CHAPTER II

2. REVIEWS RELATING TO GOVERNMENT COMPANIES

2.1 MYSORE MINERALS LIMITED

Highlights

Mysore Minerals Limited was incorporated in May 1966 under the Companies Act, 1956 for taking over the business carried on by the "Board of Mineral Development" of the State Government. The Company is engaged mainly in exploration, exploitation and marketing of minerals and precious stones in the areas leased / reserved for operation by the State Government.

(Paragraph 2.1.1)

The accumulated losses of Rs.36.98 crore as on March 2004 eroded the paid up capital.

(Paragraph 2.1.5)

Failure to close down non-operational mines resulted in payment of Rs.4.94 crore on salaries and wages of personnel attached to these mines.

(Paragraph 2.1.10)

The Company incurred losses of Rs.9.19 crore due to high cost of production.

(Paragraph 2.1.14)

Non revision of rates in terms of agreement for sale of iron ore resulted in revenue loss of Rs.3.27 crore.

(Paragraph 2.1.24)

The Company incurred losses of Rs.6.17 crore due to acceptance of development cost at lower price, payment of hardship allowance, non-claiming of minimum premium, etc. in the execution of Memorandum of Understanding entered with Jindal Vijayanagar Steel Limited.

(Paragraphs 2.1.28 to 2.1.34)

Failure to implement Voluntary Retirement Scheme in respect of surplus staff resulted in expenditure of Rs.6.70 crore towards salaries and wages.

(Paragraph 2.1.35)

Introduction

2.1.1 Mysore Minerals Limited was incorporated in May 1966 under the Companies Act, 1956 for taking over the business carried on by the "Board of Mineral Development" of the State Government. The Company is engaged mainly in exploration, exploitation and marketing of minerals and precious stones in the areas leased/reserved for operation by the State Government. The Public Sector Reform Commission after considering the losses incurred by the Company, recommended (August 2002) for privatisation or closure of the Company. The Consultant,[∞] who was appointed to make a basic study on the affairs of the Company, recommended in his report for privatisation of the Company, after considering the decline in turnover, incurring of continuous losses, existence of surplus staff and negative net worth. Based on the report of the Consultant and recommendations of the High Power Committee, the Government approved (September 2003) the privatisation of the Company. The Government is yet to decide about the extent of privatisation (August 2004).

Objectives

2.1.2 The main objectives as set out in the Memorandum of Association, inter-alia, are:

- to search for minerals and precious stones and to acquire mining and other rights, work mines / quarries, minerals and precious stones;
- to acquire minerals for sale;
- to act as an agent of the State Government in the exploitation of the mining areas reserved for operation by the State;
- to carry on trading in minerals for sale or export; and
- to promote, improve, establish and develop, manage and run mineral, metallurgical, chemical or other allied industries, etc.

The Company has not promoted/established any mineral, chemical, metallurgical or other allied industries other than the Granite Cutting and Polishing Unit (GCP) at Hassan, which was closed down (1998) and the Stone Ware Pipe Factory at Bageshpura, where no significant activities were being carried out.

Organisational set-up

2.1.3 The management of the Company vests with the Board of Directors (Board) consisting of not less than three and not more than 12 Directors including a Chairman and a Managing Director appointed by the State Government. The Managing Director is the Chief Executive of the Company. As on 31 March 2004, the Board consisted of 12 Directors.

[∞] K.G.Acharya and Company

During April 1999 to March 2004, 13 incumbents held the post of Managing Director for periods ranging from 14 days to 10 months. Frequent changes at the decision making denied the Company the expertise and benefit accruing from continuity.

Scope of Audit

2.1.4 The working of the Company was earlier reviewed and included in the Report of the Comptroller and Auditor General of India (Commercial) for the year 1982-83. Subsequently, certain aspects relating to iron ore raising contracts were reviewed and included in the Report of the Comptroller and Auditor General of India (Commercial) for the year 1989-90. The Committee on Public Undertakings (COPU) also examined (September 1986, January 1987 and April 1991), *suo moto,* the transactions of the Company covering the period up to 1985-86 and in particular the working of the Granite Cutting and Polishing (GCP) Unit at Hassan and Stone Ware Pipe Factory at Bageshpura. The recommendations of COPU in its 26th, 27th and 47th Reports were presented to State Legislature during November 1986, March 1987, and April 1991 respectively.

The present review covers the performance of the Company during the five years up to 2003-04. Apart from the records maintained at Head Office, initial records kept at 10 units♣ (out of 56 units) were test checked and reviewed by Audit.

Audit findings, as a result of test check were reported to the Government/Company in March 2004 with a specific request for attending the meeting of Audit Review Committee on Public Sector Enterprises (ARCPSE), so that view point of the Government / Management was taken into account before finalising the review. The meeting of ARCPSE held on 21 April 2004, was attended by the Managing Director of the Company. No representative from the Government side attended the meeting but the replies of the management were endorsed by the Government. The views expressed by the members have been taken into consideration during finalisation of the review.

Financial position and working results

2.1.5 The authorised and paid up share capital of the Company as at 31 March 2004 was Rupees seven crore and Rupees three crore, respectively; of which Rs.2.97 crore were contributed by the State Government and balance by a State Government company viz., Karnataka State Industrial Investment and Development Corporation Limited. The financial position of the Company for the last five years up to 2003-04 is given in **Annexure 8.**

The accumulated losses of Rs.36.98 crore eroded the paid up capital of Rupees three crore.

The accumulated losses of Rs.36.98 crore as at 31 March 2004 eroded the paid up capital of Rupees three crore. The trade dues and other liabilities (including provisions) increased from Rs.26.52 crore in 1999-2000 to Rs.100.96 crore in 2003-04, mainly on account of interest accrued on borrowing.

♣ Jambunathanahally, Subbarayanahalli, Byrapura, Karya, Kaladgi, Thirthahally mines, Chamarajanagar, Doddaladahally, Hosadurga quarries and GCP unit at Hassan.

Borrowings

2.1.6 Based on the request (November 1998) of the Company, the Government converted (March 1999/March 2000) royalty of Rs.8.88 crore payable for the years 1998-2000, as interest free loan. Audit observed that the Company had accounted for loan of Rs.5.35 crore only. The Government stated (April 2004) that action was being taken to reconcile and account the difference in the accounts.

The Government had also sanctioned loans of Rs.10.64 crore from time to time to the Company for meeting expenditure for clearance of provident fund dues and settlement of voluntary retirement benefits. The terms and conditions in respect of loan of Rs.5.30 crore were to be notified separately. The Government is yet to notify the terms and conditions (August 2004). Audit observed that the Company had treated Rs.5.30 crore, as interest free loan.

Working results

2.1.7 The working results of the Company for the last five years up to 2003-04 are given in **Annexure 9.**

The Company incurred losses continuously during 1999-2003. The Company attributed the losses to the ban on non-forest activities in forest areas and also to the recessive and depressive market conditions year after year. The Company earned a profit of Rs.3.02 crore (provisional) during 2003-04. This was mainly on account of increase in sale of iron ore, which had an unprecedented demand during the year.

Activities

2.1.8 The minerals produced by the Company during the last five years up to 2003-04 were mainly chromite, iron ore, lime stone and magnesite. The total turnover of these minerals ranged between 61 to 79 per cent of total turnover. As on 31 March 2004, the Company had 45 mining and 37 quarry lease, out of which exploitation of mineral was carried out in 28 mining lease and 16 quarry lease. The extent of achievement of the objectives of the Company has been discussed in the succeeding paragraphs.

Exploration and prospecting for minerals

2.1.9 The Company formed an exploration wing at Kumsi in 1976, to carry out investigation and exploration of the existing mining areas and prospecting of new mineral occurrence areas by drilling and surveying to obtain prospecting license and to acquire mining leases. It was also responsible for preparation of mining plans, quality control, preparation of forest checklist, chemical lab works, etc.

Audit observed that the Company had not done any exploration work (drilling) during 1999-2004. The heavy backlog in drilling affected the prospecting of mineral deposits and working of mineable areas. The Government stated

(April 2004) that backlog in drilling was due to financial constraints and it had not affected the working of mineable areas since the earlier exploration would last till the end of 2005. The reply is not acceptable as it was not prudent to wait for further exploration till the proven reserves were exhausted.

The position of reserves as on 31 March 2004 as per the mining plan of the Company is given below:

(in lakh tonne)

Minerals	Ore Reserves as on 1 April 1999 (proved/probable)	Quantity produced during the period 1999-2004	Ore Reserves as at 31 March 2004 (proved/probable)
Manganese	29.75	-	29.75
Chromite	10.48	0.80	9.68
Iron Ore	847.27	42.98	804.29
Magnesite	3.37	0.77	2.60
Others	4,019.16	19.81	3,999.35
TOTAL	**4,910.03**	**64.36**	**4,845.67**

It could be seen from the above that as against mineral reserve of 4,910.03 lakh tonne as at 1 April 1999, the Company extracted 64.36 lakh tonne (representing 1.31 per cent of the available reserve) only over a period of five years ended March 2004.

Mining Lease

2.1.10 The Company had 45 mining lease covering 7,611 hectare as at the end of 31 March 2004. The Company was operating 24 lease covering 4,344 hectare departmentally. Four lease covering 787 hectare were operated on ore-raising / joint-venture basis. The balance 17 lease covering 2,480 hectare were not being operated on account of uneconomic production, poor demand, ban on mining in forest area and dispute regarding land.

Failure to close down non-operational mines resulted in payment of Rs.4.94 crore on salaries and wages of personnel attached to these mines.

The Company had 37 quarry lease covering 827 acre as on 31 March 2004, of which five lease were being operated departmentally; 11 lease were being operated on raising contracts and the balance 21 lease were not under operation due to high cost and prohibitory orders clamped by the Government.

The Company has not taken any action to close down / surrender the non-operational mines so far (August 2004). This resulted in payment of Rs.4.94 crore on salaries and wages of the personnel attached to these mines during the last five years without any return.

The Government stated (April 2004) that only economically viable mining/quarry leases were being operated by the Company either departmentally or otherwise based on the market demand for the product from time to time. The Government also stated that the economic viability of the mines were being examined and action would be taken to surrender such uneconomical leases.

Payment of dead rent

The Company paid dead rent of Rupees two crore due to non-operation / surrender of the leases.

2.1.11. Audit observed that 30 lease (in addition to those stated above) obtained between 1971-1998 were neither operated nor surrendered by the Company. As a result, it was forced to pay dead rent of Rupees two crore during 1998-2004. The Government stated (April 2004) that based on the demand and supplies in market some of the mining and quarry lease were operated to meet the requirement of the market and the balance area kept in reserve for further exploitation. The reply is not tenable as these lease were with the Company from six to 33 years without being operated, indicating that they were in excess of the requirement of the Company.

Absorption of royalty

2.1.12 The Company requested (April 2000) the Government for deferment of the royalty for 2000-02 in view of its critical financial position. Pending approval of the Government, the Company retained the royalty collected from the buyers. The Government, however, rejected (January 2002) the request and demanded the advance payment of royalty for all future supplies. The Company worked out (December 2003) the royalty including dead rent, surface rent and cess of Rs.8.57 crore payable for 2000-02. The Company had, however, collected (as per the books of the Company) Rs.5.93 crore only from the buyers. The difference of Rs.1.79 crore (considering the dead rent of Rs.0.85 crore, which the Company had to bear) was not collected from the buyers and the reasons for the same were not on record. The Company had charged this amount as expenditure during 2002-03. The Government stated (April 2004) that there was no royalty pending from the buyers and action has been taken to pay the balance amount depending upon the financial position of the Company. The reply is not tenable as the Company has charged this amount of Rs.1.79 crore as expenditure in 2002-03 as stated above.

The Government had also claimed interest of Rs.3.14 crore (15 per cent for granite and 24 per cent for minerals) on royalty and dead rent payable for the period up to 31 March 2003. The Company approached (December 2003) the Government for waiver and the decision of the Government is still awaited (April 2004).

Production performance

Targets and achievements

2.1.13 The main minerals produced by the Company are chromite, manganese, iron ore, limestone and magnesite. The Company stopped (1996) mining of manganese ore due to the Supreme Court judgement prohibiting mining activities in forest areas. Iron ore mining was being operated by a joint-venture company (Jindal Vijayanagar Steel Limited) from 2000-01. The details of budget and the actual achievement thereof for the last five years ending 31 March 2004 are indicated below:

Mineral	1999-2000		2000-01		2001-02		2002-03		2003-04 (Provisional)	
	Budget	Actual	Budget	Actual	Budget#	Actual	Budget#	Actual	Budget#	Actual
	(in lakh tonne)									
Chromite	0.22	0.13 (59.09)	0.53	0.15 (28.30)	-	0.19	-	0.19	-	0.12
Iron ore	1.68	0.19 (11.31)	-	-	-	-	-	-	-	-
Magnesite	0.31	0.25 (80.65)	0.26	0.15 (57.69)	-	0.10	-	0.16	-	0.16
Limestone	3.12	2.30 (73.72)	3.33	2.78 (83.48)	-	3.69	-	3.03	-	2.58
Rough Granite blocks (in cubic metre)	8,920	7,230 (81.05)	10145	6,324 (62.34)	-	8,160	-	9,000	-	Not available

(Figures in bracket indicates percentage achievement)

From the table it could be observed that the production ranged from 11 to 83 per cent of target during 1999-2001. The Company had not fixed any target for 2003-04 for reasons not on record. There was also no system of analysing the reasons for the shortfall in achieving the target in order to take corrective action.

Departmental production

Uneconomic working of Mines

The Company incurred losses of Rs.9.19 crore due to high cost of production.

2.1.14 The Company had 19 mines covered by 24 mining lease and five quarries working departmentally as on 31 March 2004. As a result of high cost of production four to ten units incurred losses of Rs.9.19 crore during the last five years as detailed below:

Year	No. of units	Amount of loss (Rs. in crore)
1999-2000	4	1.44
2000-2001	8	1.26
2001-2002	9	2.14
2002-2003	10	2.38
2003-2004	4	1.97
Total		**9.19**

Audit observed that four• units have been incurring losses continuously over a period of three years ending March 2004 (total loss of Rs.5.73 crore up to

The Company has not fixed the budgetted quantity.

• Chamarajanagar, Karya, Taridalu and Rajansiriyur.

March 2004), but no efforts were made by the Company either to reduce the cost of operation to make them viable or to award the same on raise-cum-sale contract. The Government stated (April 2004) that action was being taken to enlist some of the quarries /mining leases on raise-cum-sale basis.

Mineral-wise profitability

2.1.15 The mineral-wise profitability based on the cost records of the Company for the last five years ending 2003-04 is indicated in **Annexure 10.**

It could be seen from the Annexure that the Company incurred loss of Rs.4.21 crore in producing chromite, magnesite and iron ore during the last five years ending 31 March 2004. In respect of iron ore, the Company had been incurring losses till 1999-2000, when work was being carried out departmentally. The main reasons for incurring losses were:

- under-utilisation of machinery (referred to in paragraph 2.1.17);
- excess consumption of power (referred to in paragraph 2.1.18);
- excess deployment of man-power (referred to in paragraph 2.1.35);

The Company has been earning profit from 2000-01 onwards as the work of mining has been awarded to ore-raising contractor from then onwards.

Cost analysis

2.1.16 The Company has a system of compiling mine-wise cost of production under historical cost system. The total monthly cost of production of each mine/unit is ascertained considering the total expenditure incurred by the respective mines/units. But in the absence of pre-determined/standard cost fixed for each of the mine, the Management could not analyse cost variance to take immediate steps to contain expenditure, wherever possible.

Hiring of excavators

2.1.17 The Company deployed two excavators purchased in 1997 in Ilkal Granite Quarry for raising of granite. In addition to above, the Company has also been hiring excavators. The rate of hire charges paid by the Company for the excavators used in the work was Rs.2,300 per hour up to December 2002 and Rs.2,500 thereafter as against cost of operation of departmental excavators ranging from Rs.1,014 to Rs.1,086 per hour.

Audit observed that one of its own excavators went out of operation in March 2001. The Company did not initiate any action to get it repaired on the ground of financial constraint even though the cost of repair was Rs.0.94 lakh only and the saving ranged from Rs.474 to Rs.1,286 per hour (as compared to hired excavator).

Audit also observed that there was under utilisation of own excavators to the extent of 50 per cent of effective working hours even after allowing 25 per cent of the available working hours for repairs and maintenance. Considering the difference in rate of hire charges paid and cost of operation of own excavators, the loss due to under utilisation of the excavators in Ilkal during 1999-2004 amounted to Rs.92.94 lakh. The Government stated (April 2004) that the matter of under utilisation of machinery leading to losses was being looked into.

Consumption of Power

2.1.18 The Byrapur Chromite Mine is an underground mine. The ore is extracted by using power. The Company availed of high tension power supply with a contract demand of 250 KVA from Karnataka Power Transmission Corporation Limited (KPTCL) {erstwhile Karnataka Electricity Board (KEB)}. Besides this, the Company was having a DG set, which was used as a back up. The cost per unit of own generation ranged from Rs.4.62 to Rs.28.74 during the period April 1998 to September 2003 as against the rate per unit ranging from Rs.4.02 to Rs.8.88 of KEB / KPTCL. The power supply availed of from KEB / KPTCL was disconnected in December 1996 for non-payment of energy charges. Consequently, the captive generation became the only source of power for extracting the ore. This resulted in avoidable expenditure of Rs.33.81 lakh due to higher cost of generation. The Government stated (April 2004) that the supply of power from KEB was not regular and in view of safety of underground workers and production, the generator was used continuously. The reply is not tenable since the power supply was disconnected due to non-payment of energy charges. Moreover, use of own generation from generator during the period of non-supply of power only, would have reduced the cost.

Raising contracts

2.1.19 The Company awards raising contracts, after inviting tenders, based on the premium quoted by the parties. The agreement entered into with the contractor provides for levy of penalty for the shortfall in monthly minimum production and claiming of reimbursement of salaries/wages of the staff of the Company.

Non-claming of dues

2.1.20 On a review of the granite raising-cum-sale contracts, following irregularities were observed:

- **Mallainapura and Yadapura quarries -** The Company entered (February 2002) into agreement with Metro Granite, Bangalore for removal of granite blocks from the above quarries. In terms of agreement, the raising contractor was to commence the production by June 2002. The contractor, however, did not commence the operation till May 2003. The Company without claiming the penalty of Rs.60.18 lakh for the shortfall in production, cancelled the agreement in May 2003 and entered into fresh agreement in October 2003 with the same party on the same terms and conditions.

- **Bettadapura quarry -** The Company entered (August 1999) into an agreement with Oriental Granite and Marble Tiles Private Limited, Bangalore for raising granite blocks. The Company did not claim premium of Rs.16.68 lakh for the shortfall in the production in terms of the agreement. The contract was cancelled on expiry in August 2002.

The reasons for non-claiming the amount as per the contracts were not on record. The Government stated (April 2004) that action to forfeit the security deposit and to initiate legal process to recover the premium would be taken up. No action has been taken so far (August 2004).

Sales performance

Marketing strategy

2.1.21 The Committee on Public Undertaking in its 47th Report (April 1991) observed that there was no regular system of evaluating the performance of Marketing Division in terms of turnover by fixing realistic targets and monitoring achievement. Audit also noticed that the Company was not having a defined sales policy and definite arrangements for marketing its products.

2.1.22 The following table indicates the details of export and domestic sales for the last five years up to 2003-04.

Year	Sales (Rupees in lakh)		
	Export	Domestic	Total
1999-2000	198.71	1,488.16	1,686.87
2000-01	117.07	1,878.31	1,995.38
2001-02	503.15	2,650.07	3,153.22
2002-03	88.70	3,158.85	3,247.55
2003-04	358.13	4,069.29	4,427.42

It could be seen from the above, that though there was overall increase in the value of sales year after year, there was decline in export sales during the year 2002-03 and 2003-04, compared with that of 2001-02. The increase in sales from 2001-02 and onwards was mainly on account of awarding ore raising contract for iron ore with selling arrangement and also on account of unprecedented demand for the iron ore fines.

Audit observed that the Company was not able to export Manganese ore during the last five years even though it had a stock of 27,238 tonne of ore valuing Rs.1.45 crore.

The Government stated (April 2004) that due to losses and non-availability of sufficient funds, there were decline in exports and no export orders for granite was taken up.

Advance commitment for supply of iron ore fines

2.1.23 The iron ore fines generated in the mining of iron ore were being disposed off to Minerals and Metal Trading Corporation of India Limited (MMTC) at the negotiated prices and to other buyers on the list price of the Company, revised from time to time. Audit observed that:

- in respect of 29 cases (during December 2003 to March 2004), the Company adopted pre-revised rates even though the letter of intents were issued on / after the date of revision of list prices. This resulted in undue benefit of Rs.7.31 crore to the buyers;

- in respect of 19 cases (during December 2003 to March 2004) the Company agreed to supply the fines at the rates indicated in letter of intents even though the advances were received after due date indicated in the letter of intents and the list price has been revised thereafter. This resulted in undue benefit of Rs.5.71 crore to the buyers.

Non-revision of selling prices

2.1.24 The Company entered into separate agreements (October 1999) with Kalyani Ferrous Industries Limited (KFIL) for raising of iron ore at Jambunathanahalli and Subbarayanahalli iron ore mines and with Mukunda Steels Limited (MSL), Mumbai for marketing the same. The selling price was fixed at Rs.253 per tonne for calibrated iron ore. As per Clause 6 of the agreement, the rates fixed for the sale of ore shall be firm for two years after the moratorium period of one year and thereafter the prices were required to be reviewed and re-fixed on 1 April of each year taking into consideration the revision in prices, if any, by Minerals and Metal Trading Corporation of India Limited (MMTC). The rates were due for revision in April 2003.

The Company, based on the request by KFIL and MSL, revised (January 2002/May 2003) the agreements by interchanging their roles (KFIL was now given contract for marketing of ore and MSL was given contract for raising the ore), with the same terms and conditions. Audit observed that the Company, however, failed to incorporate revised prices as per the earlier agreement in the new agreements, with the result the rates are now due for revision only in April 2005 and April 2006, respectively.

Non revision of rates in terms of agreement for sale of iron ore resulted in revenue loss of Rs.3.27 crore.

Non revision of rates, based on the revision done by MMTC, resulted in loss of revenue of Rs.3.27 crore on the supply of 5.03 lakh tonne of ore during 2003-04. The Government stated (April 2004) that the revised agreements were entered due to inter-change in the roles of these parties. The reply is not tenable, as while entering into revised contract, on one side the Company did not refix the selling price based on the then prevailing rate of MMTC and on the other side the period of review of selling price was changed.

Inventories

2.1.25 The Company had not fixed any norms to hold an inventory at any point of time. The following table indicates the comparative position of inventory, consumable stores and spares and their distribution at the end of five years up to 2003-04:

(Rupees in crore)

	1999-2000	**2000-01**	**2001-02**	**2002-03**	**2003-04 (Provisional)**
Stock in trade (finished goods)	15.95	12.55	12.14	22.40	17.32
Stock of stores and spares	1.27	1.41	1.49	1.33	1.41
Stock in trade in terms of months sales	11.4	7.6	4.6	8.3	3.80
Stock of stores and spares in terms of months of consumption	5.0	6.9	5.7	4.7	6.20

It could be seen from the table that there was heavy accumulation of finished goods. In terms of months' sale it varied from 4.6 months' to 11.4 months' sale.

2.1.26 The granite blocks measuring 11,598.706 cubic metre produced during 1981-2000 remained unsold as at 31 March 2004. Due to lack of demand and defects in the blocks produced, the Company was not able to dispose off the blocks. The estimated realisable price of these blocks was Rs.1.16 crore (as on 31 March 2004) as against the cost of Rs.5.22 crore incurred on the production. These blocks were proposed for disposal in December 2001 through tender after determining the price of blocks grade-wise by using the service of expert in the granite field. The blocks were, however, still lying in the quarries (August 2004). Thus, delay in liquidating of these stock not only resulted in blocking of working capital in the form of inventory but also lead to decline in the value year after year due to deterioration in the quality of granite. The Government stated (April 2004) that the Board was seized of this matter.

GCP Hassan

2.1.27 Granite Cutting and Polishing unit (GCP), which was setup (January 1986) at Hassan at a cost of Rs.2.52 crore, as a 100 per cent 'Export Oriented Unit' (EOU), with an installed capacity of 40,000 square metre of processed granite per annum, failed to achieve full capacity due to lack of export orders. The unit become unviable as being an EOU, it was not allowed to sell its products in the local market in absence of export orders.

COPU in its 47th report (24 April 1991) attributed the heavy losses by GCP Hassan to the following main reasons:

- fixation of low production targets;
- non-fixation of sale target with reference to production targets and order requirements;

- production of granite not in accordance with the requirement of customer orders leading to heavy rejection by the customers; and
- failure of unit and the Company to monitor compatibility of production with sales, etc.

Due to lack of export orders, the Company has to either pay a duty of Rs.4.34 crore for debonding and marketing the granite stock of Rs.1.65 crore or destroy it alongwith consumables.

The Company did not analyse these reasons further to take adequate action and continued with the production of granite. This resulted in accumulation of stock. The Company discontinued the production in February 1998 after accumulating stock of 16,525.29 square metre; the market value as on 31 March 2004 of this stock was Rs.1.65 crore.

As the Company could not fulfill its export obligation as envisaged, the Customs Department imposed (1998) penalty of Rs.1.25 lakh as per the Export-Import Policy. In addition to the above, the Development Commissioner, Ministry of Industries and Commerce, Government of India, advised (July 2002) the Company to approach the Central Excise Authorities for debonding with a proposal to destroy its unsuitable stock and finished goods and consumable.

The Superintendent of Central Excise, Hassan range, however, demanded (November 2002) the Customs Duty of Rs.4.34 crore forgone on capital goods and consumables already utilised in the production of the goods without achieving the stipulated export obligations and Rs.33.82 lakh for not achieving the value addition.

In view of lack of export orders to execute and restrictions to sell the products in local market on account of considering the unit as 100 per cent EOU, the option now available with the Company, is either to pay Duty of Rs.4.34 crore for debonding and marketing the stock of Rs.1.65 crore available in domestic market or to destroy it alongwith consumables worth Rs.81.72 lakh and dispose off the property after scrapping the machinery and closing the unit.

The Government stated (April 2004) that the issue would be taken up with the Excise and Customs Authorities to dispose off the stock in the domestic market.

Joint Venture with Jindal Vijayanagar Steel Limited

The Company incurred losses of Rs.6.17 crore due to acceptance of development cost at lower price, payment of hardship allowance, non-claiming of minimum premium etc., in the execution of Memorandum of Understanding.

2.1.28 The Government of Karnataka set up a joint venture between Jindal Vijayanagar Steel Limited (JVSL) and the Company, to provide adequate supply of iron ore to the steel plant of JVSL at Torangallu. A Memorandum of Understanding (MOU) was signed between the Company and JVSL in January 1997 and a joint venture company was registered under the Companies Act as “Vijayanagar Minerals Private Limited” (VMPL). According to the MOU, the Company was to make available the existing Thimmappanagudi iron ore mines for exploitation by VMPL, while JVSL was to make available A, D and E blocks of Kumaraswamy iron ore mines for exploitation and to develop a mine of the capacity of around eight million tonne per annum, primarily to meet the requirement of JVSL and commitments of the Company. JVSL was to purchase 3.5 million tonne of fines, while the Company was to purchase 1.5 million tonne of lumps at transfer price (lower than market value), to be decided later by the joint venture partners. VMPL was free to sell the balance quantity of lumps and fines with the first option of refusal by the Company. VMPL started production from February 2001.

Audit observed the following :

Acceptance of development cost at a lower price

2.1.29 As per MOU, the Company was to hold equity of 30 per cent in VMPL, while the balance 70 per cent equity was to be held by JVSL. The cost of the developmental work done by the Company in Thimmappanagudi was to be evaluated and treated as contribution of the Company towards equity capital. The Thimmappanagudi iron ore area was handed over to VMPL on 1 August 1998 for development and production.

The cost of developmental work carried out by the Company in this area was got evaluated at Rs.3.72 crore and VMPL was requested (December 1998) to treat this as contribution towards share capital. The other partner, however, did not agree for this evaluation and it was decided (January 1999) to refer this to an independent mine valuer and the valuation done by him would be final.

The cost of development work was evaluated at Rs.2.43 crore by the mine valuer. This was also not agreed to by the partner and the Company was asked to consider the development cost of Rs.1.33 crore. The Company initially did not agree to the offer but finally agreed (September 2000) for Rs.1.74 crore. The basis of Rs.1.74 crore as against Rs.2.43 crore given by the independent valuer was not available on record. Acceptance of lower value for cost of development work resulted in loss of Rs.69 lakh.

The Government stated (April 2004) that the cost of development of mine assessed by the Assayers was not agreed by VMPL on the plea that the ore available in the section had already been exploited by the Company. Further, by disposing of the stock available at the mine, the Company had realised Rs.2.50 crore as against the loss of Rs.69 lakh. The reply is not tenable as the Company had only handed over the mine with infrastructure to VMPL for exploiting the ore and not the stock lying in the mine, which belonged to the Company. As such realisation of Rs.2.50 crore by sale of these ore was in no way connected with the development cost.

The shareholders agreement was yet to be finalised and the same was stated to be pending with the Government (August 2004). Pending finalisation of share holders agreement, shares for Rs.1.74 crore have not been allotted to the Company even after lapse of over five years of handing over of the mine to VMPL. This deprived the Company of any return on investment.

Payment of Hardship Allowances

2.1.30 According to the MOU, VMPL would be responsible to either absorb the services of, or provide a Voluntary Retirement Scheme (VRS) for all the workers and employees of the Company in its Iron Ore Division at Thimmappanagudi. As per the service agreement (February 1999), VMPL was to pay (January to April 1999) Rs.3.50 crore in four installments to the Company, as one time settlement, to meet the funds required for VRS. The Company received Rs.1.50 crore only between January and July 1999. The balance payment of Rupees two crore was yet to be paid by VMPL (August 2004).

The Company introduced the VRS in October 1998 and allowed 1,300 employees to retire. As the Company was not able to settle the dues of the employees, it paid hardship allowance at the rate of 50 per cent of salary up to May 1999 and increased the same to 75 per cent on the demand of the employees from June 1999 till the settlement was made in August 2000 from its own fund. The Company paid hardship allowances of Rs.76.09 lakh to its employees. In the absence of any clause for reimbursement of such expenditure in the service agreement and specific clause regarding payment of interest for the delayed/non payment of installment, the Company was forced to bear this additional expenditure. The Government stated (April 2004) that the Company was making efforts to recover the balance amount.

Non claiming of minimum assured premium

2.1.31 According to the draft shareholder agreement, the minimum premium of Rs.66 lakh, Rs.1.06 crore and Rs.1.32 crore was payable for first, second and third financial year respectively.

Audit observed that the Company did not claim the assured minimum premium payable as per the terms of draft agreement. This resulted in short recovery of Rs.89.24 lakh in the minimum annual premium payable during 2001-04.

The Government stated (April 2004) that the claim for shortfall in minimum premium had been sent to VMPL.

2.1.32 JVSL and the Company agreed (June 1999) for the premium of Rs.30 per tonne for lump and Rupees six per tonne for fines payable by VMPL to the Company. These rates were arrived at on the basis of the then existing purchase price of MMTC and on the assumption of generation of ore and fines in the ratio of 30:70. The premium was to be revised and re-fixed from 1 April 2003, based on the prevailing market price.

Audit observed that the actual production of ore and fines were in the ratio of 7:93, thereby generating 5.05 lakh metric tonne of excess quantity of fines as compared to the norms decided earlier. This resulted in loss of Rs.1.21 crore to the Company due to lower payment of premium.

The Government stated (April 2004) that this issue has been taken up with VMPL and the matter will be further pursued.

Non revision of Premium

2.1.33 Audit also observed that the Company did not revise the rate of premium and continued to raise invoices at the existing rate for the supplies effected after 1 April 2003. Reasons for non-revising the rate, considering the market rate for the supplies effected after 1 April 2003, were not available on record. The failure to fix premium on the basis of market price prevalent on 1 April 2003, resulted in short collection of premium of Rs.1.04 crore. The Government stated (April 2004) that the matter would be pursued further with VMPL.

Non-exercising of option to purchase the iron ore lumps

2.1.34 The MOU provided that out of the production of eight million tonne per annum, the Company was entitled to buy 1.5 million tonne at the transfer price. The transfer price for lumpy ore was fixed (January 1999) at Rs.164 per tonne. The total production of the joint venture during April 2001-04 was 25.47 lakh tonne including 2.57 lakh tonne of lumpy ore. As this production of lumpy ore was much lower than that provided for in MOU, the Company had the option to buy all the quantity on transfer price. The Company, however, did not insist upon VMPL to supply lumpy ore to it at transfer price.

Failure of the Company to insist upon the joint venture to supply lumpy ore at transfer price resulted in loss of revenue of Rs.1.58 crore (worked out on the basis of the minimum market rate of Rs.225.63 per tonne and transfer price of Rs.164 per tonne).

The Government stated (April 2004) that by considering the premium payable and further crushing charges, the cost per tonne of ore worked out to Rs.254 as against the minimum market rate of Rs.225.63. The reply is not tenable since the transfer price fixed for lump and fines was after crushing only. The premium payable by VMPL had no relation to the transfer price as it had to pay the premium to the Company on the ores mined.

Manpower

2.1.35 In order to reduce the surplus manpower, and to improve productivity, the Company introduced (October 1998) VRS under which 1,300 employees were allowed to retire (October 1998) as discussed in paragraph 2.1.30. After relief of these employees, the Company had 2,454 employees.

The production activities of the Company came down after 1997-98 due to closure of some of its mines and also awarding of ore raising contract to outsiders in respect of some of its mines and quarries, which rendered the staff surplus.

The Company assessed its manpower requirement and identified (September 2002), 604 persons as excess in different categories. The average salary per month of this excess staff worked out to Rs.33.51 lakh. Though the Company identified these staff as excess in September 2002, no action has been taken so far (August 2004) either to implement VRS for these excess

Failure to implement VRS in respect of surplus staff resulted in expenditure of Rs.6.70 crore towards salaries and wages.

employees or to request other Government companies, through the State Government, to take this excess staff on deputation. This has resulted in increase in the cost of production. Considering the monthly expenditure of Rs.33.51 lakh incurred on this surplus staff, the total expenditure on salaries and wages for these employees from September 2002 to April 2004 worked out to Rs.6.70 crore. The Company stated (April 2004) that excess employees had been identified and details were called for from all the units about the employees, who were willing to go on voluntary retirement, to avoid expenditure towards salaries and wages.

Internal Control and Internal Audit

2.1.36 The Internal Audit of the Company has been entrusted to a firm of Chartered Accountants on a monthly remuneration basis. Audit observed that:

- Internal Auditors Reports were mainly pointing out the deficiencies in internal control in the areas of cash / bank transaction recorded, invoicing of sales, payment of advances, purchase of stores, repairing of vehicles and machinery, etc.

- no periodical reports on physical target vis-a-vis achievements, performance of individual units under profit centre and on effectiveness of internal control system in key functional areas were, however, submitted to the management by the Internal Auditors as envisaged in the scope of audit.

- the Internal Auditors Reports and the compliance thereon have not been reviewed periodically and brought to the notice of the Board.

The important tools such as budget, internal audit and audit Sub-Committee helps the management to exercise effective internal control system in the day to day affairs of the Company. Though the Company prepares the budget annually, the achievement thereof was not being monitored from time to time to have better control of affairs and to take preventive/corrective action. Further, reasons for non-achievement was also not being analysed. Similarly, though firms of Chartered Accountants were being appointed as Internal Auditors, the reports of the Internal Auditors were not being placed before the Board for taking corrective action as stated earlier. The Audit sub-committee, one of the main tool for exercising the internal control, was formed only in March 2003. This sub-committee has not held any meeting subsequent to its formation.

The Statutory Auditors in their Report to the shareholders on the accounts of the Company for the years 1999-2000 to 2002-03 have also opined about need of strengthening the internal control/internal audit system existing in the Company.

The Government stated (April 2004) that steps were being taken to strengthen the internal control in the Company and to place the reports of the Internal Auditors before the Board.

Conclusion

The Company was established with the main objective of exploring, exploitation and marketing of mineral wealth from the leased area in the State. The Company could not achieve the targeted production in any of the years. Due to non-operation of certain leases, the Company had to pay heavy dead rent. Non-closure of the mines, where production operation was suspended, also forced the Company to incur extra expenditure towards salaries and wages. The Company sustained losses due to high cost of production compared with the realisation. The Company had incurred extra expenditure towards hardship allowance, sustained revenue loss on account of accepting the development cost at a lower rate, non claiming of minimum assured premium, etc., in the execution of the Memorandum of Understanding with Jindal Vijayanagar Steel Limited. Closure of some of its mines and quarries and also awarding of ore-raising contract to outsiders has rendered the staff surplus.

The Company needs to improve the productivity of its mines and quarries to earn profit regularly. Action needs to be taken to surrender non-operational, unproductive mines and quarries to avoid payment of dead rent. The Company needs to recover the dues as provided in the Memorandum of Understanding with Jindal Vijayanagar Steel Limited. The Company needs to reduce its surplus manpower.

2.2 KARNATAKA POWER CORPORATION LIMITED AND VISVESWARAYA VIDYUT NIGAM LIMITED

SECTORAL REVIEW ON FUEL MANAGEMENT IN POWER SECTOR COMPANIES

Highlights

The generation of power is done by Karnataka Power Corporation Limited (KPCL) and Visveswaraya Vidyut Nigam Limited (VVNL). The installed capacity of KPCL was 4,365.50 Mega Watt (MW) comprising of 1,470 MW coal based thermal power station at Raichur, 2,891 MW hydel (17 stations) and 4.50 MW wind energy (one station). The installed capacity of VVNL was 354.32 MW, comprising of 127.92 MW Diesel/Low Sulphur Heavy Stock power station at Bangalore and 226.40 MW hydel (four stations).

(Paragraph 2.2.1)

Receipt of low grade coal against the billed grade from Singareni Collieries Company Limited resulted in extra cost of Rs.151.83 crore to KPCL.

(Paragraph 2.2.5)

Poor quality of coal resulted in loss of generation of 757.118 million units in KPCL.

(Paragraph 2.2.6)

Excess quantum of combustibles in ash over and above the norms resulted in consumption of excess coal at an additional cost of Rs.13.44 crore in KPCL.

(Paragraph 2.2.8)

Failure to pursue the matter with the Government for concessional sales tax resulted in payment of additional sales tax of Rs.33.35 crore by VVNL.

(Paragraph 2.2.12)

There has been excess consumption of lube oil valuing Rs.8.36 crore in VVNL against the norms.

(Paragraph 2.2.14)

Introduction

2.2.1 Karnataka Power Corporation Limited (KPCL) and Visveswaraya Vidyuth Nigam Limited (VVNL) are two power generation companies owned by Government of Karnataka.

As on 31 March 2004, the installed capacity of KPCL was 4,365.50 Mega Watt (MW) comprising of 1,470 MW coal based thermal power station at Raichur, 2,891 MW hydel (17 stations) and 4.50 MW wind energy (one station). The installed capacity of VVNL was 354.32 MW, comprising of 127.92 MW Diesel / Low Sulphur Heavy Stock (LSHS) power station at Bangalore and 226.40 MW hydel (four stations).

KPCL procures coal mainly from Singareni Collieries Company Limited (SCCL), Andhra Pradesh, Western Coalfields Limited (WCL), Maharashtra, Mahanadi Coalfields Limited (MCL), Orissa and South Eastern Coalfields Limited (SECL) whereas VVNL procures Diesel/LSHS oil from Indian Oil Corporation Limited (IOCL).

The transmission of power generated by these two companies is done by Karnataka Power Transmission Corporation Limited and distribution is done by four electricity supply companies owned by Government of Karnataka.

Scope of Audit

2.2.2 Fuel Management is an integrated management approach of planning, procurement, transportation, storage and utilisation of fuel, including secondary fuel, with a view to controlling cost, ensuring a uniform flow of fuel of requisite quality and quantity at the appropriate time and at the right price.

The present review conducted during November 2003 to January 2004 covers the activities relating to procurement, transportation, storage and consumption of fuel for five years from 1999-2000 to 2003-04.

The audit findings as a result of test check of records for the period from 1999-2000 to 2003-04 are discussed in two parts in the succeeding paragraphs. The first part focuses on fuel management at Raichur Thermal Power Station of KPCL while the second part focuses on Diesel Generation plant (D.G. Plant) of Vishweswaraya Vidyut Nigam Limited.

Audit findings as a result of test check were reported to the Government/Companies in April 2004 with a specific request for attending the meeting of Audit Review Committee on Public Sector Enterprises (ARCPSE) so that view point of the Government / Management was taken into account before finalising the review. The meeting of ARCPSE held on 6 May 2004, was attended by the Principal Secretary to the Government of Karnataka, Energy Department and Managing Directors of both the Companies. The views expressed by the members have been taken into consideration during finalisation of the review.

Fuel Management at Raichur Thermal Power Station of KPCL

2.2.3 Raichur Thermal Power Station is a super thermal power station with an installed capacity of 1,260 MW (six units of 210 MW each). During 2003-04 the seventh unit of 210 MW was commissioned increasing the total installed capacity to 1,470 MW as on 31 March 2004. Coal is the main fuel, which constitutes more than 60 per cent of the cost of generation. Heavy furnace oil and light diesel oil are used as secondary fuel for start-up operations.

The Fuel Management Wing is headed by the Chief Engineer (Fuel Management) who is assisted by three Superintending Engineers, each in-charge of Fuel Management, Operation of Coal Handling Plant and for overall monitoring of coal activities.

Procurement

2.2.4 Based on the targeted generation, the Company plans the requirement of coal based on specific consumption of coal per kilo watt hour (KWH), plant load factor (PLF), etc. Further, based on this targeted generation and quantity of coal required, the source of supply is decided by the Standing Coal Linkage Committee (Standing Committee) constituted by the Government of India, considering the quality of coal required and constraints in transportation. The year-wise budget, actuals, linkage and materialisation of supply for the five years ended 31 March 2004 is given below:

Year	Installed capacity (Mega Watt)	Budgeted		Actuals		
		Generation (MU)	Coal Qty	Linkage allotted	Receipts	Per cent of receipts to linkage
			in lakh tonne			
1999-2000	1,260	8,650	64.40	70.50	53.81	76.3
2000-01	1,260	9,000	65.70	65.95	61.18	92.8
2001-02	1,260	9,000	59.40	62.85	57.85	92.1
2002-03	1,260	9,200	59.80	63.50	62.47	98.4
2003-04	1,470	10,330	59.92	88.80	75.93	85.5

(MU- million units)

From the above, it was observed that the linkages provided was in excess of budget in all the years. The Company stated (May 2004) that projection was done on a higher side to the linkage committee, so as to ensure sufficient coal was supplied to meet the budgeted generation.

2.2.5 The Company entered into 'Fuel Supply Agreements' with WCL from April 2000 and with SCCL from September 2000. Prior to this, there was no agreement with WCL and SCCL. The Company has not entered into any agreement with MCL and SECL so far (August 2004).

Audit observed that while the agreement with WCL provided for joint sampling and analysis at both loading and unloading ends, the Company agreed, at the insistence of SCCL, for joint sampling (September 2000) at loading end only, as an interim measure. The Company has also been

Receipt of low grade coal against the billed grade from Singareni Collieries Company Limited resulted in extra cost of Rs.151.83

analysing the coal received at unloading end on regular basis since December 2001. Audit observed that the Company, however, continued with the procedure of joint sampling at loading end only even in subsequent renewal of agreement inspite of noticing grade slippages on analysis done at unloading end. In the absence of any provision for joint sampling at unloading end, the Company had to pay the cost of coal as per the analysis done at loading end. This resulted in extra payment of Rs.151.83 crore up to March 2004.

The Company stated (May 2004) that it was aware of the shortcomings in the system and the matter was being pursued with SCCL.

Quality of coal

2.2.6 The table below gives details of unit wise reduction in generation due to supply of poor quality coal as assessed by management for the last four[∝] years:

Unit	Reduction in Generation (million units)				
	2000-01	2001-02	2002-03	2003-04	Total
I	100.265	26.429	35.987	23.291	185.972
II	78.570	23.390	20.867	11.686	134.513
III	97.247	1.479	-	3.124	101.850
IV	55.587	9.212	2.610	0.718	68.127
V	66.812	32.185	21.195	2.713	122.905
VI	106.880	28.063	-	6.027	140.970
VII*	NA	NA	NA	2.781	2.781
Total	**505.361**	**120.758**	**80.659**	**50.340**	**757.118**

* commissioned in 2003-04**;** NA- Not applicable.

Poor quality of coal resulted in loss of generation of 757.118 million units.

The above table confirms the fact that there was reduced generation of 757.118 million units due to poor quality of coal during the period. The Company has confirmed (May 2004) the facts.

Consumption of fuel

2.2.7 A review of performance of the units revealed that the units were utilising heat for generation of one unit of power in excess of the heat required as per manufacturer's specification, even after considering the aging factor of the units as determined by the management, as per details given below:

(in Kilo calories)

Units	I	II	III	IV	V	VI	VII
As per manufacturer's specification	**2,395**	**2,395**	**2,425**	**2,374**	**2,344**	**2,337**	**2,281**
Year	**Actual Heat rate**						
2000-01	2,503	2,512	2,537	2,510	2,511	2,518	-
2001-02	2,499	2,484	2,486	2,486	2,486	2,502	-
2002-03	2,500	2,501	2,498	2,507	2,500	2,486	-
2003-04	2,482	2,490	2,494	2,499	2,502	2,507	2,507

[∝] figures for 1999-2000 not available.

The resultant excess consumption of coal computed on average 'Gross Calorific Value' (GCV) of coal and average rate per tonne of the respective years worked out to Rs.204.98 crore.

2.2.8 The Company has fixed a norm of five per cent and one per cent combustibles in bottom and fly ash respectively. As per the ash analysis, the annual average combustibles in bottom and fly ash, however, ranged from 5.3 per cent to 10.3 per cent and 1.3 per cent to 1.4 per cent, respectively, for the last five years as per details given below:

(in percentage)

Year	Bottom Ash	Fly Ash
1999-2000	6.8	1.3
2000-01	7.9	1.3
2001-02	10.3	1.4
2002-03	7.9	1.3
2003-04	5.3	1.3

Excess quantum of combustibles in ash over and above the norms resulted in consumption of excess coal at an additional cost of Rs.13.44 crore.

The combustibles in ash to the extent of 82,411.96 MT, over and above the norm fixed by the Company, had become a waste and the Company had to consume equivalent quantity of coal at an additional cost of Rs.13.44 crore. The reasons for poor performance over the years were not analysed.

The Company stated (May 2004) that no norms had been fixed by the manufacturers and the above norms fixed were benchmarks set by the Company itself. The fact remains that the Company could not achieve the norms set by it.

Internal Control

2.2.9 Audit observed that the Company did not have a manual for Internal Control procedures. The Company assured (May 2004) to prepare the same within six months.

Fuel Management in Visveswaraya Vidyuth Nigam Limited

2.2.10 The erstwhile Karnataka Electricity Board (Board) established (1993-94) Diesel Generation Plant (D.G.Plant) of 127.92 MW capacity consisting of six units of 21.32 MW each to be run as base load station using Low Sulphur Heavy Stock (LSHS) as main fuel with High Speed Diesel (HSD) as secondary fuel for start up operations. With the incorporation (July 1999) of Visveswaraya Vidyuth Nigam Limited (VVNL), D.G.Plant of the Board was transferred to VVNL.

Procurement

2.2.11 The erstwhile Board entered into an agreement (June 1989) with Indian Oil Corporation Limited (IOCL) for supply of entire requirement of fuel oils and lubricants during the complete life span of the plant. IOCL has erected required storage facility on the land adjacent to the plant, leased by the Board, at their cost.

The Company constructed its own storage tanks for LSHS and HSD having a capacity of 1,434 Kilolitre (KL) and 365 KL, respectively. The plant draws LSHS through pipeline from IOCL main storage tank to its storage tank whenever required. The HSD and lubricants are being supplied by IOCL through tankers and stored directly in storage tank of the plant.

A test check of records revealed the following:

Concessional sales tax for LSHS

2.2.12 The Government reduced (March 1997) the Sales Tax on sale of LSHS to an industrial unit located in the State for use by such units as consumables, from eight per cent to four per cent for a period of three years, with effect from April 1997, against declaration in Form 37.

The erstwhile Board was not able to get the benefit of reduced Sales Tax since Form 37 prescribed a declaration that goods purchased were used as inputs in the manufacture of other taxable goods inside the State for sale. The electricity produced by using LSHS was not a taxable commodity under Karnataka Sales Tax Act.

Audit observed that the Board did not take up the matter with Commercial Tax Department (Department) till June 1999. The Department clarified (August 1999) that the notification was not applicable to the Board, as the concession was extended to petroleum products used in captive generation of electricity. The Department, however, did not clarify the issue regarding use of LSHS as consumables by the Board for which concession was extended in the notification. The Board did not pursue the matter either with the Department or the Government for further clarification and continued to pay tax at the normal rate.

Failure to pursue the matter with the Government for concessional Sales Tax resulted in payment of additional Sales Tax of Rs.33.35 crore.

Audit also observed that the Company (VVNL) after its formation (July 1999) and registration (September 2000) under Karnataka Sales Tax Act, started availing concessional rate of tax from January 2001 by furnishing Form 'D' instead of Form 37.

Failure to pursue the matter with the Commercial Tax Department for further clarification regarding LSHS as consumable resulted in payment of additional Sales Tax (including cess) of Rs.33.35 crore during April 1997 to December 2000.

Performance of D.G.Plant

2.2.13 The performance of D.G.Plant for the five years up to 2003-04 was as follows:

Year	Installed capacity (MW)	Budgeted Generation (MU)	Energy generated (MU)	Auxiliary consumption (MU)	Plant Load Factor (per cent)
1999-2000	127.92	720.000	707.489	21.332	63.13
2000-01	127.92	767.000	658.402	19.515	58.70
2001-02	127.92	770.000	768.725	22.748	68.60
2002-03	127.92	730.000	706.817	21.815	63.10
2003-04	127.92	740.000	397.910	13.900	42.00

Although it was envisaged in the project report to run the plant at plant load factor (PLF) of 68.5 per cent, the plant was operated below the expected PLF except in 2001-02, as per the instructions of load dispatch centre of KPTCL.

Consumption

Excess consumption of lube oil

2.2.14 The manufacturer of the equipment has specified the consumption of lube oil, after completion of operation of the plant for 500 hours, for operation at various load levels, subject to tolerance of five per cent, as under:

Load factor (in per cent)	Consumption (kgs/hour)
100	22.730
90	21.400
75	17.820
50	14.850

There has been excess consumption of lube oil valuing Rs.8.36 crore in VVNL against the norms

During the five years ending 2003-04, the Plant was operated at plant load factor ranging between 42 per cent and 68.6 per cent. Audit observed that the lube oil consumption by the six operational units ranged from 24.357 kg/hour to 32.699 kg/hour, which was more than even the norm prescribed for 100 per cent load level. Considering the lube oil required at 75 per cent PLF, with due allowance of five per cent tolerance, the excess lube oil consumed during the five years worked out to 1,512.80 metric tonne equivalent to 1,662.15 kilo litre valuing Rs.8.36 crore.

The Company stated (May 2004) that the lube oil consumption was higher than the norms as per guaranteed parameters and the issue had been taken up with the manufacturers.

Wasteful expenditure on fuel for generation of unaccounted energy

2.2.15 The energy generated from the diesel generating stations is stepped up to 66 KV and transmitted to various sub-stations of KPTCL through six 66 KV lines. Energy meters have been fixed to record the energy sent out in all the six lines.

A review of the daily statement of the energy generated, auxiliary consumption and the energy sent out revealed that the entire net generation after auxiliary and colony consumption has not been transmitted to KPTCL lines. The energy not fed to the lines ranged from three to 10 per cent of the daily generation. The energy loss for the three months (January 2001, January 2002 and January 2003) test checked in audit amounted to 3.954 MU, 4.714 MU and 2.212 MU respectively, totalling to 10.880 MU.

The Company stated (May 2004) that the difference was due to transformation loss and error in meter recording, for which corrective action was being taken by installing required equipment.

Internal Control

2.2.16 The Company is following the accounts and audit procedures as followed by the erstwhile Karnataka Electricity Board. The supply bills of the sole supplier is being scrutinised and passed for payment after due verification with reference to relevant documents. The quality of the fuel is being ensured by analysis through an external agency.

However, the changes in the statutory levies were not given effect to immediately. There was also delay in reconciliation of accounts with the sole supplier.

Conclusion

Karnataka Power Corporation Limited has a separate Fuel Management wing for efficient handling of the supply and utilisation of coal for its thermal stations. The Company, however, made excess payments towards supply of lower grade coal and there were also losses due to excessive combustibles in ash and utilisation of excess heat for generation. As regards, Visveswaraya Vidyut Nigam Limited, the Diesel Generating Plant was operating below the Plant Load Factor fixed in the project report; there was also excess consumption of lube oil and payment of additional sales tax. Steps need to be taken to exercise control in respect of combustibles in ash and excess consumption of lube oil over the norms.

2.3 KARNATAKA STATE INDUSTRIAL INVESTMENT AND DEVELOPMENT CORPORATION LIMITED AND KARNATAKA STATE FINANCIAL CORPORATION

SECTORAL REVIEW OF INTERNAL CONTROL SYSTEM AND INTERNAL AUDIT IN STATE FINANCIAL SECTOR UNDERTAKINGS

Highlights

Business Plan and Resource Forecasting was not finalised before commencement of the year and the reasons for variations were not analysed by Karnataka State Industrial Investment Development Corporation Limited (KSIIDC) and Karnataka State Financial Corporation (KSFC).

(Paragraphs 2.3.6 to 2.3.8)

No internal audit plan was prepared to conduct internal audit and there was no proper system to monitor the audit reports.

(Paragraphs 2.3.11 and 2.3.12)

Internal control system in respect of appraisal, sanction, disbursement, monitoring, demand and recovery of term loans was defective.

(Paragraphs 2.3.14 to 2.3.22)

KSIIDC adjusted Rs.6.79 crore, being principal of outstanding loans under 'Release and adjustment', in violation of its own decision.

(Paragraph 2.3.25)

Value of land accepted by KSIIDC for sanction of loan, was overvalued at the time of appraisal.

(Paragraph 2.3.29)

KSIIDC failed to disinvest 52.67 lakh shares, which were cleared by Disinvestment Committee during January 2001 to February 2002.

(Paragraph 2.3.33)

Introduction

2.3.1 Internal control is an integral part of the process designed and effected by the management of an organisation to achieve its specified objects ethically, economically and efficiently. It helps in creating reliable financial and management information system besides effective decision making. Internal Control System is most effective when it is built into the entity's infrastructure and is an integral part of the essence of the organisation.

Internal control in the Government financial institutions assumes more significance in view of the fact that these companies had to properly appraise all applications submitted critically so that the risk of default by the borrowers is reduced to the minimum.

Scope and coverage of Audit

2.3.2 The main objective of the review was to see whether the internal control systems, particularly regarding the term-lending activities, of the Government financial institutions were functioning. There are two Government companies♠ and a Statutory corporation (Karnataka State Financial Corporation - KSFC) under the Financial Sector.

One of the two Government companies (KSIIDC) and the Statutory corporation (KSFC) have been selected for review.

2.3.3 KSFC and KSIIDC were established in March 1959 and June 1964 respectively, with the main objectives of promoting and developing industrial growth in Karnataka by providing financial assistance in the form of term loans, equity participation, equipment leasing, deferred payment guarantee and merchant banking. In the recent years, the activities of these undertakings have been mainly confined to term lending.

KSIIDC identifies industrial opportunities, provides guidance to entrepreneurs of the medium and large-scale industries, whereas KSFC caters to the small and medium scale industries.

2.3.4 The comprehensive review on the working of the KSIIDC was included in the Report of the Comptroller and Auditor General of India (Commercial) for the year ended 31 March 1999. The review was discussed by COPU in March 2002. The present review examines the mechanism of internal control systems prevalent during 1998-03. The activities / transactions of Head Office and one Branch Office were covered during October 2003 to February 2004. Sixty♦ cases, out of total 68 cases selected have, however, been covered.

The comprehensive review on the workings of the KSFC was included in the Report of the Comptroller and Auditor General of India (Commercial), for the

♠ Karnataka State Industrial Investment and Development Corporation Limited (KSIIDC) and Karnataka Urban Infrastructure Development and Finance Corporation Limited

♦ The records were not produced by the Company in respect of eight cases.

year ended 31 March 2001, which was yet to be discussed by COPU (September 2004). The present review examines the mechanism of the Internal Control during 2000-03. The audit coverage in respect of KSFC was 10 per cent of the sanctions of head office for each year (i.e. 25 cases).

2.3.5 Audit findings as a result of test check, were reported to the Government/Company/Corporation in May 2004 with a specific request for attending the meeting of Audit Review Committee on Public Sector Enterprises (ARCPSE) so that view point of the Government / Management was taken into account before finalising the review. The meeting of ARCPSE, held on 7 July 2004, was attended by the Principal Secretary to the Government of Karnataka, Commerce and Industries Department and Managing Directors of KSIIDC and KSFC. The views expressed by the members have been taken into consideration while finalising the review.

Tools of Internal Control and their role

Budget

2.3.6 Budget is a quantitative, financial expression of a program of measure planned for a given period. The Budget is drawn up with a view to plan future operations and to make ex-post-facto checks on the results obtained. Timely preparation of Budget and analysis of the variations noticed in the actual execution serves the purpose of internal control. Audit observed the following deficiencies in the preparation and analysis of the Budget:

KSIIDC

BPRF was not finalised before commencement of the years and the reasons for variations were not analysed.

2.3.7 The Company prepared Business Plan and Resource Forecasting (BPRF) annually, based on which the funds were borrowed from financial institutions, banks and through inter-corporate deposits, depending on the requirement. Audit observed that:

- the Company did not prepare BPRF well before the commencement of the year. BPRF for the relevant years were finalised after two to five months of the commencement of the year. The Company admitted the fact and stated (July 2004) that steps would be taken to prepare BPRF before the commencement of the financial year.

- the Company did not analyse the reasons for variances noticed between actual and budgeted figures to take corrective action as huge variances continued year after year. This indicated that the projections in the BPRF were not realistic. The Company stated (July 2004) that there were no major variations as compared to the revised budget. The reply is not tenable since the revised BPRF was prepared at the fag end of the year after considering the actual at that time.

KSFC

2.3.8 The Corporation prepared Business Plan and Resource Forecasting (BPRF) for submission to Small Industries Development Bank of India (SIDBI). The Corporation, based on BPRF, borrowed funds from financial institutions, banks and also through private placement of public bonds/subsidy bonds depending on the requirement.

Audit observed that:

- the Corporation did not finalise/approve the BPRF well before the commencement of the financial year. The BPRF for the years 1999-01 were approved by the Board in December 2000 and November 2001 respectively. The BPRF for the year 2002-03 was not approved by the Board of Directors of the Corporation. The Corporation stated (June 2004) that the BPRF was prepared after completion of Annual Accounts and its finalisation was dependent on SIDBI's approval. The Corporation also stated (June 2004) that apart from BPRF, Internal Budgets were prepared every year at the beginning of the financial year for monitoring the internal performance.

- the Corporation did not analyse the reason of variations to take corrective action.

Non-finalisation of BPRF in time and non-analysis of huge variations in projections indicated that both KSIIDC and KSFC were not properly using the budget as a tool of Internal Control.

Functional Manuals

2.3.9 Functional manuals provide guidance to the personnel in-charge of appraisal, disbursement and recovery and also to proceed for legal action as per terms and conditions. Audit observed that KSIIDC did not prepare any functional manual indicating that the Company has not formulated any internal control systems for the above activities even after four decades of existence.

The Company stated (July 2004) that steps would be taken to put in place the functional manuals which would provide guidelines to the personnel to discharge their duties more effectively within three months.

Audit Committee

2.3.10 As per Section 292-A of the Companies Act, the Audit Committee should have discussions with the Auditors periodically about internal control systems, the scope of audit including the observations of the auditors and review the half yearly and annual financial statements before submission to the Board and also ensure compliance of internal control systems.

Audit observed that:

- in KSIIDC, the Audit Committee held five meetings during January 2002 to August 2003. In none of the meetings, internal controls prevailing in the Company, its adequacy or compliance were discussed. The Statutory Auditors attended only two of the five meetings. The Company stated (July 2004) that suitable steps would be taken to improve the functioning of the Audit Committee.

- in KSFC, the Audit Committee did not meet after October 1998. Thereafter, the Board of Directors constituted an Audit Review Screening Committee (ARSC) during September 2001, which was directed (October 2002) to review the audit reports and to take action immediately. The ARSC held only two meetings on 24 February 2003 and 2 May 2003, wherein a few sanctions of less than Rs.25 lakh, approved at branch level were discussed. The Corporation stated (June 2004) that periodical meetings of ARSC would be ensured in future.

Internal Audit

2.3.11 Internal Audit is an appraisal activity established within an entity as a service to the entity. Its functions include, amongst others, examining, evaluating and monitoring the adequacy and effectiveness of the accounting and internal control systems.

A review of Internal Audit systems revealed the following:

KSIIDC

No internal audit plan was prepared to conduct internal audit and there was no proper system to monitor the audit reports.

- The Company has no Internal Audit department. Internal Audit/Concurrent audit was being conducted by a firm of Chartered Accountants, who submitted half yearly reports up to 30 September 2000 and thereafter, quarterly reports to the Managing Director. As there is no Internal Audit Manual, the scope and coverage were intimated to the Internal Auditor at the time of appointment.

- No elaborate plans for internal audit were made on the plea that it was a year long continuous activity.

- The observations contained in the reports were too general and even the cases involving serious lapses were not highlighted properly.

- The Internal Audit did not carry out audit of the policies of the Company or comment on the performance of the Schemes.

- Out of the 15 Internal Audit reports finalised during the period covered in the review, only four reports were discussed. The Company has also not evaluated the performance of the Internal Auditors. Further, Statutory Auditors in their reports opined that the scope and coverage of Internal Audit system needs to be enhanced.

The Company stated (July 2004) that adequate steps would be taken to improve Internal Audit.

KSFC

2.3.12 The Corporation had compiled (1992) guidelines for the purpose of Internal Audit in the form of a manual and the same were being updated from time to time. The Internal Audit (IA) in the Corporation is conducted departmentally with a General Manager (IA) at Head Office and Internal Audit Cells at Hubli, Bijapur, Mysore and Raichur headed by AGMs (IA). The Internal Audit Department conducts two types of audit i.e., routine audit and concurrent audit, which was introduced in 2000-01.

Audit observed that:

- no Audit plan for 2000-03 was prepared. The plans prepared for 2003-05 revealed that these were not comprehensive and audit of only 50 per cent of the units has been planned.

- although the Internal Audit Manual prescribes selective and detail checks in strong and weak areas respectively, the areas, quantum, sampling techniques were not spelt out. The Company stated (June 2004) that it has started defining sampling techniques since October 2003.

- the transactions of Head Office were not audited during 1998-2003, even though high value sanctions (above Rs.25 lakh) were done at Head Office. The total sanctions at Head Office during 1998-2003 was Rs.771.19 crore equivalent to 46.16 percent of the total sanctions. The Corporation stated (June 2004) that sanctions, recovery and legal documentation areas pertaining to Head office were subjected to Internal Audit selectively. It was further stated that Internal Audit Department was being strengthened with a view to broaden the coverage of audit more intensively and take up auditing of Head Office extensively.

- the concurrent audit was introduced (2000-01) in the area of sanctions, disbursements, review of recovery achieved and follow up of default cases. Concurrent audit is an operation, which goes continuously and is done throughout the year to check the activities, operations and financial transactions. This, however, was neither done along with the operations nor at an envisaged interval of three months. The period covered ranged from one to 12 months, thereby defeating very purpose of concurrent audit. The areas covered under concurrent audit were of routine nature resulting in the duplication of work.

- no system exists to monitor the Internal Audit reports.

- the Statutory Auditors have also stated that the scope, depth of coverage and other operations of Internal Audit system were inadequate.

Internal Audit was, thus, not being used as an effective tool of internal control in the interest of organisation.

Internal Control in major activities

2.3.13 The lending function involves three major activities viz,

- Appraisal and sanction.
- Disbursement (obtaining security and documentation) and monitoring.
- Demand and recovery.

Internal controls in respect of these functions are discussed in the following paragraphs.

Term loans

Appraisal and sanction

Internal control system in respect of appraisal and sanction of loans was defective as assumptions used by promoters were not examined independently. SWOT analysis was not done properly.

2.3.14 Appraisal is the critical examination of technical, financial and commercial feasibility of a project and judging the managerial competence of promoters to implement and run the project successfully. Appraisal of projects is necessary to determine whether it would be worthwhile to make investment in those projects. The quality of appraisal depends on the degree of accuracy of estimates on which the project is based. Preparation of appraisal report becomes easier if the project report is prepared after considering all the relevant information /data, giving due importance to the different factors concerned with the project.

KSIIDC

In the Report of the Comptroller and Auditor General of India (Commercial) on the working of the Company for the year ended 31 March 1999, it was commented that the Company had relied mainly on the feasibility reports submitted by the promoters while making appraisal of the investment proposals. Audit observed that there was no change in the system of appraisal even now.

2.3.15 A scrutiny of the appraisal system revealed the following shortcomings/deficiencies:

- Credit risk analysis ensures objective appraisal of the project risks and minimises the level of subjectivity and individual bias involved in lending decisions. The Company, however, did not analyse credit risk for appraisal of projects.

- The assumptions of the entrepreneurs, viz. projections of market demand, cost of production, cash flow, etc. based on which the financial assistance was sanctioned, were not subjected to critical evaluation with reference to reliable external data.

The Statutory Auditors in their supplementary reports had also commented upon these aspects.

The following further deficiencies were also noticed in appraisal system during the period covered in review.

Sl. No.	Deficiency	No. of cases of deficiency/total checked	Percentage to cases checked
1	Credit worthiness of applicant was not ascertained from banks/financial institutions	14/47	30
2	Projections in the applications were accepted without critical scrutiny	20/47	41
3	Missing critical/vital information in appraisal format (i.e. suppression of facts like loanee track record, servicing previous loans, working capital tie-up, etc.)	25/42	52
4	Promoters background/track record not evaluated properly	16/41	29
5	Improper technical appraisal	13/60	22
6	Improper Commercial/marketing appraisal	17/58	29
7	Improper managerial appraisal	11/58	19
8	Appraisal containing plain statements without adequate supporting documents	22/58	38
9	Incorrect default ratio	35/57	61
10	Strength, Weakness, Opportunities and Threats (SWOT) analysis not done properly	29/59	49
11	Audited accounts of existing units not verified	23/52	44
12	Statutory clearances not obtained at the time of appraisal	14/58	24

From the above table it would be observed that the project appraisal system in the Company is not effective and needs improvement.

The Company stated (July 2004) that the deficiencies pointed out by audit were available for verification. The reply is not tenable as the records shown to audit did not clarify the deficiencies pointed out by the Audit.

KSFC

2.3.16 Based on the standard procedures being adopted by IDBI and SIDBI, the Corporation brought out (1981) a manual for project appraisal with a view to provide directions for the appraising officers to proceed on generally accepted norms. Appraisal Manual prescribed that thorough examination of background of the borrower and technical, financial and market appraisal should be conducted. Several instances of failure in appraisal, follow up of recovery and lapses in Internal Control were pointed out in Reports of the Comptroller and Auditor General of India (Commercial) for the year ended 31 March 2001 and 31 March 2003, for which action was yet to be taken by the Company (August 2004).

Audit also observed that the Corporation had not been analysing the credit risk of the project on the basis of its 'Strength, Weakness, Opportunities and Threats' (SWOT) to ensure more objective appraisal of the project risks and to minimise level of subjectivity and individual bias involved in lending decisions. The Corporation agreed (July 2004) to adopt the said analysis in future.

During the period covered in the present review, the following deficiencies (out of 25 cases test checked) were noticed in appraisal system :

Sl. No.	Nature of deficiency	No. of cases of deficiency
1	Credit worthiness of the applicant was not ascertained from banks/financial institutions.	03
2	There was no evidence in support of the projections in the applications.	09
3	Missing critical information in appraisal format (i.e. suppression of facts like loanee track record, servicing previous loans, working capital tie-up etc.)	05
4	Promoters background/track record not evaluated properly.	05
5	Improper technical/commercial appraisal	11
6	Audited accounts of existing units not verified.	03
7	Statutory clearances not obtained at the time of appraisal.	02

The Corporation stated (June 2004) that being a developmental financial institution, a calculated risk was taken and certain relaxations were extended.

Disbursement and Monitoring of Term Loans

KSIIDC and KSFC

2.3.17 A scrutiny of the system of monitoring and disbursement revealed the following deficiencies:

Non preparation of project completion reports

2.3.18 The Company has a monitoring system requiring preparation of Project Completion Report after the final disbursement. It contains vital information on whether the assets created are as stipulated at the time of sanction and serves as an important evidence for creation of assets. In respect of KSIIDC in 25 out of 45 cases reviewed, this report was not prepared.

Improper inspection reports

2.3.19 The inspection reports on the progress of the project did not contain information on whether the project was being implemented as per the schedule. Vital details about actual progress of each stage such as land acquisition and development, building plan, progress of construction, procurement of machinery and commissioning, in certificate form were missing.

Proper inspection register for inspection of the assisted units was not maintained. Even a checklist has not been designed for the use of inspecting officers visiting the assisted units.

Non-obtaining of audited accounts

2.3.20 The details of production, sales and audited accounts were not obtained at periodical intervals to ascertain the health of the assisted unit and also to take action against defaulters.

Both KSIIDC and KSFC agreed (July 2004) with the above observations made by audit.

Non appointment of nominee directors

2.3.21 As per the terms of sanction of loan, the KSIIDC is empowered to nominate Directors in the assisted units. This is one of the important ways to ascertain the status and to have control over the affairs of the assisted unit. Nominee Directors were appointed in 93 cases out of 426 cases as on 31 March 2003.

The Company stated (July 2004) that immediate steps would be taken to appoint nominee Directors wherever required, to enable proper monitoring and follow up of loans sanctioned.

In respect of KSFC, the loan sanction letter contains the condition regarding powers of the Corporation to appoint nominee Directors in the assisted units. Nominee Directors were, however, appointed on selective basis and, as at March 2004, nominee Directors were appointed only in respect of four companies. The Corporation stated (June 2004) that the assisted units were not responding properly with nominee Directors and the impact was very little.

The reply is not acceptable as the Corporation did not insist on the pre-condition of sanctions of loans, which resulted in loss of control over the affairs of the management of assisted units.

In respect of KSIIDC, the following further deficiencies were noticed in the monitoring and disbursement.

Sl. No.	Deficiency	No. of cases of deficiency / total checked	Percentage to cases checked
1	Non fulfillment of terms of sanction before first disbursement	23/51	45
2	Relaxation of terms of sanction in respect of creation of security	19/50	38
3	Non-fulfillment of first investment clause	8/48	17
4	Deviation from approved plan without prior sanction	11/44	25
5	Non-insurance of assets	21/48	44
6	Non-preparation of Project Completion Report	25/45	56
7	Non-verification of audited accounts during implementation and moratorium period	20/44	45

It was stated (July 2004) that the deviations have been considered at the time of disbursement and the decisions have been taken in the interest of the Company and in the interest of the project.

Demand and Recovery

KSIIDC

2.3.22 As per generally accepted procedures, recovery of loans and advances is one of the important operations as the Company has to plough back the funds and recycle it for development of industrial activity. The position of demand and recovery during the last five years up to 2003-04 were as follows:

(Rupees in crore)

Year	Demand			Recovery			Percent of recovery		
	Principal	Interest	Total	Principal	Interest	Total	Principal	Interest	Total
1999-2000	219.69	275.36	495.05	91.70	77.23	168.93	42	28	34
2000-2001	159.60	286.69	446.29	91.57	79.87	171.44	57	28	38
2001-2002	221.92	387.32	609.24	79.00	59.82	138.82	36	15	23
2002-2003	203.03	508.18	711.21	95.10	55.17	150.27	47	11	21
2003-2004	215.95	710.21	926.16	114.21	31.29	145.50	53	4	16

Recovery which was 34 per cent in 1999-2000, reduced to 16 per cent in 2003-04.

It was seen that the percentage of recovery, which was 34 in 1999-2000, dropped to 16 in 2003-04.

The COPU in its 94th Report observed (March 2002) inefficiency on the part of the Company in the recovery of the outstandings. No remedial measures, however, were taken to arrest the trend as the outstandings increased from 66 per cent in 1999-2000 to 84 per cent in 2003-04.

The Company while admitting (July 2004) poor recovery agreed to improve the position in future.

Management of Non-Performing Assets

KSIIDC

2.3.23 Non Performing Assets (NPA), as per Reserve Bank of India norms, during the last five years were as follows:

(Rupees in crore)

	1999-2000	2000-01	2001-02	2002-03	2003-04
Total assets /loan value	870.74	925.85	1,035.26	1,038.58	942.69
Standard assets	405.13	464.12	430.72	367.11	191.25
Non performing assets	465.61	461.73	604.54	671.47	751.44
Percentage of NPA to loan balance	53.46	49.87	58.39	64.65	79.71

Percentage of NPA increased from 53.46 in 1999-2000 to 79.71 in 2003-04.

It was observed from the above that even though the total assets increased from Rs.870.74 crore in 1999-2000 to Rs.942.69 crore in 2003-04, the standard assets decreased from Rs.405.13 crore in 1999-2000 to Rs.191.25 crore in 2003-04 and the percentage of NPA which was 53.46 in 1999-2000 increased to 79.71 in 2003-04. The Company stated (July 2004) that increase in NPA was due to recessionary conditions in the industrial sector and on account of liberalization of economy.

The Statutory Auditors in their supplementary report for the year 2002-03 stated that the Company was identifying NPA only at the end of the year; the high percentage of NPA was due to reasons like inadequate appraisal, non-review and non-monitoring of assets. In view of the above, the Internal Control system for management of NPA requires to be strengthened.

Due to poor documentation audit could not conclude as to whether demands were sent to all parties. Internal Auditors in their report stated that notices were not sent to the parties at regular periodicity and added that in selective cases the reminder/notices were sent to customers as a formality. It was suggested by the Auditors that a standard procedure be initiated whereby reminders are promptly sent to all defaulting loanees within specific time frame.

The following further deficiencies were noticed in demand and recovery procedures.

Sl. No.	Deficiency	No. of cases of deficiency/total checked	percentage to cases checked
1	Reasons for default not recorded and not analysed	27	-
2	Delay in initiating action against persistent defaulter to ensure the safety of assets	17/54	31
3	Chronic default cases not referred to Default Review Committee	20	-
4	No periodical inspection of assisted units to verify security and health of the unit	27/55	49

Sl. No.	Deficiency	No. of cases of deficiency/total checked	percentage to cases checked
5	Not comparing mahazar[∞] with Project Completion Report to ensure no assets are missing	6/6	100
6	No action against promoters for missing assets	7/7	100
7	Not invoking collateral/personal guarantee	7/9	78
8	Not preferring insurance claims	6/6	100

The Company stated (July 2004) that statement of clarification on the above deficiencies were available for verification. Audit on review of these statements found that the clarifications given were not sufficient. Thus, deficient appraisal, inadequate monitoring system and lack of prompt demand in the Company resulted in huge accumulation of dues year after year. The Statutory Auditors have also observed that the high percentage of NPA was mainly due to reasons like inadequate appraisal, timely review and monitoring of these assets.

KSFC

2.3.24 As per the procedure laid down in the Audit Manual of the Corporation, the recovery of loans advanced is one of the important operations as the Corporation has to plough back the funds and recycle it again for development of industrial activity. Further, it specified that recovery department should keep continuous watch over the defaults and shall take appropriate timely action for the recovery of dues. Any laxity in these two crucial functions would result in poor recovery. The deficiency of the procedure in vogue in respect of demand and recovery, in respect of 25 cases test checked, were as follows:

Sl. No.	Nature of Deficiency	No. of cases of deficiency
1.	Reasons for default not recorded and not analysed.	12
2.	Delay in initiating action against persistent defaulter to ensure the safety of assets.	09
3.	No periodical inspection of assisted units to verify security and health of the unit.	07
4.	Not comparing mahazar[∞] with Project Completion Report to ensure no assets are missing.	02
5.	No action against promoters for missing assets.	04
6.	Not invoking collateral/ personal guarantee.	05

The Corporation stated (June 2004) that it was a developmental financial institution and to have a flexible approach extended some concessions so that temporary problems of the industries could be averted. The reply is not

[∞] Statement prepared by the Company officials at the time of take over.

tenable as it did not give the specific explanation to the deficiencies pointed out in Audit.

Release and adjustment

KSIIDC

2.3.25 Audit observed that the Company has been sanctioning additional loans to clear existing overdue loans. Release and adjustment not only results in regularizing default cases but also makes them eligible for further fresh sanctions. As per the guidelines of RBI/IDBI, asset classification is to be made on the basis of period of default. In respect of released and adjusted cases, however, the asset becomes standard asset thereby becoming eligible for recognition of interest income. "Release and adjustment", thus, not only violates the guidelines for asset classification but also results in overstatement of interest income and incorrect picture of default/recovery ratio. As per the audited accounts, 19 to 57 per cent of the release and adjustment was done in the month of March every year.

The details of loans released and adjusted during the last four years up to 2003-04 were as follows:

(Rupees in crore)

Year	No of cases	Principal	Interest	Total	Adjustment in March	Percentage
2000-01	136	5.63	11.66	17.29	8.21	47
2001-02	114	6.92	8.81	15.73	8.94	57
2002-03	64	6.03	8.09	14.12	6.22	44
2003-04	30	0.76	3.97	4.73	0.89	19

Principal component of Rs.6.79 crore in outstanding loans was adjusted under 'Release and adjustment' in violation of its own decision.

The Company decided (April 2002) that the release and adjustment should only be for the interest portion. Audit, however, observed that principal component of Rs.6.03 crore and Rs.0.76 crore were adjusted during 2002-03 and 2003-04, respectively, in violation of its own decision.

2.3.26 In respect of four test checked cases, it was seen that this practice was resorted to repeatedly for three to nine times involving Rs.35.40 lakh to Rs.1.27 crore. Additional sanctions were also made to these parties, who were otherwise ineligible for sanction owing to persistent default. Audit observed that inspite of extending these facilities, the units were not prompt in repayment and were classified as sub-standard asset as on 31 March 2004.

Details of release and adjustment and overdue position in respect of the above cases is indicated in the following table.

(Rupees in lakh)

Sl No	Name of the Unit	Release and Adjustment		Fresh Sanctions		Overdues as on August 2004
		No. of times	Amount	No of times	Amount	
1	Torgal Distillaries	9	106.99	2 - 23.03.01 & 30.06.01	175.00	414.28
2	Safalya Industries	5	50.36	3 - 06.11.00, 30.08.01 & 01.04.02	170.00	336.49
3	Hotel Sandesh	4	35.40	3 - 06.11.00, 28.02.01 & 26.02.02	276.00	244.35
4	Deldot Systems	4	227.26	2 - 31.03.01 & 11.06.01	560.00	517.96

The Company stated (July 2004) that in every term lending institution this was the normal practice. The reply is not tenable as the release and adjustments amount to window dressing of accounts without any actual outflow of funds.

Management of assets taken over

KSIIDC

2.3.27 Section 29 of the State Financial Corporation Act, 1951 (SFC Act) empowers the Company to acquire possession of the loanee unit and dispose off the same to recover its dues in case the unit fails to repay the dues. As on 31 March 2003, the assets taken over in respect of 114 loan accounts were valued at Rs.50.24 crore as against the outstanding loan of Rs.103.39 crore representing margin of security of 48.6 per cent. The Company did not maintain a consolidated register/list of the assets acquired under section 29 of the SFC Act.

2.3.28 It was observed in the following cases that the security available was less than six per cent/ nil of the loan balance:

Name of the unit	Principal	Security value	Percentage of security
	(Rupees in lakh)		
Herbertson Plast, Bangalore	70	3.9	6.0
Saroja texport, Bangalore	75	0	0.0
European software, Bangalore	200	1.65	0.8
Scintell software, Bangalore	200	2.28	1.1
Indiana Dairy, Bangalore	291	0.00	0.0

Nil or negligible security value indicates that the Company had not properly valued the security offered. It was observed that Company was not periodically updating the data regarding the units taken over and available for sale.

Value of land accepted for sanction of loan, was overvalued at the time of appraisal.

2.3.29 One of the reasons for insufficient security was over valuation of assets especially land at the time of project appraisal. The value of the land accepted for sanction of loan, etc. was found to be too low after take over by the Company and valuation by the Company's valuers. In respect of the cases reviewed in Audit, the post take-over valuation was available only in four cases and in all the cases the post take-over value of the land was substantially less than at the time of project appraisal, as detailed below.

Name of the assisted Unit	Area and Survey No	Value at the time of appraisal	Value as per post valuation
		(Rupees in lakh)	
Rustamji Granites	8,633 sq.ft. with old building at No.23 Alfred street Richmond town Bangalore (collateral security)	227	66*
Kelachandra Fashions	No.30,31 and 32, Dasanahalli, Hesaragatta Hobli, Bangalore North measuring 16.4 acres	80	16**
Madhura Coffee Curing Works	3.6 acres and 1.9 acre, No 95/10 and 95/4 Arecad village, Siddapur, Coorg	72 and 51.75	7.2 and 3.8
Explore tech	Plot .No.35, Halagevoderahalli, Kengeri	15	4.05

***** currently tenanted and not saleable with vacant pocession.
** valuation at the time of OTS proposal **.**

KSFC

2.3.30 Section 29 of the SFC Act empowers the Corporation to takeover the management or possession of assets or both of the defaulted units and to realise the property pledged or mortgaged. As at 31 December 2003, assets of 1,844 units had been taken over for recovery of dues amounting to Rs.907.57 crore; of these 1,314 cases (dues Rs.782.94 crore) were more than one year old and account for 71 per cent of the cases under section 29 of SFC Act. Delay in disposal of assets would result in deterioration of their value and consequently lower realisation. The Corporation has not fixed any maximum period within which the acquired asset should be disposed.

There is no prescribed system to safeguard the acquired asset against abuse. The Corporation, out of the 1,844 cases of acquired assets, has taken insurance only in 99 cases. Reasons for not insuring the balance 1,745 cases were not on record. The acquired assets were being entrusted to private security agencies to guard the same till their disposal or handing over to loanees after payment of dues. Assets valuing Rs.1.79 crore were stolen while under the custody of these agencies as on 31 March 2001.

Others

Consortium advances

KSIIDC

2.3.31 In respect of consortium advances, where the assets were taken over under section 29 of the SFC Act, the Company as on 31 March 2003 has realised Rs.10.84 crore on disposal of these assets. This is shown as 'Current Liability' in the books of the Company, pending final appropriation with other financial institutions. However, no proper records were maintained indicating the date of sale, share of different financial institutions and reasons for non-allocation.

KSIIDC did not receive its share from KSFC out of sale proceeds of taken over assets.

Similarly, the Company has to receive its share of sale consideration from other financial institutions. The Statutory Auditors in their supplementary report for the year 2001-02 stated that Company's share in respect of 14 cases has not been received from KSFC. Total dues from these parties was Rs.13.01 crore towards principal (Rs.3.98 crore) and interest (Rs.9.03 crore). The Company, however, had written off (1993-99) dues of Rs.1.54 crore towards principal and waived interest of Rs.2.33 crore in five cases. The Company's control in respect of recovery of these dues requires streamlining and improvement.

The Company stated (July 2004) that write off of the dues in the internal books of the Company did not hinder the normal recovery and all efforts were being continued by the recovery department.

In these cases, the recovery was, however, from KSFC as the assets had been sold by them. The Company has neither received its share nor ascertained the reasons/status from KSFC.

KSFC

2.3.32 Based on the informal understanding reached with KSIIDC, the Corporation has to receive its share of sale consideration from KSIIDC and vice-versa in respect of consortium advances. In the absence of consolidated data regarding number of cases, amount of principal, interest and other dues, date of disposal of the asset and pro-rata amounts receivable, the quantum of consortium advances receivable from KSIIDC / Official Liquidator (in respect of the loans where the assets were disposed by Official Liquidator) or payable by KSFC could not be ascertained in Audit. Further, it was also observed that no such amounts of consortium advances were reflected/ accounted for in the accounts of the Corporation, which is indicative of lack of control over this issue.

Equity participation

KSIIDC

2.3.33 The COPU in its 94th Report recommended (2002) that the Company should try to get back the amount invested through equity immediately after the firm stabilizes or after a reasonable period of three years. Despite the recommendations, the Company did not get back its initial investment in equity even after a lapse of three years.

In pursuance of the above practice, the Company invested in share capital of various undertakings. The investments in equity for the last five years up to 2003-04 were as follows:

(Rupees in crore)

Particulars	1999-2000	2000-01	2001-02	2002-03	2003-04
Quoted investment					
No of companies	67	67	66	65	65
Cost of investment	79.68	79.67	79.20	78.92	81.17
Market value of the investment	50.74	46.46	22.93	36.49	71.78
Percentage of erosion of cost	36	42	71	54	12
Unquoted investment					
No of companies	72	73	73	73	70
Cost of investment	13.54	24.98	24.95	25.48	19.16

From the table it would be observed that the market value of the quoted investment was deteriorating year after year up to 2001-02 and the value erosion ranged from 36 percent in 1999-2000 to 71 per cent in 2001-02. As on 31 March 2004, the market value was more than cost only in respect of 11 out of 65 cases.

KSIIDC failed to disinvest 52.67 lakh shares which were cleared by Disinvestment Committee during January 2001 to February 2002.

During January 2001 to February 2002, the Disinvestment Committee of the Company cleared for disinvestment / buyback of 52.67 lakh shares in 14 Companies. No action, was, however, taken to dispose off these shares so far (January 2004).

The Company replied (July 2004) that in five companies disinvestment has been made in March 2004 and in other cases action is being taken.

Erosion of cost of investments in 54 out of 65 cases of quoted investment, non-disposal of shares cleared for disinvestment at appropriate time, non identification of the cases for disinvestment, is an indication that the Company should evolve a definite policy in this regard.

Equity participation out of Government funds

2.3.34 As per the directions of the Government, the Company invested Rs.16.50 crore in the equity shares of the following companies, out of the financial assistance received from the Government as equity as on 31 March 2004:

KSIIDC invested Rs.16.50 crore in equity of five companies out of fund received from the Government.

Name of the Company	Equity investment (Rupees in crore)
Renuka Sugars Limited	2.00
Bellary Steels & Alloys Limited	5.00
Prabhulingeshwara Sugars	2.50
Kalyani Steels Limited	4.50
SCM Sugars Limited	2.50
Total	**16.50**

Such investments in equity by the State Government through KSIIDC would result in lack of direct control of the Government over the Company in which such investment has been made.

The Company replied (July 2004) that out of Rs.16.50 crore the disinvestment has taken place to the extent of Rs.60 lakh against Renuka Sugars Limited and Rs.2.25 crore against Kalyani Steels Limited and realised Rs.3.82 crore.

Conclusion

The Budgets have not been used as a tool of internal control as they were neither finalised in time nor variations analysed. Internal Audit reports have not been used as a tool of internal control due to lack of effective monitoring. The role of Audit Committee was not effective. Internal Audit wing of Karnataka State Financial Corporation did not audit the transactions of its Head office even though involving high value sanctions. Internal control in respect of appraisal and sanction, disbursement and monitoring, demand and recovery of term loans were defective resulting in accumulation of dues.

The internal control system of the organisations is required to be strengthened to make it more effective. Effective monitoring of Internal Audit Reports is required to be done to make it a more effective tool of internal control.

2.4 KARNATAKA FOOD AND CIVIL SUPPLIES CORPORATION LIMITED

SECTORAL REVIEW ON THE PERFORMANCE OF FAIR PRICE SHOPS AND MINIMUM SUPPORT PRICE OPERATIONS

HIGHLIGHTS

The Company has incurred a loss of Rs.3.30 crore due to opening of shops without conducting viability study.

(Paragraph 2.4.3)

An amount of Rs.5.84 crore was pending recovery mainly due to non-submission of required details/documents, improper documentation and absence of a system for monitoring dues at periodical interval in the Company.

(Paragraphs 2.4.5 and 2.4.6)

The Company incurred a loss of Rs.52.71 lakh due to excess driage.

(Paragraph 2.4.11)

Failure to include the interest component in the cost sheet resulted in non-recovery of interest of Rs.2.64 crore.

(Paragraph 2.4.12)

Introduction

2.4.1 Karnataka Food and Civil Supplies Corporation Limited was incorporated in September 1973 as a wholly owned Government company, to function as an agent of the State Government to procure and distribute foodgrains and other essential commodities through the Public Distribution System (PDS) in the State.

The operations of the Company are presently confined to:

- distribution of essential commodities under PDS through a net work of wholesale and retail outlets.
- procurement under 'Minimum Support Price Operation' as sub-agent of Food Corporation of India (FCI).
- distribution of liquefied petroleum gas and the sale of petrol and diesel at certain places and sale of non controlled commodities like maida, suji, salt, toor dal, etc.

- acting as one of the implementing agencies for various schemes of Government like Sampoorna Grameena Rojgar Yojana, Food for work programme, Mid-day meal scheme, etc.

The Company had 183 wholesale points and 255 retail points (covering 19 out of 27 districts) controlled through 29 District offices as at the end of March 2004 as against the total number of 306 wholesale points and 20,613 retail points in the State. The Company covered 0.81 lakh and 2.26 lakh numbers of Below Poverty Line (BPL) and Above Poverty Line (APL) card holders respectively, out of 75.64 lakh and 45.43 lakh numbers of BPL and APL card holders in the State.

Scope of Audit

2.4.2 The present review, conducted during October 2003 to February 2004, covers performance of fair price shops being operated under Public Distribution System (PDS) and Minimum Support Price Operations (MSPO) of the Company during the five years ending March 2004. Records at Head Office of the Company, located at Bangalore and nine District offices♣ (out of 29 District offices) covering 196 retail points (out of 255 retail points) were test checked.

Audit findings, as a result of test check were reported to the Government/Company on 23 April 2004 with a specific request for attending the meeting of Audit Review Committee on Public Sector Enterprises (ARCPSE), so that view point of the Government / Management was taken into account before finalising the review. The meeting of ARCPSE, held on 17 May 2004, was attended by the Managing Director of the Company and by the Principal Secretary, Food and Civil Supplies Department of the Government. The views expressed by the members have been taken into consideration during finalisation of the review.

Performance of fair price shops

The deficiencies / shortcomings noticed in audit are discussed in succeeding paragraphs:

2.4.3 The Company is opening fair price shops as per the directions of Food and Civil Supplies Department (Department). Since the definite number of cards attached to the fair price shops was not known, no viability study was done by the Company before opening of fair price shops. The Company did not have management information system to know the viability of each fair price shop and also to ascertain the annual profit/loss of each fair price shop. The Company had 184 fair price shops in four districts♦ as against total 255 fair price shops being operated by it in the State as on 31 March 2004. More number of fair price shops in these districts were opened as per the directions of the Department, due to closure of private fair price shops during 1983.

♣ Bangalore East, Bangalore West, Bangalore North, Bangalore South, Tumkur, Davanagere, Dharwad, Mysore and Hassan

♦ Bangalore East, Bangalore West, Bangalore North and Bangalore South.

The Company has incurred a loss of Rs.3.30 crore due to opening of shops without conducting viability study.

Audit observed that out of 184 fair price shops, 162 fair price shops were incurring losses continuously for the last three years and the total loss amounted to Rs.3.30 crore due to opening of fair price shops without conducting viability study.

The Company stated (May 2004) that in order to make the retail points economically viable, the Department was requested to attach more number of BPL cards to the Company's retail points and the matter was under consideration of the Department and action would be taken to merge the retail points to the other retail points nearby.

2.4.4 Based on the instructions (November 1998) of the Government, the Company directed the district offices to submit the claims in respect of transport cost bills to the Deputy Commissioner on or before the due date (10^{th} of every month) to avoid any possible financial constraints.

Audit observed that there was delay in submitting bills for reimbursement of differential and transportation cost by six to seven months. This resulted in lapse of grant provided to the Department, which in turn delayed reimbursement. A further scrutiny of the bills revealed that at any point of time, two to three months bills for amounts ranging from Rs.3.24 crore to Rs.7.55 crore were pending with the Department resulting in blocking up of funds. The Company stated (May 2004) that delay in submission of bills was mainly due to delay in certification by the Department. The reply is not tenable as the delay in certification by the Department was due to non-furnishing of required details / documents to them by the Company.

An amount of Rs.2.78 crore was pending recovery mainly due non-submission of required details/documents by the Company

2.4.5 Claims of Rs.2.78 crore towards commission, differential cost and administration charges on sugar in respect of PDS items supplied to the Police Department and revision of issue price of rice and wheat pertaining to 1998-2003 were outstanding as on June 2004. This was stated to be due to non-submission of bills in time and non-furnishing of clarification sought for by the Police Department. The Company stated (May 2004) that delay in submission of bills in time was due to delay in certification of bills by the Department. The reply is not tenable as the delay in certification by the Department was due to non-furnishing of required details / documents to them by the Company.

An amount of Rs.3.06 crore was outstanding for more than three years mainly due to poor documentation and absence of a system for monitoring dues at periodical interval in the Company.

2.4.6 Due to various discrepancies viz., book entries without documentation, lack of follow-up action for recovery, non availability of records, non-confirmation of the balances, etc., the Company has written off (August 2003) dues of Rs.1.24 crore under Advances and Rs.98.64 lakh under Sundry Debtors, outstanding up to 1991-92. Audit observed that there was no effective follow up action for timely recovery of the dues even in respect of outstanding balances of Sundry Debtors after March 1992.

An amount of Rs.3.06 crore was outstanding under Sundry Debtors for the year ending 31 March 2003 pending recovery for more than three years.

The main reasons for this was poor documentation, absence of a system in the Company for monitoring the recoveries at periodical intervals and improper follow up action. This also consequently resulted in blocking up of funds.

The Government stated (May 2004) that instructions had been issued to all the District Managers to take immediate action to recover the balance from the parties and also to take confirmation from the parties for the amount due from them.

Minimum Support Price Operation (MSPO)

2.4.7 The food procurement policy of Government of India envisages support price operations for coarse grains, pulses and paddy procured directly from farmers to avoid distress sale by them on account of excess production. Food Corporation of India (FCI) is the nodal agency for the support price operations and the Company is the sub-agent. Whenever the market prices fall below the minimum support price fixed by the Government of India, the sub-agents have to procure the foodgrains at the minimum support price. The expenditure incurred by the sub agents was to be reimbursed by the FCI at the rates approved by the Government of India. The scheme was introduced in October 2000. The deficiencies / shortcomings noticed in audit are discussed in the succeeding paragraphs :

2.4.8 The Company claimed reimbursement of expenditure on the procurement of 1,50,284 tonne of coarse grains during July 2001 to January 2003 against which FCI admitted claims for 1,37,283 tonne only. The difference of 13,001 tonne valuing Rs.5.79 crore (13,001 tonne X Rs.14,450 per tonne) has not been reconciled so far (August 2004).

2.4.9 As per the cost sheet approved by Government of India, reimbursement of cost of gunny bags (100 kg capacity), used to store the grains, was to be made at the rate of Rs.22 per bag. The Company used 40.11 lakh gunny bags to store the grain.

Audit observed that while releasing the cost of gunny bags, FCI restricted the cost of gunny bag to Rs.14 per gunny bag (amount actually paid by FCI for its own use) as against Rs.15 and Rs.18 per gunny bag paid by the Company. This resulted in loss of Rs.64.23 lakh (being the difference between the actual cost of procurement and the reimbursement made by FCI).

2.4.10 The Company stored the grains in various godowns belonging to the Karnataka State Warehousing Corporation (KSWC)/Central Warehousing Corporation (CWC) without entering into an agreement and without finalisation of storage and fumigation tariff. While making adhoc payment to KSWC/CWC towards storage and fumigation charges, the Company erroneously considered a quantity of 3.43 lakh tonne as against of actual quantity of 2.22 lakh tonne stored in their godowns. This resulted in excess payment of Rs.96.45 lakh towards warehousing charges. The Government stated (July 2004) that this amount would be adjusted at the time of final payment.

The Company incurred a loss of Rs.52.71 lakh due to excess driage over the norms prescribed.

2.4.11 The economic cost for procurement of coarse grain for 2000-02 provided for reimbursement of one per cent driage on the basic cost. As against the quantity of 1,57,128 tonne of maize procured under this scheme, FCI admitted a quantity 1,54,794 tonne only resulting in disallowance of 763 tonne of maize, which was in excess of one per cent provided in the cost sheet. This resulted in loss of Rs.52.71 lakh. The Government stated (July 2004) that excess driage above one per cent would be recovered during final settlement of storage bills of the KSWC. The final settlement of storage bills was yet to be done (August 2004).

Failure to include the interest component in the cost sheet resulted in non-recovery of interest of Rs.2.64 crore.

2.4.12 The cost sheet approved by Government of India for 2000-01 provided for interest, calculated at 11.55 per cent per annum, on the basic cost of coarse grains plus market cess for a period of six months. The Company, while forwarding (October 2001) the proposal to Government of India for fixation of tentative cost of Rs.571.55 per quintal for 2001-02, did not include the interest component. Non-inclusion of the interest component in the cost sheet resulted in non-recovery of interest of Rs.2.64 crore, worked out at the rate of 11.30 per cent per annum (as provided in the contract for 2002-03) for a period of six months.

The Company stated (May 2004) that the claims based on actual expenditure would be submitted to FCI/Government of India for reimbursement.

Conclusion

The Company has been incurring losses due to opening of fair price shops without conducting viability studies. Huge amount is pending recovery mainly due to improper documentation. In respect of activities under the Minimum Support Price Operation, the Company incurred a heavy loss due to non-acceptance of claims by FCI.

Steps need to be taken to ensure that:

- **proper viability studies are undertaken before opening of fair price shops,**
- **proper documentation is done for speedy recovery of dues, and**
- **claims with FCI are closely monitored.**