CHAPTER II

PERFORMANCE REVIEW RELATING TO GOVERNMENT COMPANY

2 INTERNAL CONTROL SYSTEM IN KERALA STATE FINANCIAL ENTERPRISES LIMITED

Highlights

Budgets were prepared and approved after delays of up to six months after commencement of the relevant financial year, and variations between budget and actuals were not analysed. The budgets did not serve the purpose of internal control.

(Paragraph 2.7)

Functional Manuals were not updated after 1991 .

(Paragraph 2.8)

The Company neither maintained the stock account of receipt books nor kept the same under safe custody resulting in absence of control over their issue to various officials responsible for handling cash .

(Paragraph 2.9)

The Audit Committee was formed after a delay of four and a half years and did not transact the intended business. No Internal Audit Manual was prepared and the scope and coverage of Internal Audit was inadequate.

(Paragraphs 2.11 and 2.12)

There were deficiencies in the internal control procedures with regard to enrolment of subscribers and sanction/disbursement of loans. Default in prized chitties for the five years ended 31 March 2005 ranged between Rs. 32 crore and Rs. 52 crore. Borrowed funds ranging between Rs. 61 crore and Rs. 214 crore were diverted for payment of prize money. Credit worthiness of persons was not ensured before admission to chitties and defaulters in one chitty were allotted tickets in other chitties.

(Paragraphs 2.16 and 2.17)

Introduction

2.1 Internal Control is an integral part of the process designed and put in place by the management of an organisation to achieve its specified objectives effectively, economically and efficiently. It helps in creating a reliable financial and management information system besides facilitating effective decision making. Internal Control System is most effective when it is built into the entity's infrastructure and is an integral part of the essence of the organisation. Internal control in Government financial institutions assumes greater significance in view of the fact that they deal with public money and therefore these institutions have to transact business in such a manner that the risk of default by the borrowers is reduced to the minimum.

Kerala State Financial Enterprises Limited (KSFE) was incorporated in November 1969 as a Government Company with a view to socializing chitty[1] business in the State, so as to ensure safety, security and better service to the public thereby protecting them from exploitation by private financial institutions. The Company also provides other facilities such as consumer/vehicle loans and short/medium term loans such as Chitty Loan, Trade Loan, loans for Hire Purchase and House Modernization Scheme, Housing Finance Scheme, Special Car Loan, etc., to the public. The Company also started accepting deposits from the Public from 1975.

The Company is managed by a Board consisting of five Directors including the Managing Director as on 31 March 2006. The Managing Director is the Chief Executive of the Company and is assisted by a Business Manager and a Finance Manager at the Head Office. There are five Regional Offices located at Thiruvananthapuram, Kollam, Ernakulam, Thrissur and Kozhikode managed by respective Regional Managers. The business of the Company is being carried through a network of 266 branches (as on 31 March 2006) spread all over the State.

Scope and coverage of Audit

2.2 The present Performance review examined the internal control system prevalent in the Company during the period from 2001-02 to 2005-06. Since the characteristics of sample data was not homogeneous, the activities/transactions of the Head Office and six main branches undertaking chitty business and granting all types of loans under each of the five regional offices were covered during November 2005 to January 2006. Further, 280 default cases out of a total of 2331 such cases were also examined by audit.

Audit Objectives

2.3 The Performance review was conducted with the objective of analysing the effectiveness of the internal control mechanism prevalent in the Company by examining whether;

[1] Chitty means a transaction whether called chitty or kuri by which one or more persons hereinafter called the 'Foreman' or 'Foremen' enter into an agreement with a number of persons that everyone of the contracting parties shall subscribe a certain amount of money by periodical instalments for certain definite period and that each in his turn, as determined by lot or auction or by both, shall be entitled to the prize amount payable in cash.

- the budget prepared served as a tool of financial control;
- functional manuals were available and served the intended purpose;
- a proper financial control system had been evolved and was functioning effectively;
- the role of the Audit Committee and Internal Audit was adequate in ensuring internal control;
- there was a proper system in the Company for conduct of chitty business and for appraisal, sanction, disbursement, follow-up and recovery of loans;
- effective steps were taken for controlling the Non-Performing Assets (NPA); and
- computerisation was adequate and effective.

Audit criteria

2.4 The criteria considered for assessing the achievement of audit objectives were as follows:

- timeliness in preparation of annual budgets, analysis of variance with actuals and corrective action taken;
- guidelines provided in functional manuals in respect of chitties, loans and for effective functioning of the Company;
- financial control system in respect of cash and bank balances, receipt books, inter-unit accounts, control accounts, etc;
- provisions of Companies Act, 1956 relating to formation and functioning of Audit Committee ;
- Rules and Procedures prescribed in the Kerala Chitties Act and Rules 1975 as well as Hand Book of Schemes for conduct of chitties, sanction, disbursement, follow-up and recovery of loans;
- State Government orders and directions on setting up of Vigilance Wing;
- Reserve Bank of India prudential norms for classification and provisioning for NPA.

Audit Methodology

2.5 Audit methodology adopted for attaining the audit objectives was;

- review of minutes book and agenda papers of the meetings of the Board of Directors, Annual Reports, Manual of procedure and various circulars issued in respect of various schemes;

- scrutiny of Internal Audit Reports, Internal Audit Plan, files in respect of branch automation, records relating to Revenue Recovery, Business, etc., kept at the Head Office of the Company; and

- review of chitty ledgers, documents, loan files, stock registers of receipt books and stationery, register of revenue recovery cases and progress reports kept at six branches of the Company.

Audit findings

2.6 Audit findings emerging from the performance review were reported to the Management/Government in July 2006 and discussed in the meeting of the Audit Review Committee on Public Sector Enterprises (ARCPSE) held on 04 August 2006, which was attended by the Additional Secretary, Taxes Department, Government of Kerala and Managing Director of the Company. The views expressed by the Management/Government have been taken into consideration while finalising the review.

Audit findings are discussed in the succeeding paragraphs.

Budgetary Control

2.7 Budget is a quantitative, financial expression of a programme of measures planned for a given period. The Budget is drawn up with a view to plan future operations and to make *post-facto* checks on the results obtained. Timely preparation of Budget and analysis of the variations noticed with reference to actual execution serve the purpose of Internal Control. The Company prepared an annual budget for each financial year. The budgeted and actual figures in respect of various schemes operated by the Company during the five years up to 2005-06 were as indicated in **Annexure 9**. The following deficiencies in the preparation and analysis of the budget were noticed in audit:

Budgets were prepared and approved after delays of up to six months

- The Company did not prepare the annual budgets in time. The budgets for all the years (2001-02 to 2005-06) were prepared and got approved after delays ranging up to six months after commencement of the relevant financial year.

  The Management stated (July 2006) that since the accounts were maintained manually, the collection of data from the branches and compilation of the same in the Corporate Office was a cumbersome task which led to the delay. The reply is indicative of the fact that the Company did not devise any system for timely preparation of budgets.

- It would be seen from the **Annexure** that there were short-falls in disbursement of loans as compared to budgeted figures particularly in respect of New chitty/Pass book loans in which the percentage of short-fall ranged from 12.28 (2002-03) to 46.88 (2004-05). In the new housing finance scheme it ranged from 6.28 (2003-04) to 23.81 (2005-06). In trade loan the same was as high as 71.38 *per cent* in 2005-06. Similarly, short-fall in actuals for sugama deposit scheme ranged between 3.52 *per cent* (2002-03) and 19.74 *per cent* (2004-05). The Company did not conduct any detailed analysis of the variance between the budgeted figure and the actual performance.

The absence of proper analysis of the variances resulted in fixation of unrealistic targets.

Functional Manuals

2.8 Functional Manuals provide guidance to the personnel in-charge of appraisal, disbursement and recovery of loans and also enable them to proceed with legal action as per the prescribed terms and conditions.

Functional Manuals not updated after 1991 and hence did not serve the intended purpose

The Company prepared a Manual of Procedure (MOP) in 1984 which was updated in April 1991. No updation of MOP after 1991 was done with a view to incorporating the detailed procedure, terms and conditions, etc., of new schemes launched subsequently. The changes/modifications effected in schemes and the delegation of powers (modified) issued were available only in circulars issued from time to time. The Manual, thus, did not serve the intended purpose.

The Management stated (July 2006) that earnest efforts would be made for the publication of an updated edition incorporating all the schemes and its procedures.

Financial Control

Non-maintenance of Stock Accounts of Receipt Books

Stock account of receipt books not maintained and receipt books not kept under safe custody.

2.9 Except in four branches (three branches in Thrissur Town and the Kesavadasapuram Branch) where computerisation was done, in all other branches (262) of the Company, receipts/cash challans were being issued manually on receipt of money from the customers. In two branches (Ernakulam and Trivandrum Main) it was noticed that :

- no stock account of receipt books, giving details such as the opening number of books, number of books issued and the closing balance was maintained ;

- the names of persons to whom the receipt books issued were also not recorded ;

- the receipt books did not contain serial numbers ; and
- the receipt books were not kept under safe custody.

Non-maintenance of proper stock account of receipt books/cash challans and their safe custody reflects the absence of control over accounting of receipts as the misuse of receipt books/leaves thereof, if any, can go undetected.

The Management stated (July 2006) that stock register for cash challans was maintained in the Head Office and that a parallel cash register was also maintained in the branches and there was adequate internal control. The reply is not tenable because there was no stock account of cash challans and their safe custody at the branch level. In the Audit Review Committee meeting (4 August 2006) the Management assured that the Challans would be kept under safe custody and numbering them would be considered.

Reconciliation of control accounts with personal ledger balances

2.10 The Company was not reconciling the balances as per the General ledger control account with the personal ledgers in respect of 'Hire Purchase (HP) advance' and chitty subscribers. This irregularity in respect of chitty subscribers persisted inspite of it being pointed out by the Statutory Auditors every year.

In the Company's main branch at Thrissur it was observed in audit that there was an unreconciled difference of Rs.0.95 lakh between 'HP advance' as per General Ledger and personal ledger balances. Though the difference was cleared by taking the same to a Suspense Account, no adjustment had been effected in the personal ledger balances.

The Management stated (January 2006) that on computerisation of branch accounting, cumulative schedules of non-prized and prized subscribers would be taken and tallied with the control accounts. In the absence of timely reconciliation, malpractices, if any, in respect of chitty transactions would go unnoticed.

Audit Committee

2.11 As per Section 292A of the Companies Act, 1956 (amended in December 2000), the public Companies having paid up capital of not less than Rs. five crore shall form an Audit Committee. The Audit Committee should discuss with the Auditors periodically about the internal control systems, the scope of audit including the observations of the Auditors and review the half yearly and annual financial statements before submission to the Board of Directors and ensure compliance of internal control systems.

Audit Committee formed after a delay of 4½ years and did not transact any of the intended business

In the formation and functioning of Audit Committee the following deficiencies were noticed in audit;

- The Committee which was to be constituted in January 2000, was formed only in July 2004 i.e., after a delay of 4½ years

- The first meeting of the Committee was held in December 2005 only after a delay of 17 months wherein it simply noted the scope and coverage/terms of reference of the Audit Committee. The second meeting which was held in April 2006, discussed only the Annual Accounts.

- No review on the internal control system prevalent and its adequacy was conducted.

The Management stated (July 2006) that conduct of periodical meetings and other provisions pertaining to Audit Committee would be complied with in future.

Internal Audit

2.12 The Internal Audit Department (IAD) carries out the function of independent appraisal of the control mechanism in the Company with the objective of assisting the management by furnishing appraisals/ recommendations/pertinent comments on various activities. IAD also has the responsibility to report on the financial position of branches and bring to notice wasteful expenditure.

Internal Audit Manual was not prepared and reporting system was deficient. Scope and coverage of Internal Audit was inadequate.

A scrutiny of the Internal Audit functions revealed the following deficiencies:

- The Company had not prepared any Internal Audit Manual prescribing its area, scope, coverage, quantum, etc.

- Internal Audit Reports were not being submitted to the Board of Directors/Audit Committee.

- The Company's decision (October 2001) to implement the concurrent audit system has not yet been implemented. As on 1st August 2006, the IAD could complete the inspection of only 58 *per cent* of the branches planned up to 30 September 2005.

- There was considerable delay in settling internal audit objections, largely due to non-furnishing of clear and complete replies.

- Verification of outstanding observations by the inspecting team was not being done with the result that compliance of audit observations was not ensured.

  The Management stated (July 2006) that verification report was included in the summary report. The reply is not correct as the Audit scrutiny confirmed that no such report was being included.

- The Statutory Auditors had commented (2001-02 to 2004-05) about the inadequacy in the scope and coverage of the Internal Audit System prevalent in the Company, but no remedial action had been taken.

The Internal Audit system in the Company, thus, did not serve as an effective tool of Internal Control.

Vigilance Cell

Company did not have an effective vigilance mechanism

2.13 The State Government directed (1997) all the State PSUs to set up Vigilance Cells in various departments and Public Sector Undertakings. Accordingly a Vigilance Cell headed by one Deputy Superintendent of Police as Vigilance Officer (appointed by the Government of Kerala) was set up in 1998 by the Company. In January 2003, the officer had to relinquish charge as he was not found suitable and since then a Senior Manager from the Company has been serving as Vigilance Officer. The following deficiencies were noticed in respect of the Vigilance cell:

- Though the Government directed (1997) that the Vigilance Cell be provided with supporting staff for office as well as field work, the Cell was functioning without any supporting staff since inception.

- Proper documentation of activities/liaisoning with the Administrative Department/sending of periodical reports / returns, etc., was not being done. Details of number of cases detected, referred to Vigilance and action taken thereon were not being maintained. In the absence of proper documentation and follow-up, the Vigilance mechanism in the Company had been rendered ineffective.

Branch Automation

2.14 The Company operates various schemes (13 major schemes) through 266 branches functioning throughout the State. Considering the volume of business along with the number of branches and in order to minimise the lapses in the areas of preparation of demand, collection and balance statement (DCB) of chitties and loans, reconciliation of inter-office accounts, verification of multiple liability of loanee/surety/subscriber, etc., the automation of various functions/on line net working of branches was necessary. Though the Company started the computerization process in 1995 it has not completed the process even after 10 years.

The Management stated (July 2006) that systems/accessories had been delivered in 66 branches during April 2006 and that it expected to complete the installation by 30 September 2006. It further stated that single PCs had also been supplied to 186 branches where full automation was to be done in the 2nd phase. The reply does not explain as to why the computerisation process initiated in 1995 still remains incomplete though it is extremely important for enabling/strengthening the control function.

Internal control in major activities

2.15 The lending function in the Company involve the following major activities:

- Enrolment of subscribers and conduct of Chitties;
- Sanction of various types of loans detailed in paragraph 2.1 supra;
- Disbursement (obtaining security and documentation) and monitoring; and
- Demand and recovery.

The deficiencies in the internal control procedures in respect of the above activities are discussed in the succeeding paragraphs:

Enrolment of subscribers and conduct of Chitties

2.16 The main business of the Company is confined to conduct of chitties where it acts as a foreman. Chitty business is being regulated by the Kerala Chitties Act, 1975. The rules/procedures formulated on the basis of Kerala Chitties Act and Rules, 1975 for conducting chitty *inter alia* included the following:

- First instalment could be remitted by cheque subject to realization before registration of chitty.
- A subscriber cannot hold more than 10 *per cent* of the total tickets in a chitty.
- Every non-prized subscriber of chitties would be eligible for availing New Chitty Loan up to 50 *per cent* of sala after remittance of 10 *per cent* of the total instalments, provided the remittances were up to date.
- In case the subscriber committed defaults in remitting three consecutive chitty instalments, he should be removed from the chitty as per chitty rule.

In addition to the above the procedure to be followed and securities to be accepted were also provided for under the Hand Book of Schemes formulated by the Company. In the absence of proper internal control over chitty transactions and deviation from prescribed procedures, there was default in the payment of chitty subscriptions**.**

The default position in prized (both running and terminated) chitties and the collectable demand from 2000-01 to 2004-05 was as under:

Year	Collectable demand	Default
	(Rs. in crore)	
2000-01	1619.79	31.97
2001-02	2085.46	51.62
2002-03	2684.29	44.80
2003-04	2845.50	39.22
2004-05	3156.59	40.65

The Chitty default in prized category alone during the five years ended 31 March 2005 ranged between Rs.32 crore and Rs.52 crore.

It would be seen from the above that the default during the five years ended 2004-05 ranged between Rs.31.97 crore and 51.62 crore. Audit scrutiny revealed the following deficiencies in the system of chitty management which contributed to the default in chitties and non-recovery of overdues.

- The Manual of Procedure requires preparation of statements showing default in respect of non-prized subscriptions. No such statements were, however, prepared on the ground of non-availability of information in the absence of automation of branches. As such the default in payment in the case of non-prized chitties was not ascertainable.

- In the case of chitty default the Company had to substitute the tickets of defaulters and bear the liability of subscriptions for the purpose of payment of chitty prize money to successful bidders. For this purpose cost bearing funds collected by the Company (from the public towards sugama savings bank deposit and fixed deposit) had to be diverted. The borrowed funds so diverted for payment of prize money during the period 2000-01 to 2004-05 were Rs.60.51 crore, Rs.155.09 crore, Rs.214.10 crore, Rs.171.67 crore and Rs.84.70 crore respectively.

- Although the Company had 266 branches there was no system in place to ascertain the status regarding the number of tickets held by a person in various chitties in various branches. This was due to absence of on-line networking among the branches.

Credit worthiness of persons not ensured before admission to chitties.

- No checks/procedures were formulated for ensuring the paying capacity of persons admitted to chitties. In all the 111 cases test checked in audit this deficiency was noticed.

  The Management stated (July 2006) that they could not restrict the enrolment to chitties based on income criteria of the applicants and, based on the recommendations of Audit, strict directions were given to the managers to ascertain the paying capacity of the persons proposed to be enrolled in high denomination chitties.

- In the case of payment of first subscription money by way of cheque the encashment had to be ensured before commencement of chitty. It was, however, noticed that this was not being ensured. This irregularity persisted inspite of the Statutory Auditors having also commented about this.

- Although, as per Handbook of Schemes formulated by the Company subscription of tickets in a chitty was to be restricted to a maximum of 10 *per cent* of total number of tickets, subscribers were being allotted tickets in a chitty beyond the limits prescribed, and there was default by such subscribers in payment of subscription.

Defaulter in one chitty allotted tickets in other chitties.

- Subscribers who defaulted payment of subscription in one class of chitty were allotted tickets in other chitties as well disregarding their default status. The aggregate default in such cases amounted to Rs.21.90 lakh.

- For canvassing chitties agents were eligible for 20 *per cent* commission. Such agents were being paid the major portion (15 *per cent* to 17 *per cent*) of the commission in cash at the time of remittance of the first instalment itself. In the case of remittance by cheques, the Company did not monitor the realization of cheque. This resulted in loss on account of payment of agency commission by the Company to the agents when the cheques were ultimately dishonoured. Audit scrutiny revealed that 16 subscribers enrolled through agents had remitted only the first instalment and thereafter defaulted. The arrears amounted to Rs.28.37 lakh (March 2006). The agent should have been paid the commission proportionately based on the instalments realised instead of paying the entire amount in the first instance itself, so as to avoid loss.

  The Management stated (January 2006) that the progressive payment system for paying commission to chitty agents would not be attractive, since enrolment to chitties had become a tough job. The reply is not tenable as the Company should have devised a suitable system for payment of commission with a view to curtailing avoidable payments.

- As per guidelines a non-prized subscriber could be allowed to transfer/ assign his rights in a chitty to any other person, with prior consent in writing from the Company. It was noticed that a non-prized subscriber with five tickets in a chitty assigned two tickets to third parties after receiving Rs. 3.10 lakh as consideration towards the subscription remitted for the two tickets. While granting the permission for assignment, the Company did not reckon the dues (Rs.6 lakh) of the subscriber in the remaining three tickets of the same chitty and adjust the amount of Rs.3.10 lakh against the dues.

  Management replied (July 2006) that it would be looking into the matter seriously.

- The Company paid prize money on the security of salaried persons. However, there was no system in place to ensure that recovery from salary was enforceable through the employers. Due to this, recovery from salary could not be enforced. This deficiency was noticed in six cases involving an amount of Rs.3.77 lakh paid towards prize money.

Loans

2.17 Till 1993 the Company was conducting the business of chitty only. Thereafter for meeting the urgent needs of non-prized chitty subscribers a New Chitty Loan (NCL) scheme was introduced. Under this scheme the subscriber would be eligible for a loan of 50 *per cent* of the total chitty amount on remitting 10 *per cent* of chitty instalments without default. In addition to this the Company provides loans to the public under various schemes as detailed in paragraph 2.1 *supra*. The Hand Book of Schemes formulated by the company prescribes the procedures to be followed in respect of these Loans which *inter alia* provide for purpose, eligibility, securities, disbursement procedure, repayment, etc. Instructions through circulars are also being issued from time to time to ensure better control. The following deficiencies arising from non-observance of rules and procedures in the case of sanction/disbursement of such loans were noticed in audit:

- The Hand Book of Schemes prescribed sanction and disbursement of loans on personal securities. Loans were, however, sanctioned on the security of personal surety of salaried persons, the recovery against whom was not enforceable. Out of 72 cases test checked, nine cases in 3 branches (involving Rs.1.57 lakh) were found with such deficiency.

- The Company did not have in place a system to ascertain the liability of a loanee/surety, if any, in any other branches except in Reliable Customer Loan where the liability report of the loanee/surety was being obtained from the Head Office.

  It was further noticed in audit that the same person was accepted as surety in the same branch itself even without considering the liability (in other loans) or inadequacy of net salary to effect recovery. This indicated that even routine control procedures were not being followed before sanction of loans.

  The Management stated (July 2006) that it was considering introduction of a centralised liability verification system at Head Office with the help of computers, after full computerisation of branches. The reply is not acceptable as in the case of Reliable Customer Loan the Company could get the details where the details of liability of surety are furnished by Head Office itself and the same system could have been evolved in respect of other loans also.

- In order to avoid acceptance of forged salary certificates in the case of loanees and sureties, the Company had issued directions for verification through telephonic contact/direct contact (over and above the usual postal enquiry) with the officers who issued the certificates. However, in none of the 29 cases test checked, involving loan amount of Rs.13.98 lakh, this procedure was followed. The default in 16 cases out of these 29 cases amounted to Rs.4.63 lakh as on March 2006. It was further noticed that the Company advanced a loan of Rs.0.74 lakh during 2004-05 on the strength of a fake salary certificate.

The Management stated (July 2006) that stringent directions were given to the managers concerned to personally verify the genuineness of the sureties in future.

- In 26 cases involving loan amount of Rs.22.04 lakh, many columns in the agreements executed with the loanees and sureties were kept blank. In some cases, even the signatures of the loanees and sureties were not got witnessed. The dues in these cases amounted to Rs.12.08 lakh as on 31 March 2006. This deficiency defeated the purpose of execution of the agreement itself.

  The Management replied (July 2006) that strict directions would be given not to repeat the lapse in future.

- As per the guidelines in force, a non-prized chitty subscriber who had availed of Chitty Loan and defaulted remittance of three consecutive chitty instalments should be removed from the chitty as per chitty rules and recovery proceedings to realise the chitty loan amount with interest and cost should be initiated. It was, however, noticed that this procedure was not followed in four cases where the dues amounted to Rs.1.84 lakh (March 2006).

  The Management stated (July 2006) that from the very inception the non-prized defaulted subscribers were removed and substituted by the Company and recovery action taken against such subscribers. The reply is not tenable since in the cases mentioned, the Company financed the tickets of the defaulted subscribers after their termination and again allowed them to remit the arrears after two years and regain their status as subscribers.

Demand and Recovery

2.18 Defaults are common in the chitties and it would be possible to minimise these through formulation of an effective control mechanism. Judicious screening at the time of enrolment, prompt action at the initial occurrence of default and continuous follow up with subscribers would go a long way in reducing default. Recovery of loans and dues against chitties were important to the Company in order to plough back funds for recycling for operations of the various schemes.

The following deficiencies in the demand and recovery of loans were noticed in audit:

- The Company was not issuing notices and reminders to the loanees/sureties/Drawing and Disbursing Officers at intervals prescribed in the Manual of Procedure for remittance of dues.

- Direct contacts were seldom resorted to. The Company also did not have a regular system of sending teams to the field for effective follow up as prescribed for realization of dues. This lapse was noticed in all the six branches test checked.

- The Company was not preparing the Demand, Collection and Balance (DCB) statements in respect of chitties conducted and loans granted, due to which the Management could not exercise any control over demand and recovery.

  The Management stated (July 2006) that the system pointed out by Audit would be introduced in full measure along with full computerisation of branch activities within a couple of years.

Management of Non-performing Assets (NPAs)

2.19 The percentage of NPA in the loan outstanding under various schemes for the period 2000-01 to 2004-05 were as under:

Schemes	2000-01	2001-02	2002-03	2003-04	2004-05
New chitty Loan (Gross NPA)*	39.32	35.49	40.99	38.01	34.29
New Chitty Loan (net NPA)**	31.45	30.94	34.11	35.38	27.23
New Fixed deposit Loan, Reliable customer loan	0.85	26.42	18.32	10.62	5.08
Hire purchase, consumer vehicle loan	0.66	16.75	20.37	26.50	27.70
Trade finance scheme	2.09	31.97	37.05	39.40	35.75
New housing finance scheme	0.66	24.56	22.73	21.46	21.35

It would be seen from the above that the NPA under Hire Purchase and Consumer vehicle loan, Trade Finance Scheme and New housing finance scheme increased from 0.66 *per cen*t, 2.09 *per cent* and 0.*66 per cent* in 2000-01 to 27.70 *per cent*, 35.75 *per cent* and 21.35 *per cent* respectively in 2004-05.

The Company did not make borrower-wise classification of NPA as required under the prudential norms prescribed by the Reserve Bank of India. Statutory Auditors had also commented about this lapse in their reports for the period 2000-01 to 2004-05, but no action was taken by the Company.

Audit scrutiny further revealed that the high incidence of NPA in New Chitty Loan was on account of the following :

- Granting loans even before the remittance of ten *per cent* of the total instalments of chitty and Disbursement of loans without ascertaining the repaying capacity of the subscribers;

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* Gross NPA indicates amount of NPA in respect of subscriber loanees who defaulted chitty instalments as well as interest for more than six months.

** Net NPA indicates amount of NPA relating to loanees who defaulted interest payment only and not included under gross NPA.

- Allotment of more than 10 *per cent* of total tickets to the same persons;
- Non-removal of defaulters (more than three instalments) and non-initiation of recovery proceedings in time;
- Granting loans on the security of personal surety of salaried persons from whose salary the recovery was not enforceable;
- Absence of a mechanism to verify the multiple liability of loanee/surety; and of an effective system to verify genuineness of salary certificates.

Revenue Recovery Proceedings

2.20 After failure of the normal course of recovery action, the next option available to the Company is to initiate Revenue Recovery (RR) proceedings under the Kerala Revenue Recovery Act, 1968. The provisions of the Act were made applicable to the Company from June 1970. The Deputy Tahsildars (SDT) on deputation from the State Government were authorised to exercise the powers under this Act.

Amount pending revenue recovery increased from Rs.55.89 crore in 2001-02 to Rs.81.53 crore in 2005-06.

The amount pending under RR increased from Rs.55.89 crore (8717 cases) in 2001-02 to Rs.81.53 crore (17355 cases) in 2005-06. A review of the RR registers maintained in the branches covered and other documents revealed the following deficiencies:

- The RR registers maintained at the branches lacked vital information such as the number of accounts referred for RR and the amount due, number of accounts closed during the year and amount realised, cases pending for RR and the balance pending recovery, etc.

  The Management stated (July 2006) that it was taking steps to prepare and tally RR schedule of branches with those maintained at the Head Office, for which some more reconciliation of accounts was required.

- As per the instructions of the Head Office, cases of default exceeding 12 instalments should be reported for RR proceedings. Though the defaults ranged up to 26 instalments involving total dues of Rs.16.42 lakh (30 cases), these were not referred to RR.
- Abnormal delay in initiating RR action, ranging between 19 and 148 months, was noticed in reporting 339 cases (above 18 months default) involving an amount of Rs.1.86 crore.
- Delay in disposal/non-disposal of attached properties was noticed on the ground of low offers received. This was due to, among other reasons, overvaluation of the respective properties at the time of granting loans (Rs.3.34 crore).

The Management stated (July 2006) that the proportion of non-collection of dues owing to overvaluation was relatively small (8.6 *per cent*). Factors like recession, involvement of white money in RR auction sale, psychological hesitation to purchase RR property, procedural problems in the conduct of auction sale, etc., had contributed to failure of auction sales. The reply is not tenable since one of the reasons was the overvaluation of securities and substantial amount (Rs.3.34 crore) was involved in this. The locational disadvanatages of land accepted as security and other factors also contributed to non-disposal of securities.

- No scientific system had been evolved by the Company for valuation of property offered as security. There were no guidelines regarding fixation of value for different types of properties situated at various locations. There was also no system in place to countercheck the valuation report of the property by other agencies with a view to avoiding overvaluation, if any.

These matters were reported to Government in July 2006; their reply is awaited (August 2006).

Acknowledgement

Audit acknowledges the co-operation and assistance extended by the staff and the Management of the Company at various stages of conducting the performance audit.

Conclusion

The annual Budgets could not be used as an effective tool of internal control as these were neither finalised in time nor were the wide variations analysed. Functional Manuals had lost much of their relevance as these had not been updated after 1991. Stock records for receipt books were not maintained and as such the Company did not have control over its misuse as well as leakage of revenue. The Company did not have an effective vigilance set up. The objective of the Audit Committee has not been fulfilled as it was not constituted in time and, even after its creation, the Committee has only reviewed the annual accounts of the Company that too once. Since the Head office of the Company and branches were not fully computerized, it was not able to collect/generate the required reliable data for effective control. Internal Control in respect of conduct of chitties, sanction, disbursement, monitoring, demand and recovery of loans was weak and this resulted in increase in NPAs and accumulation of dues.

Recommendations

- ***Budgets should be prepared in time and on more realistic basis with a view to using it as an instrument of internal control.***

- ***The functional manual of procedure ought to be updated to ensure incorporation of latest schemes and adoption of latest best practices in the field.***

- ***There should be proper control over stock of receipt books to prevent defalcation/misappropriation.***

- ***The systems and procedures for loan sanction, disbursement and recovery should be made more effective.***

- ***The Internal audit system and the vigilance set-up require strengthening.***

- ***The functioning of the Audit Committee ought to be streamlined.***