CHAPTER III

PERFORMANCE REVIEWS RELATING TO STATUTORY CORPORATIONS

3.1 KARNATAKA STATE WAREHOUSING CORPORATION

CONSTRUCTION AND OPERATION OF WAREHOUSES

Highlights

Land was purchased without cost-benefit analysis, flouting important parameters viz., accessibility of land etc. Land purchased at 24 locations, during the period under review, at a cost of Rs.3.25 crore and at 17 locations purchased for Rs.0.30 crore before the review period are lying vacant for periods ranging from one to four years and six to 23 years respectively. The sub-committee formed to recommend on the suitability of land for construction of godown remained ineffective as it met only once and identified only six sites for purchase.

(Paragraph 3.1.9)

There was delay ranging from 4 to 28 months in constructing godowns under 'State of Art' technology. The godowns constructed under 'State of Art' technology utilised excess space of 11,767.66 square metre at an extra cost of Rs.7.67 crore as compared to creation of the same storage capacity under the conventional method.

(Paragraph 3.1.16)

The Corporation incurred additional interest burden of Rs.4.12 crore by not availing loan available at cheaper rates and drawing instalment of loans without considering the progress of work.

(Paragraph 3.1.18)

Introduction

3.1.1 The Corporation established (November 1957) under the Agricultural Products (Development and Warehousing) Corporation Act, 1956 started functioning in 1958. Consequent on enactment of the Warehousing Act, 1962, the Corporation is deemed to have been established under Section 2 (k) of the said Act.

The main functions of the Corporation, *interalia*, include construction of godowns, storage of agricultural products, fertilizers, manures, cement etc., and to undertake clearance of goods to and from the godowns, transportation, provide disinfestation services to farmers, co-operatives and traders.

Scope of audit

3.1.2 The performance review covering the activities relating to construction and operation of warehouses by the Corporation from 2001-02 to 2005-06 was conducted during October 2005 to March 2006. Construction of 37 out of 50 godowns constructed and purchase of land at 25 locations out of 34 purchase cases during the period were reviewed. Records of four[1] Regional offices and 19 warehouse centres (13 having capacity above 10,000 metric tonne (MT), three between 5,000-10,000 MT and three below 5,000 MT) out of the six[2] Regional offices and 116 warehouse centres were test checked.

Audit objectives

3.1.3 The Performance review was conducted with a view to ascertain whether:

- proper and adequate storage facilities were constructed/created and made available to consumers in an economic and efficient manner at the right time and at the right location;
- hiring/de-hiring of private storage capacity was done economically and efficiently;
- funds were borrowed economically and utilised properly;
- proper measures were taken to minimize losses of food grains during storage; and
- norms for deployment of manpower were adhered to.

Audit criteria

3.1.4 The Audit criteria considered for assessing the achievement of audit objectives were the following:

- guidelines and instructions/directions issued for purchase of land and construction of godowns;
- codal provisions for entrustment of execution of works, locations prescribed in the scheme and budget for construction of godowns;
- directions of Government regarding occupancy, utilisation of godowns;
- effective utilisation of funds of the schemes;
- provisions of Warehouse Act regarding operations; and
- norms for deployment of manpower.

[1] **Gulbarga, Raichur, Mysore and Shimoga**
[2] **Bangalore, Gulbarga, Hubli, Raichur, Mysore and Shimoga.**

Audit methodology

3.1.5 The methodology adopted for attaining the audit objectives with reference to the audit criteria was as follows:

- Examination of Government Orders, minutes of Board of Directors and Technical committee meetings regarding acquisition of lands and construction of godowns;
- Examination of Project Reports;
- Scrutiny of records relating to construction of godowns and purchase of land;
- Scrutiny of records and returns relating to occupancy ratio, performance of warehouses, fixing of rent for godowns hired;
- Issue of audit enquiries; and
- Interaction with the management.

Audit findings

3.1.6 Audit findings, emerging as a result of test check were reported to the Corporation / Government in June 2006 and discussed in the meeting of Audit Review Committee on Public Sector Enterprises (ARCPSE) held on 13 September 2006. The meeting was attended by the Principal Secretary to Government of Karnataka, Co-operation Department and the Managing Director of the Corporation. The views expressed by the representatives of the Corporation/Government have been taken into consideration while finalizing the report.

Capacity utilisation

3.1.7 The Corporation is providing storage facility to the depositors. The occupancy of the godowns during the period from 2001-02 to 2005-06 is detailed below:

Sl. No.	Particulars	2001-02	2002-03	2003-04	2004-05	2005-06
	Operation					
1	No. of warehouse centres	107	109	116	116	116
2	Capacity (in lakh MT) at the end of year					
	- Owned	3.30	3.46	4.05	4.76	4.98
	- Hired	3.73	3.07	2.42	2.35	4.07
	- Total	**7.03**	**6.53**	**6.47**	**7.11**	**9.05**
3	Average capacity	7.45	6.69	6.64	7.11	8.55
4	Average occupancy	6.40	5.45	4.35	4.54	6.40
5	Percentage of occupancy to capacity	85.9	81.4	65.5	63.9	74.8

It would be evident from the table that the average occupancy which decreased from 6.40 lakh MT in 2001-02 to 4.35 lakh MT in 2003-04 and 4.54 lakh MT in 2004-05 recovered back to 6.40 lakh MT only in 2005-06. The percentage of occupancy to the capacity also varied from 85.9 *per cent* in 2001-02 to 74.8 *per cent* in 2005-06.

The Management attributed (June 2006) reasons for poor occupancy during these years to the drought situation in the State and also stated that the performance of each centre was being analysed/reviewed in the Regional Managers and Warehouse Managers meeting from time to time.

Creation of new capacities

3.1.8 During the five years ending 31 March 2006, the Corporation constructed 50 godowns (26 godowns under the conventional method and 24 under the 'State of Art' method) with a total capacity of 2.165 lakh MT at a cost of Rs.59.90 crore. It also purchased land at 34 locations for a total amount of Rs.6.43 crore.

A review of records relating to purchase of land and construction of godowns revealed that these were undertaken on *ad hoc* basis without proper planning/ evaluation as is evident from the following paragraphs:

Purchase of land

Land was purchased without cost-benefit analysis, flouting important parameters viz., accessibility of land etc. The sub-committee formed to recommend on the suitability of land for construction of godown remained ineffective as it met only once and identified only six sites for purchase.

3.1.9 It is of vital importance from the business point of view to assess the potential of the location before purchase of land. The land to be purchased should be easily accessible by road and rail, should be close to the regulated markets, etc. Keeping this in view, the Board constituted (September 2000) a sub-committee consisting of the Managing Director, Administrative Officer, two non-official Directors and a nominee of the State Bank of India to recommend on the suitability of the land for construction of godowns.

During April 2001 to October 2005, the Corporation purchased land at 34 locations, in some places along with buildings/godowns at a total cost of Rs.6.43 crore.

Audit scrutiny revealed that:

- The Board cleared proposals for purchase of land on a case-by-case basis without any cost-benefit analysis, evaluation of the pay-back period and identification of the source of funding.

- The sub-committee met only once in March 2001 and recommended for the purchase of six sites that it had identified in January 2001. Thereafter, the sub-committee did not function.

- As of March 2006, land at 17 locations purchased before 2001-02 at a total cost of Rs.0.30 crore remained unutilised for 6 to 23 years. The land purchased at 24 locations during the period under review for Rs.3.25 crore also remained unutilised for one to four years.

- Construction of seven out of the 50 godowns constructed during the period of review was undertaken after 7 to 16 years of purchase of the land. It was noticed during audit that land had been purchased flouting parameters to be observed in selection. The Management agreed (June 2006) to follow the norms like potentiality, accessibility, evenness of land etc., before purchase.

- The State Government directed (May 2003) the Corporation to immediately stop purchase of land from private parties as it had come to their notice that the Corporation had bought land from private parties at 3-4 times the market price and also furnish the relevant records of such purchases during the previous four years for their verification. There was no record to indicate that the relevant records as directed by the Government were produced. However, the Corporation as per decision of the BODs, purchased land at three locations during November 2003 to October 2005 from private parties at Rs.1.90 crore.

The Management stated (June 2006) that guidelines for purchase of land would be framed for approval of the BODs, which would be followed strictly in future.

Some of the individual irregularities noticed in purchase of land are discussed below:

Bilichodu Village, Jagalur taluk

3.1.10 The Corporation received (January 2004) a unilateral offer from Sri.S.K.Veerana, for sale of his property consisting of a cinema theatre with land and building. The property was inspected (August 2004) by the officials of the Corporation who reported that it was not suitable as the business in the area was seasonal and the same could be utilised as a seasonal warehouse only. The Corporation was also aware of this fact as it had hired (March 2004 to October 2005) the same property for storing maize and earned negligible storage charges of Rs.0.65 lakh against rent of Rs.0.55 lakh. Thus, the decision of the Board of Directors to purchase the above property in October 2005 at a cost of Rs.29 lakh was not justified.

The Management stated (June 2006) that the local Member of the Legislative Assembly had recommended purchase of the property to open warehouses; that the Chairman, the Managing Director and the Director had also opined that the property was suitable for warehousing activities. The reply further stated that the place had the potential to develop as a good business centre. The reply is not acceptable as the requirement could have been easily met by hiring godown as was done earlier.

Annur Village, Maddur taluk

3.1.11 Annur Paper Mills unilaterally offered (February 2003) to sell its land of 1.5 acre along with buildings and godowns (1,622 square metre). In respect of this property, the officers of the Corporation reported (March 2003/ June 2004) that the godowns on the property were constructed specifically for industrial purpose and required lot of modifications for usage as a warehouse, no clear approach road for the movement of vehicles from the main road was there and the occupancy in its own godown of 6,000 MT in the same area was very poor (15 *per cent*). Further, the Corporation was also aware that the said land was auctioned (June 2004) by Karnataka State Industrial Investment and Development Corporation Limited at Rs.22 lakh to a partner of Annur Paper Mills. In spite of this, the Corporation purchased this property (August 2005) at a cost of Rs.68.15 lakh (as fixed by the BODs) against the auction price of Rs.22 lakh without justification. The land has not been put to use so far (August 2006).

The Management stated (August 2006) that the Board had decided (August 2006) to recover the amount already paid to the owner of the property. Recovery of the amount is awaited (August 2006).

Ummadahalli, Mandya

3.1.12 Based on the recommendations (March 2001) of the sub-committee, the Board decided (July 2001) to purchase a property of 5 acre 34 gunta at Ummadahalli near Mandya. While the transaction was under finalisation, the Corporation received a complaint (April 2004) that the land was 2-3 feet below the road level and surrounded by irrigated land with narrow approach. Without verifying the facts of the complaint, the property was purchased (July 2004) at a cost of Rs.55.44 lakh. This land also remained vacant till date (August 2006).

The Management stated (September 2006) that the approach road to the purchased land was wide enough and added that there was a proposal to build a 10,000 MT capacity godown on the land. The reply is not acceptable as land purchased in July 2004 to construct a godown remained unutilised and the Corporation continued hiring private godowns in the area.

Shikaripura

3.1.13 Arihant Rice Industries, Shikaripura unilaterally offered (August 2002) to sell two acre of land with two godowns of 2,150 MT capacity for Rs.73.98 lakh. It was reported (August 2002) by the officers of the Corporation that the godowns were not suitable for storage in view of weak truss requiring strengthening and recommended continuation of the existing system of hiring. The Board, however, decided (November 2002) and purchased (February 2003) the property at Rs.55 lakh. It was, however, noticed in audit that the Corporation had been hiring godowns before this purchase in the same area for short periods (November to February) to store maize and against the payment of annual rent of Rs.0.58 lakh it had earned only Rs.2.23 lakh during December 2001 to February 2003. Thus, the purchase of property at a cost of Rs.55 lakh lacked justification.

Bangalore and Srirangapatna

3.1.14 In order to meet the demand of the farmers to provide cold storage facilities and storage for agricultural produce in Bangalore, the Chairman of the Corporation directed (April 2000) the management to expedite purchase of the required land for the purpose. The Corporation invited tenders (April 2000) for purchase of land for the purpose. Land measuring 6,020 square feet was purchased (July 2001) from one Sri. Kubere Gowda for Rs.57.90 lakh in spite of the adverse report of a sub-committee about narrow approach road to the land. Further, on the basis of a unilateral offer of a private party, the Corporation also purchased (May 2002) one acre of land with two godowns situated eight kilometres from Srirangapatna at a cost of Rs.32.76 lakh.

The property at both the places could not be utilised due to lack of business, the BODs decided (June 2003) to dispose of the property and also directed the management to take action against the officers/officials responsible for the purchase. No action has been taken so far. The above transactions resulted in blocking up of funds of Rs.90.66 lakh.

The Management accepted (June 2006) the facts and stated that action would be taken to dispose of the land. The reply was, however, silent about action for fixation of responsibility in these cases.

Yeliyur, Mandya

3.1.15 As per decision of the Board, the Corporation purchased (June 2003) land measuring 151 gunta with godowns situated at Yeliyur, Mandya. This was in spite of the adverse remarks on suitability of the land by both the sub-committee (January 2001) and the Regional Manager (January 2003). The land purchased at Rs.36 lakh remained unutilised (July 2006).

The Management stated (June 2006) that the land would be disposed off after placing the matter before the Board.

Construction of godowns

3.1.16 To meet the growing demand for increased storage, the Corporation embarked on construction of godowns under 'State of Art' technology which required six months to complete as against 24 months under the conventional method. Besides, the 'State of Art' warehouses were more durable, elegant and leak proof. The Board approved (February 2001) construction of a warehouse under the 'State of Art' technology at Koralur on a pilot basis. The Managing Director, without the prior consent of the Board, entrusted construction of 25 godowns (23 godowns in July 2001 and two godowns in March 2002/April 2003) to Larsen & Toubro Limited (firm) on a turnkey basis, at a negotiated price of Rs.47.11 crore under the 'State of Art'

There was delay ranging from 4 to 28 months in constructing godowns under 'State of Art' technology. The godowns constructed under 'State of Art' technology utilised excess space of 11,767.66 square metre at an extra cost of Rs.7.67 crore as compared to creation of the same storage capacity under the conventional method.

technology. The firm constructed 24 godowns[3] at a cost of Rs.42.63 crore. Simultaneously, the Corporation also got constructed 26 godowns at a cost of Rs.17.27 crore under conventional method. The construction of these godowns were to be completed within six months from the date of award.

Audit scrutiny revealed that:

- None of the 24 godowns constructed under 'State of Art' technology was completed within the stipulated time. There was delay of six months in respect of two godowns and delays ranging from 12 to 28 months in respect of 22 godowns. While the delay under conventional method was less, it ranged from 1 to 25 months in respect of 18 godowns. Thus, the very purpose of going in for 'State of Art' Technology was defeated.

- There was further delay of 1 to 29 months in the commencement of commercial operation of 29 godowns even after their completion. The reasons for delay were not on record. These delays resulted in hiring of godowns by incurring rent of Rs.2.74 crore (April 2000 to March 2006).

- Despite the decision of the Board to go in for only one godown under 'State of Art' technology, the Corporation undertook construction of a large number of godowns. The godowns constructed under 'State of Art' technology utilised excess space of 11,767.66 square metre, incurring additional cost of Rs.7.67 crore as compared to creation of the same storage capacity under the conventional method.

Fund Management

3.1.17 During the five years ending 31 March 2006, the Corporation constructed 50 godowns under the following schemes:

Sl. No.	Source of funding	Agencies[©]	No. of godowns constructed	Capacity (in lakh MT)	Value (Rs. in crore)	Borrowings (Rs. in crore)
01	Own funds	KSSIDC	02	0.025	0.54	0
		HSCL	11	0.35	8.13	0
02	RIDF -V	HSCL	07	0.16	3.57	1.96
03	RIDF - VI	HSCL	06	0.18	5.03	4.39
04	External borrowings – banks/ State Government	L&T	24	1.45	42.63	41.40
Total			**50**	**2.165**	**59.90**	**47.75**

[3] For want of land, construction of Mandya godown was not taken up.

[©] Karnataka Small Scale Industries Development Corporation Limited (KSSIDC); Hindustan Steel Works Construction Limited (HSCL) and Larson and Tourbo Limited (L&T).

A review of fund management by the Corporation revealed the following:

The Corporation incurred additional interest burden of Rs.4.12 crore by not availing loan available at cheaper rates and drawing instalment of loans without considering the progress of work.

3.1.18 Under the Rural Infrastructure Development Fund Scheme (RIDF) the Corporation was eligible for loan upto 90 to 95 *per cent* of project cost at an interest rate of 6.5 *per cent*. The Corporation, however, did not explore this possibility and instead availed loan of Rs.41.40 crore from banks and the State Government at interest rates ranging from 9.61 to 12 *per cent* in respect of 24 godowns. As a result the Corporation incurred extra expenditure of Rs.2.45 crore on interest. The Management stated (June 2006) that in view of urgency to meet the demand of maize procurement and Food for Work Schemes, these works were not placed before Cabinet Sub-committee for getting finance under RIDF. The reply is not acceptable as the Board failed to consider the availability of loan at cheaper interest rates under RIDF.

Further, due to lack of co-ordination between the Engineering and Finance Departments, the loans were drawn as per schedule without linking drawals to the progress of work. This resulted in incurring of additional interest of Rs.1.67 crore for the delayed period of construction.

Delay in release of subsidy under Gramin Bhandaran Yojana (GBY)

3.1.19 As per the subsidy scheme under GBY, the Corporation is eligible for subsidy for setting up godowns for storing agricultural products of the farmers in rural area. The National Bank for Agriculture and Rural Development (NABARD) releases 50 *per cent* of the eligible subsidy as advance and the balance is released to the lending bank after inspection by a Joint Committee♦. The entire subsidy released to the Bank was to be adjusted against the loans.

NABARD sanctioned (December 2003) subsidy of Rs. 5.33 crore for the construction of 22 godowns under the ‘State of Art’ technology and released (June 2003) Rs.2.67 crore (50 *per cent* of subsidy) to the lending bank. Though the construction of godowns was completed between June 2003 and September 2005, the balance subsidy of Rs.2.57 crore was yet to be released (August 2006) due to non-inspection by the Joint Committee. Consequently, the Corporation incurred an additional interest burden of Rs.1.25 crore (August 2006) on the loans drawn from the State Bank of India at higher rates to meet the deficit in subsidy.

The Government stated (September 2006) that after completion of inspection by the Joint Committee, action would be taken to get the balance subsidy released.

Irregular funding

3.1.20 There is no provision for funding private parties for construction of their godowns under the State Warehousing Act. This was also reiterated by the Finance wing of the Corporation. In spite of this, the Managing Director extended between January 2001 and April 2004, advances of Rs.62.22 lakh to private parties for construction of godowns in Mandya and Shimoga. The

♦ **consisting of officers from NABARD, lending bank and Director of Marketing and Inspection of the concerned State.**

Corporation had taken these godowns on hire after construction and recovered the advance to the extent of Rs.56.92 lakh from the rent. The Corporation is yet to recover (August 2006) balance advance of Rs.5.30 lakh. It was noticed in audit that in respect of 12 godowns in Mandya, for which advances were provided, the average percentage of occupancy declined from 88 *per cent* (2001-02) to 21.5 *per cent* (2005-06). In spite of this, the Corporation continued to occupy these godowns on rent to facilitate clearance of the advance given for the construction.

The Management while concurring with Audit stated (June 2006) that it would not provide such advances in future.

Performance of warehouses

3.1.21 The financial performance of the warehouses for the last five years ending March 2006 was as below:

Year	No. of centres	Operating profit (Rs. in crore)	Profit centres		Loss centres	
			No. of centres	Amount (Rs. in crore)	No. of centres	Amount (Rs. in crore)
2001 – 02	107*	9.38	68	9.25	10	0.13
2002 – 03	109	12.56	95	12.45	14	0.11
2003 – 04	116	11.93	90	11.70	26	0.30
2004 – 05	116	10.50	88	9.84	28	0.64
2005 – 06	116	11.84	87	12.27	29	0.50

*** Information regarding Bangalore and Shimoga regions is not available.**

It would be evident from the table that the operating profit showed a declining trend from the year 2002-03 onwards and showed marginal improvement in 2005-06. The number of centres, which incurred operating losses, increased from 10 in the year 2001-02 to 29 in the year 2005-06 and the operating loss for the year increased from Rs.11.04 lakh in 2002-03 to Rs.64.24 lakh in 2004-05 and marginally decreased to Rs.50 lakh in 2005-06. Further, review of the performance of centres revealed that all the loss making centres, except three in 2003-04, could not even recover their establishment and godown rents ranging from Rs.12.42 lakh to Rs.42.53 lakh during the same period. The Corporation had no system of analysing the performance of centres.

The Management stated (September 2006) that action has been initiated to identify loss making centres and redeploy the officials.

Non-occupation of godowns

3.1.22 The Karnataka State Beverages Corporation Limited (KSBCL) requested (June 2003) the Corporation to provide storage facilities for their products. The Corporation decided (June 2003) to provide the cellar floor of four godowns of 17,542 square feet in Mysore centre for Rupees five per square feet. The godowns were handed over to KSBCL in June 2003. The

KSBCL requested (March 2004) the Corporation to take back the godowns as in the absence of storm water drain the rain water entered the area causing damage to their commodity. KSBCL handed over (March 2004) the possession of the godown to the Corporation. Another customer, who agreed to hire (October 2005) 12,000 square feet at Rs.3.50 per square feet, did not occupy the godown for the same reason. On this being pointed out by Audit, the Corporation rectified the drainage system and thereafter gave it on hire to another party from April 2006. Due to delay in construction of storm water drains, the Corporation was deprived of revenue of Rs.21.12 lakh for the period April 2004 to April 2006.

The Management stated (June 2006) that the drainage problem had been rectified and that the godowns had been occupied by Vijayananda Road Lines since April 2006. The Management took corrective action after this was pointed out by Audit.

Storage and transit losses

3.1.23 The Food Corporation of India (FCI) is one of the bulk depositors in the godowns of the Corporation. As per agreement, FCI admits transit loss of one *per cent* of the quantity received and storage loss of 0.5 *per cent* of the quantity released in the case of rice and no storage loss is allowed in the case of wheat. Any loss in excess of the limits fixed is to be borne by the Corporation. In respect of transit loss during transportation, the concerned Warehouse Manager is required to prefer the consignor claim with the Indian Railways on behalf of the FCI, within 24 hours of receipt of stock at railhead.

It was, however, noticed in audit that FCI after admitting the permissible loss, recovered Rs.96.51 lakh and Rs.36.01 lakh from the Corporation on account of excess storage loss and transit loss respectively during the period from 1987-88 to 2005-06. The Corporation did not initiate action to identify the exact cause of storage loss exceeding 0.5 *per cent*. Further the decision of FCI to withhold Rs.36.01 lakh towards transit loss was not justified as the Corporation had raised the consignor claims with the railway authorities in time.

The Government stated (September 2006) that the FCI has accepted the claim and would reimburse the entire amount.

Performance of weighbridges

3.1.24 The Corporation has 20 weighbridges (10 prior to 1998 and 10 after 2004) installed at a cost of Rs.1.17 crore.

A review of the performance of weighbridges for the five years ending March 2006 revealed that out of the total income of Rs.83 lakh from these weighbridges, Hassan and Tumkur Unit-I, alone contributed Rs.74 lakh. All other weighbridges contributed only Rs.6.67 lakh. Five weighbridges costing Rs.31.69 lakh did not earn any income, the reasons for which has not been analysed by the Corporation.

The Management stated (June 2006) that they would exploit all possibilities to earn more revenue in future.

Manpower

3.1.25 As on 31 March 2006, the Corporation has six Regional Offices each headed by a Manager and 116 warehouses with a total working strength of 360. It was noticed in audit that the Corporation had not fixed norms for manpower requirement.

The Government stated (September 2006) that norms would be proposed before the Board and would be implemented in a phased manner.

Internal audit

3.1.26 The Corporation has an Internal Audit wing, headed by an Internal Audit Officer with five assistants, under the direct control of the Managing Director. The Corporation does not have an Internal Audit Manual defining the scope, coverage and periodicity of audit.

The Internal Audit wing audited only some of the warehouses, out of the total 116 centres, during the five years ended 2005-06, as detailed below:

Year	No. of warehouses audited
2001-02	47
2002-03	46
2003-04	70
2004-05	26
2005-06	9

As on 31 March 2006, audit of Hangal and Tumkur-II centres (5,000-10,000 MT capacity) and 16 centres below 5,000 MT capacity had not been conducted during last five years.

In view of the above the functioning of the Internal Audit wing was ineffective and the coverage inadequate. This fact had also been repeatedly commented upon by the Statutory Auditors in their reports on the accounts.

The Management stated (June 2006) that an Internal Audit Manual would be prepared ensuring adequate coverage.

Acknowledgement

Audit acknowledges the co-operation and assistance extended by the staff and the Management of the Corporation and also the officers of the Government at various stages of conducting the performance review.

Conclusion

The Corporation did not have a proper plan for the purchase of land, construction of godowns and their utilisation. Land was purchased without assessing its suitability, requirement, etc., and in some cases on the basis of *suo moto* offers made by private parties for sale of land, and in one case even after an adverse report from officers of the Corporation. The Corporation also paid exorbitant rates for purchases in some cases. The sub-committee formed to recommend on the suitability of land for construction of godowns remained ineffective as it met only once during the last five years and identified only six sites for purchase. There were delays in construction of godowns as well as in the commencement of commercial operation of godowns after construction leading to godowns being taken on hire. Deficient fund management also led to higher interest outgo.

Recommendations

- **The Corporation should evolve a long-term comprehensive plan for purchase of land and construction of godowns so as to provide service efficiently at economical rates.**

- **The functioning of the sub-committee should be made more effective so that suitable land and property are acquired at economical rates.**

- **Land should be purchased in a transparent manner only after ascertaining its suitability and requirement, and reasonability of the prices quoted. The cases of purchases of land pointed out in the review need investigation to fix responsibility.**

3.2 KARNATAKA STATE FINANCIAL CORPORATION

INFORMATION TECHNOLOGY AUDIT OF 'ON-LINE SYSTEM'

Highlights

Not negotiating for the lowest rates quoted for individual items while purchasing hardware for implementation of the 'On-line systems' resulted in avoidable extra expenditure of Rs.30.14 lakh.

(Paragraph 3.2.7)

The application packages lacked many in-built controls and validations to safeguard against incorrect data entries and proper process of data making the information generated by the system not reliable in many areas.

(Paragraphs 3.2.8 to 3.2.10)

The Management has not formulated any policy regarding physical and logical security of IT assets including software and existing data. Insufficient security features in respect of access control, passwords and login control rendered the system vulnerable to unauthorised access and data manipulation.

(Paragraphs 3.2.11 and 3.2.12)

The Disaster Recovery and Business Continuity Plan was neither approved by the Board nor uniformly followed. The data backup was not periodically checked to ensure recovery of data.

(Paragraph 3.2.14)

Introduction

3.2.1 Karnataka State Financial Corporation was established in March 1959 under section 3(1) of the State Financial Corporations Act, 1951 with the main objectives of promoting and developing industrial growth in the State of Karnataka by providing financial assistance in the form of term loans, equity participation, equipment leasing, etc. In the recent years, the activities have been mainly confined to term lending, catering to small and medium scale industries. The Corporation, headquartered at Bangalore, with seven Zonal Offices and 30 Branch Offices is headed by a Chairman and the Managing Director nominated by the State Government, who is assisted by two Executive Directors and six General Managers.

The Corporation, which has been using computers since 1983, established an in-house computer centre in 1985 headed by an Assistant General Manager, mainly for development and maintenance of various applications. The Corporation has an 'On-line system' with 11 modules to facilitate its core activities.

Scope of audit

3.2.2 Audit evaluated the IT controls in the 'On-line systems' of the Corporation for the year 2004-05, which was extended to earlier years wherever required.

Audit objectives

3.2.3 The audit objective was to evaluate the effectiveness, reliability and integrity of the 'Loan Management System' module of 'On-line systems' in particular and other modules, in general, at the Head Office of the Corporation in Bangalore.

Audit criteria

3.2.4 Audit criteria considered for assessing the achievement of audit objectives were manual data; electronic data, wherever made available, and manuals for the implementation of computerisation in the Corporation.

Audit methodology

3.2.5 The sample data of the information contained in data tables received from the IT Department of the Corporation in the form of an Export Dump was scrutinised using the generalised audit software – IDEA.

Brief history of on-line system

3.2.6 The objectives spelt out, for taking up the 'On-line systems', among other things, were to bring in improvement in efficiency and effectiveness, make decisions qualitative through accurate and timely information and monitor projects easily. The 'On-line systems' was to upgrade the relatively stale information existing in the 'batch processing systems' that were in use, provide data on a continuous and updated format to clients/in-house users. As per the original proposal before the Board, 'On-line systems' was to be implemented in 1994-96, by establishing a network between the Head Office and all the branches. However, the 'On-line systems' was developed and implemented in phases over a period of five years (1994-1999), comprised of 11 modules viz., Appraisal, Inspection, Disbursement and Monitoring (IDM), Recovery, Loan Accounting, Finance Accounting, Bills Processing, Insurance, Fixed Deposit, Bonds Management, Line of Credit Systems and Lease Accounting. The actual cost of implementation of the project was

Rs.4.51 crore. The proposal of networking, however, remained unfulfilled and the on-line system was made operational independently in all the branches.

Extra expenditure due to improper evaluation of bids

Non-negotiation for lowest rates quoted for individual items while purchasing the hardware resulted in avoidable extra expenditure of Rs.30.14 lakh.

3.2.7 The Board approved (January 1999) the implementation of the on-line computerisation in the Corporation at a cost of Rs.4.10 crore. However, the tenders were invited in December 1998 itself and the quotations were taken only from four vendors[$]. No justification for resorting to limited quotations for such huge procurement, instead of calling for open tenders to avail the benefit of competitive bids, was on record. The Corporation then split the requirement of hardware among all the four parties and placed orders. It was noticed in audit that the Corporation paid different prices for the same items amounting to Rs.30.14 lakh. The Government stated (December 2005) that the orders for individual items on different vendors were not decided because of compatibility of equipments, after sales service and support. The reply is not tenable as the Corporation could have considered the lowest price of each item and asked the parties to match the same. Further, except one firm (WIPRO) other firms were not the manufacturers of items required and none of them manufactured UPS. Under the circumstances, the action of the Corporation in not negotiating for the lowest rates of individual items among the four vendors resulted in avoidable extra expenditure of Rs.30.14 lakh.

Deficiencies in design and development

Inadequate controls/validations in the system rendered it to be of limited use in facilitating the process of loan Appraisal, Inspection, Disbursement, Monitoring and Recovery as detailed below:

Data capture

The application package lacked many in-built controls and validations to safeguard against incorrect data entries and proper process of data making the information generated by the system not reliable in many areas.

3.2.8 It was noticed in audit that essential details of entrepreneurs like bank account number, passport/permanent account number, net worth, etc., were not mandatorily captured under the pre appraisal/technical appraisal menu. Similarly details regarding the various approvals obtained for a project to be financed, bankers' opinion, demand and supply forecast and rates of depreciation were not compulsorily entered. This seriously limited the usefulness of the information generated by the system to facilitate the process of loan appraisal. The Management stated that approvals of various authorities cannot be mandatory as it varies for different loanees and bankers' opinion contains a subjective element and hence cannot be uniform. The reply is not acceptable as some of the approvals to be obtained were common to all and it was against the provisions of the Loan Disbursement Manual of the Corporation to ignore bankers' opinion.

[$] HCL INFOSYSTEMS Limited, WIPRO Limited, TATA IBM Limited and Compaq Computer Asia (P) Limited.

Input control and validations

3.2.9 The system lacks input control and input validations as detailed below:

- In the pre-appraisal/technical appraisal menu, data keyed in was accepted by the system, without any validation checks like
  - Sanctioning of loans beyond the maximum prescribed limits;
  - cases of security offered;
  - jurisdiction of the branch sanctioning the loan; and
  - Promoter's contribution below the minimum prescribed for various schemes.

  As regards validating jurisdictions of branches, the reply of the Management that provisions were made to cover all places is not acceptable as against a district specified places outside the districts should be considered for rejection by the system. Similarly, the reply of the Corporation that validation of promoters' contribution was prompted by the system at the time of generating reports cannot be accepted as it could be overruled.

- In the master table of loan accounts, the next principal due date was beyond one year in 112 cases and extended even up to the year 2010. In a few cases, the next interest due date had already lapsed, i.e. it was less than even the current date. The next interest due date could not have elapsed when the next principal due date was beyond one year. The Management stated (August 2005) that the differences related to pre-closed cases. The reply is not acceptable as in such event a trail should be maintained to prevent loss of data integrity.

- In the Oracle table, containing data on Loan-wise/unit-wise rate of interest furnished to Audit, 7,531 records were there and an analysis of the data in the table disclosed that contracted rate of interest as well as penal rate of interest was zero in 24 cases. As rate of interest cannot be zero, 'nil' rate of interest in the above cases disclosed the lack of input validations. The Management replied (August 2005) that these are closed cases. The reply is not acceptable for the reason that the rates of interest should have existed even in such cases.

- Similarly, the table containing the details of sanction of loan furnished to Audit had 2,150 records and in respect of 123 cases, the rate of interest was zero. The Management stated (August 2005) that for rate of interest the data available in the accounts module is used. The reply is not acceptable as this deficiency in system design makes the rate of interest keyed in as redundant.

- In the Inspection, Disbursement and Monitoring module the system accepted earlier dates for a subsequent inspection and the entire amount sanctioned could be keyed in for disbursement in addition to the amount already released. Moreover, changes to repayment schedule affecting Debt Service Coverage Ratio were to be keyed in, though the same were available in the appraisal stage; loan repayment start date was to be entered in two stages of loan master table and loan repayment schedule table. It was also observed that the system did not support for recording approval of competent authorities for changes to repayment schedules.

Process control

Deviation from business rules

3.2.10 The system did not alert against deviations from the provisions of the Loan Disbursement Manual of the Corporation like non-inspection of the unit within three months of sanction of loan or when the party approached for disbursement, whichever was earlier. Further, the system did not prompt for inspections due subsequent to disbursement, periodical reminders to loanee in respect of undisbursed loan amounts and to call the borrowers for Project Implementation Review Committee (PIRC) meeting on due dates. Similar prompts in case of partially disbursed cases, to speed up the project implementation or call the borrower before PIRC and prompting communication in cases of cancelled/restricted loans by PIRC to borrowers within 10 days was not supported by the system.

General controls

The Management has not formulated any policy regarding physical and logical security of IT assets including software and existing data. Insufficient security features in respect of access control, passwords and login control rendered the system vulnerable to unauthorized access and data manipulation.

Non formulation of IT Policy

3.2.11 Though the Corporation has over the years developed substantial IT applications, it is yet to formulate and document a formal IT policy and a long term / medium term IT strategy incorporating the time frame, key performance indicators and cost-benefit analysis for developing and integrating various systems. No planning / steering committee with clear roles and responsibilities exist to monitor the development of software for each functional area in a systematic manner which led to avoidable losses and non achievement of objectives of the Corporation. The Government stated (December 2005) that an IT Policy would be formulated shortly with the approval of the management.

Access Control mechanism and segregation of duties

3.2.12 It was noticed that there was no access control matrix document prepared and got approved by the Board. No details of class of individual officers / staff who fall into different categories and how many are designated as System Administrators with full access rights were produced to Audit. Similarly, details of number of officers designated as Database Administrators and their tenure were not maintained. Moreover, duties and functions assigned to system administrators and database administrators were also not documented.

A group of officers were operating with a common password in Accounts Appraisal and IDM Modules. Thus, there was no structured implementation of and monitoring of any password policy. In the two branches visited by Audit, there were no clear guidelines from the Head Office with regard to framing of passwords and also change of passwords from time to time.

The Government stated (December 2005) that the above issues would be covered in the IT policy proposed to be formulated.

Inadequate Change Management Controls

3.2.13 It was noticed during audit that program changes were sent to branch offices as version patches on cartridges. In two branches test checked, the branches had not maintained any record to indicate the actual date of receipt of patch from the Head Office, actual date of copying of patch and the person who carried out the exercise. In the absence of a uniform method to be followed it may lead to a risk of loss of data integrity and incompatibility when all offices are networked. The Government stated (December 2005) that suitable action would be taken in case of future changes to programs.

Lack of adequate Disaster Recovery and Business Continuity Plan

The Disaster Recovery and Business Continuity Plan was neither approved by the Board nor uniformly followed. The data backup was not periodically checked to ensure recovery of data.

3.2.14 No policy was formulated and detailed procedure documented for recovery of data, programs and other software in case of disaster. In two test checked branches as well as in the Head office, it was noticed that there were no off-site backups of the data. Fire fighting equipments were not installed in the server room.

It was noticed in audit that there was no formal policy regarding the frequency of taking back up and test checking it for retrieval. In two test checked branches, the backup data were not being checked for retrieval. In another branch, it was noticed that monthly backup was not being taken.

In the absence of a proper system, the business of the Corporation to the extent it is dependent on the electronic data will be very badly affected in the event of any disaster. The Government stated (December 2005) that refinement of existing policies would be made at the time of making proposed IT Policy being submitted to the Board.

Lack of system testing before implementation

3.2.15 Audit enquiry revealed that no proper testing of the system duly documenting the same was done before using the package. An independent pre-implementation testing at various stages of development would have reduced many inaccuracies in design and development, obviating the effort to key in data all over again. Further, no formal post-implementation review of all the modules was carried out and results thereof documented for necessary follow-up action / maintenance. The Government stated (December 2005) that programs will be thoroughly tested and feedback will be obtained.

Performance of the system

3.2.16 Any computerisation effort has to be supplemented by appropriate input, processing and output controls to ensure confidentiality, integrity, and reliability of the data stored and flowing through the IT applications. However, it was noticed that because of deficient control environment the objectives of the computerisation of improving the efficiency and effectiveness of the organisation have not been achieved even after spending Rs.4.51 crore over a period of five years. The related observations are given below;

- The time taken for sanction of loans had been the same and had even increased in some cases after the introduction of the package, to which the Management stated (August 2005) that the number of days taken for processing the application cannot be attributed to delay in processing by the on-line package. The reply is not acceptable since time taken to process applications for financial assistance being one of the key factors of efficiency, reduction was expected to be realised by the system making all the relevant information available in a timely and accurate manner.

- One of the main objectives of on-line systems was to overcome limitations of batch processing systems. However, the Key data in different modules were still not being entered even after five years and manual files continued to be maintained.

- Vital data about disbursement of loans, extent of utilisation by the beneficiaries and their recovery from the loanees were not being keyed in into the system. They were, therefore, not available to the management for decision making.

- There were no records in some of the key tables pertaining to many topics like details of changes in first investment clause, details of changes in means of finance during disbursement, details of changes in project cost, and details of release with dues with authority for approval.

- No data was found keyed in regarding existing assets of the loanee and details of performance of loanee units gathered on inspection.

- No data was captured for 'conditions imposed' for disbursement of loans, details regarding requests of the loanee for changes regarding working capital arrangements, security offered, etc.

- The number of records in various tables capturing different details of loanees – ranging between 2 and 9,127, varied with the number of records in the master table of loan accounts, which contained 11,480 records. The huge variation in the number of records indicated that data entry in all tables was not mandatory.

The Management stated (August 2005) that these tables were introduced subsequently hence there were differences. It was further stated that the difference related to cases, which were closed prior to implementation of 'On-line systems'. The reply is not acceptable as data for both tables should not be available, if they pertained to old cases. The Management stated (August 2005) that suitable modifications would be incorporated wherever necessary.

Acknowledgement

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Conclusion

Structured efforts at computerisation of IT activities would have enabled the Corporation to have a transparent, efficient and effective system to facilitate all aspects of loan appraisal, disbursement and monitoring. However, due to lack of properly directed efforts the Corporation still has a mix of manual and automated process with key areas still being manual, and thus not free from error or discretion. Moreover, the application packages lacked in-built controls and validations to safeguard against incorrect data entries and proper processing of data with the effect that the information generated by the system was not reliable in many areas. Thus, even after spending money and valuable time, the Corporation has not been able to use IT advantageously to bring in transparency and efficiency. This is a serious short coming in an organisation that disburses over Rs.300 crore annually as loans.

Recommendations

- **The Corporation needs to rework its entire strategy towards computerisation to harness true value of IT in not only enabling business but in improving processes.**

- **Proper input, processing and output controls need to be implemented in the organisation. It needs to fine tune the validations to bring them in line with manuals/circular instructions/lending policies.**

- **It needs to formulate and document an IT policy immediately.**