

Chapter - III

Compliance Audit Observations

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3. Compliance Audit Observations

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

Government Companies

Karnataka Neeravari Nigam Limited

3.1. Irregular payment of incentive to the contractors

Payment of incentive in contravention to tender conditions resulted in undue benefit to the contractors by ₹ 11.11 crore.

The Schedule of Rates of Water Resources Department, Government of Karnataka, introduced incentive to contractors for speedy completion of the works from the year 2011-12. The Karnataka Neeravari Nigam Limited (Company) adopted the said incentive clause while inviting tenders (September 2011) for the works of Modernisation of Bhadra Canal System. The tender documents included a clause enabling payment of a weightage amount of 25 per cent (incentive) on specified items of work with the condition that it would be released to the contractor, only if the contractor completes 90 to 100 per cent of the modernisation work within the single closure period/ stipulated period.

The Accounts Department of the Company, which was supposed to verify the compliance to these conditions, ignored and paid incentive in respect of three works though the contractors have not completed the work in single closure period/stipulated period.

The cases of irregular payment of the incentive are detailed below:

A. The Company awarded (December 2011) the work of Modernisation of Bhadra Right Bank Main Canal from 0.00 km to 20.00 km including lining works¹¹³ and rehabilitation of structures (balance work) - Package 2(a)(1), to Haigreeva Infratech Projects Limited (Contractor) for ₹ 77.74 crore with a stipulation to complete the work in two calendar months (*i.e.* 2.12.2011 to

¹¹³ A Cement Concrete layer provided at the bed and sides of canal to improve the life and discharge capacity of canal.

1.02.2012) by considering the irrigation closure period¹¹⁴ from 2.12.2011 to 5.01.2012 (both days inclusive).

Audit observed that:

- As per the work award, the single irrigation closure period was from 2.12.2011 to 5.01.2012 (*i.e.* 35 days, both days inclusive). Out of 15 items of works eligible for incentive, 13 items were partially completed ranging between 0.56 *per cent* and 89.84 *per cent* during this period, whereas the remaining two items did not even start within the single closure period.
- Though the Contractor did not complete 90 *per cent* of the modernisation work within the single closure period as per tender condition, the Company released (August 2014) incentive of ₹ 10.35 crore for 13 items of work (**Appendix-9**) stating that he achieved 90 *per cent* within the second canal closure period in May/June 2012.

The rationale behind introducing the incentive was to plan and complete the work within the stipulated time considering the stoppage of water in the canal. Payment of incentive for less than 90 *per cent* completion undermined the very purpose of incentivising the Contractor. Therefore, it was in violation of the contractual terms resulting in undue benefit of ₹ 10.35 crore to the Contractor.

The Government replied (December 2017) that as the Contractor was available for only 36 days during the single closure period against 60 days agreed, remaining 24 days were allowed to complete the balance work. The Contractor executed more than 90 *per cent* of the revised quantities within the extended period duly approved without penalty. Hence, incentive was paid to the Contractor.

The reply was not justified as the Company, as well as the Contractor were aware that a single canal closure period was 35 days only and the eligible items of works were to be completed within the stipulated single closure period for payment of incentive. The Work Order clearly defined the total contract period as 60 days (from 2.12.2011 to 1.02.2012) and out of that, 35 days (2.12.2011 to 5.01.2012) was canal closure period. In spite of the stipulation, the Contractor did not complete 90 *per cent* of the modernisation work within a single closure period. Hence, the incentive paid was irregular.

B. Similarly, the work of Modernisation of Bhadra Left Bank Distributaries 1 to 8 and their Laterals (balance work) - Package 1(a)(1), was awarded (December 2010) to Sri. S. M. Biradar (Contractor) for ₹ 5.27 crore with a stipulation to complete the work in nine months considering the canal closure period from 4.12.2010 to 5.01.2011 and from 1.06.2011 to 1.07.2011 (*i.e.* 64 days).

¹¹⁴ Irrigation Closure Period refers to the period when the canal was closed for maintenance and water was not let into the canal during this period.

The Contractor was eligible for incentive of 25 *per cent* only if the entire work (*i.e.* 100 *per cent* of two eligible items) was completed within the stipulated canal closure period.

Audit observed that though the Contractor did not complete the entire work within the stipulated canal closure period, the Company paid ₹ 43.24 lakh (**Appendix-9**) as incentive, which was irregular.

The Government replied (December 2017) that though the stipulated period for completion was nine months, the actual working period given was only 62 days. The Contractor completed the 100 *per cent* of two items of work eligible for incentive within the extended closure period.

The reply was not correct as the items of work eligible for incentive were to be completed 100 *per cent* within the specified closure period as defined in the work order. The Contractor was unduly favoured by allowing extended closure period in violation of the contractual terms.

C. In yet another work of Modernisation of Bhadra Left Bank - Minors of Distributary 27 (balance work) - Package 1(c)(4), where the incentive was payable on completing full work within the single canal closure period, the Company paid incentive of ₹ 32.71 lakh to Sri. P.K.Shivaram (Contractor). This amount was paid for the work, which was not completed within the single canal closure period. The Government replied that the same would be recovered. The recovery was yet (December 2017) to be effected.

Thus, payment of incentive by the Company indicated failure of internal control system resulting in disregarding the tender conditions and extending undue favour to the contractors by ₹ 11.11 crore, which should be recovered.

Karnataka Neeravari Nigam Limited

3.2. Avoidable payment

Non-adherence to, as well as non-utilisation of, relevant provisions of the Conditions of Supply of Electricity of Distribution Licensees resulted in avoidable payment of ₹ 3.80 crore.

The Karnataka Neeravari Nigam Limited (Company), entrusted (September 2005) the work of design, erection, testing and commissioning of Sri Rameshwara Lift Irrigation Scheme including the construction of the sub-station, electrical works and operation of the system for two years to Subhash Projects and Marketing Limited (Contractor) at tendered cost of ₹ 86.47 crore. The lift work was completed and commissioned in March 2013.

For operation of the above Lift Irrigation Scheme, the Company obtained (April 2013) a High Tension (HT) power connection with a sanctioned load of 20,800 HP from Hubli Electricity Supply Company Limited (HESCOM). The Conditions of Supply of Electricity of Distribution Licensees as notified (June 2006) by Karnataka Electricity Regulatory Commission (KERC) and the

conditions of sanction by HESCOM stipulated that the HT consumer¹¹⁵ were to maintain an average Power Factor¹¹⁶ of not less than 0.90 and install suitable correcting apparatus (capacitors¹¹⁷) for maintaining the same, failing which, surcharge shall be leviable as per tariff schedule. The conditions also stipulated that the consumer was liable to pay the interest for delayed payments, at the rates prescribed by the Government from time to time.

Audit observed (February 2017) that:

- As per the instructions to bidder (which forms part of the agreement), the Contractor was to ensure that the Power Factor of the system does not fall below 0.90 during off load and/or monsoon period. He was to make necessary arrangements for connecting the required capacitors in the circuit. However, the Power Factor was not maintained at 0.90 in any of the months between June 2013 and April 2015 by the Contractor and thereafter, upto March 2017 by the Company. An amount of ₹ 1.24 crore was paid as Power Factor penalty. The Power Factor ranged from 0.28 to 0.87 between June 2013 and March 2017 (except in December 2014 when it was 0.93).

The operations of the Lift Irrigation Scheme were vested with the Contractor for two years upto April 2015. The Company, however, did not monitor the maintenance of the Power Factor resulting in payment of penalty towards non-maintenance of Power Factor.

- The Company delayed payment of electricity bills and paid ₹ 45 lakh as penalty from April 2013 to March 2017. Though the Company directed recovery of penalty from the officials responsible for the same, no action was initiated.
- The Company was using electricity for pumping water from March 2013 and it did not utilise the power upto 75 per cent of the sanctioned load of 20,800 HP in any of the months except September 2016, paying demand charges for the entire sanctioned load.
- The General Terms and Conditions of Tariff Order permitted seasonal industries to reduce contract demand during off-season. The Company, which was a seasonal consumer of electricity, *i.e.* consuming electricity only during the rainy season (from June to September) when water was pumped to the canal, did not exercise the option to reduce the contract demand. As a result, it incurred additional contract demand charges amounting to ₹ 2.11¹¹⁸ crore, which could have been avoided.

The Company replied (June 2017) that the delay in payment of electricity bills occurred due to insufficient funds. Further, it was also stated that several

¹¹⁵ Consumers supplied with High Tension power.

¹¹⁶ The ratio of the real power used to do work and the apparent power supplied to the circuit.

¹¹⁷ Capacitors are passive electronic components that provide a static source of reactive power in electrical distribution systems.

¹¹⁸ The amount of savings calculated on the reduced contract demand of 50 per cent of sanctioned demand of 20,800 HP for a maximum period of six months as per tariff order.

notices were issued to the Contractor to maintain the requisite Power Factor and penalty would be recovered from the Contractor.

The reply was not justified as the Company's financial position was not in such a bad shape that it was not possible for it to pay electricity charges. The Company kept an amount of ₹ 79.09 crore to ₹ 1,590.77 crore during 2012-13 to 2014-15 in deposit accounts with banks and treasury. Also, the chances that the Company would not be able to recover the amount remained high as the liability of the Contractor was limited only to the agreement period of two years (*i.e.* till April 2015).

Thus, the failure of the Company to adhere to the provisions of the Conditions of Supply of Electricity of Distribution Licensees, resulted in avoidable payment of ₹ 3.80¹¹⁹ crore.

The matter was referred (May 2017) to the Government and their reply was awaited (November 2017).

Krishna Bhagya Jala Nigam Limited

3.3. Undue financial benefit to the Contractor

Premature payment of weightage of ₹ 51.58 crore and excess payment of ₹ 4.82 crore contrary to tender conditions resulted in extending undue financial benefit to the Contractor and potential loss of interest of ₹ 6.02 crore on the amount prematurely released.

The Schedule of Rates (SR) of Water Resources Department allowed 25 *per cent* weightage over the rates in SR for all the items of works involved in modernisation of canal network, for completion of the works during canal closure period of about three to four months and less. The 25 *per cent* weightage was payable only in the last/final Running Account (RA) bill, subject to completion of 90 *per cent* of work in a single closure period.

The Krishna Bhagya Jala Nigam Limited (Company) awarded (February 2014) the work of Remodelling of Shahapur Branch Canal from 0.00 km to 30.00 km (estimated cost ₹ 215.02 crore) to Shri. D. Y. Uppar (Contractor) on tender basis at ₹ 267.62 crore (which was 10 *per cent* above the recast tender amount of ₹ 243.29¹²⁰ crore). Both the Work Order and the Agreement stipulated (February 2014) that the work should be completed within 90 days from the last day of (24 March 2014) letting water into the canal during rabi season of 2013, *i.e.* by 25 June 2014. The canal was closed from 24 March 2014 to 31 August 2014 and the Contractor completed the work within that period. The final bill was paid (January 2016) for an amount of ₹ 7.65 crore after adjusting ₹ 259.72 crore already paid in various RA bills, which included the weightage of 25 *per cent* for completion within 90 days.

¹¹⁹ ₹ 1.24 crore *plus* ₹ 0.45 crore *plus* ₹ 2.11 crore *equals* ₹ 3.80 crore.

¹²⁰ The initial estimated cost of ₹ 215.02 crore was revised to ₹ 243.29 crore due to change in Schedule of Rates from 2012-13 to 2013-14.

Audit observed (February 2017) that:

- The Company paid (20.07.2014) an amount of ₹ 51.58 crore as weightage for completion of 90 *per cent* of the work within the canal closure period from the 3rd Running Account (RA) bill submitted on 26 June 2014, instead of paying in the final bill which was submitted on 4 May 2015. The premature payment of 25 *per cent* weightage of ₹ 51.58 crore resulted in extending undue benefit to the Contractor by way of interest of ₹ 6.02 crore¹²¹ on that amount; and
- From the final bill, it was observed that the Company paid ₹ 214.34 crore towards works and ₹ 53.04 crore towards 25 *per cent* weightage. Premium of 10 *per cent* was paid on the weightage amount also. This resulted in excess payment of ₹ 4.82¹²² crore to the Contractor.

The Government replied (June 2017) that wherever the weightage of 25 *per cent* was released in the 3rd RA bill, the quantities executed as per the measurement book and the bill were more than 90 *per cent* of the tendered quantity, and the value of the quantities in the bill was more than 97 *per cent* of the contract value. Further, it was replied that the recast amount of ₹ 243.29 crore included weightage of 25 *per cent* and the tender was a percentage tender and not an item rate tender. Hence, the Government asserted in its reply that the payment was correct.

The reply was not correct for the following reasons:

- The incentive was paid from third RA bill onwards. As per SR, it was payable only in the last/final RA bill. From the reply, it was apparent that weightage was to be paid only in final bill (as per clause 50 of the contract, which was in line with the clauses 5 and 16 of SR) and not in the RA bills; and
- As the 25 *per cent* weightage was an incentive payable based on fulfilment of the conditions, *viz.* completion of work within canal closure period, it should not be considered as amount put to tender. Further, as per General Conditions of the SR, the weightage of 25 *per cent* is to be paid over the SR rates.

Thus, premature payment of 25 *per cent* weightage of ₹ 51.58 crore and excess payment of ₹ 4.82 crore contrary to SR/tender conditions, resulted in extending undue financial benefit to Contractor, besides loss of potential interest of ₹ 6.02 crore on the amount prematurely released.

¹²¹ Calculated at State Bank of India Prime Lending Rate of 14.75 *per cent* for 289 days on ₹ 51.58 crore.

¹²² Calculated on actual total incentive paid *i.e.* ₹ 53.04 crore - $((53.04/110) \times 100) = ₹ 4.82$ crore.

Karnataka Road Development Corporation Limited

3.4. Avoidable payment of compensation

Failure to ensure complete access to the land as per the contractual provisions resulted in avoidable extra expenditure of ₹ 35.20 crore.
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To cater to the possible increase in toll leviable traffic plying between towns, viz. Sandur, Hospet, Kudalagi and Torangal, and with a view to support socio-economic development by providing vital linkages in the central part of Karnataka between Taluks/Districts/State Highways, the Karnataka Road Development Corporation Limited (Company) awarded two works as detailed below:

Table No. 3.4: Works awarded by the Company

Sl. No.	Work	Date of Award	Contract price (₹ in crore)	Conditions of Agreement
1	Development of road from Kudalagi-Sandur to Torangal (Road length of 45.65 kms) - Kudalagi Work.	22.07.2011	94.31	Possession of land corresponding to 60 per cent of the total road length at the time of issue of work order to the Contractor and balance after six months.
2	Improvements to road from Honnali town to Honnali Taluk Border (Road length of 44.25 kms) - Honnali Work.	18.03.2013 (site handed over on 27.06.2013)	113.86	Possession of land for minimum road length of 20 kms at the time of issue of work order to the Contractor and balance after six months.

Both works were to be completed within 24 months from the date of issue of work order. The agreements provided for payment of compensation if:

- The Company failed to give possession of the site to the Contractor by the date stated in the contract data (Clause 21); and
- It did not give access to a part of the site to the Contractor by the Site Possession Date¹²³ stated in the Contract Data (Clause 38.1).

Though the Kudalagi and Honnali works were to be completed by 21 July 2013 and 26 June 2015 respectively, both the works were delayed. While the Kudalagi work was completed in February 2016, the Honnali work was still (November 2017) under progress.

During audit, it was observed that:

For the Kudalagi Work:

- The Company issued the Work Order/Notice to Proceed with Work (NPW) on 22.07.2011 without ensuring possession of land for 60 per cent of total road length to be handed over to the Contractor for executing the work. On the date of issue of Work Order, the Company

¹²³ The date of issue of Work Order.

handed over (17.09.2011) only 14.88 kms (33 *per cent*) of the road length as against the required length of 27.39 kms (60 *per cent*) of the estimated road length of 45.65 kms. Though the encumbrances like electrical utility shifting and tree cutting process were completed during September 2012/October 2012 *i.e.* within the contract period (21 July 2013), the work of shifting the Water Supply pipeline was not completed within the contract period of 21 July 2013.

- The approval of the drawings for Cross-Drainage work took 439 days, and consequently, the work was delayed.
- This matter was also brought to the notice of the Board of the Company, who, admitting delay on its part, approved (August 2014) the claim (October 2013) of compensation of ₹ 25.27 crore by the Contractor as per the agreement. The compensation was in the form of adopting the cost proposed by the Contractor based on relevant Schedule of Rates and approved by the Company. The compensation could have been avoided had the Company handed over the land to the extent of 60 *per cent* of the total road length and provided access to the site on time.
- Further, the Government Order (May 2011), approving entrustment of the work to the Company, contemplated levying of toll on this road to repay the loan of ₹ 112 crore obtained for these works from Housing and Urban Development Corporation Limited (HUDCO). The work, which was to be completed by July 2013, could be completed only in February 2016. Therefore, collection of toll also got delayed. The Company incurred an interest of ₹ 23.24 crore towards the loan. The tender for user collection fee was yet to be processed (November 2017), resulting in potential loss of revenue of ₹ 16.08 crore during the period 2015-17 as estimated by the Company itself.

For the Honnali Work:

- This work was delayed due to the Company's failure in giving possession of land and access to site as per the agreement, despite frequent communications (March 2014/May 2014/January 2015) from the Contractor.
- The Company, while admitting (August 2015, June 2016) that it did not hand over the full road length as per the conditions of the agreement, accorded two extensions upto December 2016 and agreed for a compensation of ₹ 9.93 crore (based on rates projected by the Contractor because of delay and as approved by the Company as per Clause 38), of which, ₹ 5.29 crore was paid till October 2017.

In response to these issues, the Company replied (October 2017) that:

- The Kudalagi work was taken up in anticipation of obtaining clearance from the departments concerned. However, due to delay in getting clearances from various departments, there was delay in handing over of hindrance free land;
- Almost 80 *per cent* of the Honnali Work was completed before the due date. However, existence of several old structures on this stretch of

land, disputes amongst the localities to part with land and court cases delayed the acquisition of requisite road lengths; and

- In both the works, the Company had the option to either acquire land and shift the utilities before awarding the project, or start the project wherever the encumbrance-free land was available and initiate parallel action for clearing encumbrances in other parts. The Company took the latter option to ensure progress.

The fact remains that the Company did not finalise the contract keeping the above uncertainties in mind. Otherwise, the Company could have included an appropriate clause in the contract, for handing over only those sites first, where encumbrance-free land was available. It could also initiate parallel action for clearing encumbrances in other parts, without having to incur heavy compensation for non-adherence to contractual obligations.

Similarly, though the Company was aware that delay in approval of drawings was one of the events for payment of compensation, it did not ensure timely approval of drawings.

The Sub-Committee formed (May 2014) to look into the issue of price adjustment and review of rates, suggested (June 2014) identifying the officers responsible for the delay and fixing responsibility. However, the Company did not fix any such responsibility till date (October 2017).

Thus, due to improper planning in handing over of land and delay in approval of drawings, the Company incurred avoidable compensation of ₹ 35.20¹²⁴ crore, of which, ₹ 4.64¹²⁵ crore was yet to be paid.

The matter was referred (November 2017) to the Government and their reply was awaited (December 2017).

Karnataka Power Corporation Limited

3.5. Injudicious procurement of spares

Procurement of spares without ensuring environmental clearance for operations resulted in write-off of spares worth ₹ 5.04 crore.

Karnataka Power Corporation Limited (Company) operated six units of diesel based generating power plants (DG Plant), each having a capacity of 18 MW, in Yelahanka, Bengaluru. Under Sections 25 and 26 of Water (Prevention and Control of Pollution) Act, 1974, and under Section 21 of Air (Prevention and Control of Pollution) Act, 1981, (Acts), every project proponent was required to obtain the Consent For Operation (CFO) from the State Pollution Control Board every year. The Company obtained (23 May 2008) CFO from the Karnataka State Pollution Control Board (KSPCB) upto 30 June 2010. In the same CFO, KSPCB ordered (May 2008) the Company to submit a time-bound commitment to contain the stack emissions well within the prescribed limits,

¹²⁴ ₹ 25.27 crore for Kudalagi Work + ₹ 9.93 crore for Honnali Work.

¹²⁵ Total compensation (₹ 9.93 crore) – Amount already paid (₹ 5.29 crore).

explore the possibility of using the fuel oil LSHS (Low Sulphur Heavy Stock) with sulphur content less than one *per cent* and change over to gas at the earliest. As the Company did not comply with the stipulations, it could not get CFO for the period from 1 July 2010 to 30 June 2011.

In the meantime, Company procured spares worth ₹ 14.50¹²⁶ crore between March 2011 and November 2011 against the Purchase Orders (PO)¹²⁷ floated during the period July 2010 to February 2011 to operate the plant. It was pertinent to note that before placing the POs, the Company already had a stock of spares worth ₹ 12.07 crore.

KSPCB ordered (September 2010 and again in July 2011) the Company to submit a time-bound commitment with an action plan regarding completion of maintenance/servicing units of the DG Plant, changeover to Liquefied Petroleum Gas (LPG) and to dispose of the accumulated oil sludge to the KSPCB-authorized recyclers. KSPCB observed that despite issue of notices and directions (May 2008, September 2010, June 2011 and June 2012) action was not initiated to control pollution. Thereafter, KSPCB ordered (August 2012) stoppage of operations of four out of six units due to non-compliance to its directions and issued CFO to operate the two units. Finally, based on further orders (May 2013) of KSPCB, the Company suspended (August 2013) the operations of the DG Plant in its entirety.

Consequently, Company resolved (February 2014) to establish a gas power plant by dismantling the DG Plant and impaired the entire plant during 2014-15. Not being able to dispose of the unutilised spares, the Company ultimately wrote off (July 2016) inventory of spares worth ₹ 13.91 crore, which included spares worth ₹ 5.04 crore purchased between March 2011 and November 2011.

Thus, non-compliance to environmental laws, regulations and norms required for operation of its plant, and consequent shut-down of its operations, resulted in accumulation of inventory and ultimate write-off of spares worth ₹ 13.91 crore, including ₹ 5.04 crore worth of freshly acquired spares. Considering the frequent notices and the fact that the orders of KSPCB were binding, there was enough evidence for the Company to realise that they were falling short of meeting expected standards and were liable to be ordered to shut down. Hence, it was imperative to plan the procurement only to the extent immediately required.

The Company replied (September 2017/October 2017) that procurement of spares was done keeping the following in mind:

- Carrying out of regular Schedule Maintenance Works of all units as per the recommendations of Original Equipment Manufacturer (OEM);

¹²⁶ This amount was arrived at by calculating the costs of the materials, after conversion from Euro, at the time of receipt of the materials and their accounting.

¹²⁷ Purchase Order (PO) No. 55 dated 26.07.2010, PO No. 56 dated 26.07.2010 and PO No. 57 dated 14.02.2011.

- Attending to breakdown maintenance of all six units in order to meet the requirement of Load Dispatch Centre and to achieve generation target; and
- That KSPCB only wanted it to initiate certain remedial measures to tackle pollution and did not intend to stop the plant operations completely in 2009-10.

The reply was not justified for the following reasons:

- The units were shut down due to high stack emissions, arising out of want of proper maintenance. This should have been evident to the Company due to their repeated non-compliance of guidelines/ strictures issued by KSPCB in this regard; and
- The Company, being fully aware that the plant was to shift over to gas, could have exercised adequate discretion to limit its order to the barest minimum.

Audit is therefore of the view that there was no necessity for placing further purchase orders as there was already a stock of ₹ 12.07 crore lying at the time of placing of the orders.

As a result, spares piled up and huge stock of materials worth ₹ 13.91 crore, which included new purchases of ₹ 5.04 crore, was written off. The Company, by exercising prudence in the purchases, could have avoided this write-off, especially ₹ 5.04 crore.

The matter was referred (October 2017) to the Government and their reply was awaited (November 2017).

Gulbarga Electricity Supply Company Limited

3.6. Lack of monitoring of the works

Failure to encash bank guarantee and lack of monitoring works resulted in loss of ₹ 1.17 crore.

Gulbarga Electricity Supply Company Limited, Gulbarga (Company) invited (January 2011) bids on partial turnkey basis for the construction of independent 11 KV feeders to non-agricultural loads and bifurcation of agricultural loads from the existing feeders in Basavakalyan and Humnabad talukas of Bidar District under Phase II of Niranthara Jyothi Yojana Scheme. The lone bid of Srinivasarao Pokuri, Electrical and Civil Contractors, Hyderabad (bidder) at ₹ 4.89 crore for Basavakalyan and ₹ 2.74 crore for Humnabad, totalling ₹ 7.63 crore was approved (July 2011) by the Purchase Committee of the Company. Apart from the materials to be supplied by the

bidder¹²⁸, poles, conductor, insulators with GI pins and transformers costing ₹ 15.90 crore was to be supplied by the Company.

The Letter of Intent (LOI) was issued to the bidder in August 2011. The Detailed Work Award (DWA) was issued (February 2012) to PSR Elecon Pvt. Ltd., Hyderabad (Contractor), who took over the bidder's firm. As per the conditions of the DWA, the works were to be completed within 180 days from the date of issue of LOI. The Contractor furnished Performance Bank Guarantee (BG) for ₹ 0.76 crore being the 10 *per cent* of the value of the contract, with validity period upto 12 April 2015.

As the progress of the work was very slow even after several notices (September 2011 to October 2015), the Company terminated (November 2015) the contract and proposed for imposition of liquidated damages as per clause 14 of the General Terms and Conditions of Contract, forfeiture of Performance Guarantee and completing the balance work at risk and cost of the contractor.

At the time of termination of contract, the Contractor commissioned only eight out of 23 feeders. While 14 were at different stages of completion, work on one feeder was not taken up. The Contractor supplied materials worth ₹ 3.30 crore against the order value of ₹ 4.55 crore and completed erection worth ₹ 0.61 crore against the order value of ₹ 3.09 crore. The Company made payment of ₹ 2.42 crore against ₹ 3.91 crore being the value of bills submitted by the Contractor. Further, the Company supplied materials valued ₹ 11.18 crore to the Contractor. The Contractor did not respond to the request of the Company for undertaking a joint survey to ascertain the usage of material drawn from its stores. The Company conducted (November 2016) a survey of the inventory of the departmental material and noticed that the material worth ₹ 1.17 crore out of ₹ 11.18 crore was neither utilised in the work nor returned to the stores by the Contractor.

Audit observed that:

- Though the Company identified (January 2013) the reasons for slow progress as poor labour batches at site, it did not insist the Contractor to increase the labour batches and monitor the progress of work against the supply of materials from its stores, resulting in non-return of materials worth ₹ 1.17 crore in works;

Clause 14.2 of the General Terms and Conditions of Contract provided for recovery of liquidated damages, which worked out to ₹ 1.52 crore. The Company withheld ₹ 1.49 crore (towards penalty) as retention money due to slow progress from the beginning;

- The Contractor provided BG for ₹ 0.76 crore as performance guarantee. The Company did not monitor the validity of BG, which expired in April 2015. The Company did not encash the same within

¹²⁸ 32 items like Conductor, Copper Control Cables, Lightning Arresters, Isolators, DP Structures, Guy Set, Clamps, Earth Electrodes and TC Sets, etc.

validity period despite slow progress of work. The Company, thus, lost an opportunity to recover ₹ 0.76 crore against the amount due from the Contractor;

- The termination order issued in November 2015 imposed forfeiture of performance guarantee while knowing very well that the validity of BGs submitted by the Contractor was not extended. The same order also instructed the Executive Engineer (Electrical) of Humnabad Division for undertaking joint inspection of the inventory. This inspection was carried out in the absence of the Contractor during November 2016, *i.e.* after a delay of one year. This clearly showed lack of persuasion of recovery/monitoring of the works by the Company; and
- Even though the termination letter indicated completion of balance work at risk and cost of the Contractor, the Company was yet (May 2017) to take up the balance work estimated at ₹ 17.38 crore including supply of materials and take recourse for recovery.

In its reply (May 2017), the Company's Chief Engineer (Electrical) stated that the cost would be recovered out of the pending bills and there would be a shortage of ₹ 43.75 lakh even after adjusting the amount from other works. As ascertained, the Company did not recover any amount till November 2017.

Thus, due to failure to encash BG and lack of monitoring the works, the Company suffered a direct loss of ₹ 1.17 crore due to non-return of materials in works, lost opportunities to recover ₹ 0.76 crore from the Contractor, and the project did not achieve the objectives of Niranthara Jyothi Yojana for over four years beyond target date in the two taluks, till date.

The matter was referred (June 2017) to the Government and their reply was awaited (November 2017).

The Mysore Paper Mills Limited

3.7. Injudicious expenditure

Imprudent decision of the Company to retain Corporate/Registered Office in Bengaluru resulted in injudicious expenditure of ₹ 1.28 crore.

The Mysore Paper Mills Limited (Company) was operating a paper mill and a sugar mill in Bhadravathi. Owing to huge accumulated losses and erosion of net worth, the Company registered with Bureau of Industrial and Financial Restructuring (BIFR) as a sick unit in March 2012. The Government of Karnataka (GoK) was providing financial assistance to the Company. The Company decided (September 2015) to operate its business directly from Bhadravathi retaining six of its staff in Bengaluru to attend to Managing Director's secretarial matters and marketing the products of the Company. The operation of the paper mill was stopped in November 2015.

The Karnataka State Bureau of Public Enterprises (KSBPE), GoK, stipulated (October 1994) that while hiring rented premises by the Public Sector Enterprises (PSEs), proper assessment of the requirement of space with reference to staff strength should be made and the need for hiring the building in commercial/expensive locations should be related to the nature of the functions of the enterprise. It allowed expensive accommodation only in cases where enterprises maintained certain commercial standards keeping in view the competition faced by them in the market. GoK also emphasised (March 2003) that in the wake of Public Sector Reforms, the PSEs should be run and managed effectively and efficiently.

In violation of these norms and instructions of GoK, the Company hired (July 2015) a premises of 5,500 sq. ft. at Bengaluru, for a period of three years, which was way above its requirement (out of the 40 employees, only six were retained in Bengaluru, the remaining were transferred to Bhadravathi) without justifying the necessity in terms of staff strength, the functions of the enterprise or the competition it faced. The monthly rent was ₹ 5.27 lakh¹²⁹ and the total rent paid was ₹ 1.28 crore¹³⁰ from October 2015¹³¹ till now (September 2017). In view of the virtual closure of operations due to financial crisis, the action of the management was against the interest of the Company and lacked financial propriety and prudence. The other option available for the Company was to examine the possibility of shifting to its own building, which was being used as a guest house.

On the issue being pointed out by Audit (April 2017), the Government replied (June 2017) that arrangements were now made to share the entire space to Bengaluru B. R. Ambedkar School of Economics (School of Economics) except two office cabins and two work stations in the premises (for the Company) with effect from 15 May 2017 and there would be no further expenditure on the rents being incurred. Further, it was replied that keeping the commercial interest in mind, Company chose the said office space initially for sufficient space and proximity and that month-wise stock and sale of ₹ 152 crore could be achieved between November 2015 and March 2017 only by having the office in a centralised area.

The reply was not justified on the following grounds:

- Sub-letting of the premises was not allowed under clause 7 of the agreement with Karnataka State Co-operative Federation Limited (lessor), which specifically mentions that “The lessees shall not sub-let or part with the possession of schedule premises or any part thereof to anyone else or assign or transfer their rent/leasehold rights in any manner whatsoever”. Therefore, sub-letting the premises under the terminology of sharing was void *ab initio*;

¹²⁹ ₹ 4.62 lakh *plus* service tax and cess.

¹³⁰ Rent at ₹ 5,26,880 per month including all taxes for October and November 2015, ₹ 5,28,990 from December 2015 to May 2016, ₹ 5,31,300 from June 2016 to June 2017 and ₹ 5,45,160 from July 2017 to September 2017.

¹³¹ Since the decision to shift to Bhadravathi was taken in September 2015.

- The Company, however, kept the lessor informed (November 2015) of their proposed action to share space with any other tenants of lessor. Though no response was forthcoming from the lessor, the Company went ahead with its action of sharing space with the School of Economics in May 2017. However, the Company could not enter into a valid agreement with the School of Economics; and
- The month-wise stock and sale of ₹ 152 crore could have been achieved even with the smaller space as the space required was only for meetings and tendering. Hence, the contention of the Company did not justify the action of keeping a space of 5,500 sq. ft.

Thus, Company did not visualise the financial impact of hiring a bigger building at Bengaluru for its Registered Office, which resulted in injudicious expenditure of ₹ 1.28 crore. In the absence of an enforceable agreement, Company may incur an additional burden of ₹ 49.06 lakh for a further period of nine months at ₹ 5.45 lakh per month.

Cauvery Neeravari Nigama Limited

3.8. Inefficient management of surplus funds

Loss of interest of ₹ 1.16 crore due to non-availing of auto-sweep facility for the funds in its current account.

The Cauvery Neeravari Nigama Limited (Company) executes irrigation projects, which are funded through capital grants in the form of equity from Government of Karnataka (GoK) besides borrowings through issue of bonds. The Company parks the said funds in its bank accounts maintained by Head Office and appropriates funds to its Divisions for release of various payments to contractors, suppliers, salaries to employees, etc. Prudent management of funds entail maintenance of adequate liquidity to meet the expenses and optimal returns on surplus funds.

Audit observed that the Board of Directors of the Company *inter-alia* authorised (June 2003) the Managing Director to convert temporary surplus funds into interest bearing bank deposits or to invest otherwise.

A review of the management of surplus funds of the Company between April 2013 and January 2017 revealed that the Company parked funds upto ₹ 366.88 crore in its current account without opting for auto-sweep facility with State Bank of Mysore (SBM).

The Company should have availed auto-sweep facility¹³² in order to earn interest on the surplus funds. It was also observed that the Union Bank of

¹³² Auto-sweep facility is an option for bank account holders wherein any amount above the threshold limit is automatically converted into fixed deposit for flexible maturity period at the interest rates applicable to term deposits. It also facilitates automatic transfer from the fixed deposit to current account if the balance in the current account falls below the threshold limit.

India, a Nationalised bank, also offered (August 2013) current account with auto-sweep facility to the Company and the Company did not avail the same.

By parking the unutilised/surplus funds in current account without auto-sweep facility, which combine the liquidity of a current account with returns of term deposits, the Company lost an opportunity to earn an interest of ₹ 1.16¹³³ crore.

The Company replied (June 2017 and August 2017) that during the period 2012-17, it invested surplus funds in various banks as interest bearing deposits and earned an interest of ₹ 11.30 crore. Further, SBM was requested (April 2017) for auto-sweep facility, which was provided only from June 2017. It was also replied that interest rate in auto-sweep facility was 3.75 *per cent*, whereas Company earned 6.10 *per cent* by investing the surplus funds.

The reply was not convincing in the instant case, as the subject matter deals with the surplus amount, which was not converted into interest bearing deposits and was lying idle in a current account. The interest of ₹ 11.30 crore, as informed by the Company, pertains to the funds that were invested in term deposits. Hence, the reply did not address the Audit contention of an opportunity foregone for earning additional interest of ₹ 1.16 crore as pointed out above. Instead of opting for similar facility with SBM in 2013 itself, when offered by Union Bank of India, the Company took the initiative to avail auto-sweep facility with SBM only in April 2017 *i.e.* after Audit commented on it (April 2016).

The reply regarding low interest rate was not relevant as the interest rate of 3.75 *per cent* (November 2016 to January 2017) for auto-sweep facility was adopted by Audit as a conservative basis only, considering the least rate of interest in State Bank of Mysore, whereas the Company considered the fixed deposit rate, which are not comparable to each other for reasons aforesaid in this paragraph.

Therefore, despite the latest attempts by the Company to opt for auto-sweep facility, the fact remains that the Company lost out an opportunity for earning additional interest of ₹ 1.16 crore between 2012 and 2017.

The matter was referred (July 2017) to the Government and their reply was awaited (November 2017).

¹³³ Calculated at the lowest rate of interest (4 *per cent* per annum from April 2013 to October 2016 and 3.75 *per cent* per annum from November 2016 to January 2017) on the lowest amount of balance during a particular month.

Karnataka State Small Industries Development Corporation Limited

3.9. Avoidable expenditure

Non-acceptance of bank guarantee submitted by the lowest bidder and consequent cancellation of bid resulted in escalation of cost of the work by ₹ 86 lakh.

The Karnataka State Small Industries Development Corporation Limited (Company) invited tenders (July 2009) for development of infrastructure works like construction of roads, construction of drains, deck slab, asphaltting of roads, water supply and allied works in Industrial Estate at Ranebennur II stage. The quote of Shri. C. M. Patil (bidder) at ₹ 1.07 crore, which was 11.45 per cent less than the estimated tender amount of ₹ 1.21 crore was the lowest. The Technical Sub Committee (TSC) of the Company accorded approval (November 2009) for entrustment of work to the lowest bidder. Accordingly, the Company issued (November 2009) Letter of Intent (LOI) to the lowest bidder with a stipulation to furnish the Bank Guarantee (BG) from a nationalised bank for ₹ 14.00 lakh and enter into an agreement by 7 December 2009, failing which, it would be presumed that the bidder has no interest in the work and action would be initiated as per terms and conditions of the tender.

The lowest bidder requested (7 December 2009) the Company for extension of time upto 31 December 2009 for submission of BG as the banker required 15 to 20 days to issue BG. TSC, however, noted that the agency did not come forward to furnish the BG and recommended (14 December 2009) cancellation of bids and retendering immediately. Accordingly, the work was retendered (21 December 2009). Aggrieved by the cancellation of the bid, the bidder approached (29 December 2009) the Hon'ble High Court of Karnataka, Bengaluru. The Hon'ble High Court, in its interim order (31 December 2009), stayed the operation of the tender notification dated 21 December 2009 issued by the Company till the next date of hearing subject to the condition that the petitioner, *i.e.* the bidder, should produce a BG on or before 4 January 2010. The bidder, in compliance to the court orders, submitted BG to the Company on 4 January 2010 and requested to execute an agreement to start the work. The Company did not take any action on receipt of BG. The case was finally disposed of during July 2012 by the Hon'ble High Court of Karnataka with a direction to refund BG within two weeks and if the work was retendered, to allow the bidder to participate in the tender process.

The Company returned (July 2012) the Bank Guarantee and retendered the same work in November 2012. The work was finally awarded (February 2013) to a lone bidder at a negotiated rate of ₹ 2.13 crore. The work was completed in March 2014 at a cost of ₹ 1.93 crore, which was ₹ 86 lakh more than the lowest bid amount in the first bid received in November 2009.

Audit observed (April 2016) that:

- The Company violated the Court Orders dated 31 December 2009 by not allowing the Contractor to carry out the work, even though BG was submitted as per the Court Order;

- As per clause 6 of tender conditions, where the rates quoted were below the tendered rates, Bank Guarantee was to be submitted at the time of issue of Work Order. Accordingly, there was sufficient time available for the Contractor to submit BG. However, the Company, in its Letter of Intent, stipulated to furnish the BG and execute the agreement with relevant documents by 7 December 2009;
- Further, when the issue was discussed in the Technical Sub Committee Meeting (14 December 2009), the Company suppressed the fact that the bidder requested for time to furnish BG and conveyed that the agency did not come forward to submit BG. Based on this information, the Committee decided that the work should be re-tendered;
- When the Contractor furnished BG as per the directions of the Court within the stipulated time, (*i.e.* 4 January 2010), the Company did not take cognizance of the same and issue work orders. Instead, the Company remained silent; and
- There were no recorded reasons for not waiting till 31 December 2009 for the bidder to submit BG. Neither the tender documents nor the LOI stated that the work was of urgent nature. While retendering would take at least 60 days to fructify considering the provisions of The Karnataka Transparency in Public Procurements Act, 1999, the Contractor would have submitted BG within three weeks after the stipulated time. Therefore, the urgency showed by the Company in cancelling the bid and retendering the work lacked rationale.

All these actions indicated lack of commitment to get the work completed in time.

The Company replied (September 2016) that though the bidder submitted BG as per the directions of the Hon'ble High Court on 4 January 2010, the Court did not direct the Company to issue work order to the agency. Hence, the work order was not issued and kept in abeyance till the final judgment. The delay was unavoidable and subsequent entrustment at higher rates was inevitable.

The reply was not correct, as it was evident that when the Hon'ble High Court extended the date for submission of BG by the bidder, the Company should have considered the BG and entrusted the work to the lowest bidder. The spirit of the interim order allowing time to submit BG to bidder should have been taken cognizance of.

Thus, non-acceptance of the request of the lowest bidder for extension of time for submission of BG and not considering the BG submitted by the bidder as per the directions of the Hon'ble High Court of Karnataka, led to cancellation of the bid. Retendering the work resulted in executing the work at an extra cost of ₹ 86 lakh and also caused delay in providing the necessary infrastructure to the industrial estate.

The matter was referred (June 2017) to the Government and their reply was awaited (November 2017).

Karnataka State Handicrafts Development Corporation Limited
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3.10. Non-implementation of Enterprise Resource Planning system due to ill planning

Non-completion of Enterprise Resource Planning system even after ten years resulted in unfruitful expenditure of ₹ 75.97 lakh.

Karnataka State Handicrafts Development Corporation Limited (Company) is involved in development of handicrafts since 1964. As the existing Computerised Accounting System become outdated, the Company decided (2007) to implement Enterprise Resource Planning¹³⁴ (ERP) system to aid in its functioning.

Between 2007-08 and 2012-13, the Company tried to implement this project with the help of five consultants and a team of Technical Experts at various times and corresponding stages. One of the consultants opined that ERP was not suitable, while another one recommended a mini ERP. The Technical Experts opined that the process of vendor selection was not correct. Due to the confusing multiplicity of opinions, the Company could not go ahead with their suggestions in accomplishing its goal even after having spent ₹ 4.10 lakh towards these consultations.

The Company (March 2012) eventually appointed Karnataka State Electronics Development Corporation Limited (KEONICS), a State PSU, as a consultant, considering that it was exempted from the purview of Karnataka Transparency in Public Procurement Act, 1997, as far as tendering was concerned, but without assessing the capability of KEONICS to handle a project of this nature. The Company entered into two agreements with KEONICS on 27 August 2012 and 14 September 2012 for engaging consulting agencies, selection of implementation partners, programme management and for facilitating and implementation of SAP. Accordingly, as per these agreements, KEONICS was to select an implementing agency to implement SAP and operate and maintain SAP till September 2014. KEONICS was to make ERP fully functional for a consideration of ₹ 40.65 lakh and the Company was to provide necessary infrastructure. KEONICS selected Unisoft as the implementing agency. The Company procured the software, based on KEONICS's recommendation, from SAP and paid ₹ 44.61 lakh¹³⁵ as per the software supply agreement dated 17 August 2012. As of October 2017, KEONICS was paid an amount of ₹ 25.37 lakh towards facilitating SAP implementation.

The Company did not pay Annual Maintenance Charges (AMC of ₹ 9.74 lakh per annum) to SAP and was liable to pay penal interest to them at 3 *per cent* above prime lending rate per annum as per the agreement. SAP terminated the support services for the software from October 2015 as its payments remained

¹³⁴ Enterprise Resource Planning (ERP) is business process management software that allows an organisation to use a system of integrated applications to manage the business and automate many back office functions related to technology, services and human resources.

¹³⁵ ₹ 41.36 lakh as licence fee and ₹ 3.25 lakh as maintenance fee for four months ending December 2012.

due since January 2013. Consequently, the Company was not able to get the latest updates and support from SAP. Unisoft stopped development of the System in April 2017.

Having spent ₹ 75.97 lakh¹³⁶, the Company was yet (August 2017) to make any substantial progress in operating the ERP system even after lapse of almost ten years since inception.

Audit observed that the reasons for the inability to operationalise the ERP system in a decade were as follows:

- The Company went ahead in implementing such a technically critical project without any criteria for selection of consultant and also started implementing the ERP without any ground work to assess its own requirements; and
- Despite appointing so many consultants/experts, it did not give them any clear cut directions as to what was expected of them, nor made any use of their expertise, defeating the very purpose of their selection.

The Company implemented only the Material Management Module, which too was not working since April 2017.

With SAP not supporting the software for non-payment of support services fee, Unisoft withdrawing from the implementation, KEONICS failing to make it functional and the Company not being able to plan and decide the course of action to follow, the Board of the Company decided (July 2017) to float fresh tenders for implementation and customisation of ERP.

Thus, due to non-implementation and full operationalisation of SAP till date, the expenditure of ₹ 75.97 lakh incurred on the project proved to be unfruitful so far, nearly a decade after the project was initiated.

The matter was referred (September 2017) to the Government and their reply was awaited (November 2017).

Karnataka Urban Infrastructure Development and Finance Corporation Limited

3.11. Wrong specification in bid

Discrepancy in the tender document was ignored while evaluating the bids, which resulted in extra cost of ₹ 55.76 lakh.

The Karnataka Urban Infrastructure Development and Finance Corporation Limited (Company) is a nodal agency for implementation of various infrastructure projects in urban localities, through City Municipal Councils. The projects were funded through external aid or internal borrowings.

The Company undertook (2010) the work of Improvement to Water Supply System in Chamarajanagar City Municipal Council under Asian Development Bank (ADB) assisted North Karnataka Urban Sector Investment Program.

¹³⁶ Includes cost of consultancy of all, including KEONICS (₹ 26.82 lakh), cost of software (₹ 44.61 lakh) and others (₹ 4.54 lakh).

The work comprised of rehabilitation and strengthening of electro-mechanical works, supplying and laying of Ductile Iron (DI) pipes, construction of service reservoir, supplying and laying PE/DI¹³⁷ distribution pipeline network of length 58 kms, providing and fixing bulk flow meters with accessories. The Detailed Project Report (DPR) prepared (2009) by the Project Consultant estimated the cost at ₹ 6.74 crore including use of DI pipes of length 1,815 metres at ₹ 6,334 per metre for connecting feeder main from balancing reservoir to individual Elevated Service Reservoirs (ELSR). The Company, however, mentioned the above item as Pre Stressed Concrete (PSC) Pipes instead of DI Pipes in the Bill of Quantity (BOQ No. 6) of bid documents.

The work was tendered (September 2010) and the quote of Suprada Construction Company, Engineers and Contractors, Bengaluru (Contractor) was evaluated as the lowest at ₹ 7.56 crore, with DRS Infratech Pvt. Ltd (DRS) being the L2 bidder at ₹ 7.94 crore. The Project Consultant brought the discrepancy in the specification in bid document for pipe (from DI to PSC) to the notice (January 2011) of the Project Manager, with a copy each marked to the Managing Director and the Chief Engineer of the Company. He further suggested to obtain confirmation from the bidders that the rates quoted were for 500 mm DI pipe only under item 2, BOQ No. 6 and to safeguard the Company's interest. The Project Manager replied (February 2011) to the Consultant that it was too late to take any action as the financial evaluation report was about to be placed before the Bid Evaluation Committee¹³⁸. The Bid Evaluation Committee, which evaluated the bids technically and financially did not even discuss this discrepancy while evaluating. However, the tender was finalised and the Company entered into an agreement (June 2011) with the Contractor.

The Chief Engineer, during his inspection of the site, observed (June 2011) that there was no provision for PSC pipes in the Detailed Project Report and directed the Assistant Executive Engineer to prepare a detailed variation statement showing the variation in the value of DI Pipe and PSC Pipe and get the same approved from the competent authority. The work was programmed for completion in November 2012 and was actually completed only during May 2015. By then, the Company paid an amount of ₹ 11.04 crore already.

In this regard, Audit observed that:

- The Bid Evaluation Committee ignored this discrepancy between DI and PSC pipes while evaluating the technical, and later the financial, bids;
- Like the Project Manager who ignored the suggestion of the Consultant to rectify the error before finalising the bid, the Managing Director and the Chief Engineer of the Company, though being aware of the same, neglected the error;
- The Financial Bid was opened on 11 January 2011 and the Empowered Committee finalised the bids only on 26 May 2011. Therefore, there

¹³⁷ Poly Ethylene/Ductile Iron pipes.

¹³⁸ Comprising Executive Engineer, Assistant Executive Engineers, Procurement Specialist Consultant and Team Leader Consultant.

was ample time available to the Company to review the bids keeping in mind the suggestions (January 2011) of the Consultant;

- The Contractor quoted ₹ 4,600 per metre for PSC pipes and ₹ 8,300 per metre for DI pipes, whereas DRS quoted ₹ 6,500 and ₹ 7,500 respectively. The Company without rectifying the error regarding the type of pipes required, finalised the bid in favour of the Contractor;

The Company, also stated that it evaluated the quotes of both L1 and L2 bidders for the item (BOQ No. 6) and compared it with DI pipe rates only. Considering this, the Contractor would have become the second lowest (L2) and DRS the lowest (L1) as detailed below:

Table No. 3.11: Evaluation of bids considering DI Pipe

Sl. No.	Particulars	Contractor (₹ in crore)	DRS (₹ in crore)
1	Total amount quoted	7.56	7.94
2	Less: Value of pipes	0.83 ¹³⁹	1.18 ¹⁴⁰
3	Value quoted for other works /items (Sl. No. 1 – Sl. No.2)	6.73	6.76
4	Considering DI pipe for the entire length of 2,765 mtrs.	1.51 ¹⁴¹	1.36 ¹⁴²
5	Value of quote considering DI pipe (Sl. No. 3 + Sl. No.4)	8.24 (L2)	8.12 (L1)

The contract should have been, therefore, given to DRS, the L₁ bidder if only DI pipes are considered, instead of PSC pipes; and

- As against the bid quantity of 1,815 metres of PSC pipes, 2,065 metres actually were used during the course of execution. At the time of execution, the Contractor claimed the differential cost of ₹ 3,700 per metre (₹ 8,300 less ₹ 4,600) for laying DI pipes and the Company paid the differential amount on the executed quantity. Considering DRS as L₁, the cost worked out to ₹ 20.65 lakh as against ₹ 76.41 lakh paid to the Contractor (₹ 3,700 × ₹ 2,065 metres)¹⁴³. By considering the suggestion of the Consultant, the Company could have avoided extra expenditure of ₹ 55.76¹⁴⁴ lakh.

The Company replied that the mistake was due to a typographical error and rectification of the same could have been possible only before closure of bid submission date in the form of corrigendum. Further, it was replied that the Empowered Committee decided to negotiate with the L₁ bidder, *i.e.* the Contractor after obtaining approval of ADB. Since ADB did not permit the same, the Company was not in a position to discuss about the financials of the bids with the bidders.

¹³⁹ 1,815 metres × ₹ 4,600/metre = ₹ 83,49,000 or ₹ 0.83 crore.

¹⁴⁰ 1,815 metres × ₹ 6,500/metre = ₹ 1,17,97,500 or ₹ 1.18 crore.

¹⁴¹ 1,815 metres × ₹ 8,300/metre = ₹ 1,50,64,500 or ₹ 1.51 crore.

¹⁴² 1,815 metres × ₹ 7,500/metre = ₹ 1,36,12,500 or ₹ 1.36 crore.

¹⁴³ ₹ 7,500-₹ 6,500 = ₹ 1,000 × 2,065 = ₹ 20,65,000.

¹⁴⁴ ₹ 76.41 lakh - ₹ 20.65 lakh = ₹ 55.76 lakh.

The reply was not justified as the Company could have sought clarification from the bidders regarding the rate, since the rate called for in the BOQ was for DI pipes. Else, a certificate from the bidders that the rates quoted were for DI pipes only could have been obtained as suggested by the Consultant. Even the drawings enclosed along with the Bid documents mentioned DI pipes only.

Thus, wrong evaluation due to negligence of the officers concerned resulted in awarding the work to a bidder, who was not the lowest at an extra cost of ₹ 55.76 lakh.

The matter was referred (September 2017) to the Government and their reply was awaited (November 2017).

Statutory Corporations

Karnataka State Financial Corporation

3.12. Sanction, Disbursement and Security Realisation of Loans and Advances

Introduction

3.12.1. Karnataka State Financial Corporation (Corporation) was established in the year 1959, under Section 3 (1) of the State Financial Corporations Act, 1951, which mandates extending financial assistance to entrepreneurs for setting up tiny, small and medium scale industrial units in the State with special focus to industrially backward areas.

The main activities of the Corporation were sanctioning and disbursement of loans for setting up of projects, Working Capital and Term Loan (WCTL) assistance, besides sale of e-stamps (stamp papers). The Corporation earned profits from 2009-10 onwards.

The details of loan sanctioned, disbursed, outstanding, net profit and amount under Non-Performing Assets (NPA) for the five-year period from 2012-13 to 2016-17 are as follows:

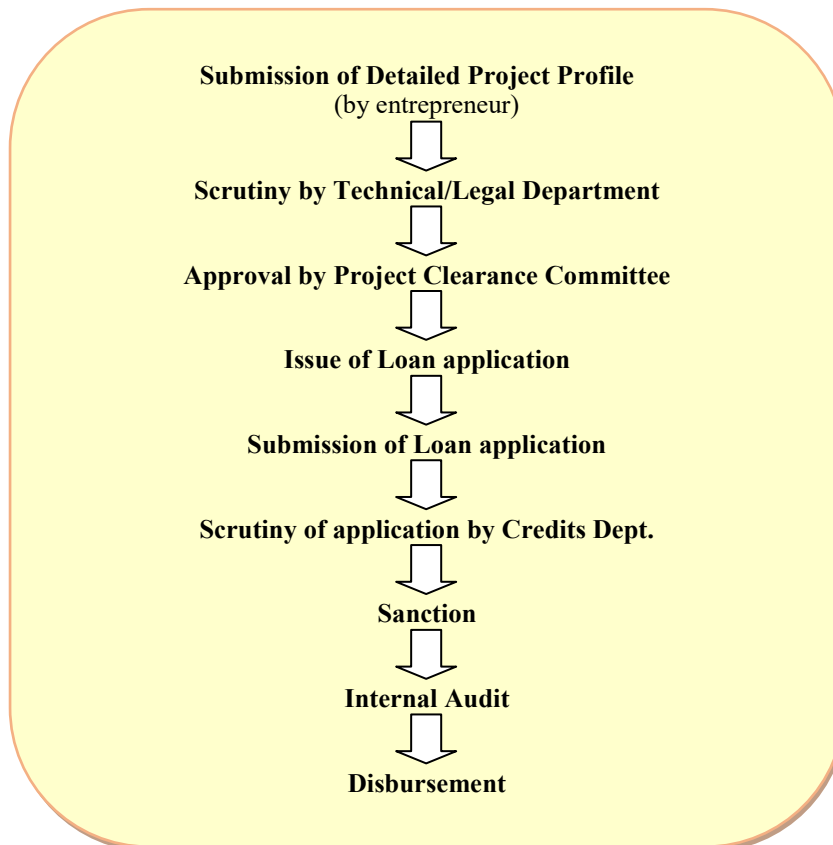
Table No. 3.12.1: Loan sanctioned, disbursed and outstanding, net profit and amount under NPA for the five-year period from 2012-13 to 2016-17

(₹ in crore)						
Sl. No.	Year	Loan Sanctioned	Loan Disbursed	Loan Outstanding	Net Profit	Amount under NPA
1	2012-13	944.06	734.70	1,885.90	17.02	331.20
2	2013-14	909.26	707.47	2,018.21	11.42	327.73
3	2014-15	675.15	553.62	1,827.89	44.47	151.63
4	2015-16	731.94	566.36	1,813.09	32.13	245.12
5	2016-17	733.43	614.38	1,801.26	29.93	217.80
	Total	3993.84	3176.53	9346.35	134.97	-

The Corporation undertook a major restructuring during April 2012 by transferring all operational activities to Branches and retaining only policy, planning and control activities at the Head Office.

3.12.2. The procedure/process involved in sanction and disbursement of loan is depicted in the flow chart:

Chart 3.12.1: Flow diagram of Loan Approval Process



An up-front fee of 0.5 *per cent* towards application processing was collected before disbursement of sanctioned loan.

3.12.3. The Audit Objective was to assess whether the Corporation complied with all the procedures, rules and regulations, norms and policies under SFC Act, and Lending Policy of the Corporation in sanction and disbursement of loans and for security realisation for non-performing assets.

3.12.4. The following sources of criteria were adopted as a benchmark for compliance audit:

- The State Financial Corporations Act, 1951;
- Lending policy and circulars of the Corporation;
- State Industrial Policy and circulars issued by the Government; and
- Rules and circulars on Lending Policy issued by the Government of India and the Reserve Bank of India.

3.12.5. The Compliance Audit covered sanction, disbursement of loan and security realisation in respect of NPA during the five-year period from 2012-13 to 2016-17. A suitable sample covering more than 25 *per cent* of the

32 branches was selected¹⁴⁵ for test-check.

The reply of the Government received in October 2017 was suitably incorporated in the Report.

Audit findings

Procedural lapses in Sanctioning of loans

Delay in processing of Loan

3.12.6. As per Clause 10.1 of the Lending Policy (2015) of the Corporation, the appraisal section shall finalise the credit appraisal within 10 days in respect of cases where the project cost was below ₹ 100 lakh and within 20 days in respect of cases where the project cost was above ₹ 100 lakh and submit the loan memorandum for sanction to the appropriate sanctioning authority through proper channel. Further, the loan sanctioning authority should decide on the loan memorandum in three days in respect of the former and seven days in respect of the latter.

The time allowed for sanction of various types of loan are as below:

Table No. 3.12.2: Time allowed for sanctioning various types of loans

Sl. No.	Sanction	
	Project cost	Time required
1	Below ₹ 1 crore	13 days
2	Above ₹ 1 crore	27 days

In respect of loans where the sanctioning authority was the Executive Committee or the Board of Directors, the time limit prescribed for sanction of loan depends on the meeting of the Executive Committee or the Board, as the case may be.

It was observed that there were delays in sanction in 120 out of 349 selected cases (34 *per cent*) in nine selected branches, with the period of delay ranging from one day to 592 days, as detailed in table below:

Table No. 3.12.3: Range of delay in days

Sl. No	Delay in number of days	No. of cases
1	1-30	88
2	31-60	20
3	61 and above	12

The Government replied that the delay was due to accommodating time for submission of one or two documents or due to observations on applications.

¹⁴⁵ Mandya, Ballari, Jayanagar, Rajajinagar, Dharwad, Belagavi, Bagalkot, Koppal and Mysuru.

Credit worthiness of the borrower

3.12.6.1. As per the Project Appraisal Manual, the Corporation was to collect various documentary evidences in support of moveable properties like Cash at Bank, Jewellery, Investments, Vehicles, *etc.* The Corporation did not collect the supporting documents in all the 349 cases reviewed.

The Government replied that the details were obtained only for confirming eligibility. The documentary evidence with regard to cash and jewellery owned by the promoters were not collected, as they could be liquidated easily by the promoters ensuring proof in respect of Cash at Bank.

However, the documents in respect of Cash at Bank was to be compulsorily maintained as per Circular No. 735 of May 1999. This may enable the Corporation to ascertain and ensure whether the disbursement was made to eligible customers only.

Credit rating of the borrower

3.12.6.2. The credit risk rating models suggest scores to various risks, which are broadly classified as Financial Risks, Business Risks, Management Risks and Legal Risks. The weightages given to each risk varies according to the type of business and the amount of loan.

The lending policy provides different models¹⁴⁶ of credit risk rating for various types of loans as detailed below:

Table No. 3.12.4: Different models of credit risk

Sl. No.	Model	Exposure limit
1	A	₹ 25 lakh (new and existing units).
2	B	Between ₹ 25 lakh and ₹ 75 lakh (existing units only).
3	C	More than ₹ 25 lakh (new units).
4	D	More than ₹ 75 lakh (existing units).
5	E	Build and sell-new unit (Residential layout and apartments) Construction and Real Estate (CRE) Score Chart.
6	F	Build and sell-existing unit (Residential layout and apartments) CRE Score Chart.
7	G	Other CRE Projects-New Units (Commercial Complex, godowns and convention centers).
8	H	Other CRE Projects-existing Units (Commercial Complex, godowns and convention centers).

The Corporation prescribed different Credit Rating grades for in-house Credit Rating as detailed below:

¹⁴⁶ The criteria for sanction of various types of loans.

Table No. 3.12.5: Different Credit Rating grades

Sl. No.	Score Range	Nomenclature
1	90 per cent and above	Highest Safety
2	80 to 90 per cent	High Safety
3	70 to 80 per cent	Adequate Safety
4	60 to 70 per cent	Moderate Safety
5	50 to 60 per cent	Average Safety
6	Below 50 per cent	High Risk-Not support worthy

As against the requirement of an in-house credit risk rating, as per the prescribed model for sanctioning all loans, Audit observed that in 172 of the 254 cases of loans below ₹ 150 lakh, which were test-checked, this stipulation was not followed. The reasons for not following the stipulations were not on record. However, in all 95 cases of loans above ₹ 150 lakh, the credit risk rating was carried out. Sanctioning of loan without Credit Rating was a violation of the stipulations and also put the Corporation's money on risk by lending money to a borrower without knowing his/her credit worthiness.

Audit further observed that wherever Credit Rating reports were prepared, no supporting documents like previous experience in the chosen field of business, working capital arrangements, market survey reports, *etc.* were available. In the absence of the supporting documents, the correctness of the scores considered for Credit Rating could not be verified.

Further, in 15 cases¹⁴⁷, where the loans slipped into Non-Performing Assets (NPA) as on 31 March 2017, the deficiencies in Credit Rating, if any, could not be analysed for want of supporting documents. Non-collection and verification of documentary evidence pointed to a lack of internal control mechanism and consequent inability to analyse the reasons for these loans slipping into NPA.

The Government replied that in future, Credit Rating for all loans would be insisted upon and that a note was already issued to the Branch Offices in this regard.

It is recommended that the Corporation should ensure strict adherence to risk modelling and documentation of all papers to support the risk ratings done.

¹⁴⁷ Koramandal Refractories Pvt Ltd (₹ 6.72 crore), Vatsala Metal Sections (₹ 3.78 crore), Deepsagar Engg. Industries (₹ 97.87 lakh), Maxworth Realty (₹ 3.45 crore), Amrutesh Industries (₹ 1.31 lakh), Sneha Apparels (₹ 26.28 lakh), Kanti Resorts (₹ 13.32 crore), Pramod Developers (₹ 86.41 lakh), Dr. N Sobha (₹ 64.51 lakh), S G Mugabast (₹ 1.11 crore), Sri Sai Bricks (₹ 5.98 lakh), Tayamma Metals (₹ 82.65 lakh), Nadig Promoters and Developers (₹ 1.37 crore), Viswa Papers (₹ 55.60 lakh) and Siddheswara Saw Mill (₹ 8.94 lakh).

Disbursement of loans

3.12.7. Audit selected 349 cases of disbursement on random basis. Out of the 349 cases, 59 cases were closed during the audit period based on repayment of loans. Audit observed that 37 cases became NPA.

Periodical inspection of Securities (Primary/Collateral)

3.12.7.1 The Corporation secures its rights by ensuring that the properties/assets offered as security for the loans are mortgaged/hypothecated in its favour. However, there was no mechanism in place to ensure that the Corporation’s interest was safeguarded through periodical inspection of such mortgaged/hypothecated assets after sanction/disbursement of loan. Guidelines on Recovery Functions of the Corporation stipulated time schedule for the visit to units as detailed in table below:

Table No. 3.12.6: Time schedule for frequency of visit to financed units

Sl. No.	Particulars	Frequency of visit to the unit
1	Assets in Standard category	Once in six months
2	Assets in Sub-standard Category	Once in three months
3	Doubtful category	Once in two months
4	Units under Section 29	Once in a month

Out of the 349 cases reviewed in selected branches, no periodical inspection of such mortgaged/hypothecated assets was carried out after disbursement of loan in any of the cases.

Table No. 3.12.7: Details of cases where primary security was not available

Sl. No.	Branch	Name of the Borrower	Amount Due ₹ in lakh	Remarks
1	Jayanagar	BKN Food Products	98.73	The borrower relocated the financed asset without the knowledge of the Corporation.
2	Rajajinagar	Shashisekhar Naik	2.61	The financed asset was not traceable.
3	Rajajinagar	Sneha Apparels	26.28	The borrower sold financed asset, which was given as Primary security.
Total Amount due			127.62	

This happened owing to not conducting periodical inspection and not ensuring security of assets mortgaged/hypothecated by ensuring that these assets were hypothecated to the Corporation.

In its reply, the Government stated that compliance to guidelines with regard to periodical inspection and recommendations made by Audit would be ensured.

It is recommended that the Corporation may introduce a system of periodical inspection and scrupulously ensure documentation, bringing out details of inspection.

Non-adherence to policy guidelines

3.12.7.2 The guidelines framed by the Corporation provided various procedures to be followed while appraising and sanctioning of loans. The Disbursement Manual provided guidelines for disbursement of loans. Audit observed that the Corporation did not comply with these guidelines framed in the test-checked cases as explained in the table below:

Table No. 3.12.8: Non-compliance to own guidelines

Sl. No.	Particulars	Audit observation	Government's reply and its rebuttal
1.	<i>Annual Reports of the borrowers subsequent to disbursement of loans</i> As per Terms and Conditions of the Sanctions, the borrower was to regularly furnish the quarterly performance and annual statement of Accounts (including the Auditor's Report, Director's Report, Copy of the Meeting Notice and Agenda in the case of a Company) of the applicant unit and its associate concerns duly audited by Chartered Accountants during the currency of the loan.	Annual Reports were not furnished in all the 349 cases reviewed.	The Annual Reports were being collected by the Recovery Officers. However, the reply was incorrect as the Annual Reports were not available in any of the 349 cases.
2	<i>Non-review of Project Implementation</i> As per Clause 1.1(t) of Chapter 1 of the Disbursement Manual, the Project Implementation was to be reviewed periodically till it was completed by the Project Implementation Review Committee headed by the Managing Director/the General Managers/the Zonal Managers.	The Project Implementation Review was not done in any of the 349 cases test-checked.	The Project Implementation was being monitored. However, the reply was incorrect as in none of the 349 cases, the Committee periodically reviewed the projects.

Sl. No.	Particulars	Audit observation	Government's reply and its rebuttal
3	<p><i>Non-obtaining of insurance at disbursement of 60 per cent of loan</i></p> <p>As per Clause 1.1 (v) of the Disbursement Manual, the Corporation was to insist the borrower to insure the assets created, with any of the nationalised General Insurance Companies and collect a copy of the insurance policy before the release of the last 40 per cent of the sanction amount.</p>	<p>Copy of certificate for having insured was not available in 190 cases out of 349 cases test-checked.</p>	<p>In most of the cases, insurance was taken on release of 60 per cent of the loan amount and in other cases, it was covered beyond release of 60 per cent of the loan.</p> <p>The reply was not justified as copies of insurance certificates were not available in 190 of the 349 cases (54.4 per cent).</p>
4	<p><i>Non-collection of Advance Cheque</i></p> <p>As per Clause 1.1 y (ii) of Chapter 1 of the Disbursement Manual, in case of Term Loan and Corporate Loan, advance cheques for a period of one year (upto the end of next financial year) covering both principal as well as approximate interest was to be collected before disbursal of last 20 per cent of the loan sanctioned.</p>	<p>Advance Cheques were not collected in all 305 cases¹⁴⁸ of Term and Corporate loans test-checked.</p>	<p>The system was discontinued in 2009 with the discontinuation of repayment on Equated Monthly Instalment basis and that in view of the RTGS/NEFT facilities, there was no need for advance cheques.</p> <p>The reply was not justified as advance cheques served as additional security whereas RTGS/NEFT did not. The Corporation may review the practice to safeguard its own interests with respect to security of the money lent.</p>

From the above it could be seen that on account of the significant non-compliance of the guidelines on credit worthiness, non-verification of annual reports and non-review of project implementation, the Corporation bore the risk of inability to ascertain the financial standing of the borrower, personal property for the future security and the utilisation of the loan disbursed for the purpose, for which, it was sanctioned. Further, not obtaining insurance and advance cheques had potential risk of loss of disbursed amount.

As a result, the disbursed amount of ₹ 399.62 crore in the selected 290¹⁴⁹ cases was at a risk, which could easily be minimised through due compliance of applicable guidelines.

It is recommended that the Corporation may re-introduce the system of obtaining cheques as security to safeguard its own interest.

¹⁴⁸ The remaining 44 test-checked cases were under Privileged Enterprises category of loans, where advance Cheques were not required to be collected.

¹⁴⁹ Excluding 59 cases, where loans were repaid during the audit period.

Non-obtaining of Chartered Accountant certificate for promoters' contribution under First Investment Clause

3.12.7.3. According to Clause 1.1(d) of Loan Disbursement Manual, to ensure that the borrowers brought in their contribution as per the First Investment Clause¹⁵⁰, the Branch was to insist on a certificate from a Chartered Accountant (CA) in respect of cases involving Term loans and Working Capital loans above ₹ 10 lakh. Audit observed that in nine¹⁵¹ branches selected for review, CA certificates in support of first investment was not obtained in 65 of the 293 cases test-checked. This exposed the Corporations to the risk of disbursement of loans without ensuring the borrower's share of investment.

Out of 65 cases, where the Corporation did not obtain the certificate for first investment, 14 cases¹⁵² slipped into NPA involving an outstanding amount of ₹ 19.50 crore. Disbursement of loan without obtaining certificates for first investment was also one of the contributory factors to the loans slipping into NPA.

The Government replied that it was a normal practice to ensure compliance of First Investment Clause through CA certificate except in case of transport, PE loan and Corporate Loan schemes and loans below ₹ 10 lakh. Further, it was audited quarterly as a routine. The reply was not correct as the cases mentioned by Audit did not include cases of transport, PE loans, Corporate loans and loans below ₹ 10 lakh. Also, the reply was silent on the audit observation that in 65 such cases, certificate was not obtained and that 14 of such cases slipped into NPA.

Non-collection of proof for payment made to contractors for construction of buildings while releasing each instalment of loan

3.12.7.4. Clause 1.2(c) of Disbursement Manual stipulated that in case of release of funds towards building/construction, the branch was to ascertain from the borrower whether the building work was entrusted to a contractor. In such cases, the terms of contract were to be obtained, studied and receipt from the contractor regarding payment made by the borrower be received. This was to ensure that the Corporation was reimbursing the amount paid by the borrower. Such receipts were to be cross-verified with the contractor to avoid any dispute at a later stage.

Further, as per clause 1.2 (d), in the case of buildings constructed by borrowers themselves, purchase bills pertaining to major items were to be

¹⁵⁰ Initial investment by the promoter.

¹⁵¹ Mandya, Ballari, Koppal, Bagalkote, Belagavi, Dharwad, Jayanagar, Rajajinagar and Mysuru.

¹⁵² **Belgaum Branch:** Sunanda.G (₹ 110.86 lakh), **Bagalkote Branch:** Noble Stones (₹ 107.69 lakh), Balaji Udyog (₹ 20.02 lakh), Guru Krupa Granites (₹ 48.75 lakh), **Koppal Branch:** Brahmi Granites (₹ 118.97 lakh), Kalyan Basveswara Seeds (₹ 190.60 lakh), Sri Sai Stone & Iron Ore Crushing (₹ 14.62 lakh), Tayamma Metals (₹ 82.65 lakh), **Ballari Branch:** Datta Narashima Swamy (₹ 25.99 lakh), Mastek Steels Pvt.Ltd. (₹ 150.24 lakh), **Mandya Branch:** M. Prasanna, (₹ 8.89 lakh), **Dharwad Branch:** Koramandal Refractories (₹ 672.25 lakh), Rama Rao (₹ 199.99 lakh) and **Mysuru Branch:** Someshwara Magnesite (₹ 198.59 lakh).

verified to ensure that payments were made for acquisition of such items. The above clauses were to ensure that loan was being utilised for the purpose for which it was sanctioned and non-compliance to the above clauses.

It was, however, seen that the above clauses were not complied with in all the 39 Construction and Real Estate cases reviewed by Audit involving ₹ 156.63 crore. Eight¹⁵³ cases out of the above 39 became NPA of ₹ 7.34 crore out of total NPA of ₹ 217.80 crore for 2016-17. The Technical Officer was to make a pre-disbursement inspection and submit a report to the branch head concerned. The report was to indicate the progress of work, material available at site and plant and machinery to be procured. However, no documents in support of these were found enclosed with pre-disbursement inspection report. Hence, the Corporation could not establish the utilisation of loan for the purpose for which it was sanctioned and the reasons for which these eight loans with an outstanding balance of ₹ 7.34 crore became NPA. This was an indication of failure of internal control mechanism.

The Government replied that periodical inspection was carried out and that it was a normal practice for the promoters not to enter into any agreement with the building contractors. Further, it was not practicable to collect proof of payments. The reply, however, confirmed that the Corporation did not adhere to clause 1.2 (c) of the Manual. Further, the reply was silent on the 39 cases of non-compliance observed by Audit.

Disbursement of loans without pre-audit by Internal Audit Department

3.12.7.5. The Corporation's Internal Audit Wing was headed by Deputy General Manager at the Corporate Office and Internal Audit wings of Circle concerned, headed by Assistant General Managers audit the branches. Each loan case, irrespective of the amount sanctioned, was referred to the Internal Audit wing for concurrent audit after the loan was sanctioned and communication of sanction was issued. Further, the first disbursement was made only after the concurrent audit and satisfactory compliance of the observations of the Internal Audit. In Ballari Branch, out of 34 cases reviewed, Audit observed that in eight¹⁵⁴ cases, involving an outstanding balance of ₹ 17.02 crore, Internal Audit was conducted only after disbursement. However, in other cases, Internal Audit was conducted after sanction but before disbursement. As the lapse observed in Ballari Branch covered about 24 *per cent* of the test-checked cases, the system prevailing in that Branch may be probed.

It was replied that there was communication gap in Ballari and that departmental enquiry was initiated in this regard.

¹⁵³ Pramod Developers (₹ 86.41 lakh), Guruprasad Builders & Developers (₹ 36.41 lakh), S.A Naik (₹ 60.13 lakh), S G Mugabast (₹ 1.11 crore), Balaji Complex (₹ 42.10 lakh), Maxworth Realty (₹ 3.45 crore), Bhuvana Constructions (₹ 5.13 lakh) and Premier Properties (₹ 48.75 lakh).

¹⁵⁴ Fortune Hotels Bar and Restaurant (₹ 1.48 crore), GSR Road Lines (₹ 0.89 crore), Limra Road Lines (₹ 1.12 crore), Aishwarya Paradise (₹ 4.54 crore), Aishwarya Bar & Restaurant (₹ 1.04 crore), C Hariprasad Reddy (₹ 0.90 crore), R R Hotels (₹ 0.73 crore), Ramprakash Reddy (₹ 6.32 crore).

It is recommended that the system of obtaining Chartered Accountants Certificate before disbursement to ensure promoter's contribution and collecting proof of payment made to contractors may be enforced. Besides enquiry at Ballari Branch, there was a requirement to strengthen the Internal Control system.

Realisation of Security for Non-Performing Assets

3.12.8. Proper documentation of the Primary and Collateral Security, important elements for ensuring recovery of the loan amount, was an essential pre-requisite in cases of default. The documents submitted towards Primary and Collateral Security were verified by the Legal Cell at the Branch Office for its authenticity and genuineness. Besides, the loan agreements, undertakings from personal guarantors, hypothecation and mortgage deeds in respect of the assets given as Primary and Collateral Security were being executed. However, despite ensuring a good system of obtaining security for loan, the Corporation was not able to recover through these securities due to non-compliance of Section 29 and Section 31(1) (aa) of State Financial Corporations Act, 1951, (Act) as mentioned below:

3.12.8.1. Section 29 of the Act, stated that where any industrial concern, which was under a liability to the Financial Corporation, made any default in repayment of any loan or advance or any instalment thereof, the Financial Corporation may exercise the right to take over the management or possession or both of the industrial concern, as well as the right to transfer by way of lease or sale and realise the property pledged, mortgaged, hypothecated or assigned to the Financial Corporation.

The Corporation framed the Guidelines on Recovery Functions based on the provisions of the Act. As per the guidelines, in case of default:

- First reminder was to be issued within 30 days of default in case of fully disbursed loan;
- Second reminder was issued within 15 days of default of two instalments of either principal or interest;
- A Default Review Committee headed by Branch Manager at branch level, was to review the default case within 45 days of default in payment;
- Show Cause Notice to the borrower, with a copy to guarantors/collateral security owners, informing them about the proposed take-over of the unit, was to be issued within 15 days from the decision taken in Default Review Committee; and
- The unit, financed by the Corporation, was to be seized within 90 days from the issue of the Show Cause Notice if the borrower failed to come up with an acceptable proposal. The order to seize the property was to be issued by the Competent Authority and the same was to be executed within 15 days from the date of signing of the order.

The following non-compliances of the guidelines, framed under Section 29 of the Act, were observed in 70 default cases:

Table No. 3.12.9: Non-compliance to guidelines framed under Section 29 of State Financial Corporations Act, 1951

Sl. No.	Particulars	Audit Observation
1	<i>Non-issue of Show Cause Notice under the provisions of the Act</i>	In one case, involving ₹ 15.13 lakh (overdue ₹ 14.38 lakh and interest ₹ 0.75 lakh) as of June 2017, in respect of Sri. Shrikanth Anant Naik, Belagavi Branch, show cause notice was not issued. (Principal ₹ 45 lakh not demanded).
2	<i>Non-seizure of properties under Section 29 of the Act</i> The unit should be seized within 90 days from the date of issue of Show Cause Notice.	In 33 cases, the Corporation did not seize the properties even after issue of the show cause notice for recovery of overdue interest of ₹ 17.47 crore as of June 2017. It allowed the business to continue despite the absence of an acceptable proposal for revival of the units.
3	<i>Non-issue of advertisements for sale of property after seizure</i> The Corporation should release first sale advertisement within one month after the completion of 30 days' time given for the borrower to submit acceptable proposals for taking back the unit/asset.	In 18 cases, involving ₹ 22.70 crore (Principal due ₹ 11.83 crore and interest due ₹ 10.87 crore) as of March 2017, advertisement for sale of property after seizure was not issued.

Further, as per Section 31(1)(a) and (aa) of the Act, action against personal guarantor was to be taken within three months from the date of identification of personal properties. Audit observed that in the selected 9 branches, action under Section 31(1)(a) and (aa) in the above default cases, which involved an outstanding amount of ₹ 40.32 crore, was not initiated.

It was replied that in order to regularise the account, the promoters were given more time and opportunity, and hence the delay. However, the Corporation did not effectively use the recovery mechanism.

It is recommended that the Corporation may use Section 29 and 31(1) (aa) of the State Financial Corporations Act, 1951, and ensure swift action to liquidate the securities, as these are the strongest weapons of recovery available to the Corporation to avoid writing off of dues.

Conclusion

The Corporation did not adequately monitor the implementation of its Lending Policy to ensure due compliance.

The procedural lapses showed lack of internal control in the organisation, running the risk of loan defaults. The Corporation did not maintain proper documentation of cases of sanction and disbursement of loan.

The Corporation did not liquidate the securities obtained as a guarantee against default. Non-initiation of action under Section 29 and Section 31 of State Financial Corporations Act, 1951, helped the borrowers escape recovery of loans.



Bengaluru
The 15 FEB 2018

(BIJIT KUMAR MUKHERJEE)
Accountant General
Economic and Revenue Sector Audit
Karnataka

Countersigned

New Delhi
The 15th Feb, 2018



(RAJIV MEHRISHI)
Comptroller and Auditor General of India

Appendix-9
(Referred in Paragraph 3.1)

Quantity of work executed by the Contractors during the specified closure period under Bhadra Project in Karnataka Neeravari Nigam Limited

Modernisation of Bhadra Right Bank Main Canal from 0 km to 20 km - Balance work (Package 2a1)								
Sl. No.	Items eligible for incentive	Description of the work	Unit	Original tendered quantities	Revised quantities	Actual quantity executed within single closure period ^^	Percentage of completion to the revised quantities	Incentive paid (5 th RA bill) (₹ in lakh)
1	E2	Excavation in all kinds of soil	Cum	2,44,716.00	1,14,400.98	99,214.81	86.73	18.92
2	E3	Excavation in Soft Rock	Cum	9,847.00	9,847.05	7,890.80	80.13	2.13
3	E4	Excavation in Hard Rock	Cum	2,672.50	2,672.50	-	-	-
4#	E6	Providing Semi-pervious/Pervious casing embankment	Cum	88,270.00	1,78,520.59	88,270.00	49.45	41.63
5	E7	Providing and constructing un-coarsed rubble stone masonry (from quarry)	Cum	17,683.00	17,682.69	14,802.20	83.71	115.09
6#	E8	Providing and constructing un-coarsed rubble stone masonry (with excavated items)	Cum	10.14	1,817.07	10.14	0.56	0.01
7	E9	Providing Cement Concrete for Side Lining	Cum	7,447.00	6,103.28	5,465.97	89.56	83.15
8	E10	Providing Cement Concrete for Canal Lining	Sqm.	5,44,326.00	4,44,395.98	3,99,266.15	89.84	694.75
9#	E11	Dismantling, Shifting and re-erecting mechanical concrete paver and DG set	Each	12.00	15.00	12.00	80.00	0.16
10	E12	Providing steel reinforcement	Kg	3,51,361.00	2,72,178.31	2,16,972.66	79.72	41.97
11	E13	Providing expansion joint filler boards	Rmtr.	28,914.00	25,712.86	22,803.61	88.69	5.10
12	E14	Providing GI pressure relief pipes	Each	23,144.00	18,918.00	15,964.00	84.39	6.75
13	E15	Providing Deep filter drains	Each	23,144.00	18,864.00	15,964.00	84.63	2.49
14	S4	Providing Semi-pervious/Pervious casing embankment	Cum	1,223.00	1,223.00	-	-	-
15	S11	Providing steel reinforcement	Kg	3,52,777.00	1,48,480.80	75,949.01	51.15	23.01
*	S12	Providing dry rubble stone pitching	Sqm.	2,302.00	-	-	-	-
*	S14	Providing expansion joint filler boards	Rmtr.	560.00	-	-	-	-
		Total						1,035.16

* These items were removed in the modified scope of work.

These items were taken from 5th RA bill, and considered as executed during the single closure period.

^^ Specified closure period was from 2.12.2011 to 5.01.2012.

Modernisation of Bhadra Left Bank Canal Dy.1 to 8 - Balance work (Package 1a1)								
Sl. No.	Items eligible for incentive	Brief Description of the work	Unit	Original tendered quantities	Revised quantities	Actual quantity executed within the specified closure period**	Percentage of completion to the revised quantities	Incentive paid (2 nd RA bill) (₹ in lakh)
1	E4	Providing and laying coarse aggregates for bed lining of canal	Cum	2,123.36	1,768.71	1,485.50	83.99	26.58
2	E5	Providing and laying coarse aggregates for side lining of canal	Cum	2,730.09	2,374.12	2,055.01	86.56	16.66
		Total						43.24

** Specified closure period was from 4.12.2010 to 05.01.2011 and from 1.06.2011 to 30.06.2011.