical doctor specified by the management to find the fitness or otherwise of the workmen for continuance of his employment.

The Company instead of awarding invalid pension as per its Cadre and Recruitment Rules amended the rules and made the VES scheme applicable in such cases. As the rules provided for payment of invalid pension for medically unfit employees there was no need for the Company to bring this VES scheme, implementation of which has resulted in avoidable expenditure of Rs.46.89 crore.

The Management stated (April 2007) that savings on account of introduction of the scheme was substantial. The reply is not acceptable as the fact remained that the Company, instead of awarding invalid pension to the medically unfit employees, introduced the scheme and paid ex-gratia of Rs.46.89 crore (in addition to invalid pension) to medically unfit employees.

The matter was reported to the Government (July 2007); their reply is awaited (August 2007).

4.7 Failure to claim discount offered by the supplier

Benefit of Rs.1.32 crore could not be availed due to non-availing of discount offered by the supplier.

Visveswaraya Vidyuth Nigam Limited (VVNL) (merged with the Company from April 2006) was procuring Diesel and Low Sulphur Heavy Stock (LSHS) from Indian Oil Corporation Limited (IOC) for its Diesel Generation (DG) Plant. As per the agreement entered into (June 1989) with IOC, the price payable was fixed by the Ministry of Petroleum and Natural Gas from time to time. The yearly consumption of the above materials ranged from one lakh metric tonne (MT) to 1.50 lakh MT.

Based on the request (April 2004) of VVNL, IOC offered (April 2004) discount on supplies of Low Sulphur Heavy Stock (LSHS) procured in excess of 5,000 MT per month. IOC, however, stipulated that VVNL should commit a minimum monthly off-take for one year. Failure to lift the minimum quantity in any month would lead to non-admissibility of discount in that particular month.

Audit observed that VVNL failed to furnish the commitment letter to IOC, despite absence of any penalty for non-lifting of the committed quantity. The

specific reason for not furnishing commitment letter to IOC was not available on record. VVNL, though, lifted LSHS in excess of 5,000 MT in six months, yet it could not avail the discount and thereby benefits to the tune of Rs.1.32 crore could not be availed.

The matter was reported to the Management/Government (August 2007); their replies are awaited (August 2007).

4.8 Purchase of stores and spares from local dealers

Non-compliance of purchase procedure resulted in an extra expenditure of Rs. 49.23 lakh.

As per procedure prescribed (June 2003) by the Company, purchases were to be made by offices located in the projects, in accordance with Karnataka Transparency in Public Procurement Act, 1999 (KTPP Act). Purchases can be made by field offices without inviting tenders only in the following cases:

- Purchases based on Stores Purchase Department Director General of Supplies and Disposals rates;
- Urgent/emergency purchases which do not brook delay involved in the making of an enquiry (for reasons to be recorded in writing); and
- Petty purchases, cost not exceeding Rs.5,000 per order.

The Company's annual requirement for 2005-06 of spares at Raichur Thermal Power Station (RTPS - a unit of the Company) was Rs.32.50 crore approximately. Test check of 60 cases of local purchases valuing Rs.2.50 crore made during 2005-06 and 2006-07 by RTPS for which Superintending Engineer (Purchase) was the designated purchase officer, revealed that the requirement of spares for the year was not assessed in the beginning of the year and tenders were not called for as per the prescribed procedure. The purchases were made from local dealers as and when required. These were not urgent/emergency purchases as the time taken between placing the purchase order to the date of supply ranged from three to nine months. The local dealers charged higher prices than the prices charged by the original equipment manufacturers (OEM) and the test check indicated that the unit had incurred extra expenditure of Rs.49.23 lakh compared to the prices charged by the OEM. It was also observed that in 45 out of the 60 cases test checked, purchases were made from three suppliers namely Jayashree Engineering, Jayashree Enterprises and Swati Sales.

Purchases made in violation of the prescribed purchase procedure resulted in an extra expenditure of Rs. 49.23 lakh.

The Company stated (June 2007) that proprietary items which form accessories/spares to major equipments were required to be procured only from OEM and in these cases enquiries were sent only to OEMs, but in some cases, OEMs did not supply the materials directly but authorised the dealer to quote the rates. The Company further stated that there was no mechanism to know

the Excise Duty invoice value of the manufacturer, at the time of placing purchase order.

The reply of the Company is not tenable as its own purchase procedure was flouted which resulted in an avoidable payment of Rs.49.23 lakh being the difference between the prices of the OEMs and that charged and paid to the agents. It paid a sum of Rs.250.19 lakh to the agents as against the all inclusive price of Rs.200.96 lakh of the OEMs.

The matter was reported to the Government (May 2007); their reply is awaited (August 2007).

Karnataka Power Transmission Corporation Limited

4.9 Over-payment in 'annual true-up'

Not adhering to the provisions of the power purchase agreement in 'annual true-up' calculations resulted in over payment of Rs. 89.98 crore to an independent power producer.

The Company had been purchasing energy from Tannir Bavi Power Corporation Limited, now GMR Energy Limited (GMR), an independent power producer (IPP), with effect from June 2001. The power plant of IPP has an installed capacity of 220 MW which could generate 1,927 million units annually, working 24 hours a day. As per the power purchase agreement (PPA), the charges towards supply of energy is to be calculated and paid in two parts - fixed charges and variable charges. The Company has to pay fixed charges not only for energy purchased but also for energy not purchased; the payment for energy not purchased was termed as 'deemed generation charges.' No variable charges are payable for energy not purchased.

The monthly total fixed charges are to be calculated based on the formula adopted for the purpose in the agreement, which takes into account the cumulative quantities from 1 April to the end of the month. Thus the monthly bill for March every year takes into account the quantities for the whole year. The PPA also provides for an 'annual true-up' to assure that the total 'deemed generation charges' paid in the monthly bills were not any more or any less than those which would have been paid had deemed generation charges been calculated for the entire year (Clause 7.6). This meant that the monthly bills, generated using the formula prescribed for it, could be erroneous, thus requiring a re-calculation called 'annual true-up'. No procedure or formula to calculate the 'annual true-up' was however provided in the agreement.

As per clause 3.3 of the agreement, the energy supplied by the Company (KPTCL) to the IPP for start-up *etc.,* shall be deducted on monthly basis from the electricity purchased by the Company. As per Clause 6.4 of the PPA, the deemed generation payment shall not exceed (the payment for) 85 *per cent* of the declared capacity[96] multiplied by the hours *minus* the energy delivered. The

[96] **Declared capacity is the net electrical generating capacity of the facility available for delivery as declared by the IPP from time to time**.

impact of these two clauses was not reflected in the formula for calculation of monthly fixed charges. The same were, however, ensured in the monthly bills by suitably adjusting the quantities of net metered energy and deemed generation payable for the month.

While examining the 'annual true-up' statements for the years 2001-02 to 2006-07 audit observed (July 2006) that the Company failed to ensure that the above clauses (Clauses 3.3 and 6.4) were adhered to while making the annual true-up calculations. In the 'annual true-up' for the respective years, total fixed charges for whole year were calculated for so much of units of energy arrived at by multiplying 85 *per cent* of the contract capacity by the hours available in that year. The difference between the amount so calculated and the aggregate of monthly total fixed charges paid were released in the 'annual true-up'. The payments were released without ensuring (i) that fixed charges for the energy supplied by it to the IPP was deducted, and (ii) that the payment for deemed generation was limited to 85 *per cent* of the declared capacity.

Thus, not ensuring the contractual conditions regarding deemed generation payment resulted in overpayment of Rs.89.98 crore during the period from June 2001 to March 2007. Even though the Clause regarding 'annual true-up' was designed to rectify possible errors in monthly bills and to ensure that the IPP was not paid in monthly bills any more than that would have been payable for the whole year, the Company failed to do so resulting in the over payment.

The Company in its reply (February 2007) has furnished an extract of the relevant provisions of the contract (as quoted above) and has not offered any remarks on the over payment.

The matter was reported to the Government (May 2007); their reply is awaited (August 2007).

4.10 Improper evaluation

The Company had to incur extra expenditure of Rs.65 lakh due to improper evaluation of the tender.

The Company invited (June 2004) tenders for establishing 2x8 MVA, 66/11KV sub-station at Dalasanur at an estimated cost of Rs.2.92 crore on turnkey basis. Out of five firms which responded to the offer, three firms were technically qualified. Alstom Ltd, quoted the highest rate of Rs.5.31 crore. Alstom Ltd, however, indicated a discount of 0.6 *per cent* in the discount column, six *per cent* in the remarks column and an amount equivalent to 60 *per cent* of the quoted value in the amount column of the schedule of discount to the offer. The Company instead of rejecting the offer of Alstom Ltd, as their financial bid was inaccurate, assumed a discount of 60 *per cent* and evaluated (November 2004) the tender as the lowest at Rs.2.12 crore and letter of intent issued (February 2005). Alstom Ltd rejected (March 2005) the letter of intent (February 2005) and confirmed that the discount was 0.6 *per cent* and not 60 *per cent*. As Alstom Ltd rejected the offer, the Company forfeited (August 2005) the Earnest Money Deposit of Rs.2.74 lakh. The Company, then offered (March 2005) the work to Siddhartha Engineering Private Ltd

(lowest offer) for Rs.2.12 crore against its offer of Rs.3.13 crore. Siddhartha Engineering Private Ltd also rejected the offer.

The Company then re-tendered (October 2005) the work at revised cost of Rs.3.60 crore. Narayan Electricals Ltd, whose offer was lowest at Rs.3.78 crore in this re-tendered bid was awarded (December 2005) the work.

Thus, due to wrong evaluation and non-rejection of offer of Alstom Ltd, and non award to lowest bidder for Rs.3.13 crore, the Company had to incur an avoidable extra expenditure of Rs.65 lakh.

The Government stated (June 2007) that the Company evaluated the tenders with utmost care and had several discussions regarding the discount and freak rate and that the letter of intent was issued to Alstom Ltd thereafter. The reply is not tenable as there was no logic or rational in considering the offer of Alstom and then offering the same rate to the lowest bidder.

4.11 Extra expenditure due to re-tendering

The Company rejected the original bid on the ground that the quoted rate was on the higher side and resorted to re-tendering thereby incurring extra expenditure of Rs.26.66 lakh.

The Company invited (October 2004) tenders for establishing 2x8 MVA 66/11kv sub-station at Holavanahalli, Tumkur District at an estimated price of Rs.3.47 crore based of Schedule of Rates (SR) of 2003. Three firms responded to the offer (December 2004). The offer of only Siddhartha Engineering Works was technically suitable. The price bid of the Siddhartha Engineering Works of Rs.3.78 crore which was 9.16 *per cent* above the cost put to tender, was rejected (March 2005) by the Central Purchase Committee (CPC) on the ground that the quoted rate was on higher side. The price increase in the intervening period since SR2003 was not considered while rejecting the tender. Tenders were floated afresh (March 2005) with a tender cost of Rs. 3.50 crore against which four firms participated of which three firms were found technically suitable. K.G.N. Electricals quoted the lowest rate at Rs.4.34 crore, which was 24.03 *per cent* above the amount put to tender. CPC decided (June 2005) to offer the lowest bidder a rate of five *per cent* above the cost put to tender and letter of intents was issued to the firm accordingly. The firm, while rejecting the counter offer (June 2005) requested the Company to compare their quoted price with SR for 2005-06 which were under finalisation. Accordingly, the estimated cost was re-cast (July 2005) to Rs.3.86 crore and as per the norms followed by the Company, the firm was offered an all inclusive rate of Rs.4.05 crore which was five *per cent* above the re-cast estimate. The same norms were, however, not applied at the time of evaluation of the original tender (March 2005).

Hence, by not following uniform standard norms, the Company rejected the bid of Siddhartha Engineering and ended up in awarding (July 2005) the contract at a higher rate, thereby incurring an extra expenditure of Rs.26.66 lakh.

The Government stated (August 2007) that the prices quoted by Siddhartha Engineering Works were compared with SR of 2003 and updated circulars of Major works Division (of 2004-05). The reply is not acceptable as the original estimate of Rs.3.47 crore was based only on SR 2003 and did not consider the updated circulars of Major works.

Bangalore Electricity Supply Company Limited

4.12 Avoidable expenditure

The Company procured Coyote Conductor without any specific requirement resulting in blocking-up of funds of Rs.4.69 crore.

Against a requirement (March 2004) of 60 kilometres (kms) Coyote Conductor by Bangalore Rural Area Zone, the Company placed (April 2005) purchase order on Sharavathi Conductors, for supply of 750 kms of Coyote Conductor costing Rs.4.82 crore, with a delivery schedule of June 2005 to November 2005. The supplies were, however, completed in May 2006.

Audit scrutiny revealed that the Company already had a stock of 24.236 kilometres of the Coyote Conductor as of 31 March 2005 and the specific requirement was for 60 kilometres only against which the purchase order for 750 kilometres was placed.

It was further noticed that the Company itself contemplated (January 2006) whether to cancel the orders or not when there was a stock of 286.35 kilometres of Coyote Conductor in the stores and no drawal was expected in the immediate future. Meanwhile, (January 2006) the supplier had supplied 457.312 kilometres out of the ordered quantity of 750 kilometres leaving a balance of 292.688 kilometres. The Company, however, could consume 195.198 kilometres in 2005-06 till January 2006. Though the Company had the option of cancelling the remaining order, it did not consider the same and instead granted (January 2006) extension of supply upto 2006. Thus, improper assessment of the requirement of coyote conductors resulted in blocking-up of funds of Rs.4.69 crore.

The Management stated (March 2007) that the order was not cancelled due to non-availability of UG Cable at any stores. The reply is not tenable as 621.080 kilometres of the conductor, valued at Rs.4.69 crore, were lying idle in Company's stores as of February 2007.

The Government stated (July 2007) that the purchase order was not cancelled for the reason that the cost of procuring Coyote Conductors afresh would have been on the higher side. The reply is not tenable as there was no immediate requirement for the material in January 2006 and it remained unused till now (August 2007).

4.13 Avoidable payment

The Company placed orders for 13,500 kilometres of Rabbit ACSR conductors after a delay of two months resulting in avoidable payment of Rs.1.67 crore on account of price variation claims.

The Company invited tenders (January 2005) for purchase of 30,000 kilometres of Rabbit ACSR conductors. Out of the 11 bids received, bids of seven firms were found technically feasible. Deepak Cables, Pondichery was the lowest with a free on road destination (FORD) price of Rs.23,340.53 per km computed on the basic ex-works price of Rs.19,900 per kilometre. As per the Industrial Policy 2001 of Government of Karnataka, 75 *per cent* of the items reserved for the Small Scale Industries (SSI) Sector by the GOI, would be procured from the units located within the State. ACSR Conductor is one of the items reserved by the Central Government for exclusive manufacture in the SSI Sector. Accordingly, the Board of Directors (BoD) decided (July 2005) to split the quantity and allotted 25 and 75 *per cent* of the total quantity to the outside firm and local firms respectively. Deepak Cables, Pondichery was allotted 7,500 kilometres and Deepak Cables, Tumkur, was allotted 22,500 kilometres. The supplies were to be completed by April 2006.

Deepak Cables, Tumkur while accepting the offer of the Company (September 2005), intimated that it could supply 9,000 kilometres only against the allotted quantity of 22,500 kilometres. Accordingly, the Company placed orders (October/November 2005) on Deepak Cables, Pondichery and Tumkur for 7,500 kilometres and 9,000 kilometres respectively, on ex-works price of Rs.19,900 per kilometre which included price variation clause without ceiling. The Company did not consider placing orders for the shortfall of 13,500 kilometres on any other firms.

Subsequently, the BoD decided (January 2006) to place orders on other firms who had responded to the tenders (January 2005), and placed orders (February 2006) on three local firms for 13,500 kilometres with the same ex-works price of Rs.19,900 per kilometre including price variation clause and supplies to be completed by June 2006.

It was observed (December 2006) that the Company failed to place orders in October/November 2005 for the remaining 13,500 kilometres on these firms, so as to complete the supplies by April 2006. The Company placed orders for the balance quantity after two months, resulting in payment of price variation claims for supplies effected by these firms to the tune of Rs.1.67 crore, which was avoidable.

On this being pointed out, the Government stated (May 2007) that the materials were procured exclusively for Rural Load Management System (RLMS) and due to delay in taking decision regarding RLMS, the purchase orders were not placed immediately. The reply is not tenable, as the Company had assessed the requirement at 30,000 kilometres during 2005-06 with supplies to be completed by April 2006 and should have placed orders at the first instance itself to meet the shortfall of 13,500 kilometres. Failure to do so

made the Company liable to pay price variation claims of Rs.1.67 crore for supplies made after April 2006, which was avoidable.

4.14 Loss due to wrong application of tariff

Application of HT 2(a) instead of HT 2(b) resulted in loss of revenue Rs.16.22 lakh.

The LT installation standing in the name of Ghousia College of Engineering, Ramanagaram, was converted (August 2001) to HT installation, and the tariff applicable indicated as HT 2(b).

It was observed (March 2007) that the installation was billed under HT 2(a) instead of HT 2(b) for the period from October 2001 to February 2007. This resulted in short-billing of revenue by Rs.16.22 lakh for the above period**.**

As per Clause 29.08 of Conditions of Supply of Electricity of Distribution Licensees in the State of Karnataka, the licensee shall not recover any arrears after a period of two years from the date when such sum became first due, unless such sum was shown continuously in the bills as recoverable as arrears of the charges of electricity supplied. As no amount was shown as arrears, the Company was forced to lose revenue to the tune of Rs.16.22 lakh.

The Government accepted (August 2007) the audit observation and stated that demand was raised (March 2007) on the consumer. It further stated that the Consumer had appealed (June 2007) to the Company against the demand raised.

Karnataka Neeravari Nigam Limited

4.15 Extra expenditure

The Company allowed contractor to make modifications in the quoted rates while he was accepting to take up the work and revision was made in the method of calculating item rates in violation of the guidelines approved by the BoD which resulted in extra expenditure of Rs.8.85 crore.

The Company noticed (2005) that the bidders participating in the tenders were quoting very high rates and after opening of the tenders (other than lowest) were offering substantial rebate. Consequently, the lowest bidder, was also reducing the rates at the intervention of Chief Engineer/Managing Director level. Noticing this trend, the Technical Sub-Committee (TSC), of the Company framed (May 2005) guidelines for evaluating tenders which were accepted (June 2005) by the Board of Directors (BoD). As per these guidelines, the tender premium was to be worked out on the basis of the following:

- 20 *per cent* below the Schedule of Rates (SR) in respect of all canal excavations and embankments,
- five *per cent* above SR in respect of cross drainage and lining works.

These guidelines also provided that in case the overall premium percentage tendered was more than the worked out premium, the bid price could be negotiated with the lowest bidder and the quoted premium was to be reduced to the worked out premium.

It was observed that tenders were floated (February 2005) for the work of earthwork excavation, formation of embankment including lining and cross drainage (CD) works from kilometre 182 to 192 of Upper Tunga Main Canal at a estimated cost of Rs.25.04 crore. The bid of Sri M.Y.Kattimani, Category I Contractor, was the lowest at Rs.27.46 crore.

Keeping in view the guidelines (June 2005) the bid amount of the lowest bidder was re-worked out to Rs.22.81 crore which was 8.91 *per cent* below SR and the work was awarded (August 2005) to him.

The lowest bidder while accepting to take up work at the above offered price, modified the item rates at his own discretion. The matter was placed before the TSC and new formula[97] was given (October 2005) which was based on the rates quoted by the contractor which resulted in higher rates for earthwork items and lesser rates for concrete items.

As per the above guidelines, the tender accepting authorities and/or the contractor are not authorised to vary the individual rates at their discretion. Therefore, to arrive at the item rates on the basis of the quoted rates, the conditions prescribed in the guidelines should have been followed strictly. The formulae for computing the item rates suggested by the TSC in October 2005 after the award of contract was not in the best interest of the Company. The deviation had resulted in undue benefit to the contractor amounted to Rs.8.85 crore.

The Company agreed and stated (May 2007) that if the revised procedures were adopted for evaluation of all the subsequent tenders, a lot of savings would accrue. Fact remains that due to incorrect application of the revised procedure (guidelines), the Company incurred extra expenditure of Rs.8.85 crore in the instant case.

The matter was reported to the Government (August 2007); their reply is awaited (August 2007).

4.16 Unfruitful expenditure

Failure to implement E-Governance rendered the expenditure of Rs.67.31 lakh unfruitful.

The State Government decided (September 2000) to implement E-Governance in the Water Resources Department (WRD). The major activity as per WRD's E-Governance Plan was the development of a Management Information System covering the entire hierarchy of the Department catering to the Project

[97] Item rate of (x) will have to be revised to (y)
y=x (price bid as worked out based on norms)/(tendered amount)

Monitoring, Project Evaluation and Establishment Information System requirements of the WRD, Karnataka Neeravari Nigam Limited (KNNL) and Krishna Bhagya Jala Nigam Limited (KBJNL). In this direction, a High Level Committee (HLC) was constituted (September 2000) to pursue the implementation of E-Governance.

Based on the request (January 2001) of the WRD, Computer Maintenance Corporation (CMC) Limited undertook a Systems Requirement and Specification Study and submitted the report (March 2001). The HLC decided (July 2001) to assign the development of Application Software to CMC Limited at a total cost of Rs.1.25 crore out of which Rs. 64.72 lakh was towards development of customised application software, testing and implementation in seven pilot sites and the balance amount of Rs.60.28 lakh was towards implementing the software in all the sites of KNNL, KBJNL and among WRD. The project was to be completed within 20 weeks from the date of the agreement (February 2002). The State Government selected (February 2002) KNNL as the nodal agency and directed it to enter into an agreement with CMC Limited for the development of application software, testing and implementation in the pilot sites at a cost of Rs.64.72 lakh. Accordingly, an agreement (Neeravari Agreement) was entered into (February 2002) by KNNL with CMC Limited. The agreement, *inter alia,* provided for testing and implementation in seven pilot sites coming under KBJNL and WRD. A Nodal Officer of WRD was entrusted with the responsibility of granting approvals to the test plan, input and output formats, application software and commissioning of the software. These approvals were to be enclosed to the bills submitted for payment.

The software was installed in the pilot sites (November/December 2002). While expressing difficulties experienced during live data entry and generating required reports, KBJNL requested (July 2003) KNNL to ensure the rectification of the software before the release of final payment. Full payment (May 2002 to February 2004) of Rs. 67.31 lakh including four *per cent* sales tax was, however, made by KBJNL based on the certification of the Nodal Officer without rectification of defects. As the pilot project was not successful, the software could not be implemented in the remaining sites and the balance amount of Rs.60.28 lakh was not paid.

CMC Limited assured (October 2004) that the problems existing at the pilot sites would be rectified. Due to the continued existence of the problems, the software could not be operationalised in the pilot sites, even after four years of initiating the project. As there was no progress in implementation of the software, KNNL approached (May 2006) the Centre for Development of Advanced Computing (C-DAC), Pune to conduct System Requirement Study to develop Management Information System.

Due to improper planning, ineffective monitoring and failure to include a suitable clause to protect against unsatisfactory performance, the expenditure of Rs.67.31 lakh was rendered unfruitful.

The matter was reported to the Management/Government (July 2007); their replies are awaited (August 2007).

Karnataka Road Development Corporation Limited

4.17 Loss in execution of Hemagiri Bridge

Failure to include financial and other incidental charges in the estimate resulted in non-re-imbursement of Rs.1.03 crore.

The State Government entrusted (January 2001) the work of construction of Hemagiri Bridge to Karnataka Road Development Corporation Limited (Company) with technical consultancy from MECON Limited.

The Company awarded (December 2002) the work to the lowest bidder Nagarjuna Construction Company Limited, at Rs.3.99 crore. The work was completed (December 2003) for Rs.4.38 crore which included five *per cent* administrative cost of the Company. In addition to the above, the Company incurred an expenditure of Rs.1.03 crore towards financial and other incidental charges.

At the time of taking up the work, the Company had projected (January 2003) to the Government Rs.4.37 crore as the cost of the project, which included Rs.20.33 lakh at five *per cent* of the total cost towards the administration expenditure of the Company. The Company claimed (January 2004) Rs.4.38 crore after completion of the work and against the above claim, the Government paid Rs.4.17 crore and no commitment was available from the Government regarding payment of administrative cost.

It was observed that the Company was executing all projects out of Government grants and borrowed funds which were reimbursed by the Government. In the subject case, in the absence of any specific commitment from the Government to provide funds in advance for execution of the project, the Company had to depend on borrowed funds. The Government released Rs.4.17 crore during December 2005 to September 2006 *i.e.,* after completion of work. As per the records, interest and other financial charges incurred on this work were Rs.1.03 crore.

Thus, failure on the part of the Company to include financial and other incidental charges attributable to the project in the estimate resulted in loss of Rs.1.03 crore to the Company.

The Government stated (May 2007) that it had reimbursed the expenditure of financial and other incidental charges of Rs.1.03 crore incurred by the Company during the financial year 2002-03. On verification it was noticed that the Company had not received the amount till August 2007.

4.18 Avoidable expenditure

Failure to identify a suitable executing agency by the Government resulted in Company incurring loss of Rs.84.70 lakh.

The Government entrusted (May 2001) the implementation of the Traffic Management and Traffic Infrastructure Project for Bangalore City to the

Company. As per Government order, the Company had to conduct detailed studies to assess the traffic, fix the alignment and establish the feasibility of flyovers and other works to be taken up and short-list the ones to be taken up immediately. Sanction was also accorded to raise a loan of Rs.175 crore from HUDCO for the first two years and the Company was entitled to two *per cent* of the project cost towards its charges.

During execution of the project, the Company engaged consultants and feasibility study, project report and designs were finalised (June 2002) at a cost of Rs.1.04 crore. When the Company was to execute the work, the Government in the meeting (July 2002) chaired by Chief Secretary, decided to entrust the execution of the work to Bangalore Development Authority (BDA)/Bangalore Mahanagara Palike (BMP).

Accordingly, the Company handed over the feasibility reports and designs already prepared by its consultants to BMP/BDA for its execution. As per the directions (August 2003) of the Board, the Company requested (August.2003) the Urban Development Department (UDD) to reimburse the entire expenditure incurred by it or to issue Government Order for re-imbursement of the same by BDA/BMP and UDD of Rs.29.71 lakh, Rs.22.94 lakh and Rs.50.92 lakh respectively. The Company also requested BDA/BMP for reimbursement of their proportionate expenditure incurred towards feasibility study and project preparation, against which BMP paid Rs.18.82 lakh to the Company but BDA refused to reimburse the expenditure. The BDA stated (January 2005) that conceptual changes had been effected in the projects and that these had been executed by obtaining the services of consultants.

The BDA further added (January 2005) that they had executed the works without any budgetary support from the Government. As BDA refused to reimburse the amount and there was no response from UDD, the Company had written-off of Rs.84.70 lakh in its accounts for 2005-06.

The Government stated (May 2007) that there was no loss to the Company or Government as the project is for public purpose and the feasibility report prepared by Company was utilised by BDA in the execution of the project. The reply is not acceptable as the Company had written off Rs.84.70 lakh as loss in its accounts of 2005-06.

Gulbarga Electricity Supply Company Limited

4.19 Cancellation of tenders

Cancellation of technically and financially responsive tenders without valid reasons resulted in extra expenditure of Rs.2.37 crore due to higher rates obtained in re-tendering.

The Company floated (March 2006) tenders and invited bids in two parts, technical and commercial, from manufacturers of Aluminium Conductor - Steel Reinforced (ACSR) conductors for the requirement of 38,000 kilometres of Rabbit and 7,282 kilometres of Weasel conductors. The requirement was both for new lines and changing old conductors. In response, three manufacturers

submitted their bids (April 2006) and the bids of all the three firms were found to be technically and commercially suitable. The requirement was reduced to 5,735 kilometres of Rabbit and 6,678 kilometres of Weasel conductors, as a separate tender had been invited for re-conductoring of lines on turnkey basis. Consequently, the manufacturers were asked (May 2006) to quote for the revised quantities. The price bid for the revised quantities were opened (May 2006) and the lowest unit computed rates obtained were Rs.28,655 for Rabbit conductor and Rs.17, 246 for Weasel conductor per kilometre.

The Purchase Committee, however, decided (June 2006) to invite fresh tenders for the revised quantities on the following grounds.

- The (original) bid has been amended with regard to quantity after opening the technical bid and time given only to those bidders who had applied. Since this could have a bearing on the pre-qualifying requirement also, the appropriateness of processing the tender on the basis of the tenders received has to be examined.

- The tender conditions do not provide for disqualifying those firms who had not performed either in Gulbarga Electricity Supply Company Limited (GESCOM) and other utilities. As this is a standard condition, this has to be incorporated in all future tenders.

- The non-applicability/loading of entry tax to Galaxy Cables Industries, Sangli and Traco Cable Company Limited, Kochi while evaluating their offers needs to be explained.

- The competitiveness of the prices of both Weasel and Rabbit ACSR conductors needs to be examined with reference to what other Electricity Supply Companies (ESCOMs) have obtained in the recent past.

Notice inviting tenders for procurement of the revised quantities of conductors were issued (July 2006) afresh. The lowest offers received against the fresh tenders were, much higher, resulting in extra- expenditure of Rs.2.37 crore on procurement of conductors as shown below.

Type of conductor	Lowest price of the first tender (per km)	Lowest price of the second tender (per km)	Quantity (km)	Extra expenditure (Rs.)
Rabbit	28,655.40	31,150.48	5,735	1,43,09,284
Weasel	17,246.10	18,650.90	6,678	93,81,254
Total				**2,36,90,538**

It was observed that the reasons given by the purchase committee did not have any bearing on the competitiveness of the tenders received or its acceptability in view of the following:

- The qualification requirements as per tender conditions were that the bidder must have supplied a minimum quantity of 3,000 kilometres of

weasel conductor and 5,000 kilometres of Rabbit conductors in an year to KPTCL/GESCOM or other ESCOMs in the preceding three financial years and that the bidder must not have defaulted in supplies.

- The tender conditions also provided for variation in quantities and the bidders had quoted for the revised quantities.
- Even after loading entry tax the lowest quoted price remained the same and there was no reason to reject any of them.
- If required, the committee could have obtained and compared the prices obtained by other ESCOMs in similar tenders to decide upon the reasonableness of the quoted prices. Thus, the decision to cancel the tender was not justified and resulted in extra-expenditure of Rs.2.37 crore.

The matter was reported to the Management/Government (April 2007); their replies are awaited (August 2007).

Karnataka State Industrial Investment and Development Corporation Limited

4.20 Non-recovery of term loan

Non-recovery of term loan assistance to Shambhavi Agrotech Private Limited.

Shambhavi Agrotech Private Limited, Bidar approached (July 2001) the Company for financial assistance to set up a chemical industry for the manufacture of dust pesticides and liquid formulations. The estimated cost of the project was Rs.1.58 crore, which was proposed to be funded by way of term loan from the Company (Rs.90 lakh) and promoter's contribution (Rs.68 lakh). The Company sanctioned (August 2001) the term loan of Rs.90 lakh carrying interest at 15 *per cent* per annum. The loan was disbursed between November 2001 and March 2002. The loan was secured by mortgage of the loanee's movable and immovable properties in addition to personal guarantees of the promoters and collateral security worth Rs.27 lakh in the form of immovable properties. The loanee revised (July 2002) the project cost to Rs.1.90 crore and approached (July 2002) for an additional loan of Rs.23.50 lakh while Rs.8 lakh was to be by way of contribution of promoters. The revision was to put up additional facilities for the manufacture of 'weitable' powder which was proposed to be mixed with pesticides to give better results. The Company sanctioned (August 2002) the additional loan and disbursed the same in September 2002.

The loanee completed the trial runs and commenced production (September 2002) but stopped its operations immediately thereafter as it could not sell its products in the market due to availability of the similar products in the market at lesser price. Due to default in repayments, notices under Section 29 of State Finance Corporations Act were issued (August 2003 and May 2005) to the loanee and the unit was taken over (December 2005) by the Company. The total outstanding as on 31 December 2005 was Rs.1.93 crore.

In this connection, Audit observed that:

- the loanee reported to have made cash payment of Rs.15 lakh and bank payment of Rs.25.48 lakh towards machinery and laboratory equipments to Sneha Plastics Private Limited, Mumbai, during May 2001 to August 2002, which was not verified while disbursing the initial term loan of Rs.90 lakh. On verification with the Bank it was found (August 2007) by Audit that the payment of Rs.25.48 lakh was made either to the sister concerns of the loanee or was utilised for its own purposes.
- while the loanee approached the Company for assistance, the default ratio was 52.27 *per cent* in the sector.
- the promoters were engaged in money lending in addition to running a *dhal* mill.
- the production started in September 2002 and stopped immediately thereafter as cheaper products, both imported and indigenous were available in the market.
- the total net-worth of the promoters as per the appraisal was Rs.67.91 lakh which included investment of Rs.30.66 lakh in Sridevi Dhal Industries, a sister concern of the promoters. Sridevi Dhal Industries had availed term Loan of Rs.48 lakh from the Company in 1998 and defaulted in repayment to the Company since July 2001. Inspite of this, the Company accepted investment in Sridevi Dhal Industries as collateral security.

The Company did not study the background and networth of the promoters and did not conduct proper market survey indicating defective appraisal system. Even the collateral security offered valued at Rs.27 lakh in the appraisal was found (June 2006) to be worth only Rs.5.04 lakh.

Thus, failure to assess the viability of the project and the financial credentials of the promoters resulted in non-recovery of Rs.1.93 crore.

The matter was reported to the Management/Government (August 2007); their replies are awaited (August 2007).

Karnataka State Police Housing Corporation Limited

4.21 Avoidable extra expenditure

Usage of steel reinforcement in excess of requirement as per Indian Standard code for reinforcement resulted in avoidable extra expenditure of Rs.1.59 crore.

The Company took up (March 2003) construction of 4,489 and 511 number quarters for Police Constables and Sub-Inspectors respectively at 271 different locations in the State at an estimated cost of Rs.180 crore under Accelerated Housing Scheme II. The project was to be financed by a grant of Rs.45 crore and loan of Rs.90 crore from HUDCO and Rs.45 crore from HDFC. The buildings were designed as three storied brick masonry structures with four quarters in each floor (total 12 quarters). As of June 2007, 2,870 quarters were completed and the work of balance quarters was in progress.

The floor/roof slabs of the Police Constables' quarters were designed to be simply supported by the brick masonry walls of the building. The requirement of steel reinforcement for the slabs depends upon the span of the slab and the live load apart from the self weight including floor finish. The maximum live load in residential buildings as per Indian Standard (IS) code 875 is 200 kilogram per square metre and the IS code 456 prescribes a safety factor of 1.5 for the total load. The IS code 456 specifies the methods and procedures of design of plain and reinforced concrete structures. The requirement of steel reinforcement required for the type of concrete slabs designed by the Company for the building was worked out in Audit based on the above IS specifications and was compared with the reinforcement provided in the structural drawing of floor/roof slabs issued for construction. It was observed (June 2006) that the Company provided steel reinforcement at closer spacing than required for the type of slabs designed for the building. *e.g.,* the tor steel rods of 10 millimetre (mm) diameter as main steel were provided at a spacing of 150 mm instead of required spacing of 280 mm. As against the total requirement of 1,049 kilogram of steel per floor as per IS Code, a provision of 1,773.60 kilogram was made. The excess reinforcement steel provided, amounted to 724.60. Kilogram per floor or 1.81 quintals per quarters**.** The extra expenditure incurred for 2,870 quarters completed as on June 2007 was Rs.1.02 crore and the balance expenditure that would be incurred for remaining 1,619 quarters would be Rs.57.49 lakh at an average steel price of Rs.1,962 per quintal

The Company replied (December 2006) that the design arrived at by Audit is theoretical one for an ideal situation and that in reality the competence of supervisory staff, skill of the construction worker and characteristics of the material were entirely different and it was further added that the slab design was appropriate as it was based on safety and durability considerations and engineering judgement based on experience. The Company further replied (June 2007) that the views of audit will be kept in mind in future designs.

The design arrived at by Audit was with reference to IS code and the Company had not justified excess quantity of steel with reference to relevant technical parameters and IS code specifications, rather it has agreed to consider the views of the audit for future designs.

The matter was reported to the Government (May 2007); their reply is awaited (August 2007).

Mangalore Electricity Supply Company Limited

4.22 Non-availing rebate

Failure to make payment within the due date resulted in non-availment of rebate of Rs.1.46 crore.

The responsibility of purchase of power from various sources and its transmission to the Electricity Supply Companies (ESCOMs) rested with the Karnataka Power Transmission Company Limited (KPTCL) upto 9 June 2005. The enactment of the Electricity Act 2003, however, divested KPTCL from trading in electricity with effect from 10 June 2005, as per Section 39 of the

Electricity Act, 2003. Consequently, the State Power Procurement Co-ordination Centre (SPPCC) was entrusted with the function of procurement of power from various sources (KPC, Central Generating Stations, Independent Power Producers, *etc.*,) and its allocation to various ESCOMs. As a result, the Government of Karnataka assigned the Power Purchase Agreements (PPAs) entered into by KPTCL for the purchase of power from various sources including Independent Power Producers (IPPs) to the ESCOMs from 10 June 2005.

Clause 9.3 of the PPAs provide for rebate for payment of bills before the due date, as indicated below:

Name of the Company	Rebate percentage per day for payment before due date	Number of days from invoice date to due date	Maximum Rebate (percentage)
Jindal Thermal Power Company Ltd.	0.05	45	2.25
G M R Energy Ltd.	0.10	25	2.50
Tata Power Company Ltd.	0.10	25	2.50
Sree Rayalaseema Alkalies and Allied Chemicals Ltd.	0.10	25	2.50

The IPPs dispatched the monthly power purchase bills to SPPCC, with a copy to the respective ESCOMs. After scrutiny of the bills, the same were transmitted to the ESCOMs by SPPCC. It was observed that Mangalore Electricity Supply Company Limited was following the procedure of effecting payment of the bills only after receipt of the scrutinised bills from SPPCC. This resulted in payment of power purchase bills after the due dates and thereby losing out the opportunity of availing rebate of Rs.1.46 crore on payment of Rs.58.58 crore for the year 2006-07.

Incidentally, it was observed that Bangalore Electricity Supply Company Limited (BESCOM) followed the procedure of releasing payments on receipt of bills from IPPs without waiting for scrutiny of the bills and adjustments, if any, were effected on receipt of the scrutinized bills from SPPCC, thereby availing full rebate.

The Government stated (May 2007) that rebate could not be availed due to delay in receipt of some bills from SPPCC and that the Company had availed benefit of rebate wherever the bills were received in time and on availability of funds. The reply is not tenable as payment could have been made without waiting for the receipt of the scrutinised bills from SPPCC, as was being done by BESCOM. Further, the Company should have ensured the availability of funds considering the rate of rebate which was 36.50 *per cent* per annum in respect of three IPPs and 18.25 *per cent* per annum in respect of one IPP.

Hubli Electricity Supply Company Limited

4.23 Extra expenditure

The Company procured costlier line materials resulting in extra expenditure of Rs.81.82 lakh.

The Company has been procuring line material made of mild steel since the time of erstwhile Karnataka Electricity Board. The Company, however, invited

tenders (January 2005) for purchase of galvanised line materials, for finalising the rate contract for one year. The reasons for switching over to galvanized line material from mild steel material were not available on records. While evaluating the prices quoted by the firms, the Company opined (March 2005) that the rates quoted were on higher side and negotiations were held with the tenderers to arrive at the negotiated rates. After finalising the negotiated rates, the Company placed orders (March 2005) on urgent basis, for purchase of galvanised line materials at a total cost of Rs.2.41 crore, for two months requirement subject to ratification by the Central Purchase Committee (CPC) in their ensuing meeting which was ratified by the Committee (July 2005). Simultaneously the Chief Engineer (Electrical) and Superintending Engineer (Electrical) of the Company also placed (May/June 2005) orders for procuring galvanised line materials at a total cost of Rs.78.38 lakh, and the total value of all the orders worked out to Rs.3.19 crore. It was, however, observed that the CPC while ratifying (July 2005), the purchase order placed earlier, decided to procure mild steel line materials from the same firms. Thus, the decision to go for galvanised line materials in place of mild steel materials which was hitherto utilised without any complaints lacked justification and resulted in extra expenditure of Rs.81.82 lakh.

The Government stated (June 2007) that galvanised line material compared to MS line material is more water and weather resistant, more maintenance free, safe and reliable. The reply is not acceptable, as the Company has subsequently reverted back to purchase of mild steel line material.

Karnataka State Coir Development Corporation Limited

4.24 Improper planning

The Company had invested Rs.42.35 lakh to establish defibring unit, which became idle due to improper planning and execution.

Under the Integrated Coir Development Scheme, the Company decided (May 1999) to establish a coir defibring unit at Sirigenahalli, Tarikere Taluk in 1999-2000. The estimated cost of the project was Rs.20 lakh against which the State Government released (December 1998) Rs.19 lakh in the form of grant (Rs.4 lakh), equity (Rs.5 lakh), and loan (Rs.10 lakh).

The cost incurred on the project was Rs.42.35 lakh as detailed below.

Particulars	Year of Completion	Amount (Rs. in lakh)
Land Acquisition	1999-2000	0.87
Building-Machinery work shed	December 2002	8.26
Building-Machinery bed and soaking tank	December 2002	5.22
Plant and machinery	March 2001	18.91
Electrical Work	March 2004	6.35
Other Expenses including Electricity deposit, Electricity charges and borewell	2002-05	2.74
Total		**42.35**

Though the machinery was procured (March 2001), the same was not put to use mainly due to delay in arranging power supply. Even after power supply was finally arranged (March 2004), the machineries could not be commissioned due to defects/malfunctioning. The Company thereafter failed to get the machinery repaired/rectified by the supplier.

On being pointed out (March 2005) the Company got the machineries inspected by a Joint Director of the Coir Board who suggested (September 2005) that repairs were necessary for the machinery to be used in production. The Company decided (December 2005) to obtain another report from the Technical Consultancy Services Organisation of Karnataka (TECSOK). The machinery supplier was present on the day of inspection (23 August 2006) at the instance of TESCOK. TESCOK submitted (August 2006) a report concluding that the machinery which was in satisfactory working condition could be put to use provided good quality and big coconut husks is used as raw material (as the machine rejected small and inferior quality husks). Due to non-availability of required raw material the Company shifted the machinery (June 2007) from Sirigenahalli to Vakkawadi.

Thus, due to improper planning/execution and failure to ensure availability of basic raw material, the investment of Rs.42.35 lakh became idle and shifting of the unit would further render the expenditure on civil works and electrical works infructuous.

The Company stated (May 2007) that though the application for power supply was made (December 1999) to Electricity supply company, the power connection was made only in March 2004. It further stated that as raw material was a constraint it was decided to shift the unit to Vakkawadi and the building constructed at Sirigenahalli would be used as a centre of training and other production activities.

The reply is not tenable as no action was taken after procurement of machinery (March 2001) till pointing out by audit (March 2005). Meanwhile the warranty expired. There is no guarantee that the machine will run in Vakkawadi. Fact is that Company should have confirmed compatibility of the machinery to local raw material before procurement.

The matter was reported to the Government (May 2007); their reply is awaited (August 2007).

Karnataka Power Transmission Corporation Limited, Bangalore Electricity Supply Company Limited and Gulbarga Electricity Supply Company Limited

4.25 Procurement, maintenance and repair of transformers

Introduction

4.25.1 Transformer is static equipment used for stepping up or stepping down of voltage in transmission and distribution of electricity. Electricity is usually generated at voltage of 11 Kilo volts (KV) and it is then stepped up through

Power Transformers to higher voltage (upto 400 KV or more) for transmission to the load centres. At the receiving substations the voltage is brought down to appropriate levels through step down transformers. The transformers used at the generating stations and in the high voltage substations are called power transformers, while transformers used in distribution systems are called distribution transformers.

In Karnataka, the transmission of power for 33KV and above capacity lines is handled by Karnataka Power Transmission Corporation Limited (KPTCL), while the distribution is done by five Electricity Supply Companies *viz.,* Bangalore Electricity Supply Company Limited (BESCOM); Gulbarga Electricity Supply Company Limited (GESCOM), Mangalore Electricity Supply Company Limited (MESCOM); Hubli Electricity Supply Company Limited (HESCOM); Chamundeswari Electricity Supply Corporation Limited (CESC).

The records of the procurement, maintenance and repair of Power and Distribution Transformers during the period 2003-04 to 2005-06 in KPTCL, BESCOM and GESCOM were reviewed during November 2006 to February 2007.

Procurement

4.25.2 Based on targeted works and action plan for establishing new stations, augmentation works and system improvement works, the requirement of Power and Distribution Transformers was assessed and procurement made on tender basis. The number and cost of transformers purchased during the four years ended March 2007 was as follows.

(Cost : Rs. in crore)

Year	KPTCL		BESCOM		GESCOM		MESCOM		HESCOM	
	Number	Cost	Number	Cost	Number	Cost	Number	Cost	Number	Cost
2003-04	109	60.57	2,965	8.34	300	1.08	3,762	11.05	1,375	4.55
2004-05	8	4.97	11,915	41.51	1,437	6.57	825	1.13	Nil	Nil
2005-06	168	225.59	16,850	98.50	1,482	12.02	2,005	11.69	2,400	11.94
2006-07	508	727.95	11,301	84.98	9192	56.74	1,383	12.12	5,120	31.48

The following audit observations are made on the procurement of transformers.

KPTCL

Non-placing of Extension Order

4.25.3 EMCO, a supplier of Power Transformers, was approached (May 2004) with proposal for an extension order for the supply of two Power Transformers of 100 MVA 220/66/11 KV class as the transformers were required for commissioning at Nagarbhavi sub-station scheduled to be completed (February 2005). The firm, while accepting (May 2004) the extension order stated that since the rate quoted was in November 2002, they were agreeable to

supply at the old rate with price variation formula of Indian Electrical and Electronics Manufacturers Association (IEEMA) formula, from October 2003 (the date of Letter of Intent) with a ceiling of 10 *per cent*. As per the calculations furnished by the firm, the final price for the transformers was Rs.2.81 crore each as against Rs.2.52 crore in November 2002. The firm agreed to supply the transformers within four months.

The Company, however, took a decision (August 2004) to call for fresh tenders on the following grounds:

- The updated schedule of rates (SR) as on April 2004 was Rs.2.65 crore on applying IEEMA formula on previous SR.
- The original purchase order was placed on firm basis.

In this connection, the following observations are made:

- The Company evaluated the offer of EMCO by applying price variation formula on SR prevalent in November 2002 and arrived at ex-works rate of Rs.2.65 crore whereas the price offered by the firm was Rs.2.81 crore considering price variation from October 2003.
- The transformers were proposed as an urgent requirement for 220 KV Station at Nagarbhavi sub-station which was to be commissioned in February 2005, and EMCO was ready to supply within four months.

In view of the price advantage and purported urgency, the Company could have considered the offer of EMCO by placing an extension order. Instead the transformers were ordered (May 2005) on the lowest tenderer at Rs.4.34 crore per transformer against fresh bids. This resulted in an extra-expenditure of Rs.3.06 crore as compared to the offer of EMCO for extension order.

The Chief Engineer replied (April 2007) that extension order was not considered since the extension order should be placed within six months of the date of original order as per provisions of Accounts Manual subject to the condition that the prices had not fallen during the period and the quantity ordered did not exceed 25 *per cent* of the original quantity; which were not satisfied. The original order was placed on firm basis. The reply is not tenable as the Company was aware of the increasing trend of rates and the rate offered by EMCO was advantageous to the Company and the fact stated was known to the Company at the time of approaching firm. The extension order was not considered for the reason of cost and not for expiry of six month.

Supply of sub-standard transformers

4.25.4 The transformers are procured by the Company directly from the manufacturer and in certain cases turn-key contracts are awarded for supply and installation of transformers. In both the cases, as per tender conditions the transformers are inspected and tested at the premises of manufacturer by the 'Technical Audit and Quality Control Staff (TA&QC)' of the Company and thereafter dispatch instructions are issued. The TA&QC staff issued dispatch instructions for supply of seven transformers which were purchased by turn-key contractors. Tests were conducted by the Company on five out of seven

transformers and the results were found to be not according to the specifications. The losses/load and no load losses, found during testing were higher than the losses declared in the offer of the transformer manufacturer. Accordingly, orders for recovery of penalties for the excess losses over the declared losses along with the additional guarantees for the transformers were issued. The penalty recoverable as per the test results worked out to Rs.74.01 lakh being the differential value of losses. Thus, deficient inspection of transformers before issuing dispatch clearance resulted in acceptance of substandard transformers.

Allotment of transformer for un-planned work

4.25.5 A purchase order was placed (November 2003) on EMCO for two 100 MVA 220/110/66 KVA transformers. Out of the above, one Power Transformer costing Rs.2.30 crore was allotted (March 2004) to Sharavathy Receiving Station, Hubli for replacing the failed 100 MVA transformer. The transformer was, however, diverted (April 2004) to Haveri receiving station to be installed as an additional transformer. There was, however, no sanction for augmentation of Haveri station. The estimate was prepared (April 2004) only after receipt (April 2004) of the transformer at site. The transformer was commissioned after a lapse of 31 months (December 2006) from the date of supply. Thus, allotment of transformer before sanction resulted in idling of the transformer for over 31 months and blocking up of funds to the extent of Rs.2.30 crore. It was also not used for the purpose of which it was purchased.

Maintenance of distribution transformers–BESCOM and GESCOM

Inadequate transformation capacity

4.25.6 Adequate transformation capacity is essential to meet the power requirement of the consumers with quality power and minimum interruptions and also for the safety of the transformers. The distribution transformation capacity *vis-à-vis* connected load of BESCOM and GESCOM for the four years ended March 2007 are indicated below:

Year	Connected load (MW)	Transformation capacity (MW)	Excess (MW)	Percentage
BESCOM				
2003-04	8,359.08	6,920.36	1,438.72	20.79
2004-05	9,027.15	7,471.42	1,555.73	20.82
2005-06	12,334.71	7,944.72	4,389.99	55.26
2006-07*	-	-	-	-
GESCOM				
2003-04	NA	1,727.66	-	-
2004-05	2,610.97	1,770.76	840.21	47.44
2005-06	2,736.78	2,129.34	607.44	28.52
2006-07	2,873.25	2,174.80	698.50	32.12

* Details for 2006-07 are awaited; NA-Not available.

Audit observed that the transformers were overloaded. The gap between connected load and transformation capacity increased from 21 *per cent* to 55 *per cent* in BESCOM and between 29 *per cent* to 47 *per cent* in GESCOM

during 2003-04 to 2005-06, which indicates that these Companies failed to create infrastructure commensurate with the load growth. The less transformation capacity would result in overloading of transformers and lead to failure of transformers and interruption in power supply besides loss of revenue and expenditure of repair and replacement.

Failure of transformers

4.25.7 The preventive maintenance of transformers involves periodical checking of bushings, earthing, and other connections, testing of oil, topping up of oil whenever required *etc*. No schedule, however, for preventive maintenance of transformers was prescribed. The total number of transformers in service, number of failures and percentage thereof for the four years ending 31 March 2007 in BESCOM and GESCOM are indicated below:

Year	Total No. of distribution transformers		Percentage of failure
	in service	failed	
BESCOM			
2003-04	72,243	9,376	13.0
2004-05	82,940	11,003	13.3
2005-06	92,024	11,744	12.8
2006-07	1,06,101	9,517	9.0
GESCOM			
2003-04	27,215	4,454	16.36
2004-05	28,020	5,922	21.13
2005-06	34,883	6,580	18.86
2006-07	36,632	6,090	16.62

Audit observed that, there was no significant reduction in failure of transformers over the years. The analysis of failure of transformers in various zones has revealed that while the percentage of failure in the Bangalore Metropolitan Agglomeration Zone (BMAZ) was zero which was stated to be due to better management of load and better maintenance, the failure in the Bangalore Metropolitan Rural Zone (BMRZ) and Chitradurga Zone ranged from 13.24 to 15.46 *per cent* and from 17.11 to 18.53 *per cent* during the above period respectively. The Company (BESCOM) did not implement the measures taken in the BMAZ area in other zones, which cater to the rural areas to minimise the rate of failure of transformers.

Non-implementation of Transformer Management System (TMS)

4.25.8 Separate consultancy services contracts for development of software for TMS were awarded (GESCOM-August 2003 and BESCOM-December 2003) to KPMG Consultancy Services Private Limited. The TMS involved creation of real time data base for individual transformer from procurement, installation, failure, repair and scrapping of the same, which would help in evaluating vendor performance, stock position, and preventive maintenance, performance of repair center and history of failure of transformer at transformer center. It was expected to reduce the cost involved in procurement and repair of transformers by better management at all stages. The cost involved was a one

time licence fee of rupees one lakh per district and implementation charges of rupees five lakh per division irrespective of the number of users.

The User Acceptance Test of the software was carried out (December 2003) and the same was rolled out in Tumkur Division (BESCOM) as a pilot division (January 2004). Though, the initial data of all the divisions were up loaded to the software, the same was not updated on day-to-day basis. In the absence of updated data, the software could not be used to evaluate the performance of transformers even after a lapse of three years of initial introduction of the TMS.

BESCOM replied (May 2007) that the divisions were updating the data, after which the software would be put to beneficial use. The Companies were not only deprived of an efficient management system but also the amount of Rs.16 lakh spent on the same (BESCOM-Rs.9.72 lakh and GESCOM Rs.7 lakh) remained unfruitful (August 2007).

Repairs of Power transformers

4.25.9 While minor repairs are carried out departmentally, major repairs of transformers are outsourced on tender basis by KPTCL. Early repair of faulty transformers are essential to avoid huge replacement costs, overloading of neighbouring transformers and disruption in power supply. It was, however, noticed in audit that there were inordinate delays in getting the faulty transformers repaired ranging up to 75 months and beyond resulting in huge replacement costs and idling of costly equipments, besides deterioration of transformers. The loss on account of such idling could not be quantified. A few such instances are narrated in **Annexure-16.**

Annexure 16 shows that the Company was not taking action to get the failed transformers repaired immediately on its failure, which resulted in huge replacement cost, disruption of power supply, overloading of neighbouring transformers which could not be quantified. The reasons attributable for not attending to repairs in time bound schedule was not available on records.

Repair of distribution transformers

The Company owns repair centers at various Divisional Headquarters. The Company is inviting tenders for repairing the failed transformers by utilising the facilities at the centers. These tenders are being finalised/approved at the corporate offices. All the materials except oil have to be supplied by the repairers.

Non-enforcement of guarantee clause

4.25.10 The Central Stores Division Bangalore (BESCOM) had a stock of 109 transformers of various make, which failed within the post-repair guarantee period (failed during the period from 1999 to 2001). No action was taken to get these transformers repaired free of cost within the guarantee period so far (January 2007), with the result that the Company had to bear the cost of repairs, which works out to Rs.16.31 lakh (approximately). No action was taken on the defaulting firms for recovery of the cost involved.

Non-reclamation of used oil

4.25.11 The contaminated and burnt oil released from faulty transformers can be reclaimed for re-use. The reclamation is a process to eliminate all contaminants to obtain oil with characteristics of new oil. As per the rate contract finalised (June 2006) with Subhadra Petrochemicals, Sangli, the oil is being reclaimed at 82 *per cent* of the contaminated oil at the rate of Rs.3,950 per kilolitre. It was observed that, the Companies were not regularly reclaiming the used oil, resulting in accumulation of stock of contaminated oil. As at November 2006/January 2007, 148.968 kilolitre and 739.408 kilolitre of contaminated oil was held in stock in GESCOM and BESCOM respectively, of which 122.15 kilolitre and 606.314 kilolitre of oil could have been reclaimed for use as fresh oil. Non-reclamation of the used oil resulted in procurement of fresh oil to the extent of 122 kilolitre and 606 kilolitre valued at Rs.55.48 lakh and Rs.2.75 crore by GESCOM and BESCOM respectively. Considering the cost of reclamation at Rs.3,950 per kilolitre, the companies could have avoided Rs.50.65 lakh and Rs.2.51 crore respectively in procurement of fresh oil.

Non-return of failed transformers

4.25.12 It was observed that, 238 transformers of various capacities valued at Rs.87.28 lakh failed during 2003-04 to 2006-07 at Tumkur Division (BESCOM) were not returned to stores by the field officers indicating lack of control in this regard. Further, exposure of these transformers to vagaries of nature would render them irreparable and may have to be scrapped besides incurring high replacement cost for the same.

Short claim of insurance

4.25.13 BESCOM proposed (July 2004) insuring the Distribution Transformers of 25 KVA and 63 KVA capacities, in service in the jurisdiction of identified divisions where failure rates were high to cover the risk of the cost of repair/damages to transformers failed 'After Guarantee Period'. Accordingly, machinery breakdown policies were taken for the period from July 2004 to July 2005 at 10 divisions and from January 2006 to December 2006 at 14 divisions respectively. The Company paid a total insurance premium of Rs.1.64 crore at 1.25 *per cent* of the value of transformers insured (Rs.131.12 crore.) with three insurers. The Company circulated the procedure to prefer claim which stipulated that;

- The damage to Distribution Transformers shall be recorded in the log book with brief description of the damage.
- The divisions shall intimate the Head Office about the failure with a request to insurance Company to arrange for the surveyor, where the estimated cost of repair exceeds Rs.20,000. In case the estimate does not exceed Rs.20,000, the repair shall be carried out departmentally and the bill thereof sent to Head Office for preferring claim with the insurer.

The Company preferred total claims of Rs.6.27 crore in respect of three policies during July 2004 to December 2006. The insurers settled claims for Rs.1.28 crore leaving a balance of Rs.4.99 crore as at March 2007.

In this connection, a test check of the relevant records at nine Divisions revealed that the Divisions have not maintained proper records to ensure that claims are preferred in respect of all the failed transformers. Out of a total of 24,130 insured transformers, 5,287 transformers failed during the period of insurance, the Company preferred claims for 4,264 transformers, resulting in a short claim of Rs.1.01 crore in respect of 1,023 transformers.

The matter was reported to the Government (May 2007); their reply is awaited (August 2007).

STATUTORY CORPORATIONS

Karnataka State Financial Corporation

4.26 Delay in swapping high cost borrowings

Avoidable delay in deciding the merchant bankers for the proposed issue of bonds to redeem the high cost bonds resulted in extra payment of interest amounting to Rs.11.61 crore.

In order to redeem high cost borrowing of the Corporation, which was 11.34 *per cent,* the Board of Directors (BoD) approved (3 June 2005) to raise bonds of Rs.300 crore and invited (23 June 2005) bids from Merchant Bankers. Further, considering the need for urgent mobilisation of funds to settle high cost loans, the time for submission of tender documents was reduced to 15 days from 30 days as stipulated under the Karnataka Transparency in Public Procurements Act and a time schedule to mobilise the entire funds before 25 August 2005 was ratified by the BoD.

Against the tender, the Corporation received (July 2005) quotations from seven Merchant Bankers under three options of tenure, *viz.,* 5 years, 7 years and 10 years. Two bidders quoted identical lowest offers with an average rate of 6.96 *per cent*. As their offer under five year tenure was less than the prevailing rate for Government Security paper, the Financial Bid Evaluation Committee of the Corporation felt that the mobilisation would be unlikely and decided (July 2005) to reject the lowest offer by two bidders.

The Committee decided (July 2005) to accept the second lowest offer of SPA Merchant Bankers Limited (SPAMBL) and also to give an opportunity to the other bidders to match their rates with the second lowest rates, so that the issue could be handled by a consortium. While the other Merchant Bankers accepted (July 2005) the rates, they did not agree to the ratio of amount to be raised among the three tenure options. The SPAMBL offered (July 2005) to further prune down their issue fee from 0.4 *per cent* to 0.3 *per cent* provided the ratio among the three tenure was 40:20:40 instead of 50:30:20 as desired by the Corporation. Even with the revised ratio, the IRR worked out to 7.25 *per cent* as compared to 7.20 *per cent* originally quoted. The Committee, recommended (July 2005) appointing SPAMBL as the sole arranger.

In the meanwhile, the lowest bidders issued (July 2005) a letter of clarification and modification to their offer. It was stated that the Government Security rate was expected to fall (during August) and that they were confident of mobilising the investment at a ratio of not less than 25:25:25 and the balance 25 *per cent* would be arranged in such ratio such that the overall IRR would be lower than the IRR of second lowest offer. They also agreed to give an upfront cheque against the five year tenure option. The Board took (July 2005) cognizance of the letter and issued (3 August 2005) mandate in their favour for mobilisation in the ratio of 50:30:20 within a period of 45 days. The Merchant Bankers did not agree to this and reiterated the ratio of 25:25:25 and requirement of 60 days

to mobilise the funds. The BoDs felt (October 2005) that agreeing to the counter offer would result in higher cost of funds, delay in mobilisation. The BoDs also decided to cancel the mandate issued and blacklist them from participating in the future funds mobilisation programmes of the Corporation.

The BoDs decided (October 2005) to call fresh bids for raising funds. Accordingly, an advertisement was issued (November 2005) and in response, the five merchant bankers, who were second lowest in the previous attempt, gave (November 2005) identical bids with average rate of interest of 7.56 *per cent*. The approval of the BoDs was obtained between 17 and 21 November 2005 (by circulation resolution) and the arrangers were appointed on 2 January 2006. The offer, which opened on 4 January 2006 was fully subscribed in 17 days (20 January 2006).

It was observed that instead of appointing the second lowest bidders as the arrangers in the first instance, the tentativeness in decision making at every stage resulted in delay of about five months and additional interest burden of Rs.4.98 crore (higher interest for the period 25 August 2005 to 20 January 2006).

Further, the negotiated weighted average rate of the offer of the second lowest Merchant Banker in August 2005 was 7.25 *per cent*. This increased to 7.56 *per cent* in the second bid though the parties were the same. The extra interest burden on bonds, considering the ratio of issue as 40:20:40 for redemption in 5th, 7th and 10th years respectively, worked out to Rs.6.63 crore.

The Management accepted (August 2007) that despite its bonafide intention, prudent planning and sincere efforts, it was compelled to suffer some amount of financial losses, which could be solely attributed to the factors beyond its control. The reply is not acceptable as the factors were not beyond the control of the Management, rather it was tentativeness in the decision making and lack of planning on the part of the Management that led to the additional interest burden of Rs. 11.61 crore.

The matter was reported to the Government (August 2007); their reply is awaited (August 2007).

Bangalore Metropolitan Transport Corporation

4.27 Extra expenditure

Non-inclusion of suitable clause in the purchase order resulted in extra expenditure of Rs.54.52 lakh.

The Corporation placed (October 2003) purchase order on Tata Motors for purchase of 450 bus chassis at the rates and terms applicable to STU’s/State Government Undertakings or DGS&D rate whichever is lower. The supplies were to be completed by March 2004. Tata Motors supplied (March 2004) 311 chassis, and requested for extension of the period for supply of balance 139 chassis upto April and May 2004. The BoD, however, revised (July 2004) the schedule for supply for 139 chassis between July and September 2004. Tata

Motors supplied 35 chassis (July 2004), 60 chassis (August 2004) and 44 chassis (September 2004).

During the extended schedule of supply, the Central Government imposed two *per cent* education cess on excise duty with effect from 9 July 2004 and the State Government withdrew the concessional sales tax of five *per cent* with effect from 1 August 2004. Thus the Corporation had to pay an effective tax of 13.8 *per cent* with effect from 1 August 2004.

As a result of the increase in statutory levies, Tata Motors claimed Rs.54.52 lakh towards differential duties for 104 chassis supplied in August and September 2004.

It was observed that Karnataka State Road Transport Corporation (KSRTC), the parent organisation of the Corporation, in the cases of purchase of chassis included a clause in the purchase orders to the effect that the rate quoted was inclusive of all taxes and duties. The Corporation had not included such provision in the subject purchase order. Thus, non-incorporation of a suitable clause in purchase order safeguarding the financial interest of the Corporation resulted in extra expenditure of Rs.54.52 lakh.

The Management stated (June 2007) that in order to avoid such situations in future, corrective action has been taken to modify the terms and conditions of supply. The fact, however, remains that the Corporation has incurred extra expenditure of Rs.54.52 lakh in the instant case.

The matter was reported to the Government (April 2007); their reply is awaited (August 2007).

Karnataka State Road Transport Corporation

4.28 Avoidable payment of Sales Tax

Payment of Sales Tax on transportation charges charged by the supplier resulted in avoidable payments of Rs.48.14 lakh.

The Corporation has been procuring High Speed Diesel (HSD) from Indian Oil Corporation (IOC) for its fleet. Test check of payments made to IOC during 2006-07 in 10 divisions of the Karnataka State Road Transport Corporation (KSRTC) and 28 Depots in Bangalore Metropolitan Transport Corporation (BMTC), revealed that IOC charged sales tax at 20 *per cent* on the total invoice price which was inclusive of transportation charges and the Corporation made payments accordingly. It was further observed that even though, transportation charges were shown distinctly in the invoices, but the Corporations could not avail exemption from Sales Tax on transportation charges as the agreements had not detailed transportation charges separately.

Failure to follow the provisions of Karnataka Sales Tax Act resulted in avoidable Sales Tax payment of Rs.48.14 lakh by the Corporation (Rs.45.29 lakh) and also by its sister corporations (Rs.2.85 lakh) for 2006-07.

The Management of KSRTC in their reply (August 2007) while quoting a case law pertaining to supply of cement where price was fixed free on rail (FOR) destination stated that the expenditure incurred by the seller before sale and to make the goods available to the intending customers at place of sale cannot be excluded from the taxable turnover. The reply is not acceptable as the case law cited by the Corporation is not relevant in the instant case as the price of diesel was not inclusive of freight charges. It was also observed that Mangalore Refinery and Petrochemicals Limited (another Government Company), which had supplied diesel to Depot No.6 of the Corporation, had excluded transportation charges for the purpose of calculation of Sales Tax in its invoice.

The matter was reported to the Government (August 2007); their reply is awaited (August 2007).

General

4.29 Loss making Government Companies

Introduction

4.29.1 As on 31 March 2007, the State had 82 public sector undertakings (PSUs) comprising 76 Government Companies (59 working companies and 17 non-working companies) and six Statutory Corporations. Out of 59 working Government companies 14 were loss incurring working Government companies. Five companies[98] with accumulated losses of Rs.815.97 crore were selected for review, the details of their paid-up capital, accumulated losses, *etc.,* are given in **Annexure 17**. Reasons for losses suffered by these five companies are discussed in the succeeding paragraphs.

The Mysore Sugar Company Limited

4.29.2 The Company was incorporated (1933) to operate a sugar factory by utilising the sugarcane grown in and around Mandya District. To have the optimum utilisation, the management installed three additional units *i.e.,* distillery (1933-34), acetic acid (1968) and arrack unit (1993). At present all the three units are not working. The Company is incurring losses since 2000-2001 and accumulated loss as on 31 March 2006 was Rs.151.77 crore against paid up capital of Rs.8.73 crore. The reasons for losses as observed in audit are as follows:

- Non-availability of sugar cane due to decrease in reserved area for cultivation of sugarcane from 74,483 acres to 49,000 acres due to transfer of 25,483 acres to private factories by the State Government resulting in non-achieving the optimum utilisation of installed capacity.
- Non-achievement of the crushing capacity of 5,000 tonne per day, in the last five years due to shortage of sugarcane, non-availability of water, diversion of cane, casting doubts on the viability of the plant.

[98] **One each from Sugar sector, Engineering sector, Handloom and Handicrafts sector, Development of economically weaker section sector and Financing sector.**

- Decrease in capacity utilisation of plant from 74 *per cent* in 2001-02 to 29 *per cent* in 2005-06 and higher percentage of total hours lost to available hours which ranged between 26.14 in 2002-03 and 49 during 2005-06 due to various factors like non-availability of cane, mechanical and electrical troubles, and general cleaning *etc.*

- The Government of India fixes Statutory Minimum Price (SMP) for sugar cane linked to basic recovery of 8.5 *per cent* which is binding on every sugar factory. The Company, however, paid higher rates than SMP without prior approval of the State Government due to intense competition for sugarcane, lucrative jaggery price and extraneous reasons like political pressure. The total amount due to higher payment than SMP amounted to Rs.58.05 crore during 2001-02 to 2006-07 resulting in higher sugarcane cost.

- The Company ventured (January 1999) setting up a bagasse based power plant (Co-generation plant) of 30 MW capacity to generate energy for captive requirement and to sell excess, if any. The estimated cost of the plant was Rs.76.35 crore to be financed by equity of Rs.19.09 crore and a loan of Rs.57.26 crore from HUDCO. In order to fund the equity, the company issued debentures/bonds of Rs.14.84 crore. The work was, however, stopped (September 2004) due to constraints of funds and the plant is not yet commissioned (August 2007). Thus, delay in commissioning the project resulted in payment of interest of Rs.15.55 crore on loans and loss of expected revenue from sale of additional energy that would have accrued had the plant been commissioned.

Karnataka Vidyuth Karkhane Limited

4.29.3 During February 1976, the erstwhile Government Electric Factory, Bangalore was converted as public limited company under the name of 'Karnataka Vidyuth Karkhane Limited'. The Company started incurring loss from 2002-03 and accumulated loss as on 31 March 2006 was Rs.20.72 crore against the paid up capital of Rs.5.62 crore. The following are the reasons for losses as analysed in audit:

- Decline in receipt of orders for supply of transformers from electricity transmission/supply companies in Karnataka, leading to non-achieving the optimum production level.
- The operational expenses and financial charges remained almost constant whereas there was a sharp decline in production, leading to increase in manufacturing cost.
- The Company incurred a loss of Rs.23.22 crore in the turnkey project for extension, re-conducting of 11KV lines, providing of distribution transformers *etc.,* as the Company was not having technical know how for executing such type of works as it was only manufacturing transformers.

Karnataka State Handloom Development Corporation Limited

4.29.4 The Karnataka State Handloom Development Corporation Limited, Bangalore was incorporated in 1975 with the main objective to promote, aid, and assist the rehabilitation, growth and development of the handloom industry particularly outside the Co-operative Sector in the State. The Company was incurring loss continuously from 1999 onwards and its accumulated loss as on 31 March 2005 was Rs.52.79 crore against paid up capital of Rs.44.38 crore. The reasons for loss as analysed by audit are:

- The denial of financial subsidy by State Government had a negative impact on its income, though the State Government was providing budgetary support.
- Due to shortage of working capital, the Company on an average had to incur rupees four crore per annum towards higher rate of interest on cash credit during 2001-02 to 2005-06.
- The in-house processing of cloth at Peenya, Bangalore had become costlier than outsourcing due to high cost of overheads and the unit suffered a loss of Rs.10.94 crore during 2005-06.

Karnataka State Industrial Investment and Development Corporation Limited

4.29.5 The Company was setup (1964) to act as a catalyst for promoting industrial growth in the State, especially in the medium and large scale industries, and to act as a designated agency of the State Government in formulating proposal for industrial infrastructure development. The Company, which made profit upto 1997-98 started incurring losses from 1998-99 onwards. The accumulated loss as on 31 March 2006 was Rs.574.64 crore against the paid up capital of Rs.480.62 crore. The reasons for losses as observed in audit are as under:

- Defective control in respect of appraisal, sanction and disbursement and ineffective monitoring of demand and recovery of term loans resulted in accumulation of dues and non-performing assets which were 75.09 *per cent* of the total dues as at March 2006.
- The recovery of interest on loans ranged between 4.44 and 10.85 *per cent* of total interest due.
- The Company borrows from Industrial Development Bank of India (IDBI) / Small Industries Development Bank of India (SIDBI) and other sources to finance its lending activities. The average cost of borrowings (ranging between 6.94 to 12.73) and the average interest yield[99] (ranging between 4.19 and 6.85) received on its core activities indicated

[99] **Interest yield is based on income from core activity of term, bridge, bill discounting and corporate loans and does not include interest on Non-convertible debentures, other income *etc.,* and is expressed as a *per cent* to total secured and unsecured loans, exposure pending under the same activities.**

that the company was borrowing at a higher cost to lend at lower rates. This further indicated that the administrative and other expenses had to be met out of borrowed funds leading to losses.

- Asset-Liability Management (ALM) indicates the liquidity position of the Company. The net gap in ALM which was Rs.318.69 crore as at the end of March 2002 had increased to Rs.614.54 crore as at end of March 2006 indicating the continuance of liquidity problem.

- As against the Reserve Bank of India norm of nine *per cent,* the Capital Adequacy Ratio of the Company was negative in all the years and varied between (-) 9.39 in 2002-03 and (-) 13.28 in 2005-06.

- The State Government extended guarantees during 2005-06 to the extent of Rs.200 crore to raise money and the Company swapped the high cost borrowings through bond issues with the Government guarantee. Further, the re-financiers (IDBI/SIDBI) extended certain concessions, which, *inter alia,* included reduced rate of interest (6 *per cent*), re-schedulement of loan and conversion of Rs.190.63 crore outstanding dues as redeemable preference shares (IDBI - Rs.148.45 crore; SIDBI-Rs.42.18 crore). The company, however, continued to suffer losses.

Karnataka Minorities Development Corporation Limited

4.29.6 Karnataka Minorities Development Corporation Limited was setup (February 1986) to implement various development schemes and to provide financial assistance by way of loans for starting trade/business or for pursuing profession of doctors, engineers, lawyers *etc.* The main source of income of the company is interest on the loans advanced. Share capital released by the State Government is utilised for providing loan assistance for the approved schemes of National Minorities Development Finance Corporation (NMDFC).

Though the Company is charging 2.5 *per cent* over and above the interest paid to NMDFC (for loans taken from them for disbursement to beneficiaries) on the loans disbursed to the beneficiaries yet it was incurring losses since 1986-87 and its accumulated losses as at the end of March 2006 were Rs.16.05 crore against the paid up capital of Rs.45.57 crore. The main reasons for the losses analysed in audit are:

- The interest income realised from the loans advanced is far less than the interest paid to NMDFC. The gap to some extent is met out of interest earned on the term deposits. Every year the company provides for doubtful advances which constituted about 43.7 *per cent* of the loss in 2001-02 and increased to 55.3 *per cent* in 2005-06.

- The net interest income or the margin available is not sufficient to meet the administrative expenses including the employees cost.

- The Company had to provide for penal interest of Rs.90.57 lakh for delay in repayment of loans to the NMDFC.

- The company did not prepare statement of demand collection and balance in respect of principal and interest. Hence, loan amount due/overdue and not due and interest due at the end of each year is not known leading to lack of follow-up action.
- In respect of the margin money loans granted through banks to the beneficiaries the banks are not remitting to the Company the proportionate amount payable to the Company due to lack of proper documentation of these loans.
- The Company is operating the schemes in cooperation and co-ordination with D.Devraj Urs Backward Classes Development Corporation Limited (DBCDC). Due to heavy work load the District officers of DBCDC are unable to concentrate fully on the works of both the companies and this had an adverse effect on recovery.
- Recent announcements of the State Government for waiver of agricultural loans and interest thereon have created a misconception in the minds of the beneficiaries that such waiver schemes will be extended to them also. This also had effected the recovery.

The matter was reported to the Management/Government (May/August 2007); their replies are awaited (August 2007).

4.30 Follow-up action on Audit Reports

Explanatory note outstanding

4.30.1. The Comptroller and Auditor General of India's Audit Reports represent culmination of the process of scrutiny starting with initial inspection of accounts and records maintained in the various offices and departments of Government. It is, therefore, necessary that they elicit appropriate and timely response from the executive. Finance Department, Government of Karnataka issued instructions (January 1974) to all Administrative Departments to submit explanatory notes indicating a corrective/remedial action taken or proposed to be taken on paragraphs and reviews included in the Audit Reports within three months of their presentation to the Legislature, without waiting for any notice or call from the Committee on Public Undertakings (COPU).

Audit Reports for the years 2000-01 to 2005-06 were presented to the State Legislature between March 2002 and March 2007. Eleven departments, which were commented upon, did not submit explanatory notes on 48 out of 88 paragraphs/reviews as on September 2007, as indicated below:

Year of the Audit Report (Commercial)	Total paragraphs and reviews in Audit Report	No. of paragraphs and reviews for which explanatory notes were not received
2000-01	32	1
2004-05	25	18
2005-06	31	29
Total	**88**	**48**

Department wise analysis is given below:

Name of the department	2000-01	2004-05	2005-06
Commerce and Industries	-	7	9
Energy	-	0	7
Water Resources	-	5	4
Forest	-	1	0
Tourism		2	1
Social Welfare	-	1	0
Finance	-	0	1
Co-operation	-	0	2
Information technology	-	0	2
Public works	-	0	1
Agriculture and Horticulture	-	0	1
General	1	2	1
Total	**1**	**18**	**29**

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

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

4.30.2. The replies to paragraphs were required to be furnished within six months from the presentation of the Reports. Replies to 33 paragraphs pertaining to 8 Reports of the COPU, presented to the State Legislature between February 2004 and March 2007, had not been received as on September 2007, as indicated below:

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

4.31 Response to inspection reports, draft paragraphs and reviews

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 six weeks. Inspection reports issued up to March 2007 pertaining to 77 PSUs disclosed that 3,537 paragraphs relating to 998 inspection reports remained outstanding at the end of September 2007; of these, 14 inspection reports containing 190 paragraphs were pending due to non-receipt of even first replies. Department wise break-up of inspection reports and audit observations outstanding as on 30 September 2007 is given in **Annexure 18.**

Similarly, draft paragraphs and reviews on the working of Public Sector Undertakings are forwarded to the Secretary of the Administrative Department

concerned demi-officially seeking confirmation of facts and figures and their comments thereon within a period of six weeks. All the reviews have been discussed in the Audit Review Committee on Public Sector Enterprises. It was, however, observed that 20 paragraphs and 3 reviews forwarded to the various departments during March 2007 to August 2007 as detailed in **Annexure-19**, had not been replied so far. Their views have been taken into consideration while finalising the reviews/paragraphs wherever replies from Government/Department has been received.

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

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

COUNTERSIGNED

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