CHAPTER III

PERFORMANCE REVIEWS RELATING TO STATUTORY CORPORATIONS

3.1 FUNDS MANAGEMENT IN KERALA STATE ELECTRICITY BOARD

Highlights

The Kerala State Electricity Board was constituted in 1957 with the objective of generation, transmission and supply of electricity to all classes of consumers in the State of Kerala. The Management of funds in the Board was centralised and looked after by the Financial Adviser under the supervision of Member (Finance). Audit noticed the following deficiencies in the management of funds:

- **Budget estimates were not prepared on a scientific basis with respect to schemes/projects to be executed during the ensuing year and the revenue budget did not portray a realistic estimate of the revenue and expenditure of the Board.**
- **The overall percentage of utilisation of capital receipts for capital purposes was only 26 and funds mobilised for creation of capital assets were diverted for debt servicing and for meeting revenue expenditure.**
- **Current ratio and debt service coverage ratio remained low indicating poor liquidity.**

(Paragraphs 3.1.1, 3.1.7, 3.1.8, 3.1.11 and 3.1.12)

- **There was deterioration in collection of revenue. Realisation against receivables decreased from 71 *per cent* in 2001-02 to 68 *per cent* in 2005-06. Arrears more than three years old constituted over 51 *per cent* of the total arrears.**

(Paragraphs 3.1.15 and 3.1.17)

- **The Board suffered interest loss of Rs.14.11 crore on excess/avoidable payments of transmission charges and advance income tax.**

(Paragraphs 3.1.23 and 3.1.24)

- **Non-incorporation of put/call option in the prospectus for Bonds issued resulted in interest loss of Rs.28.33 crore and future interest liability of Rs.19.51 crore.**

(Paragraph 3.1.27)

Introduction

3.1.1 Kerala State Electricity Board (Board) was constituted in 1957 under Section 5 of the erstwhile Electricity (Supply) Act 1948 (Act). The

Board is responsible for generation, transmission and supply of Electricity to all classes of consumers in the State of Kerala. The Act was subsequently repealed by the Electricity Act 2003 (New Act) effective from 10 June 2003. As per the second proviso to Section 172 (a) of the New Act, the Government of India and Government of Kerala mutually decided to continue the KSE Board as a State Transmission Utility (STU) and a Distribution Licensee. Government of India, Ministry of Power has allowed (June 2006) the same arrangement to continue up to 09 December 2006. As per Section 185 (2) (d) of the Electricity Act 2003 read with Section 69(2) of the erstwhile Electricity (Supply) Act 1948, the audit of accounts of the Board is entrusted to the Comptroller and Auditor General of India.

A seven member Board comprising the Chairman and six members look after all the activities of KSEB. The Finance Wing of the Board is headed by Member (Finance) who is assisted by Financial Adviser. Fund management is centralised and looked after by the Financial Adviser under the supervision of Member (Finance).

Scope of Audit

3.1.2 The present performance review conducted during the period from January to March 2006 covers cash management, collection and remittances of revenue, borrowings from financial institutions and management of receivables during the period from 2001-02 to 2005-06. The records available in the Corporate Finance Wing, Special Officer (Revenue) and Law Department in the Board office and Brahmapuram Diesel Power Plant, Regional Stores, Aluva, Buildings & Stores Division and Transmission Central Stores, Angamally were examined.

Audit objectives

3.1.3 The performance review of fund management was conducted with a view to ascertain whether the overall management of funds in the Board was efficient and effective by analysing whether:

- there was a well defined financial management policy;
- financial planning was adequate and took care of the funds requirement with reference to the physical targets envisaged;
- the allocation of funds was realistic and whether funds were utilised for the intended purposes;
- the funds raised were cost effective; and
- the internal resources were gainfully utilised.

Audit criteria

3.1.4 The criteria used for assessment of performance were:

- Government guidelines and statutory provisions;
- annual financial budgets and the variance between the budgets and actuals;

- periodical fund forecast statements;
- allocation of funds between revenue and non-revenue categories;
- agreements with lending agencies;
- financial ratios and effectiveness in management of receivables; and
- agreements with HT/EHT consumers.

Audit Methodology

3.1.5 Audit adopted the following methodology for attaining the audit objectives:

- Review of Government orders, guidelines and financial delegations;
- Analysis of annual and periodical budgets;
- Scrutiny of agenda notes, Board minutes, files relating to resource mobilisation from financial institutions and market borrowings;
- Review of files relating to selected HT/EHT consumers and records relating to banking transactions; and
- Stores records relating to four stores maintained at unit level.

Audit findings

3.1.6 Audit findings as a result of test check were reported to the Management/Government in May 2006 and discussed in the meeting of the Audit Review Committee on Public Sector Enterprises (ARCPSE) held on 4 August 2006, which was attended by the Principal Secretary to the Government of Kerala, Power Department and the Chairman of the Board. The views expressed by the members have been taken into consideration while finalising the review.

Audit findings are discussed in the succeeding paragraphs.

Budget and Actuals

3.1.7 In accordance with the provisions of the erstwhile Electricity (Supply) Act, 1948, the Board has been preparing the Annual Financial Statement (Budget) every year for submission to the State Legislature. It was noticed in audit that the budgets were being prepared by consolidating the unit level budgets and there was no system in vogue to verify the correctness of estimates submitted by the units. In the case of capital budgets the estimates were not prepared on a scientific basis with reference to the schemes/projects to be executed during the ensuing year.

Revenue Budget

3.1.8 A review of the Budget estimates for the five years ending 2005-06 vis-a-vis the actuals revealed that the budgets did not portray a realistic estimate of the revenue and expenditure of the Board as detailed in **Annexure 10**. It would be seen from the **Annexure** that in the case of sale, purchase, generation of power, subsidy, other non-tariff income and

There were wide variations in the estimates from year to year in case of sale, purchase, generation of power, subsidy, other non-tariff income and administrative and general expenses

administrative and general expenses etc., there were wide variations in the estimates from year to year. The percentage of actuals to estimates varied between 29 and 182 in the case of subsidy, 78 and 120 in sale of power, 74 and 115 in purchase of power, 28 and 92 in generation of power and 87 and 285 in administration and general expenses. During the year 2003-04, the actual expenditure on interest and finance charges was Rs.648.21 crore against the estimated amount of Rs.480.64 crore leading to deviation of more than 34 *per cent* of the budget. This was mainly due to payment of premium amounting to Rs.31.90 crore for swapping of loans and higher borrowings during the year. It was noticed in audit that the management failed to analyse the reasons for wide variations between budgets and actuals.

Capital Budget

The actual expenditure was much lower than the estimates due to provision in the budget for schemes/projects which were not actually implemented.

3.1.9 A review of the capital budget for the five years ended 31 March 2006, revealed that during the entire period, the actual expenditure was much lower than the estimate and the percentage of actuals to estimates was 69, 52, 39, 74 and 58 during the five years ended 31 March 2006 as shown in **Annexure 11**. The main reason for lower utilisation of funds as compared to budget estimates was non-implementation of several schemes (projects like Kuttiadi Tail Race, Athirappally, Malankara, Sengulam Augmentation, Arippara (generation projects), Master Plan for Cities, Capacitor Installation (System Improvement Works), etc.) for which budget provision had been made.

The Board/Government stated (March/August 2006) that on most items, the variance was within the tolerable limits and with the revised budget, the variation was within 10 *per cent* in respect of total income and expenditure. It was also stated that the Board was able to estimate the requirements accurately and borrowings were planned and sourced accordingly. The reply is not tenable as the Board approves the revised budgets for a financial year at the fag end of that particular year in the months of February/March and the revisions are based on actual expenditure. Since the fund management of the Board is based on the estimates projected in the Budget, it is essential that the projections should be realistic as far as possible.

Sources and Utilisation of funds

3.1.10 The sources of funds were receipts from sale of power, subsidy from the State Government, loans from the State Government, Banks and other Financial Institutions and market borrowings (by issue of bonds). These funds were mainly utilised for payment of power purchase bills, fuel, debt servicing, administrative costs and system improvement works of capital and revenue nature.

Capital Receipts and Expenditure

3.1.11 The following table shows the details of capital receipts and expenditure for the five years ending 2005-06:

(Rs. in crore)

Particulars	2001-02		2002-03		2003-04		2004-05		2005-06	
	Budget estimates	Actual	Budget estimates	Actual	Budget estimates	Actual	Budget estimates	Actual	Budget estimates	Actual
Loan from State Government including assistance from ♣APDRP,PMGY etc	190.00	14.84	150.00	53.16	290.00	15.65	100.00	42.71	100.00	66.28
Loans from Financial Institutions	1384.34	675.47	1640.00	1327.09	1277.32	1997.75	700.00	539.45	900.00	364.00
Receipts under OYEC♦ Scheme/ Service Connection Charges	100.00	130.07	100.00	155.88	100.00	185.26	120.00	201.23	212.00	265.85
Debts and deposits	200.00	168.58	200.00	632.13	350.00	529.97	249.64	990.63	847.96	776.37
I. Total Capital receipts	1874.34	988.96	2090.00	2168.26	2017.32	2728.63	1169.64	1774.02	2059.96	1472.50
Subvention from Government	(-) 801	…	(-) 557	(-) 815.57	(-) 429.49	(-) 450.97	…	(-) 342.77	(-) 492.25	(-) 144.58
Other Internal resources	(-) 424.34	(-) 375.83	(-) 864	(-) 873.77	(-) 822.83	(-) 1491.92	(-) 471.37	(-) 998.04	(-) 614.40	(-) 864.33
Total as per budget document	649.00	613.13	669.00	478.92	765.00	785.74	698.27	433.21	953.31	463.59
II. Capital Expenditure*	649.00	450.70	669.00	348.56	765.00	297.88	698.27	515.84	953.31	443.10
Percentage of utilization		45.57		16.08		10.92		29.08		30.09

The overall percentage of utilisation of capital receipts for capital purposes was only 26 and funds mobilised for creation of capital assets were diverted for debt servicing and meeting revenue expenditure.

It was noticed in audit that the actual capital receipts were more than the budget estimates except in 2001-02 and 2005-06 and the overall percentage of utilisation for capital purposes was only 26. During all these years the actual utilisation was only between 11 and 30 *per cent* except in 2001-02 when it was 46 *per cent* which showed that funds mobilised for creation of capital assets such as generating stations, transmission lines, sub-stations, voltage improvement schemes, etc., were diverted for debt servicing and for meeting revenue expenditure. This practice is in violation of Section 62 (1) of the Electricity (Supply) Act 1948 (since repealed by Electricity Act, 2003 introduced with effect from June 2003) which provides that no sum exceeding Rs.75,000 in the case of recurring expenditure or Rs.three lakh in the case of non-recurring expenditure shall be expended unless it is included in the budgets submitted to the State Legislature. It was also noticed that in the budget document presented to the State Legislature during 2001-02 to 2005-06 borrowings for capital purposes were inflated (by way of negative figures under other internal resources against capital expenditure in the above table) to the extent of Rs.5476.68 crore to accommodate the revenue deficits and repayment of principal and interest on loans.

During the five year period ended 31 March 2006, a total amount of Rs.3040.29 crore raised for capital purposes was utilised for repayment of loan. In the ARCPSE meeting, the Board agreed that in the capital budget negative figures such as subvention and internal resources were included and this was to tide over the revenue deficit especially the subsidy receivable. It was also stated that there were diversion of funds mobilised for capital purposes for revenue expenditure.

♣ APDRP : Accelerated Power Development and Reforms Programme
PMGY : Pradhan Mantri Gramodaya Yojana

♦ OYEC : Own Your Electric Connection

* Source-Scheme-wise progress report furnished to Government.

Financial Ratios

Current ratio and debt service coverage ratio remained low during the entire period indicating poor liquidity.

3.1.12 Financial stability of any organisation is assessed by analyzing various financial ratios. Some important ratios are:

- Current Ratio which shows the ability of the organisation to cover its current liabilities with its current assets.
- Debt Equity Ratio for measuring the relative proportion of external funds and shareholders' funds invested and indicates the soundness of long term financial stability of the entity.
- Debt Service Coverage Ratio which measures the fund available for servicing debt obligations.

As per the Asian Development Bank (ADB) covenant the standard for current ratio is two and that of debt equity ratio and debt service coverage ratio are one.

An analysis of the above three ratios revealed that the current ratio and debt service coverage ratio were low during the entire period indicating poor short-term liquidity and the debt equity ratio was high during the period up to 2004-05 with improvement in 2005-06 as shown below:

Particulars	2001-02	2002-03	2003-04	2004-05	2005-06
Current Ratio*	0.55	0.73	0.72	0.56	0.50
Debt Equity Ratio@	1.75	1.72	1.60	1.23	0.92
Debt Service Coverage Ratio#	0.68	0.52	0.41	0.49	0.54

The Government stated (August 2006) that current ratio was around two all these years. The reply is not tenable as the Board/Government have taken subsidy receivable and inter-unit debit balances as Current Assets and excluded security deposits from consumers from Current Liabilities.

Audit scrutiny revealed that poor liquidity led to the following:

- Debt servicing was made through further borrowings adding to the overall financing cost and poor performance.
- There was diversion of funds from capital to revenue affecting implementation of schemes/projects and resorting to high cost short term finance for projects.

Since the funds raised were pooled in one bank account, the individual cases of diversion for debt servicing and revenue purposes were not identifiable.

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* Current Ratio = Current Assets ÷ Current liabilities

@ Debt Equity Ratio = Debt ÷ Equity

Debt Service Coverage Ratio = Profit before interest and depreciation ÷ Interest and principal repayment on capital liabilities

Management of receivables

Subsidy receivable

3.1.13 The Board has been preparing its Revenue Accounts showing 3 *per cent* Rate of Return on Capital Base as surplus and the revenue gap to make up the return was being shown as Subsidy Receivable from the Government. The summarised position of the amount accounted as subsidy during the five years ended 31 March 2006 was as follows:

(Rs. in crore)

Particulars	2001-02	2002-03	2003-04	2004-05	2005-06
Sale of power	1994.33	2645.69	2969.22	3158.89	3590.11
Other income	47.52	61.27	91.52	98.13	102.62
Total income	2041.85	2706.96	3060.74	3257.02	3692.73
Total expenditure	3295.46	3641.75	3976.35	3496.28	3736.06
Revenue deficit	1253.61	934.79	915.61	239.26	43.33
3 *per cent* of capital base shown as surplus	62.83	80.78	91.82	103.49	101.26
Amount credited to revenue account as subsidy receivable from the Government	1316.44	1015.57	1007.43	342.75	144.59
Subsidy as percentage to income from sale of power	66	38	34	11	4
Subsidy as percentage to expenditure	40	28	25	10	4

It would be seen from the above that with reference to the Board's regular income from sale of power, subsidy constituted 4 to 66 *per cent* and it represented 4 to 40 *per cent* of the total expenditure during the five years ended 31 March 2006.

Accounting of huge amount as subsidy receivable over the years without cash inflow from Government had affected the liquidity position of the Board.

3.1.14 The Government issued (August 1995) orders to subsidise the short-fall in income of the Board to maintain three *per cent* rate of return. The order was issued mainly to facilitate the Board to avail of a loan of Rs.100 crore from Power Finance Corporation (PFC). There was, however, no firm commitment from the Government for reimbursement of deficit to make up three *per cent* return on capital base in the form of subsidy. Taking advantage of this provision the Board accounted for a total amount of Rs.6400.06 crore as income by way of subsidy till 31 March 2006 against which Rs.1914.71 crore only had been adjusted by the Government so far. The accounting of huge amounts as subsidy receivable over the years without actual cash inflow had affected the liquidity position of the Board. This only helped the Board to show better results of its working by covering up huge expenditure. It was noticed that the Board keeps on booking the revenue gap as receivable from the Government to show three *per cent* return on capital base despite no actual cash inflow for the last 10-11 years.

In the ARCPSE meeting, the Management stated (August 2006) that in view of the magnitude of the amount, the Board could not write off the amount shown as subsidy receivable. The Principal Secretary, Power Department assured to look into the matter.

Revenue Realisation

3.1.15 The income of the Board for the five years ending 2005-06 was as indicated below:

(Rs. in crore)

Particulars	2001-02	2002-03	2003-04	2004-05	2005-06
Revenue from sale of power	1994.33	2645.69	2969.22	3158.88	3590.11
Subsidies and grants	1316.43	1015.57	1007.43	342.77	144.58
Other income	47.52	61.27	91.52	98.13	102.62
Total	**3358.29**	**3722.53**	**4068.17**	**3599.78**	**3837.31**
Percentage of revenue from sale of power to total income	59	71	73	88	94

The main source of revenue of the Board was from sale of power. The revenue from sale of power represented 59 to 94 *per cent* of the Board's total revenue during the five years ending 2005-06. The position of receivables against sale of power, its realisation and arrears of revenue during the above period was as given below:

(Rs. in crore)

Year	Receivables at the beginning	Revenue from sale of power	Total	Collection	Receivables closing balance	Percentage of realisation to total receivables
2001-02	806.71	1994.33	2801.04	1994.32	806.72	71.19
2002-03	806.72	2645.69	3452.41	2414.21	1038.20	69.93
2003-04	1038.20	2969.22	4007.42	2782.15	1225.27	69.42
2004-05	1225.27	3158.87	4384.14	2893.10	1491.04	65.99
2005-06	1491.04	3590.11	5081.15	3475.21	1605.94	68.39

The rate of collection decreased from 71 *per cent* in 2001-02 to 68 *per cent* in 2005-06.

It would be seen from the above that the amount pending collection as at the end of each year was showing an increasing trend and the percentage of realisation to total receivables decreased from 71 in 2001-02 to 66 in 2004-05 and marginally increased to 68 in 2005-06. The decline in revenue realisation was mainly due to non-receipt of energy charges from the Government Departments, Local Bodies and Public Sector Undertakings and amount was blocked up under pending court cases in respect of HT/EHT consumers (Paragraphs 3.1.18 and 3.1.22 *infra*). As a result the Board had to depend heavily on borrowings at high cost.

Category- wise analysis of receivables

3.1.16 The following table shows year-wise dues recoverable from various categories of consumers during 2001-02 to 2005-06.

(Rs. in crore)

Category	2001-02	2002-03	2003-04	2004-05	2005-06	Increase in 2005-06 as compared to 2001-02 (percentage)
Domestic	17.22	14.40	2.44	4.90	4.33	(-) 74.85
Commercial	75.76	84.43	75.06	82.09	74.09	(-) 2.20
Public lighting	4.31	6.14	6.89	7.41	6.84	58.70
Irrigation & Dewatering	45.85	57.49	54.94	61.12	34.47	(-) 24.82
Public Water works	68.30	130.00	171.85	269.97	352.15	415.59
Industrial LT	18.93	25.76	29.28	37.30	41.62	119.86
Bulk Supply	9.62	14.34	25.74	31.42	17.75	84.51
Misc. C.C.	1.43	2.32	3.07	4.44	4.20	193.70
High Tension	97.56	136.41	148.43	163.24	137.97	41.42
Extra High Tension	284.27	344.25	408.73	450.76	481.34	69.32
Inter State	…	…	…	…	17.61	…
Total	**623.25**	**815.54**	**926.43**	**1112.65**	**1172.37**	**88.10**

The percentage increase of arrears in respect of Public Water Works, Industrial LT, Bulk Supply, HT and EHT consumers was 416, 120, 85, 41 and 69 respectively.

It would be seen that in respect of Public Water Works, Industrial LT, Bulk Supply, HT and EHT consumers, the percentage increase in dues was 416, 120, 85, 41 and 69 respectively.

Age-wise analysis of receivables

3.1.17 The details of category-wise, age-wise analysis of receivables as on 31 March 2006 were as given in the following table :

(Rs. in crore)

Category	Above 5 years	Between 3 and 5 years	Between 1 and 3 years	Between 6 months and 1 year	Less than 6 months	Total outstanding	Percentage to total outstanding
Domestic	0.80	0.62	0.59	1.21	1.10	4.33	0.37
Commercial	6.28	12.07	15.51	15.64	24.59	74.09	6.32
Public lighting	0.48	1.41	2.38	1.03	1.55	6.84	0.58
Irrigation & Dewatering	3.79	8.98	11.62	5.41	4.67	34.47	2.94
Public Water works	33.35	92.82	127.66	61.03	37.29	352.15	30.04
Industrial LT	4.90	5.34	13.14	9.21	9.03	41.62	3.55
Bulk Supply	…	…	7.17	5.04	5.53	17.75	1.52
Misc. C.C.	0.05	0.38	1.22	1.18	1.37	4.20	0.35
HT	33.24	50.87	26.83	12.79	14.24	137.97	11.77
EHT	242.47	101.78	106.51	19.26	11.32	481.34	41.06
Inter State					17.61	17.61	1.50
Total	**325.36**	**274.27**	**312.63**	**131.81**	**128.30**	**1172.37**	
Percentage to total outstanding	27.75	23.39	26.67	11.24	10.95		

51 *per cent* of total receivables were pending collection for more than three years and dues from HT/EHT and PWW consumers represented 83 *per cent*.

Out of the total receivables, 51 *per cent* were pending collection for more than three years. It would also be seen that a significant portion of total dues to the extent of 83 *per cent* were recoverable from HT/EHT consumers (53 *per cent*) and Public Water Works (30 *per cent*). Receivables to the extent of 69 *per cent* against the HT/EHT consumers were pending realisation for more than three years.

The Government stated (August 2006) that the Board had been making earnest efforts for achieving maximum efficiency in revenue collection and further improvement in collection efficiency was difficult on account of protracted litigations by private consumers and non-payment of electricity charges by the Government Departments and State PSUs. The fact remains that despite the efforts stated to have been made by the Board, the arrears in collection of revenue increased year after year.

Blocking up of funds due to pending Court cases.

Board's revenue to the tune of Rs.332.76 crore was blocked up in 312 court cases relating to 170 HT/EHT consumers.

3.1.18 As assessed by the Task Force constituted by the Board, as on 30 September 2004, Board's revenue to the tune of Rs.332.76 crore was blocked up in 312 cases relating to 170 HT/EHT consumers due to litigation arising from denial of pre-1992 tariff (a concession granted by the Government of Kerala for newly formed industrial units), non-payment of consumer deposit, non-installation of Time of Day meters (TOD)*, claims for duty exemption, imposition of penalty, etc. The Board had incurred Rs.16.90 crore towards legal charges during the five years ending 2005-06.

It was noticed that in a number of cases, consumers evaded payment by getting interim stay orders against disconnection notice issued by the Board. In spite of the fact that the Board had eight Standing Counsels (one Senior Standing Counsel and seven Additional Standing Counsels) at the Hon. High Court and eighty seven Standing Counsels at the subordinate Courts, inordinate delay was noticed in getting even interim stay orders vacated and also bringing up the cases before the Hon. Court for disposal. A few cases of inordinate delay in taking legal action came to notice during audit are discussed in **Annexure 12**.

It was further noticed in audit that follow up action of court cases were centralized in the Board Office and that there was absence of proper control and monitoring. Though 361 cases in respect of HT/EHT consumers were pending as on 31 March 2005, there was no system of short listing or prioritizing the cases for further follow up. The system needs to be restructured by deploying more competent manpower and also by decentralising petty cases involving small amounts. There was lack of co-ordination between the finance and legal wings in pursuing the cases and monitoring recovery to augment the funds position. Due to delay, in many cases private HT/EHT consumers were benefited.

The Government stated (August 2006) that proper follow-up action were being taken from the Board's side and written statement and counter affidavits prepared and transmitted to the standing counsels at the earliest to get early disposals in favour of the Board. In the ARCPSE meeting, the Management stated (August 2006) that despite the Board's efforts there were delays in the disposal of Court cases. The reply is not tenable in view of the fact that in respect of seven cases test checked, it was noticed that the cases dating back to 1997 were still pending disposal mainly due to lack of proper follow up. As

* Meters used to record the consumption of HT/EHT consumers during normal hours, peak hours and off-peak hours

a huge amount is blocked up due to Court cases, the Board should look into the fact as to whether consumers were taking advantage of deficiencies, if any, in the enabling rules framed by the Board.

Non-realisation of energy charges due to concession granted by Government in violation of statutes

Grant of concessions by Government, in violation of Electricity Supply Act 2003, resulted in non-realisation of Rs.80.41 crore from consumers.

3.1.19 Prior to formation of State Electricity Regulatory Commission (SERC) in November 2002 the electricity tariff was being fixed by the Board with the approval of the State Government. After the constitution of SERC, electricity tariff was being fixed with the approval of SERC. It was noticed in audit that even after formation of SERC, Government intervened and allowed concessions to the consumers resulting in revenue loss to the Board. A few such instances are discussed below:

3.1.20 As part of the revival proposal of Travancore Cochin Chemicals Limited (TCCL) the Government issued orders (January 2003) giving concession to the Company according to which power tariff was to be frozen at August 2001 level i.e., Rs.2.42/KWH of energy till the implementation of Barapole Hydel Project by the company in July 2004 and the interest on all arrears of electricity charges payable by the company had to be waived. The Government Order was silent on the manner in which the concession was to be compensated to the Board. TCCL was billed at the normal tariff on the ground that the full time members of the Board did not agree to the Government decision. However, in view of Government orders, TCCL paid the power bills as per concessional tariff during the period from November 2002 to March 2005 which resulted in accumulation of arrears receivable from TCCL. Kerala State Electricity Regulatory Commission pronounced (30 April 2004) the Government Order giving concessions to TCCL as null and void since these orders violated the authority of the Tariff Regulatory Commission. The allotment of Barapole Hydel Project had been cancelled (April 2004) by the Government. Total arrears as on 31 March 2006 amounted to Rs.77.41 crore excluding interest by way of undue concession extended to TCCL.

Thus, the decision of the Government to grant concession to TCCL without proper authority resulted in locking up of revenue which affected the ways and means position of the Board.

3.1.21 Indian Aluminium Company Limited (INDAL) another EHT consumer had been remitting current charges under protest on the ground that KSEB was not empowered to order revision of tariff in the context of enactment of the Electricity Regulatory Commission Act, 1998. In Kerala, the SERC was formed in November 2002 while the Board revised the tariff effective from October 2002 i.e., before the establishment of SERC. However, following the revision of tariff effective from 01 October 2002, the consumer paid the demanded amount up to November 2002 under protest and from December 2002, they were remitting current charges only at the August 2001 rates. Due to this short remittance, arrears payable by the consumer had accumulated.

Based on a representation from the consumer, the Government issued orders (April 2003) allowing relief of Rs.one crore per month for a period of three months. The financial commitment of this was to be shared by the Government and the Board equally. The consumer had unilaterally deducted the entire concession amount of Rs.three crore from the arrears due to the Board and the Government share of Rs.1.50 crore had not been received. In this case also, SERC had declared the relief given to INDAL by the State Government as null and void. In view of the SERC order, the concession of Rs.three crore granted by the Government as a relief to INDAL became unauthorized and the amount remained to be realised from the consumer.

Thus, due to grant of concessions by the Government in violation of Section 65 of the Electricity Act 2003 and failure of the Government to make good the loss, the Board could not realise Rs.80.41 crore being the value of energy sold to the above two consumers, even after a lapse of two years since issue of orders by SERC.

In the ARCPSE meeting the Principal Secretary, Power Department, agreed to look into the matter.

Dues from Government Departments/State Public Sector Undertakings and Local Bodies

The dues from the Government Departments and State PSUs increased from Rs.356.64 crore in March 2003 to Rs.797.48 crore in March 2006.

3.1.22 As on 31 March 2006 funds of the Board amounting to Rs.797.48 crore were locked up with Government Departments, Local Bodies and State Public Sector Undertakings by way of pending dues. The outstanding against the Government Departments and State PSUs increased from Rs.356.64 crore in March 2003 to Rs.797.48 crore as on March 2006 indicating an increase of 124 *per cent*. The matter was discussed (May 2004) in a meeting convened by the Chief Secretary and it was decided that Finance Department would provide necessary budget provision to liquidate the arrears of electricity charges of Government departments. The Secretaries concerned were instructed (May 2004) to issue directions to PSUs for payment of electricity charges including arrears. It was, however, noticed that no appreciable improvement in realisation of arrears had been made.

The Government stated (August 2006) that the Principal Secretaries, Power and Finance convened meetings of the Government Secretaries and other officials and as a result Rs.32.50 crore could be collected by the Board from Kerala Water Authority and Agriculture Department and follow up actions were being vigorously taken. It was, however, noticed in audit that compared to the arrears pending collection, the realisation was marginal and therefore Government's intervention in the matter was necessary.

Interest loss on excess payments

3.1.23 The Board had been paying monthly fixed transmission charges to Power Grid Corporation of India Ltd., (PGCIL) for two transmission systems (220 KV DC Kayamkulam-Edamon and Kayamkulam-Pallom lines) constructed (November 1998/December 1999) and maintained by PGCIL. Initially the charges were paid on provisional basis as fixed by the Central Electricity Regulatory Commission (CERC) and thereafter as per the final orders issued (03 June 2002 and 30 June 2003) by CERC in this regard. When the final orders of CERC were issued, it was found that the fixed charges paid as per the provisional tariff order were in excess. The excess amount paid to

The Board suffered interest loss of Rs.7.26 crore on excess payments made to PGCIL for fixed transmission charges.

PGCIL during the period between November 1998 and June 2003 amounted to Rs.42.45 crore and this was refunded by PGCIL (July 2002/August 2003). The excess amount was actually paid by the Board out of borrowed funds bearing average interest at 11.75 to 12.25 *per cent* per annum. The Board, however, failed to submit the claim to CERC in respect of interest amounting to Rs.7.26 crore pertaining to the period from November 1998 to July 2003.

The Government stated (August 2006) that as ordered by CERC, the Board had made payments (Rs.47 crore) due to PGCIL during 2005-06 without interest and had interest payment been adopted, the Board would have suffered major financial loss. The reply is not tenable since the excess provisional payment was made based on inflated claim submitted by PGCIL to CERC and the Board also failed to submit the claim to CERC even though they actually suffered interest losses. The contention that the Board may have to pay interest on reciprocal basis to PGCIL on short claims in other cases is not tenable since in such cases the excess claims were made by PGCIL only at the time of submission of demand before CERC. In the present case the Board failed to take up the matter with CERC at the appropriate time.

Interest loss on avoidable payment of Advance tax

Avoidable payment of advance Income Tax to NTPC resulted in locking up of funds entailing interest loss of Rs.6.85 crore.

3.1.24 The Kayamkulam Combined Cycle Power Plant (KCCPP) of National Thermal Power Corporation Limited (NTPC) was eligible for 100 *per cent* tax holiday as per section 80-IA of the Income Tax Act, 1961, available for enterprises engaged in infrastructure development. As per clause 7.3.4 of CERC Tariff Order dated 21 December 2000 also, the beneficiaries of new stations should get full benefit of the tax holiday and therefore the station wise/region wise profit before tax as estimated shall constitute the basis for distributing the tax liability of all stations/regions. Though no income tax was to be paid in respect of the Kayamkulam unit, the Board has been paying the tax along with the power purchase bills in proportion to the capacity of Kayamkulam unit to the total generating capacity of NTPC. The amount so paid by the Board for the period from April 2001 to March 2004 aggregated to Rs.36.80 crore and the same was refunded to the Board by NTPC in May 2003 and February/May 2004. Though the refund of this amount was received in May 2003 and February/May 2004, yet the funds were blocked up for a period ranging from seven to 32 months.

While the Board made payments to NTPC towards advance tax out of funds borrowed at the average rate of 10.58 *per cent* per annum involving actual interest liability of Rs.7.25 crore, NTPC had not paid interest on the refunded amount except a refund of Rs.23.38 crore against Rs.22.98 crore paid in 2001-02 towards Income tax. The interest loss due to avoidable payment of advance income tax to NTPC worked out to Rs.6.85 crore.

The Government stated (August 2006) that the interest on excess tax paid would be passed on to the Board only if the interest was allowed by the IT Department on such payments. The reply is not acceptable since KCCPP enjoyed tax holiday benefit, NTPC was not required to collect and pay any tax to IT Department. As such, question of passing on the interest received from IT Department on excess tax paid to the Board does not arise.

Non-rationalisation of security deposit of licensees

Due to different mode of collection of security deposit from HT and EHT consumers, Board could not collect Rs.1.33 crore.

3.1.25 The licensees of the Board for distribution of power comprised of EHT and HT licensees. As per the Board order (August 1997) the licensees had to deposit towards security, an amount equivalent to two months' electricity charges. While the mode of payment in respect of EHT licensees was 50 *per cent* by cash and the balance by way of bank guarantee (BG) the same prescribed for HT licensees was up to Rs.five lakh by cash and the balance as BG.

It was noticed in audit that due to the above differential treatment given to HT licensees in respect of mode of payment, the Board could not collect additional interest free amount of Rs.1.33 crore (up to 2003-04) from two HT licensees and utilise the amount for its working capital requirements. (One month's electricity charges: Rs.1.43 crore minus Rs.0.10 crore collected). Special status allowed to HT licensees on mode of payment of SD deprived the Board of funds amounting to Rs.1.33 crore besides benefit of reduction in financing cost of Rs.31.88 lakh.

The Board stated (March 2006) that the quantum and mode of remittance of each category of consumers were fixed after careful study and as per new State Electricity Regulatory Commission (SERC) regulations, interest on such deposits was payable. The reply is not acceptable as the Board has not given specific reasons for accepting BG in excess of Rs.five lakh from HT licensees alone and even after paying interest at six *per cent* (from April 2004) fixed by SERC on the Security Deposits, the cost of funds would have been beneficial.

Borrowings

3.1.26 The details of borrowings as at the end of the five years up to 2005-06 and receivables outstanding at the end of the year were as follows: -

(Rs. in crore)

Year	Govt. loans	Institutional loans	Total	Borrowings during the year	Receivables outstanding	Percentage of receivables to borrowings
2001-02	199.90	4572.01	4771.91	690.31	806.72	116.86
2002-03	253.06	4841.10	5094.16	1380.24	1038.20	75.22
2003-04	268.70	5086.96	5355.66	2013.38	1225.27	60.86
2004-05	311.41	4229.92	4541.33	582.16	1491.04	256.12
2005-06	377.69	3335.93	3713.62	430.28	1605.94	373.23

The borrowings were intended mainly to repay past loans, meet capital expenditure and to bridge the revenue gap. The borrowing of Rs.1380.24 crore in 2002-03 was primarily for repayment of loan amounting to Rs.1058 crore. The Board could bring down its outstanding borrowings from Rs.5355.66 crore in 2003-04 to Rs.3713.62 crore in 2005-06 by swapping of high cost loans and on account of increased revenue from sale of power.

The percentage of receivables outstanding to borrowings stood at 373 in 2005-06 against 117 during 2001-02. This was mainly on account of delay in realisation of energy charges from consumers. The heavy outstanding of uncollected amount indicate that the borrowings could have been reduced considerably through effective recovery measures in respect of receivables.

In the ARCPSE meeting, the Chairman, KSEB, agreed to the audit observation and stated that major portion of the receivables was due from the Government Departments/PSUs.

Loss due to non-incorporation of put/call option on issue of KSEB Bonds

3.1.27 The Board issued five series of Bonds (VI, VII, VII A, IX & X) aggregating Rs.1103.44 crore at interest rates varying from 15.25 *per cent* to 11.40 *per cent* per annum during the period between March 1999 and September 2002. The interest rates on institutional finance recorded a declining trend since 1999-2000. The Board, however, issued only the VI series and X series with put/call option and Series Numbers VII, VIIA and IX were issued without this option. The Bond series VII, VII A and IX were redeemable to the extent of 50 *per cent* at the end of the sixth year and balance 50 *per cent* at the end of the seventh year of issue. The same, however, could have been redeemed at the end of the fifth year under the put/call option. The VI series bond (15.25 *per cent*) was pre-closed at the end of five years in March 2004 by availing short-term loan from commercial bank at the interest rate of 8 *per cent* per annum.

Failure to incorporate put/call option in respect of Bonds issued resulted in interest loss of Rs.28.33 crore and future interest liability of Rs.19.51 crore.

It was observed by Audit that though the declining trend in interest rates was noticed by the Board as evidenced by incorporation of such a clause for Series VI issue, this clause was not incorporated in the issue of Series Nos. VII, VIIA and IX (13.25 *per cent* to 13.75 *per cent*). If the Board had included the options in the Bonds issued in July 1999, March 2000, and February 2001 it could have avoided interest loss of Rs.28.33 crore up to 31 March 2006 and future liability of Rs.19.51 crore, by exercising the call option for foreclosing the high cost bonds after the expiry of the five year lock-in-period.

The Government stated (August 2006) that in view of risk factors linked with such options, it would be prudent to have a combination of bonds with dissimilar features so as to even out the detrimental effects against the beneficial results. The reply is not tenable since the Board had not considered any uncertainty in borrowing rates and resultant risks at the time of issue of VII, VII A & IX series Bond and in fact there was an omission in considering the advantages of the option.

Delay in swapping high cost loans

3.1.28 There was a general declining trend in the interest rates on the loans since 1999-2000. Banks and other Financial Institutions reduced rates of interest on the then existing loans and evolved schemes to restructure the high cost loans into low cost loans subject to certain conditions. It was, therefore, advantageous for the Board to go for swapping/restructuring of the existing high cost loans so that there would be substantial saving in interest. It was noticed by Audit that the Board delayed the swapping of loans leading to avoidable payment of interest charges as discussed in the succeeding paragraphs.

3.1.29 As of March 2002 the Board had outstanding loans of Rs.1219.14 crore from Rural Electrification Corporation (REC) bearing interest rates ranging between 11.5 and 16 *per cent* per annum. The REC, in its Circular letter addressed to all the State Electricity Boards and other State

Delayed swapping of high cost loans resulted in loss of interest benefit of Rs.2.70 crore.

Power Utilities, announced (January 2003) their policy for swapping of loans with retrospective effect from 16 December 2002, thereby extending the benefit of current lower cost of funds to old projects/schemes also. Further, REC also finalised the guidelines on swapping of loans and intimated to all the State power utilities in March 2003.

The Board, despite being aware of the swapping scheme in December 2002 itself and even after receipt of detailed guidelines from REC, failed to effect swapping from March 2003. The swapping was done only on 20 June 2003 due to procedural delays. The outstanding balance of Rs.649.43 crore as on 20 June 2003 was swapped reducing the interest rate from 11.5 to 10.5 *per cent*. The additional interest burden arising from this on 504 loans from REC aggregating to Rs.649.43 crore for the period March 2003 to 20 June 2003 worked out to Rs.2.42 crore.

The Government stated (August 2006) that the guidelines on swapping of loans were finalised by REC only on 13 March 2003 and intimation was sent by REC on 27 March 2003 with cut off date on 20 June 2003 and also the ways and means position of the Board at that time was acute; therefore swapping could not be effected earlier to 20 June 2003. The reply is not acceptable since the Board was aware of swapping scheme of REC in December 2002 itself and model calculation was also forwarded by REC in January 2003 for availing of swapping. The Board, however, did not insist for swapping with retrospective effect on receiving the communication from REC indicating the cut off date as 20 June 2003. The question of ways and means for payment of premium also did not arise since the premium on swapping was being adjusted against future loan disbursements.

3.1.30 PFC had formulated a policy for swapping of high cost loans in January 2002 according to which the premium payable for swapping of loans was the discounted value of the interest loss during the balance period of loan maturity. The Board had outstanding loans of Rs.126.44 crore as on 31 August 2002 from PFC bearing interest rates ranging from 10.50 to 16.50 *per cent* per annum. PFC introduced a new debt restructuring scheme in August 2002 whereby loans would be restructured at the then existing lending rate on payment of 50 *per cent* of the premium. The premium would be the present discounted value of loss of interest during the balance period of loan maturity. The new scheme allowed part restructuring of loans and the quantum of restructuring in the financial year would be Rs.100 crore or 20 *per cent* of the outstanding loans whichever was less. The limit was further revised (November 2002) as Rs.100 crore or 20 *per cent* whichever was higher. Restructuring to current interest rate of 10 *per cent* (after rebate) was effected only in December 2002 (Rs.100 crore involving three loans in full and one in part) reckoning 31 December 2002 as the cut off date, paying a premium of Rs.8.55 crore. It was noticed by Audit that though the Board contemplated restructuring from November 2001 it did not take advantage of the new scheme immediately after its announcement by PFC in August 2002. Since PFC had intimated the new scheme to the Board in August 2002, the swapping of 20 *per cent* of outstanding loans (Rs.25.29 crore) could have been effected at least from 01 October 2002 (after allowing a reasonable period of 45 days for complying with procedural formalities) and the balance Rs.74.71 crore from 01 December 2002. It was also observed that even after considering the extra premium payable and interest thereon, there would have been a saving of interest amounting to Rs.28.18 lakh if the loan was swapped on two occasions i.e., in October 2002 (Rs.25.29 crore) and in December 2002 (Rs.74.71 crore).

The Government stated (August 2006) that the request from the Board for restructuring the loan under the new scheme (August 2002) was confirmed by PFC only in December 2002 and swapping of loans earlier to December 2002 was not possible. The reply is not acceptable since the Board made its request only on 29 October 2002 and restructuring with revised limit intimated vide PFC circular dated 18 November 2002 could be effected in December 2002 indicated that a reasonable time of 45 days was enough for complying with procedural formalities.

Excess payment of interest

3.1.31 The Board had been obtaining loans under the Bills Rediscounting Scheme of Industrial Development Bank of India (IDBI) for payment of supply bills. The value of materials paid to suppliers by IDBI was to be repaid in a period of five and a half years. The principal amount would be split into 20 usance bills of equal amount and paid along with interest in quarterly instalments. The rate of interest during the period of drawals was 13.5 *per cent*. The Board represented (February 2003) to IDBI to reduce the rate of interest in view of the general decline in interest rates. Reduced rates effective from 06 January 2004 were intimated by IDBI as 9.35, 9.40, 9.45, 9.50 and 10 *per cent* for usance periods of three, four, five, five and half, and seven years respectively. As the attempts of the Board to swap or preclose the loans were not fruitful; further re-discounting of supply bills was discontinued (2005-06).

There was avoidable interest liability of Rs.1.39 crore due to opting for higher usance period.

It was noticed by Audit that even after receiving intimation (January 2004) regarding reduced interest rates, the Board continued to opt for a higher usance period of five and a half years involving higher interest rate. During the period between January 2004 and March 2005, the Board had availed of credit of Rs.8.17 crore. By opting for the shorter usance period of three years with interest rate of 9.35 *per cent* for usance bills after January 2004 the Board could have avoided interest liability amounting to Rs.1.39 crore during the period January 2004 to March 2010 on the above credit amount.

The Government stated (August 2006) that the usance and applicable rate of interest were not the only parameter and liquidity factor had to be considered while choosing the period of usance bills. It was, however, noticed in audit that the Board did not choose the right usance period despite its favourable liquidity position.

Non-closure of high cost loans

3.1.32 During 2002-03, the Board obtained three loans of Rs.5.06 crore, Rs.8.32 crore and Rs.15 crore at the rate of 11.5 *per cent* per annum from Kerala Power Finance Corporation Limited (KPFC) for installation of capacitors and settlement of power purchase bills. Out of this, the loan of Rs.15 crore was closed on the due date of 01 July 2005 and the other loans of Rs.8.32 crore and Rs.5.06 crore, as per schedule of repayment, are to be closed by 30 May 2009 and 15 March 2009 respectively. Though the terms and conditions of these loans provided for premature settlement with three months advance notice without any extra charge the Board did not take any action for swapping/closure of these high cost loans.

Non-closure of high cost loan had resulted in interest loss of Rs.56.27 lakh.

It was observed in audit that during the month of December 2004, term loans were available from commercial banks at eight *per cent* per annum and the borrowing limits of the Board also permitted such borrowings. KPFC itself had sanctioned fresh loan at a rate of 6.35 *per cent* per annum during December 2004. Calculated at the differential rate of 3.5 *per cent* (11.5 *per cent* - 8 *per cent*) the interest loss on this account for the period up to March 2006 worked out to Rs.56.27 lakh on outstanding principal of Rs.17.66 crore against three loans as on December 2004.

The Government stated (August 2006) that the tenure of short term loans was too small and the suggestion of Audit to fore close long term debt by availing short term loans was against management principles. The reply is not tenable as during December 2004, the low interest term loans from commercial banks were available for five years period and repayment of these loans would occur only after the scheduled date of repayment of KPFC loans. Since the loan outstanding (December 2004) was only for an amount of Rs.17.66 crore, it could have been closed by availing low cost short-term/mid-term loans thereby avoiding the interest loss.

Payment of consultancy charges for un-availed portion of loan

Over estimation of project cost resulted in avoidable expenditure of Rs.20.85 lakh.

3.1.33 Based on the project cost of Rs.33.33 crore estimated by the Board, the Rural Electrification Corporation Limited (REC) had sanctioned (1997-98) a loan of Rs.33.33 crore through the Overseas Economic Co-operation Fund, Japan (OECF), an International funding agency, to KSEB for its system improvement projects. As per clause 15 of the loan agreement with REC the consultancy charges would be levied at the rate of 3 *per cent* of the total scheme/sub-project cost. The first instalment of the loan was released on 20 March 1998. While releasing the loan instalments, REC had deducted Rs.98.89 lakh towards consultancy fee. The Board, however, availed (March 1998 to January 2002) of a total loan amount of Rs.27 crore only including Rs.98.89 lakh charged as consultancy fee. Based on the actual cost of Rs.26.01 crore of the project, consultancy fee payable was only Rs.78.04 lakh i.e., 3 *per cent* on Rs.26.01 crore. Therefore, due to overestimation of project cost the Board had paid Rs.20.85 lakh towards consultancy fee on the unavailed portion of the loan as well.

The Board stated (February 2006) that as per clause 15 of the loan agreement consultancy charges at the rate of 3 *per cent* of the total scheme/project cost were payable and the request of the Board to waive the amount was denied by REC. The fact, however, remains that over estimation of project cost resulted in submission of application for excessive amount and avoidable payment of consultancy charges.

Payment of interest in advance outside the purview of the loan agreement

There was interest loss due to payment of interest in advance which was outside the purview of the loan agreement.

3.1.34 During the years 2002-03 and 2003-04, the Board availed of three loans of Rs.200 crore, 307.74 crore and 330 crore from KPFC at the interest rates of 11.75, 10.91 and 9.06 *per cent* respectively. KPFC mobilized the fund by issue of Non-SLR Bonds redeemable after seven years and ten years. As per the terms and conditions of the loan agreement the Board had to pay the interest half-yearly on the specified due dates. On request from KPFC, the Board paid an amount of Rs.8.24 crore on 04 February 2003, 01 September 2003 and 02 December 2003 in advance for the purpose of payment of interest on Bond application money to its investors, though such payment was not envisaged in the agreement. This amount was adjusted by KPFC subsequently (March/ December 2003 and February 2004) in the first half-yearly interest payment and the balance was paid on the due dates.

It was observed by Audit that by advancing the borrowed funds to the lending institution itself without charging any interest, the Board incurred avoidable interest loss on borrowed funds locked up for a period of 53 to 121 days. Calculated at the interest rate of the respective loans the loss worked out to Rs.20.07 lakh.

The Government stated (August 2006) that unless the Board advanced the amount KPFC would not be in a position to fund the interest due on application money.

The reply is not acceptable since the payment of interest on the application money to the subscribers of the bond was the liability of the KPFC and the Board, being the borrower, need not have advanced money for liquidating the lending institution's liability by incurring interest loss.

Acceptance of over subscription as long term loan

3.1.35 The Board requested (April 2003) KPFC for a long-term loan of Rs.300 crore for meeting its various capital payments. For financing the Board, KPFC issued Non-SLR Bond Series No. III which was to be redeemed at the end of seven years. The issue was oversubscribed to the extent of Rs.7.74 crore and KPFC requested (July 2003) the Board to accept this amount also as a long-term loan on the same terms and conditions. Thereupon the Board accepted (August 2003) the oversubscribed amount of Rs.7.74 crore at the same interest rate of the loan (10.91 *per cent*). The estimated capital liabilities of the Board was only for Rs.300 crore and there was no need for accepting Rs.7.74 crore as loan since short-term loan was available from banks at the interest rate of 8.5 *per cent* to 9.75 *per cent*, during the same period.

The Board incurred additional interest expenditure due to acceptance of over subscribed portion of bonds as long term loan

The Board thus incurred additional interest expenditure of Rs.23.56 lakh on Rs.7.74 crore from 16 August 2003 to 31 March 2006 calculated at the differential rate 1.16 *per cent*.

The Government stated (August 2006) that the terms and conditions for other loans involved Government guarantee as well as escrow cover making the task more difficult and hence the over subscription was accepted. The reply is not tenable since borrowing of the oversubscribed amount from KPFC was only a measure to help KPFC and in that process the Board had to pay avoidable interest since the average interest rate charged by commercial banks during the same period was around 9.15 *per cent*. The Board should have opted for funds bearing lower financing cost for short term purposes.

Failure to avail interest subsidy benefit

3.1.36 A loan of Rs.nine crore was sanctioned (March 2001) to the Board by PFC for civil works of Lower Periyar Hydel Generation Project covered under the Accelerated Generation and Supply Programme (AG&SP) and was eligible for interest subsidy at 4 *per cent* from 1997 to 2002 and thereafter at 3 *per cent*. The loan amount was released in two instalments of Rs.5.82 crore and Rs.3.18 crore on 29 March 2001 and 17 July 2001 respectively. The first tranche of loan of Rs.5.82 crore was released (March 2001) at the rate of 14.5 *per cent* without reckoning interest subsidy and the subsidy was allowed only from July 2001. The second tranche of Rs.3.18 crore was released (July 2001) at the revised interest rate of 13.50 *per cent*, again without giving the benefit of interest subsidy. The subsidy was allowed only with prospective effect from January 2002.

The Government stated (August 2006) that an amount of Rs.6.91 lakh had been received and the matter already taken up with PFC for speedy release of the amount.

It was, however, noticed that Board had failed to avail the benefit of interest subsidy under the AG&SP Scheme from the date of release of loan itself by initiating prompt follow-up action and an amount of Rs.16.08 lakh was remaining to be collected (August 2006). Thus, the failure of the Board to claim the benefit of reduced rate of interest from July 2001 to October 2003 and eligible subsidy during the period March 2001 to January 2002 resulted in avoidable payment of Rs.16.08 lakh after netting of the recoveries of Rs.6.91 lakh effected by the Board.

Failure to avail waiver of processing charges

3.1.37 During 2003-04 the Board had paid Rs.15.63 lakh towards processing charges to Syndicate Bank, Union Bank of India and Indian Overseas Bank (IOB) for the short-term loans aggregating Rs.175 crore. During the same period, for a loan of Rs.10 crore taken from South Indian Bank (SIB) no processing charges were paid. The Board, however, did not raise the issue of waiver of processing charges with the Union Bank and the Syndicate Bank. IOB was also addressed only after release (December 2003) of the loan. Subsequently, IOB and Syndicate Bank waived the processing charges to the extent of 50 *per cent* and 100 *per cent* in January 2004 and July 2004 respectively on future loans availed of from them. Thus, the absence of proper negotiation with the banks resulted in avoidable payment of processing charges amounting to Rs.15.63 lakh.

Absence of proper negotiation with the banks resulted in avoidable payment of processing charges

The Government stated (August 2006) that due to continuous efforts only, SIB had waived the processing charges and that on receipt of terms and conditions of sanction itself, the Board took up the matter with other banks to remove/modify unfavourable conditions and also to reduce processing charges. The reply is not acceptable as nothing was available on records to substantiate the contention of the Government.

Management of banking transactions

Delay in transfer of funds to Central Collection Account

3.1.38 The collections from consumers at the field offices of the Board were remitted to non-operative collection accounts and transferred to Central collection accounts. The local accounts were maintained primarily with State Bank of Tranvancore (SBT) and where SBT branches were not available, accounts were maintained with Canara Bank, Union Bank of India and Syndicate Bank.

As per the Memorandum of Banking arrangements (July 1991) with State Bank of Travancore, the balances in various collection accounts as at the end of the day would be transferred to Central Collection Account (CCA) of the bank the next day. The banking arrangement had been reviewed in October 2000 and renewed up to September 2002 and no such arrangement existed thereafter.

Failure of the Board to monitor transfer of funds by the branches of the bankers to the central collection account resulted in interest loss

On a review of the daily transfer of funds, it was noticed by Audit that during October 2002 to February 2005, there was delay ranging from one day to 1441 days (after allowing a grace period of three days) in 2359 cases for transfer of funds to CCA. As the balances in CCA are transferred to Cash Credit Account on daily basis any delay in fund transfer would attract interest in Cash Credit Account. At the average cash credit rate of 12.5 *per cent* per annum, the interest loss on this account worked out to Rs.23.44 lakh.

The Government stated (August 2006) that all cases of delay were promptly taken up with SBT along with claim towards interest. It was, however, noticed that Bank did not pay any interest for the delayed transfer of funds and as there was no valid agreement in force after September 2002, the Bank would not be liable to compensate for any delay.

Further it was also noticed that the Board continued payment of monthly service charges of Rs.12.50 lakh even after introduction of net working and core banking in SBT. In view of the fact that with the introduction of hi-tech electronic facilities in banks, services such as clearing of cheques, inter branch transfer of funds etc., are offered free of cost by many commercial banks, monthly payments amounting to Rs.12.50 lakh towards service charges lacked justification.

Delay in transferring loan funds to Overdraft (OD) accounts

3.1.39 The Board used to borrow funds for its capital and revenue requirements from financial institutions like Rural Electrification Corporation Limited (REC), Kerala Power Finance Corporation Limited (KPFC), Life Insurance Corporation (LIC) etc. Since these institutions were charging interest on loans right from the date on which funds were transferred from their bank accounts, these funds should have been credited to the destination accounts on the same day.

Delayed transfer of loan fund to OD account resulted in avoidable payment of interest

The Board had been availing of OD/cash credit from commercial banks to manage its working capital requirements. On a review of the relevant records it was noticed that there was delay ranging from two to 15 days in transferring loan funds received by banks from financial institutions to the overdraft account of the Board resulting in avoidable payment of interest of Rs.32.15 lakh at the OD interest rate ranging from 6.75 to 12 *per cent* per annum during the period from April 2001 to September 2005.

The Government stated (August 2006) that to avoid the delay alternative option given by REC was accepted and new account with HDFC was opened. It was, however, noticed by Audit that even after changing the bank (March 2002) for transfer of funds there was delay of two to five days which was mainly due to failure of the Board to identify and intimate the bank account to which transfers were to be made. By providing standing instructions for transfer, such delays and consequent interest loss could have been avoided.

Internal Control

Internal controls are essential pre-requisite for the efficient discharge of an organisation's functions and required for 'good governance'. These are procedures and safeguards that are put in place by the management of an organisation to ensure that its activities are proceeding as planned. Strict observance of these procedures/safeguards is vital in organisation dealing with substantial funds.

Misappropriation/Defalcation of cash

Due to absence of adequate checks and controls, there was misappropriation/defalcation of revenue collection of Rs.56.42 lakh

3.1.40 The Board has an internal control system wherein independent control over collection and disbursement exists. Collection and disbursement would remain independent of each other in all locations including the Head Office and the locations have no access to the funds collected by them. The Internal Audit of the Board is primarily concerned with the validity of transactions and balances i.e., to detect possible errors and irregularities by evaluating the handling and custody of funds, preparation and maintenance of records through observation and checking. In spite of such laid down procedures, Audit scrutiny revealed that in 15 Electrical Divisions of the Board the internal control mechanism during 2001-02 to 2004-05 was not effective in preventing defalcation of Board's revenue by its own employees. The amount of defalcation as reported by Audit in the Inspection Reports aggregated to Rs.39.75 lakh. In addition to this, misappropriation cases noticed by the Board involving Rs.16.67 lakh were also pending final disposal.

The defalcation was facilitated as a result of non-verification of daily remittances as per cash challans and the amounts actually credited in bank. If the daily remittances and the amounts credited in bank were verified on daily basis, the misappropriation could have been detected. It was also observed that minor penalties on cash misappropriation cases were imposed and the employees concerned were being reinstated into service after remitting the amount involved. Hence, recurrence could not be controlled effectively.

Cash flow analysis

3.1.41 As per the Commercial Accounting System Manual, the Board was required to maintain Daily Cash Fund Position , Daily Commitment Report, Daily Cash Flow Report and Monthly Cash Flow Reports. These statements were not prepared in the prescribed form. Ways and means projections were being made monthly and based on which financial planning was done. The Board had not prepared a Cash Book showing the daily balance of cash and balance available in various bank accounts. The Cash Book print out did not show daily balance of cash and only month-end balances were taken. In view of this cash balance at any point of time could not be ascertained. Due to non-preparation of cash flow statement as required in the Manual it would not be possible to ensure that financial management was being carried out properly.

The Government stated (August 2006) that the Board was maintaining various records as prescribed in the Commercial Accounting System Manual through which reports were generated for proper management and control of finance. The reply is not acceptable since fund management was not being carried out as prescribed in the manuals of the Board.

Acknowledgement

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

Conclusion

The Board had a centralised system of management of funds. The annual budgets prepared by the Board and submitted to the Government did not serve the purpose of funds management since the estimates not only widely varied from actuals but no analysis of the variation was also being done. Huge long term funds were sourced for debt servicing and meeting revenue expenditure. There was diversion of substantial portion of capital receipts for revenue purposes. The liquidity position of the Board was affected due to accounting of huge funds as subsidy receivable without cash inflow from the Government. During the period 2001-02 to 2005-06, realisation against receivables had decreased and Government Departments/State public sector units were the major defaulters. There was extra financing cost arising from delay in swapping of loans, interest loss due to excess or avoidable remittance of sums to Central Power Utilities. The inadequacy of internal control resulted in misappropriation/defalcation.

Recommendations

- ***The Board should put in place an effective system for preparation of more realistic budgets so that it serves the purpose of better management.***

- ***The Board should improve the revenue collection and recovery of receivables to augment the internal resources and avoid utilisation of capital funds for revenue purposes.***
- ***Measures ought to be initiated in time for reducing the financing cost by adopting better financing strategies like swapping, rescheduling, etc., of loans.***
- ***The system of collection, remittance and transfer of revenue, management of receivables and internal control should be made more effective and result oriented.***
- ***A more scientific and transparent system of cash and fund flow analysis should be devised on the prescribed lines to improve funds management.***

3.2 INFORMATION TECHNOLOGY AUDIT OF THE LOW TENSION BILLING SYSTEM IN KERALA STATE ELECTRICITY BOARD

Highlights

As the agreement for the development of software was executed after installation of the software, the Board could not ensure that Pricewaterhouse Coopers (PwC) delivered all the components of the software and provided system support during implementation

(Paragraph 3.2.46)

There were repeated invoice corrections without supporting documents which made the system unreliable.

(Paragraph 3.2.10)

Failure to demand Additional Cash Deposit (ACD), led to short recovery of ACD to the tune of Rs 13.37 crore in six Sections covered in audit.

(Paragraph 3.2.124)

Supervising officers failed to checkaccount daily cash collections (manual receipts) made during the period IT Systems were not working through manual receipts into the system leading to temporary misappropriation of collection.

(Paragraph 3.2.146)

There was no built in control over tariff classification appropriate to the purpose of use of connection.

(Paragraph 3.2.18)

As all non-traced consumers are classified as dismantled consumers, genuine consumers escaping billing cannot be ruled out.

(Pparagraph 3.2.235)

Several gaps in the system generated primary key fields like Customer ID, Invoice ID and Receipt ID, due to back end deletion of records, affecting the integrity of the database.

(Paragraphs 3.2.246)

Though the Board had formulated a policy regarding security of IT assets, lack of awareness among staff about the System security rendered the system vulnerable to unauthorised access and data manipulation.

(Paragraph 3.2.268)

The Electrical Sections failed to follow the instructions relating to regular external back up of data and offsite storage of back up involving risk of disruption of continuity of service.

(Paragraph 3.2.28)

Internal Audit was ineffective due to absence of training to the staff in conducting audit in the computerized environment.

(Paragraph 3.2.29)

Introduction

3.2.1 Kerala State Electricity Board (Board) is responsible for generating, transmitting and distributing electricity power in the State of Kerala. The Board has introduced computerizationcomputerisation in the areas of High Tension Billing, Low Tension Billing, Pay Roll, Accounting and Inventory Management.

In terms of an MoU signed (August 2001) between the Ministry of Power, Government of India and the Government of Kerala to for reform Power Sector, reforms, KSEB was to undertake computerizationcomputerisation of accounting and billing in towns by March 2002 for effective energy audit. An Indigenously Developed System (IDS) for Billing developed in Visual Foxpro platform was introduced during 2001 in eight Distribution Sections. In 2003 the Board decided to develop separate software using RDBMS* platform SQL Server with Windows 2000 Server as Operating System. The software for LT Billing, called "Jyothi" developed in association with Pricewaterhouse Coopers (PwC), was introduced in 177 out of 561 Distribution Sections during 2003-2005. The objective of computerisation of billing was to automate key revenue billing and collection activities in the section offices of the Board and to improve customer satisfaction. Between 2000 and 2006 (up to February), the Board spent Rs. 8.69 crore on the on purchase of servers, personal computers and connected accessories (Rs. 7.62 crore), licensed software (Rs.1.07 crore) for the implementation of LT Billing System.

Sale of power (SOP) in respect of all LT consumers is done through the 561 Electrical Sections. Invoices relating to sale of power to LT consumers are issued from the Section and payment collected at the Electrical Sections. KSEB at present follows two types of billing system viz., Monthly Billing System and Bi-monthly Billing System. All industrial consumers and consumers with connected load exceeding 10KW are billed monthly and the rest bi-monthly. The scoping document for the development of LT Billing System proposed the installation of an application software in Sections along with Personal Digital Analyser (PDA) appropriately programmed to automate the key revenue billing and collection activities. The process from new consumer registration to, billing, collection and reporting were to be covered by the system. Under the system, consumer data for area- wise spot billing was to be extracted to PDA and meter reading data based on which spot bills are printed, are uploaded to the system. It was proposed to enhance cash collection timings through double shift for better consumer satisfaction. Ten Data Centres were proposed to be set up across the state to have database redundancy and to facilitate common collection centres.

* Relational Database Management System

Organisational set-up

3.2.2 The IT needs of the Board are overseen by the Management Information System (MIS) department, which functions under the Member (Accounts). MIS Department is headed by Director (MIS) and has two Regional offices one each at Kochi and Kozhikode.

Scope and Methodology of Audit

3.2.3 IT audit was conducted to evaluate the IT general controls and application controls specific to computerised LT Billing system. The data pertaining to the period April 2004 to May 2006 made available to Audit in MS Access format was analysed using Computer Assisted Audit Techniques (CAAT) for checking of data completeness, regularity and consistency. In addition to the MIS department, Thiruvananthapuram, seven[*#] Electrical Sections where the software "Jyothi" is installed were covered in audit. As the same software is installed at 177 locations, only seven sections, five urban and two rural located in the southern, central and northern region of the state were selected to assess the general controls and operational issues.

Audit objectives

3.2.4 The Information Technology Audit of LT Billing System in the Board was conducted to ascertain whether:

- the LT Billing System was generating monthly/bi-monthly demands as per the tariff rate appropriate to the tariff classifications;
- the collection of demands was accounted correctly and the personal ledgers updated automatically;
- the system was generating accurately the reports required for day to day function of the Sections; and
- access to the System was restricted to authorised users.

Audit criteria

3.2.5 The audit criteria were as follows:

- business rules of the Board relating to preparation of demands and notifications relating to tariff revision;
- registers prescribed by the Board for recording amendments in billing parameters; and
- ***3.2.3*** electronic data through data extraction and queries to assess the data integrity, accuracy and completeness.The data pertaining to the period April 2004 to May 2006 made available to audit in MS Access

[*] Vellayambalam, Fort, Alappuzha North, Chottanikkara, Kaloor , Thiruvalla and West Hill
[#] Vellayambalam, Fort, Alappuzha North, Chottanikkara, Kaloor , Thiruvalla and West Hill

format was analysed using Computer Assisted Audit Techniques (CAAT) for checking of data completeness, regularity and consistency.

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Audit findings

The findings of audit are discussed in the succeeding paragraphs.

Software development

Non-fulfillment of contractual obligation byDelay in executing agreement with Pricewaterhouse Coopers (PwC)

3.2.43.2.6 The Board decided during (January 2003) to select SQL Server as the database and Windows 2000 server as the Operating System (OS). This was in consideration of the offer of Microsoft to develop the required software through PwC, free of cost. Though the Board accorded sanction (January 2003) for signing a tripartite agreement among the Board, Microsoft and Pricewaterhouse Coopers (PwC), the agreement was executed only on 25 February 2004.

Agreement with PwC was executed after developing software

Preparation of System Requirement Specification (SRS), development and customization of program acceptance testing and training were the responsibility of PwC. There was, however, no indication of the involvement of PwC or Microsoft after signing the agreement in February 2004. As the LT Billing System was introduced in Vellayambalam Section during December 2003 and the software required for introduction of the System in 80 sections was procured as early as in March 2003, there was no justification for signing an agreement with PwC during February 2004. As the agreement was signed after the development of software and no time frame was prescribed, audit could not ascertain whether PwC delivered all the components of the software in time and provided system support during implementation.The Board did not get any benefit out of the agreement signed after installing the software. Moreover it could not ensure that PwC delivered all components of the software and provided system support during implementation. Hence many deficiencies in the software remained to be rectified leading to defective billing as described in the succeeding paragraphs.

The Management stated (August 2006) that the software development started immediately after the Board's decision and PwC had associated with the Board, IT team all through the System Development Life Cycle and the delay in actual signing of MoU was due to the delay in getting draft MoU vetted by the Law Department of the Board and the other two firms.

It was, however, observed in audit Audit observed that many deficiencies in the software remained to be rectified leading to defective billing as described in the succeeding paragraphs. This was evidently due to the absence of involvement of PwC for enhancement/customization of program.

Absence of provisions in the LT Billing System

3.2.53.2.7 Though Jyothi 1.0 was introduced in December 2003 and was modified thrice, thereafter, the following essential provisions were still lacking in the system: three more versions were brought out after the introduction of Jyothi 1.0 the system lacked the following essential provisions:

The system did not have provision for Energy Audit

- Provision to capture the parameters relating to Energy Audit.
- Provision to capture the data relating to installation of capacitors by Industrial consumers.
- Facility to generate reports of revenue such as Monthly Report of Revenue required to be forwarded to the Division.
- Provision to store Meter reading exception Report, Consumption comparison report, invoice comparison report in respect of spot bills etc generated by the system for scrutiny during audit.
- Audit module to generate queries or reports for various audit purposes by the Internal Auditors and External Auditors.

The Management stated (August 2006) that Energy Audit Module would be included after Feeder Meter, Boundary Meter etc are installed for the purpose; Sales Revenue Data Module would be operationalised shortly and most of the additional reports required would be included in the next version. It further stated that an Audit Module would be incorporated in the next version.

System implementation

Delay in computerisation of the distribution sections

3.2.63.2.8 A Memorandum of Understanding (MoU) was signed on the 20 August 2001 between the Ministry of Power, Government of India and the Government of Kerala to reform the power sector in Kerala under the Accelerated Power Development Reforms Programme (APRDRP). As per the MoU, the Government of Kerala had to undertake computerisation of accounting and billing in towns by March 2002. As per the Memorandum of Agreement (MoA) signed (October 2002) between the Secretary, Ministry of Power and the Chairman, KSEB, the process of setting up the computerised billing centers was to be completed by March 2004 in three phases.

Even though computerizationcomputerisation of 80 sections was scheduled to be completed by March 2003 in the first phase and supply order was placed on 24 March 2003, the application software was ready only by December 2003. Against 200 Sections scheduled in the 2nd phase, supply order for purchase of hardware was placed only for 97 Sections during December 2003. Moreover, computerisation of the third phase of 280 sections scheduled to be completed by March, 2004, and the remaining 103 Sections in the second phase was commencedhas not started (June, 2006). As the implementation of computerisation had not been extended to the remaining Sections, one of the objectives of APDRP scheme viz. to enable the Board to conduct effective Energy Audit, could not be achieved so far (July 2006).

The Management stated (July 2006) that the delay in implementation of computerizationcomputerisation was due to time taken for various procedures connected with the procurement.

Delay in introduction of Personal Digital Analyzer for LT Billing

3.2.73.2.9 The Project Proposal submitted by Microsoft contemplated the use of Pocket PCs suitable for roaming user to help the meter reader to generate accurate bills at the door step of the consumer. The Scoping Document and User Manual also contemplated uploading of spot Bill data from Personal Digital Analyzer (PDA) a hand-held billing device to download data from the system, print demand and upload demand details into the system. electronically from meter without human intervention. The Board introduced two PDAs on trial basis at Vellayambalam Section to facilitate calculation of Energy charges and printing of invoices on the spot in order to reduce human intervention and avoid error due to data entry. The PDA was, however, not being used in the Section. There was no documented reason for discontinuing the use of PDA.

Bills of 95 *per cent* of consumers were prepared manually

It was noticed that computer generated bills were served to only less than five *per cent* of the consumers who were billed monthly and who accounted for 45 *per cent* of LT revenue in each Section. In these cases, meter reading was fed into the computer and demands were generated by the system. In respect of 95 *per cent* of consumers, who were mostly domestic consumers covered by bi-monthly billing, the details of meter reading based on which manual bills were prepared by the Meter Readers and the details of demand were subsequently fed into the system. This involved additional manpower for data entry, causing two to three days delay in data entry to facilitate cash collection, thereby reducing the seven7 days' time limit given to consumers for such remittance. Moreover manual input by the meter reader and subsequent data entry by the Senior Assistant increases the risk of data entry error and data manipulation.

While selecting the Microsoft product for LT Billing System, Government desired the device integration at Meter Reader level. However, in the absence of PDA, LT Billing System was reduced as a tool for compilation of collection. If the Board hads taken steps to introduce PDA in all the computerized Sections, there would have been a saving in man power to the tune of two Senior Assistants per Section. In cost terms the savings would be have been Rs. 2.40 lakh per Section per annum against the on investment of Rs 2.50 lakh per Section towards PDA.

The Management stated (August 2006) that the Computer System was fully equipped to implement PDA billing and the field trial at Vellayambalam was successful. It was also stated that full implementation can be carried out once the Board takes a Policy decision in the matter. The reply is not tenable as a A Policy decision in this respect should have been taken immediately after successful trial run for effective implementation of computerizationcomputerisation.

Application control

3.2.83.2.10 Any IT System should have Application controls to ensure the proper authorization, completeness, accuracy, and validity of transaction. This comprises of Input control and Process Controls. Analysis of data relating to six Sections using Computer Assisted Audit Technique revealed the lack of Input control and Process control as elucidated below:

Input control

Input controls are essential to ensure that the data received for processing are genuine, complete, accurate and properly authorized so as to prevent incorrect or fraudulent data entry. If input of consumer details, billing parameters such as meter reading, tariff category are not proper, it would adversely affect the reliability of data. Deficiencies noticed in audit with reference to due to absence of input control are discussed below:

Reduction in demand through Invoice correction

3.2.93.2.11 The demands generated by the system are revised using the provision for Bill correction based on complaints or otherwise. A scrutiny of the data relating to bill correction revealed that there was substantial reduction in demand in all the Sections covered in audit. As the fields such as calculated amount, billed amount and payable amount are replaced by the corrected value in the database and the consumption or meter reading based on which such invoice amount was altered was not entered in the database, there was no audit trail to verify the corrections. Though the corrections made were to be written in "Invoice Correction Register" there was no documentary evidence in support of such invoice correction. In the absence of such a documentary evidence the corrections made could not be vouchsafed in audit.

Reduction of demands to the tune of Rs 70.71 crore in six Sections

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The reduction in demand was to the tune of Rs 70.71 crore in six Sections in two years. **Annexure 13** indicates the magnitude of reduction in demand compared to the total collection which ranged from 17 *per cent* to 106 *per cent*.

Test check in audit of a few invoices revealed that Tthe Bill corrections register from January 2006 onwards maintained in West Hill Section did not indicate whether the corrections had been authorized by Senior Superintendent or Assistant Engineer. Out of 4407 invoice corrections, energy charge was reduced to zero in 1097 cases without authority. For example It was noticed in audit that in the case of a consumer, the meter was not readable and hence the system generated a bill for Rs 1,96,659 based on average consumption. The bill was, however, reduced to Rs 1805 charging only fixed charge and meter rent. No amount was realised towards energy charge. There was also no report as to whether the Assistant Engineer had conducted field verification and confirmed that there was no consumption. Non-collection of energy charges based on average consumption lacked authority.

Generation of highly inflated demands based on abnormal consumption was one of the factors contributing to substantial reduction in demand. This was due to absence of proper control over recording of meter reading or calculation of consumption and as a result the consumption based on which energy charges were calculated exceeded the maximum possible consumption with reference to connected load. In West Hill Section such abnormal demands were noticed in 948 invoices relating to industrial/commercial consumers.

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Repeated Invoice correction due to failure to rectify System data

3.2.103.2.12 It was observed in audit that invoice correction in the Distribution Section, West Hill, Kozhikode involved reduction in demand to the tune of Rs .20.73 crore. A sScrutiny of the database revealed that invoices of the same consumers were repeatedly corrected. Out of 6141 invoice corrections in respect of 3429 consumers carried out during the last two years, invoices were corrected on five5 to 28 occasions in the case of 180 consumers. It was also noticed that repeated correction on 28 occasions indicated that s (on 28 occasions) were made in respect of the on all the invoices issued to a particularone consumer. were corrected.

Invoices of 180 consumers corrected 5five to 28 times in last two years.

The system did not have proper control over recording of meter reading or calculation of consumption and as a result the consumption based on which energy charges were calculated exceeded the maximum possible consumption with reference to connected load in a large number of cases. Generation of demands based on abnormal consumption led to distribution of highly inflated bills to consumers and revision of bills later on.

An analysis of the causes of correction in respect of selected consumers revealed that the repeated correction became necessary due to the failure to modify master tables relating to Multiplication Factor, Meter Status and Meter Reading. This was evidently due to the absence of proper training to staff especially at Assistant Engineer/Senior Superintendent level, who were expected to analyse the cause of correction and ensure timely rectification of the defects so that such mistakes did not recur. .

The Management stated (August 2006) that the errors should have been rectified in the first occasion itself. It was also stated that Human Resource Development wing had been requested to arrange further training to staff and a circular was being issued to impose more control.

Incorrect data capture in respect of Cash Deposit

Amount of CD in the System did not tally with Register in 292 cases

3.2.113.2.13 The consumers seeking Electricity connections are required to remit Cash Deposit (CD). A tTest check of the details of CD amounts in respect of LT IV (Industrial) consumers in the Electrical Sections of Kaloor, West Hill, Chottanikkara and Thiruvalla in the System with the manual CD register revealed that the amounts in the system did not tally with the corresponding entries in the Manual CD register in 292 out of 1217 cases checked involving excess accounting of Rs .7.66 lakh in two Sections and short accounting of Rs .2.52 lakh in the other two Sections.

Supervising Officers failed to validate data entry

As per the instructions governing back data entry issued by the Board, Senior Superintendent/Asst Engineer(AE) was required to validate data entry and forward a Compact Disc containing back data along with a certificate to the effect that the data was verified and found to be correct. In view of the discrepancies noticed in large number of cases test checked it is evident that Supervising Officers failed to discharge their duties and hence the data in the system is not reliable for the purpose of additional CD collection or crediting of interest on the deposits to the Consumers account.

The Management stated (August 2006) that the responsibility for maintaining accuracy of data was with the Data Manager viz. AE of the Section.

Short collection of Cash Deposit-Rs 13.37 crore

Matrix identity: **H 3**
Matrix Weightage : **0.15**
Period : **2001-06**
Money value: **Rs.13.37 crore**
Weighted money value: **Rs.2.21 crore**

Short demand of CD amounting to Rs 13.37 crore in six sections

3.2.123.2.14 As per clause 13(4) of Kerala Electricity Supply Code, Cash Deposit should be not less than three times the monthly current charges for bi-monthly billed consumers and two times the monthly current charges for monthly billed consumers. Wherever there was shortfall in CD, the Sections were required to raise demands for Additional Cash Deposit (ACD). Analysis of data relating to CD/ACD collection in Vellayambalam, Fort, Alappuzha, Thiruvalla and West hHill, Kozhikode Sections revealed that CD was zero in certain cases. It also included nominal entries like one rupee, ten10 rupee much less the monthly minimum of Rs 85 payable by LT 1I consumers. Though there exists provision in the package for Mass Additional Cash Deposit calculation based on 12 months moving average of invoice, none of the Sections covered in audit raised ACD demand using the facility. As a result there was was the Assistant Engineers in six Sections covered in audit, failed to recover additional CD resulting in a short recovery of CD to the tune of Rs 13.37 crore in six Sections..

The Management stated (August 2006) that CD details of very old consumers and those migrated to other sections were not available and ACD demand would be issued as per rules.

Irregular marking of bills as disputed

Treatment of Bills as disputed lacked authority

3.2.133.2.15 As per the User Manual bills can become disputed vide court orders or as mutually accepted between the Board and the consumer. In case of dispute about metering equipment the meter should be replaced and the old meter sent for Technical Examination. On receipt of the Report the bills issued during the period of dispute would be examined and revised, if necessary. Audit scrutiny revealed that the report of litigation cases (Disputed Bills) under category LT VIIA generated through the system in Kaloor section contained 83 invoices involving Rs.9.07 lakh, but none of these related to 'court case' or 'awaiting technical examination report'. Moreover the bills marked as disputed were seldom followed up and released. It was also noticed that in West Hill Section 747 invoices were treated as disputed. No register of disputes was, however, maintained to watch the progress and to revoke the invoices intended for collection. In majority of the cases the reasons recorded in the system fell under the category "Wrong Bill". The practice followed by the Section in keeping invoices under disputes without proper authority was irregular and leads to delay in collection of dues to Board. . Due to irregular marking of demands as disputed and failure to revoke the demand, an amount of Rs. 41.32 lakh was The amount pending collection from Industrial consumers alone. was Rs 41.32 lakh.

Matrix identity: **G 3** Matrix Weightage : **0.20** Period : **2001-06** Money value: **Rs.0.41 crore** Weighted money value: **Rs.0.09 crore**

The Management stated (July 2006) that the procedure followed by the Sections was incorrect and such weaknesses in internal control would be addressed.

Lack of supervisory control over collection through manual receipts

3.2.143.2.16 As per User Guidelines, cash collection shall be done manually by issuing the manual receipts in the event of a system failure. As soon as the System is restored, all the collection taken manually should be entered in the system by the cashier and all corresponding reports taken. Audit scrutiny of the manual receipts issued by the cashier revealed glaring systemic deficienciesserious irregularities such as failure to account certain receipts, delay in accounting of receipts and use of manual receipts even on the dates on which there was no disruption due to System failure. as perThe details indicated are given in **Annexure 14**.

It is evident that the Senior Superintendent responsible for checking daily cash collection and accounting for the same failed to discharge their duty leading to temporary misappropriation of collection.

Absence of validation controls in data entry relating to demands

Invoice date was after Invoice due date in 130 cases

3.2.153.2.17 Invoice date, Invoice due date and Invoice disconnection due date are important parameters which affect calculation of fine, interest, disconnection etc. Audit scrutiny revealed that disconnection due date was on future date like 2008 in 20 cases and on much earlier dates in some 102 cases (31 12 December October 1900899) in West Hill Section; Invoice date was found to be later than Invoice due date in 130 records in five sections. This indicated that the due dates were not taken from the Billing cycle table and the system permitted arbitrary input of due dates.

Process control

Incorrect generation of report on Sale of Power (SOP)

3.2.163.2.18 There is a provision in the system for generating tariff category-wise summary of demand, collection and balance Report (SOP 14) of

Failure to include OB in the DCB report leading to negative balance

all consumers in the Section. It was, however, noticed in audit that the report generation relating to balance was incorrect as the system failed to include previous months CB as arrears in the report of the next month. Hence the balance pending collection in Thiruvalla Section was displayed as negative. The DCB Statement for the month of April 2006 generated from the system in the West Hill Section did not contain the figures for the opening balance, total demand and the balance. The number of consumers (14000) in the report was also largely understated (550). The figures of consumption also included abnormal consumption ignored for computation of energy charges.

As against an amount of Rs. 1.86.43 lakh crore pending at the end of April 2006 in Alappuzha North Section as per SOP 14 report, the sum of outstanding invoices pending collection was Rs 44.63 lakh. Thus, the reports generated by the System did not reflect the correct position of balance pending collection.

The Management stated (August 2006) that the tariff-wise break-up of arrears of non-domestic consumers could not be correctly worked out from manual records to include arrears. The reply is not tenable in view of the fact that As all the pre-system bills pending collection as on the specified date for switchover to computerizsation, were required to be entered into the System, but the it is evident that the Sections failed to comply with the instructions.

Failure to demand tariff minimum charge from domestic consumers

Short demand from domestic consumers Rs 2.67 lakh

3.2.173.2.19 Notification relating to tariff rate for LT consumers issued in October 2002 stipulated the payment of tariff minimum charge of Rs .30 for single phase domestic consumers and Rs .170 for three phase consumers. It was noticed in audit that the system failed to generate the minimum tariff charge of Rs .405 in respect of bi-monthly bills of several Phase 3 domestic consumers and Rs .85 ofrom phase one domestic consumers leading to short demand of Rs .2.67 lakh in five Sections.

Failure to link tariff classification to purpose of use

3.2.183.2.20 Electricity Tariff rate applicable to individual consumers is based on their tariff categorization according to purpose of use. Consumer category table contains a field to indicate the purpose for which power supply is used and another field stores corresponding tariff category in which the particular consumer is included.

No proper linkage between tariff and purpose of use

Audit scrutiny of the Consumer category table in West Hill Section revealed that the tariff category assigned and the purpose of usage had no proper linkage as shown below:

- Consumers categorized as domestic included consumers who had taken connection for industrial, agriculture and commercial purposes, Government Offices, educational institutions etc.

- Among 275 categorized under tariff for Industrial consumers, there were three consumers who had taken connection for commercial purpose and one for domestic purpose.
- Thirty four consumers categorized under tariff rate applicable for Agriculture connections included consumers who had taken connection for domestic and commercial purposes and Educational Institutions.
- Same type of Institutions has been grouped under different categories.

Similar misclassification of tariff was noticed in other Sections. Wrong categorization of consumers leadss to loss of revenue to the Board/Government due to application of lower rate for energy charge, fixed charge and electricity duty. Notwithstanding the absence of a built-in provision to assign tariff code with reference to purpose type code and reassign tariff as and when purpose code is changed, the Assistant Engineers should have taken special care in assigning tariff code.

The Management stated (August 2006) that the consumers have been assigned appropriate tariff category but there was omission to update the purpose type code whenever there was change in purpose of use. It was also stated that the properties ‘‘purpose’’, ‘‘tariff’’, ’‘user’’ and ‘‘consumer category’’ would be linked to prevent such mismatches in the database.

Non reckoning of unit of connected load for billing

3.2.193.2.21 Connected load is the basis of levy of Fixed charge from non-domestic and industrial consumers. The total connected load of the consumer is stored in Customer Connected load table with the unit of connected load recorded in Watt or KW. Audit scrutiny revealed that in majority of the cases the load was shown according to the wattage of connection with the unit shown as KW. It was further noticed in audit that if a consumer hasd a connected load of five KW, then in the system it would be shown as 5000 KW. As a result the total connected load of all consumers in a Section itself exceeded the total generating capacity of the Board, an obvious impossibility.

Lack of control over calculation of consumption

3.2.203.2.22 The system has provision to capture closing reading and opening reading, meter condition and bill cycle during monthly/bi-monthly billing. Closing reading of previous month becomes opening reading of next month and the opening reading is printed in the spot bill. In the case of Door Lock both opening and closing reading will be the same. In the case of Meter exchange initial reading of the new meter and final reading of the old meter are to be captured in Consumer Meter table. Audit scrutiny of the table in West Hill Section revealed the following:

- Calculation of consumption was not equal to previous reading minus present reading in 27,682 records. These included 3,777 door locked cases where both readings should be equal, and 18,253 cases categorized as “Available and accepted”. As the processing logic should be consistent for all cases, the exceptions indicate that authorized but invalid or unauthorized changes made into the system cannot be ruled out.

- Calculation logic was based on actual consumption in 2,10,507 records, based on average consumption in 7,782 records and blank in 4,973 records. Moreover out of the cases where consumption was recorded as based on average, meter condition was depicted as OK in 6,954 records. Out of 4,933 where calculation logic was blank, in 4,903 cases meter condition was also shown as OK. Thus, clearly when the meter was OK, the system generated bills on average consumption only and should be rectified.

Similar discrepancies were noticed in audit in all the Sections covered. This indicated that the system lacked control over calculation of consumption.

***3.2.21*Incorrect generation of disconnections list**:

Incorrect generation of disconnection list

3.2.23 The Disconnections list generated from the System at West Hill as on 15 May 2006 showed that 196 consumers were due for disconnection for non payment of arrears. Audit scrutiny revealed that the list contained many duplications and that only 37 consumers were actually due for disconnection. These included eight consumers with arrears of Rs.3,14,136 who had defaulted for more than six months. As a result, the consumers appeared in both the ‘‘Disconnection List’’ and the list of ‘Consumers Defaulted for more than six month’.

The Management stated (August 2006) that the disconnection list generated by the system was not believable and hence the Section relied on manual Consumer Personal Ledger for disconnection.

Deficiencies in consumer data

Incomplete data relating to consumers

Connected consumers were shown as not billable

3.2.223.2.24 Customers’ table contains the details of consumers in the Section. A scrutiny of the database revealed that some of the connected consumers were shown as not billable though as per user manual, all connected consumers would become billable automatically on first meter reading entry.

It was also noticed that some of the dismantled consumers and consumers who had closed their account were also shown as billable. Thus, the system did not have control to ensure that all connected consumers were billed without fail.

Customer name and address blank in several records

The database contained several records where the name of consumer was blank. Due to absence of input validation junk characters were also seen entered against the name. The database also included several records where consumer’s permanent/temporary address was blank. Section –-wise position is indicated in **Annexure 15**.

Due to improper maintenance of database, the number of consumers actually connected and their name and address could not be correctly ascertained from the system thus seriously limiting the data's usefulness as MIS.

Improper grouping of not-traced consumers as Dismantled consumers

Data of dismantled consumers were not verified and brought to billing

3.2.233.2.25 As per instructions issued at the time of switch over to computerizationcomputerisation, all 'not traced connections' were to be included under dismantled category. Consumers are dismantled on specific request or if disconnected for six months due to failure to remit dues. As the date of the dismantling field was zero in most of the records, it is evident that proper verification was not conducted at the time of switch over to the computeriszed system or thereafter. As the list included known consumers like Government Offices, High Schools etc., the possibility of genuine consumers having escaped escaping billing cannot be ruled out.

The Management stated (August 2006) that the dismantled consumers included those transferred to nearby Sections on forming new Sections. Such consumers should have been verified and excluded from the database at the initial stage of computerizationcomputerisation.

Lack of integrity of customer data

Several gaps in Customer ID indicating deletion of records

3.2.243.2.26 Customer ID is a unique field generated by the System to identify a consumer. These codes are to be protected against modification and deletion to ensure the integrity of the database. Audit scrutiny, however, revealed that there were several gaps in the Customer ID in the Customers table and the customer related table as per details given in **Annexure 16**.

Several missing invoices in the database

Invoice No is another unique number generated by the System to identify the invoice of a consumer. A s Scrutiny of the database relating to demands revealed that there were several gaps in Invoice Number involving 7218 missing invoices in five Sections.

Continuity of invoice numbers and validation of due dates are important parameters for billing. Missing numbers indicate possible back end deletion of records of demand without authority compromising IT security and integrity of database.

The Management stated (August 2006) that there was provision for deletion of records at the early stages on cancellation of Reconnection Fee and Surcharge Bills, but the provision was removed later. The reply is not tenable as it was noticed that the facility still existed in the front-end in respect of ex-system bills and pre-system bills. Facility for deletion of records which obliterates the audit trail was not conducive to data security.

Several Missing receipts indicating misappropriation

In view of the varying number of records and missing unique ID the information generated out of the System was not reliable. Deletion of records of receipt indicated could be a result of misappropriation of collection. Though as per User manual, access to database is denied to users in the Section, the integrity of the system appears to have been compromised through unauthorised back end correction.

Discrepancies between manually prepared and system generated reports

Wrong categorization of Government consumers led to incorrect generation of GB arrear report

Figures of Demand and collection in

Figures of Demand and collection in Manual report did not tally with System generated report.

3.2.253.2.27 The Section office is required to prepare a number of statements like Demand Collection Balance (DCB) statement, Monthly report of revenue collected, disconnection list, Government Building arrears, etc., for onward transmission to the Divisional office. Even though some of the reports could be generated from the System, the West Hill Section was relying only on manually prepared reports. A comparison of the manually prepared reports and the system-generated reports revealed the following discrepancies.

Government Building Consumer Arrears Statement:

- The total arrears as per the computer generated report in West Hill Section as on 15 May 2006 was Rs.4,63,861 (in respect of 17 consumers) but the manual report showed the arrears as Rs.2,95,059 (in respect of four consumers). Thus, 13 consumers included in the System did not find a place in the manually-prepared list.
- Further, tThe Report generated in the Electrical Section, Alappuzha (North) on 2 May 2006 indicated that only Rs 1,578/- was due from the Kerala Water Authority (KWA).It was noticed that as per the Statement 'Current charge arrears from Government Departments and Public Sector Undertakings' of March 2006 prepared by the Section for onward transmission to the Divisional Office, the dues from the KWA amounted to Rs.11,44,04,478. Audit scrutiny revealed that the consumers were wrongly categorized as "Ordinary Consumer" instead of KWA consumer and hence the arrears of these consumers did not reflect as arrears due from KWA

DCB Statement:

- Figures in respect of Demand for the month of April 2006 (Rs.85,32,400.21) and the Total Demand generated (Rs.83,43,048) from the System at West Hill Section also differed from the figures prepared manually. Similarly, against the total collection of Rs.79,04,801 for the month of April 2006 as per the manual DCB, the collection as per the System generated DCB was Rs.89,38,525.98.

Thus, the Board failed to ensure that the output generated, was complete and accurate.

General IT controls

Inadequate IT Security

There was no documented Password Policy

3.2.263.2.28 The Board has an IT Security Policy for the security of IT Assets, including data. The following lapses were noticed in audit:

- Absence of a well defined and documented Password Policy leading to sharing of password of the Senior Superintendent (SS) by the Senior Assistants and Daily wage staff.

Password of SS was shared by others for unauthorized access

- Failure to disable the access right of the retired/transferred employee facilitating unauthorized access to the System

Thus, inadequate access control rendered the system vulnerable to unauthorised access and data manipulation.

The Management stated (July 2006) that a comprehensive training programme covering all aspects of IT Security was scheduled to begin shortly and after training the security environment would improve. It was also stated that a comprehensive password Policy would be formulated and circulated shortly.

Absence of segregation of duties among IT staff

Role of DBA in Sections is not specifically assigned to a person

3.2.273.2.29 It was noticed in audit that no officers were separately entrusted with the duty of System Development Manager, Librarians, Security Administrator and Network Manager. Though no user in the Section Office has right to access database, Audit scrutiny revealed several back end corrections in data were noticed during audit. The person responsible for back-end correction could not be identified as the role of Database Administrator (DBA) in respect of Sections has not been specifically assigned to any person.

Failure to adhere to stipulated backup procedure

3.2.283.2.30 Audit scrutiny revealed that no external backups were being taken during the last several months in the Alappuzha North Section, as the tape drive was defective and there was no CD drive. There was no Back up Register at the Vellayambalam Section.

No external back up taken for several months

The absence of regular back up enhances the risk of inability to provide continuous computing services and increase the risk of unauthorized changes to the backup database.

The Management stated (August 2006) that a circular was being issued to all Assistant Engineers reminding them on the importance of back up.

Ineffective Internal Audit

3.2.293.2.31 Regional Audit Offices under the Chief Internal Auditor are responsible for the audit of revenue collection in the Distribution Sections of the Board. Consequent upon the introduction of computeriszation and the discontinuance of manual records, the Internal Audit wing could not conduct audit effectively as the staff were not trained in the use of LT Billing System and there was no audit module in the software. Though the Auditors Manual prescribed certain procedure/checks to be followed/conducted in computerized Sections, it was noticed in audit that such checks were not carried out.

As such the comments in Internal Audit Reports were confined to short recovery of FC due to failure to instal capacitors and non installation of

Internal audit failed to adopt computer based auditing technique

separate light meter, etc., based on manual ledgers. Though short collection of energy charges due to wrong application of tariff etc could have been detected by adopting Computer Assisted Audit Technique, no such step was taken. As the inaccuracies in the Billing parameter entries and tariff categorisation would result in repeated incorrect bill generation and the existing rules did not permit raising of additional demand in respect of past cases, the Board has lost substantial revenue due to delay in conducting internal audit in the computerized Sections. It was also noticed that there was also no machinery to monitor user logs to detect unauthorised modification of data, making the system vulnerable to misuse.

The Management stated (August 2006) that additional reports suitable for audit would be incorporated.

The above matters were reported to Government in August 2006; their replies are awaited (September 2006).

Conclusion

The Board,T though it was envisaged computerization ofthat all distribution Sections would be computerised by March 2004, only 33thirty three *per cent* of Sections have been computerised. Moreover, due to failure to introduce Personal Digital Analyser for generating invoice at the door step of the consumer, 95 *per cent* of bills were being generated manually and were subsequently fed into computers increasing the risk of data entry errors and data manipulation. The system was not generating bills as per business rules, as controls over input of data were poor and processing was erroneous in many cases leading to continuing revenue loss to the Board. Lack of awareness among staff about the system security rendered the system vulnerable to unauthorized access and loss of data integrity.

Recommendations

The Board should urgently initiate steps to:

- ***Set up Data Centres with facility for centralised processing of data, minimizing scope for data manipulation and enforcing rigidity in data input to avoid process errors.***
- ***Introduce PDA to fully automate the billing process and reduce manual work.***
- ***Scrutinise thoroughly all manual collections from March 2004 onwards at all computerized Sections to assess the quantum of receipts that have escaped escaping accounting in the system.***
- ***Revalidate back data relating to customer CD, connected load, etc., and update the database to make the system reliable.***
- ***Rectify inaccuracies in report generation and include additional reports suitable for day to day use of the Section and for MIS***

purpose with facility to upload the reports to Accounting software at Division level and MIS at Circle level.

- ***Scrutinise thoroughly the list of dismantled consumers to identify live consumers escaping assessment***
- ***Strengthen Internal audit by imparting training in Computer Assisted Audit Technique and develop effective Audit Modules suitable to Internal Auditors and External Auditors.***

Develop effective Audit Modules suitable to Internal Auditors and External Auditors

- ***Strengthen System Security and Business Continuity Planning by imparting properimparting proper user awareness training.***

3.3 SANCTION AND DISBURSEMENT OF LOANS IN KERALA FINANCIAL CORPORATION

Highlights

There was shortfall in achievement of targets in respect of sanction and disbursement of loans during the period 2001-02 to 2005-06. The shortfall as compared to targets in sanction and disbursement of loans ranged between 21.49 to 53.19 *per cent* and 38.25 to 61.15 *per cent* respectively during this period.

(Paragraph 3.3.13)

Non-inclusion of put/call option in the prospectus for issue of Statutory Liquidity Ratio bonds resulted in loss of Rs.3.83 crore.

(Paragraph 3.3.10)

Loans granted without proper/sufficient security resulted in non-recovery of overdue amount of Rs.5.53 crore in nine cases.

(Paragraph 3.3.16)

Inadequate appraisal of project, lack of sufficient expertise to run the Project and non-adherence to conditions of loan resulted in non-recovery of overdue amount of Rs.1.18 crore.

(Paragraph 3.3.21)

Non-insistence of condition on promoters contribution as well as repayment of loans through escrow account and disbursement of loan for purposes other than for which it was sanctioned rendered Rs.3.94 crore as NPA.

(Paragraph 3.3.25 and 3.3.30)

Introduction

3.3.1 Kerala Financial Corporation was established in December 1953 under the State Financial Corporations Act, 1951 to encourage, promote and aid industrialisation in the State by providing financial assistance in the form of loans and advances to small and medium scale manufacturing units both for starting new industries and for expansion and diversification of the existing industries.

The Corporation also provides loans for service sectors like tourism activities, hotels, hospitals, nursing homes, etc. The Corporation provides need based working capital assistance to small scale and medium scale industrial units and

The National Equity Fund for small entrepreneurs for equity base support for setting up new industrial units and also for rehabilitation of existing units.

The management of the Corporation is vested in a Board of 10 Directors (as on 31 March 2006). The Managing Director is the Chief Executive and is assisted by a General manager, a Financial Controller, four Deputy General Managers, Seven Assistant General Managers and thirteen managers to look after administration, accounts, appraisal, recovery, rehabilitation, entrepreneur development programme, legal matter and internal audit. The corporation has16 branch offices each headed by a Manager/Chief Manager who reports to General manager through functionaries in the Head Office.

A review on efficiency in recovery of loans by the Corporation was included in the Report of the Comptroller and Auditor General of India No.3 (Commercial) for the year ended 31 March 1989. The Report has not been discussed by the Committee on Public Enterprises (September 2006). Some of the major deficiencies like inadequate and unrealistic pre-sanction appraisals, sanction of loan for unviable projects, utilisation of substantial portion of funds by the Corporation for repayment of obligations, etc., which were pointed out in the earlier review still persist as noticed in the present study.

Scope of Audit

3.3.2 The present performance review covers the performance of the Corporation with regard to appraisal, sanction and disbursement of loans during 2001-02 to 2005-06 through a critical examination of the working of seven[*] branches (out of 16 branches) and the head office of the Corporation. Out of 968 cases of loan sanction and disbursement, 198 cases were also reviewed in audit.

Audit Objectives

3.3.3 The objective of the performance review was to examine whether:

- resources mobilisation for loan disbursement was cost efficient;
- loan applications received were documented, preliminary scrutiny conducted and further guidance given to the applicants;
- proper criteria was formulated for selection of beneficiaries;
- the appraisal of projects and sanctioning of loan were as per guidelines/the terms and conditions formulated;
- the loan disbursement and monitoring was proper; and
- an effective internal control mechanism exists.

[*] Thiruvananthapuram, Kollam, Kottayam, Ernakulam, Thrissur, Palakkad and Kannur.

Audit Criteria

3.3.4 The criteria used for evaluation of Audit objectives were as follows:

- timeliness in preparation of Business Plan and Resources Forecast, cost of resource mobilisation and their deployment/utilisation;
- eligibility criteria for selection of beneficiaries and other conditions prescribed for sanction of loans;
- procedures prescribed for scrutiny and documentation of loan applications and guidance given to the applicants;
- guidelines/procedures and targets for loan sanction, disbursement and recovery and achievement thereagainst; and
- effectiveness of internal control.

Audit Methodology

3.3.5 Audit adopted the following methodology:

- Review of Business Plan and Resources Forecast prepared by the Corporation for mobilizing resources for disbursement of loans
- Review of sanction and disbursement procedures
- Scrutiny of Board minutes, loan sanction and follow-up files pertaining to loanees, etc.
- Examination of documents, files and registers pertaining to loanees at Head Office and seven branches of the Corporation.

Audit findings

3.3.6 Audit findings as a result of test check were reported to the Corporation/ Government in August 2006 and discussed in the meeting of the Audit Review Committee on Public Sector Enterprises (ARCPSE) held on 25 August 2006 which was attended by the Secretary (Expenditure) to the Government of Kerala , Finance Department and the Managing Director of the Corporation. The views expressed in the meeting have been taken into consideration while finalising the Performance review.

Audit findings are discussed in the succeeding paragraphs.

Resource mobilisation and application

Business plan and Resource forecast

3.3.7 The Corporation prepares every year a Business Plan and Resource Forecast (BPRF) which brings out the various sources from which the resources required for loan disbursement were to be met and also the expected

There was delay in preparation of BPRF and variations between budgeted and actual figures were not analysed.

utilization pattern of the funds generated. The BPRF for the years 2001-02 to 2005-06 were prepared with delays ranging up to three months from the beginning of the financial year. Due to the delay in preparation of the budget the Corporation could not plan its activities well in advance. The details of resources planned, mobilised and utilised during the five years ended 31 March 2006 were as given in **Annexure 17**.

The Corporation failed to analyse the reasons for the wide variation between budgeted figures and actuals. The abnormal variation indicated that neither were the business forecasts prepared realistically nor was the Corporation able to meet the targets of resource mobilisation and disbursement, which affected the overall business operations of the Corporation.

It would be seen from the **Annexure** that:

- as against resources aggregating between Rs.184.70 crore and Rs.244.38 crore mobilised during each of the five years up to 2005-06, utilisation for disbursement of loans aggregated between Rs.79.98 crore and Rs.172.89 crore only, and substantial portion of the resources were utilised for repayment of borrowings.
- while the overdues against principal during the five years up to 2005-06 ranged between Rs.232.79 crore and Rs.261.34 crore, the loan recovery ranged between Rs.120.95 crore and Rs.156.77 crore only.
- as against the total overdue (Principal and interest) ranging between Rs.534.22 crore and Rs.695.61 crore, the total annual resource mobilisation during the five years up to 2005-06 ranged between Rs.184.70 crore and Rs.244.38 crore only indicating that the external resource mobilisation ranging between Rs.36 crore and Rs.123.43 crore could have been avoided. The borrowings at high cost every year without proper mobilisation of resources by way of recovery of over dues from loanees indicated that there was no re-cycling of funds and external borrowings were being invested in irrecoverable loans.

The deficiencies noticed in resource mobilisation from various sources are discussed in the succeeding paragraphs:

Share Capital contribution

3.3.8 The Government of Kerala contributed Rs.31.31 crore over the five year period against a targeted contribution of Rs.43 crore. The share capital contributions were being released to the Corporation through treasury and the Corporation was forced to retain on an average Rs.30.23 crore per year in Treasury Accounts for want of ways and means clearance. Since the funds were not released in time as per requirement, the Corporation could neither utilize the huge balance funds for disbursement of loans so as to reduce the interest burden on external resources mobilised nor deploy it in loans and advances to generate interest income.

Refinance from SIDBI/IDBI

3.3.9 During the five year ended 31 March 2006, the Corporation had drawn Rs.214.69 crore (74.16 *per cent*) against the targeted drawal of Rs.289.50 crore. The Corporation repaid Rs.276.97 crore (102.42 *per cent*) against the targeted repayment of Rs.270.43 crore to SIDBI/IDBI during the same period. The repayment to SIDBI/IDBI was the lowest during the year 2004-05 (42.80 *per cent*) as against the repayment ranging between 95.77 and 127.47 *per cent* during the remaining four years period. The Management in reply (August 2006) attributed the low performance during 2004-05 to lower availing of refinance. The reply is not tenable since the targets for repayment were known in advance and the shortfall was due to non-availability of funds in time.

Statutory Liquidity Ratio (SLR) Bonds

Failure to incorporate put/call option

3.3.10 The Corporation had been mobilising long term funds by floating SLR bonds in accordance with the guidelines of Reserve Bank of India (RBI). When such bonds were floated, the Corporation, from the point of view of financial prudence should have incorporated put/call option in the prospectus for facilitating redemption of bonds after a minimum period of three years from the date of issue so as to take advantage of the declining trend in the rate of interest in the money market since June 2001. The prospectus of bonds submitted to RBI for approval, however, did not incorporate put/call option.

The Corporation subsequently allotted bonds to commercial/urban co-operative banks and Provident Fund trust almost every year at coupon rates ranging between 14 and 6.75 *per cent* up to March 2003 and the outstanding liability as on 31 March 2006 was Rs.186.93 crore. The average cost of borrowings worked out to 11.60 *per cent*.

Audit scrutiny revealed that during 2004-05 and 2005-06 the Corporation had surplus funds {monthly balance ranging between Rs.78.14 crore (September 2004) and Rs.36.37 crore (February 2005)} in their cash/current account/short term deposits. As such the Corporation could have repaid these high cost borrowings if put/call option was incorporated in the prospectus for availing of the advantage of the falling interest rate.

Non-inclusion of put/call option in the prospectus for issue of SLR bonds resulted in loss of Rs.3.83 crore.

The Management stated (August 2006) that they had no control over the terms of issue of SLR bonds and everything was decided by RBI and intimated through SIDBI. The contention of the Corporation is not acceptable as the prospectus of Bonds submitted to the RBI for approval did not incorporate the put/call option despite the falling trend of interest rates and RBI used to approve prospectus if it was finalized in conformity with money market conditions. Since the surplus funds were fetching interest rates of 3 *per cent* only, the loss due to non-inclusion of put/call option and early redemption of bonds worked out to Rs.3.83 crore {Series No. 2010 (V) and 2011 (III)}.

Non-transfer of excess funds from the branches to head office

3.3.11 As per the Head Office directions, the branches need to transfer funds in excess of Rs.10,000 to the Head Office account on daily basis. The Ernakulam branch did not follow the directions and kept huge balances up to Rs.2.35 crore. Keeping huge balances in current accounts at the branches resulted in blocking of funds which otherwise would have been utilised effectively for granting loans, etc.

The Management stated (August 2006) that standing instructions had been issued to all branches to transfer funds in excess of Rs.10,000 to Head Office and the huge balances noticed in some branches on some days were mainly funds retained for issuing cheques towards disbursement on succeeding days. The reply is not tenable since huge balances reported by Audit were being maintained in collection account (Account No.I) on daily basis. No cheque could be issued from such collection account and the amounts were intended for transfer only. For disbursement, separate accounts (Account No.II) with balances were maintained at branches.

Reconciliation of control accounts with personal ledger balances

3.3.12 The Corporation had not reconciled the difference of Rs.2.39 crore (as on 31 March 2005) between the general ledger control accounts and subsidiary loan ledger accounts. The Statutory auditors had also commented on non-reconciliation as well as non-adjustment of balances under the suspense account and non-regularisation of credit balance of Rs.89.97 lakh (2004-05) in the individual customer account. The delay in reconciliation/adjustment of various accounts indicated weakness in the internal control mechanism.

The Management stated (August 2006) that reconciliation work has recently been entrusted to an outside agency with instructions to complete the work by December 2006.

Loan Sanction and Disbursement

3.3.13 Till July 2003 there was no codified procedure giving detailed guidelines for the appraisal, sanction and disbursement of loans. Procedure/guidelines were issued in piece-meal in various circulars for guidance. A quality system procedure (ISO 9001-2000) for approval and monitoring of loans was devised by the Corporation during July 2003 only giving guidelines for appraisal, sanction and monitoring of various loans. A loan policy was formulated during August 2005 giving a general idea of various schemes operated, maximum amount of loan granted, promoters contribution required, rate of interest, repayment period, collateral security norms, delegation of powers for sanctioning of loan, etc.

The position of target and achievement in respect of loan sanction and disbursement by the Corporation for the five years up to 2005-06 was as indicated below:

With reference to actual sanction the disbursements declined from 105.54 *per cent* to 66.03 *per cent* during the five years ended 31 March 2006.

(Rs. in crore)

Year	Sanction			Disbursement			Percentage of disbursement to actual sanction
	Target*	Achievement	Percentage to target	Target	Achievement	Percentage to target	
2001-02	350	163.82	46.81	280	172.89	61.75	105.54
2002-03	305	155.73	51.06	254	112.31	44.22	72.12
2003-04	216	169.58	78.51	205	119.02	58.06	70.19
2004-05	230	109.81	47.74	220	85.48	38.85	77.84
2005-06	180	121.13	67.29	160	79.98	49.99	66.03

The shortfall as compared to targets in sanction and disbursement of loans ranged between 21.49 to 53.19 *per cent* and 38.25 to 61.15 *per cent* respectively during this period.

The loan sanction and disbursement targets of the Corporation were reduced from Rs.350 crore and Rs.280 crore in 2001-02 to Rs.180 crore and Rs.160 crore respectively during 2005-06. The Corporation could not achieve the targets fixed (sanction as well as disbursements) in any of the five years up to 2005-06. The achievement against sanction ranged between 46.81 *per cent* and 78.51 *per cent* whereas with reference to the disbursement it was between 38.85 *per cent and* 61.75 *per cent.* The shortfall as compared to targets in sanction and disbursement of loans ranged between 21.49 to 53.19 *per cent* and 38.25 to 61.15 *per cent* respectively during this period. Even with reference to the reduced level of actual sanction of loans the actual disbursement came down from 105.54 *per cent* in 2001-02 to 66.03 *per cent* in 2005-06.

3.3.14 The details of loan applications received and sanctioned and disbursed by the Corporation during the five years up to 2005-06 are given in the **Annexure 18**. It can be seen from the Annexure that over the years there was significant reduction in loan applications considered, sanctioned and disbursed.

The Management stated (August 2006) that SSI units becoming non-viable, absence of new units in the manufacturing sector, entertaining only good and viable projects and proposals were the reasons for decline in loan applications received. It further stated that competition from banks, high interest rates charged by the Corporation, delay and lengthy procedure, poor publicity on various schemes and strength of the Corporation and lack of awareness among entrepreneurs were the other reasons for decline in the loan business. The Management's reply was silent as to why these issues were not suitably addressed by the Corporation.

In order to evaluate the performance and to assess the exposure, the Corporation carried out a sector-wise analysis at the end of each financial year. It was, however, noticed that no forecast allocating funds in accordance with the sector-wise performance was being done before the beginning of the financial year.

* no physical targets were fixed.

The defects in appraisal, sanction and loan disbursements as discussed in succeeding paragraphs contributed to the high percentage of default by the loanees.

Loan sanction

3.3.15 While the Corporation prescribed elaborate procedure for sanction of loans, it was observed that these procedures were not being strictly followed resulting in sanction of loans without proper appraisal of projects, ensuring managerial efficiency of entrepreneurs, ensuring adequate collateral security. Further, loans in some cases were sanctioned even to loanees who were chronic defaulters, etc., as discussed in the succeeding paragraphs:

Sanction of loan without proper/sufficient security

3.3.16 As per the norms prescribed, the loanees were to furnish collateral security equivalent to 150 *per cent* of the sanctioned amount for term loans, where the unit is functioning in rented/leased premises, 100 *per cent* in case of units located in industrial estates, 50 *per cent* in the case of units in own premises. In respect of working capital loan, the requirement was 100 *per cent* in own premises and 150 *per cent* in rented premises, and for short term loans the collateral coverage should be 150 *per cent* of the loan amount. The intention behind accepting higher security was to safeguard the financial interests of the Corporation in the event of default of principal and interest amount.

Loans granted without proper/sufficient security resulted in non-recovery of over due amount of Rs.5.53 crore in nine cases.

The Corporation was, however, sanctioning loans without ensuring adequacy of security as prescribed and without conducting effective site inspection to ensure reliability of securities. Due to this the Corporation could not often recover the overdue amounts arising from default. The details of amount sanctioned/ disbursed, security required as per norms and value of security obtained, amount outstanding as on 31 March 2006 in respect of nine such cases involving overdue amount of Rs.5.53 crore are given in **Annexure 19**.

In respect of these cases the following important deficiencies were noticed in audit:

- In the case of Cannannore Roller Flour Mills (P) Limited (Sl.No.1 of **Annexure 19**) the loanee had to furnish collateral security worth Rs.2.63 crore for obtaining the working capital term loan of Rs.1.60 crore. Against this, the loan of Rs.1.75 crore was sanctioned and Rs.1.60 crore was disbursed on the collateral security worth Rs.1.58 crore only. Though the security was assessed at Rs.1.58 crore before releasing the loan, it was revalued at Rs.1.36 crore (July 2005). This showed over valuation of the security property at the time of loan sanction/release.

  The Management stated (August 2006) that the loan was secured by both industrial and collateral securities valued at Rs.2.70 crore and a slight decrease in the upset valuation of land did not mean that the first valuation was on the higher side. The reply is not correct because the loan was secured on the basis of both collateral and industrial security valued at Rs.1.58 crore only and the subsequent valuation was Rs.1.36 crore showing a variation of 14 *per cent* which was material.

- Out of 75 cents of land accepted as security from Pat Gardens (Sl.No.5 of **Annexure 19**) 50 cents was earmarked for industrial land (Rs.27.50 lakh) and 25 cents as collateral security (Rs.13.75 lakh). Subsequent valuation (May 2003) revealed that the value of collateral security came down to Rs.5 lakh. Based on the valuation in August 2005 the collateral security would fetch only Rs.8 lakh which was not sufficient for the loan of Rs.28.65 lakh. Thus the collateral security was over-valued at the time of sanction. It was also noticed that the loanee had also availed a loan of Rs.10.50 lakh from the Co-operative bank for construction of Auditorium on the security of this 75 cents of land.

  At the time of loan appraisal it was reported that the collateral security offered (25 cents) was not sufficient for the loan amount recommended. As such, the loanee was required to produce additional security worth 75 *per cent* of the loan before drawing any portion of the loan. Though a special condition to this effect was included in the sanction order, this was not adhered to.

  The Management stated (August 2006) that the assets available would be sufficient to recover loan dues. It was, however, noticed in audit that even after advertising twice (August 2005 and February 2006), the sale did not materialise in the absence of sufficient bidders.

- In respect of all the three properties offered as security (collateral) by JJ Exports (Sl.No.6 of **Annexure 19**) the legal section at Kottayam branch was required to verify the genuineness of documents with reference to the records kept at various State offices. The verification was, however, not done before sanction and disbursement of loan and the documents offered as security were subsequently found to be forged.

In the absence of proper verification forged documents were accepted as security.

The Management stated (August 2006) that it had accepted the documents in good faith. The reply is not acceptable since the legal personnel of the Corporation failed in their duty of ensuring genuineness of documents.

It was further observed that the unit was set up for exporting gold ornaments. The party, however, did not have any experience in the export business. At the time of enquiry (May 2001) before sanction, it was noticed that the party had started export business about six months back only and the machinery installed were not operational. Considering the facts that there was no proper collateral security and the firm was not in existence, the chances of recovery of outstanding amount of Rs.31 lakh were remote.

- As per the prescribed norms, the additional loan could be granted to a concern when its past record was favourable. Afsal Cashew Packers (Sl.No.7 of **Annexure 19**) was a known defaulter. The party defaulted in making payment despite the business being in profit indicating that the party was a willful defaulter. Ignoring this, additional loan for working capital was sanctioned by the District Manager. The entire property (including the primary assets) offered as security for the original term loan was revalued at Rs.8.05 lakh only against which working capital loan of Rs.18 lakh was sanctioned in August 2001. The Management stated (August 2006) that the loan was sanctioned on the basis of total security including collateral security. The reply is not acceptable since the primary assets were already pledged against the original loan and cannot be considered as collateral security for the subsequent loan.

Sanctioning of loan to chronic defaulters

3.3.17 In the appraisal memorandum, the Corporation had prescribed questionnaires regarding the status of previous loans, if any, to avoid release of fresh loan to existing defaulted loanees. It was, however, noticed that loanees who were chronic defaulters were granted fresh loans by the Corporation as discussed below:

Mannarkkad Wines

3.3.18 The Corporation sanctioned (January 2001) a short term loan of Rs.92 lakh to Mannarkkad Wines, Mannarkkad (MWM) on the collateral security of one acre 21 cents of land at Mannarkkad along with the hotel building situated thereon valued at Rs.1.38 crore. The purpose of the loan was to meet the expenditure on repair and modifications of the existing hotel building, for acquiring furniture and equipments, for paying bar licence fee and to meet the working capital requirements. The loan of Rs.92 lakh was disbursed (February 2001) after adjusting interest arrears aggregating to Rs.13.60 lakh due from their associate concerns which were financed by the Corporation. The loanee defaulted in repayment of instalments and as per his request the principal outstanding as on 31 March 2002 (Rs.78.31 lakh) was allowed (April 2002) to be repaid in instalments.

Meanwhile another short term loan of Rs.23.33 lakh was sanctioned (March 2002) to the same firm for renewing the bar licence and also for minor repairs of the hotel building against the same security given for the first loan, which was not adequate. The shortfall in security was covered against the excess security given by an associate company for availing loan. The entire loan of Rs.23.33 lakh was adjusted (March 2002) towards the arrears outstanding in their previous loan account and the accounts of the associate firms. MWM defaulted repayments and the total amount outstanding as on 31 March 2006 amounted to Rs.86.40 lakh with overdue of Rs.38.39 lakh.

Audit scrutiny revealed the following:

- at the time of appraisal of loan of Rs.92 lakh, the Corporation had already sanctioned four loans to three associate concerns of MWM and disbursed Rs.2.77 crore and the outstanding (January 2001) balance against these accounts amounted to Rs.3.33 crore. The party's dealings with the Corporation were, therefore, not satisfactory. The value of fixed assets of the firm was Rs.24.96 lakh only, whereas the cost estimated for its renovation and repair worked out to Rs.1.50 crore and the firm had sought a short term loan of Rs.1 crore against which Rs.92 lakh was sanctioned and disbursed.
- at the time of appraisal of the second loan, the firm was a chronic defaulter and Revenue Recovery proceedings were underway. While considering the loan application the Corporation in its own appraisal, reported that the net worth of the firm was not showing favourable trend and the unit did not satisfy the eligibility criteria fixed for sanction of short term loan. In spite of this, the District Level Screening Committee* sanctioned the second short-term loan of Rs.23.33 lakh, without any justification.
- one of the conditions at the time of loan sanction was that up to date arrears in other loan accounts (including the accounts of associate concerns) should be cleared before the disbursement of loan. It was, however, noticed that Rs.13.06 lakh (towards the arrears in other loan accounts) was adjusted from the disbursements of the first short term loan of Rs.92 lakh. Similarly, the entire second term loan was adjusted against the arrears in other loan accounts. These facilities extended to the loanee amounted to sanctioning of fresh loans for adjusting the arrears in other loan accounts so as to change the status of the loan from sub-standard/doubtful category to standard category. This made the loanee eligible for fresh loans.

The Management stated (August 2006) that the loans of the sister concerns have been closed and the loan of MWM alone was outstanding and the dues were being remitted at the rate of Rs.25000 per week with post dated cheques. The reply does not explain the reasons for granting loans to a chronic defaulter and adjusting the amount against the dues of their sister concerns.

Holycross Hospital.

3.3.19 The Corporation extended (1998-99) a term loan of Rs.50 lakh to Holycross Hospital, Pudukkad and the unit started functioning (November 1999). An Additional loan of Rs.56 lakh was sanctioned (March 2001) for completion and expansion of the hospital on the security of primary assets already pledged for availing the original loan of Rs.50 lakh. Out of Rs.56 lakh

* District Level Screening committee comprises Chief/Branch Manager, Officers from Technical, Legal, Appraisal and Disbursement Sections.

sanctioned and Rs.21.58 lakh disbursed, the Corporation adjusted the interest dues of Rs.19.78 lakh outstanding against the original loan of Rs.50 lakh and the loanee was paid only net amount of Rs.1.80 lakh (March 2002). Both the loan accounts had been in default. The Corporation proposed (November 2005) to take over the hospital under Section 29 of SFC Act. The promoter's offer for a One Time Settlement (OTS) for Rs.29 lakh was rejected by the Corporation. The balance outstanding in both the loan accounts together amounted to Rs.1.07 crore with overdue principal of Rs.26.50 lakh and interest of Rs.35.07 lakh (March 2006).

It was observed in audit that at the time of disbursement of additional loan, the Corporation was aware of the fact that the loanee was not in a position to repay the loan already taken due to poor performance of the hospital. In order to help the unit, the loan repayment was rescheduled and the interest arrears were adjusted from the disbursed amount. By adjusting the interest arrears against the fresh loan and rescheduling of loan repayment, the loan status was converted from the sub-standard/doubtful to standard category. By regularising the default, the assisted unit was made eligible for fresh loan.

Audit scrutiny further revealed that in the absence of post sanction inspection there was major deviation in the civil work executed by the loanee resulting in increase in constructed area of the project by 355.20 square metre. The solvency of the promoters was also assessed on the basis of statements made in the affidavits filed by them without verifying the facts.

The Management stated (August 2006) that they were aware of the major deviation in civil works at the time of sanction of additional loan and the loan was sanctioned for improving viability of the hospital but the project was not implemented. The reply is not acceptable since the Corporation granted additional loan even after knowing about the poor performance of the hospital and capacity of the loanee to repay, which ultimately resulted in heavy over-dues.

Sanction of loan to entrepreneurs not having sufficient expertise

3.3.20 In the appraisal memorandum, the Corporation had prescribed questionnaires regarding qualification, experience in the line of activity, technical expertise of promoters to ensure the effective and efficient implementation and functioning of the project. If the promoter has no experience in the proposed line of activity or has no idea about the proposed venture, the key personnel behind the venture/experienced personnel to be appointed are to be interviewed. It was, however, noticed that in the following cases the prescribed procedure was not followed.

Erumapetty Medical Centre (P) Limited.

3.3.21 A term loan of Rs.50 lakh was sanctioned (March 2000 to January 2001) to Erumapetty Medical Centre (P) Limited for a hospital project in Thrissur district. An additional term loan of Rs.15 lakh was also sanctioned

(June to July 2001) for completing the project. The loanee defaulted (June 2001) the repayments of loan and the dues accumulated to Rs.1.18 crore (March 2006). Revenue Recovery action was initiated to recover the dues. As against the Corporation's offer (January 2003) of one time settlement for Rs.75 lakh the party expressed willingness to settle the case for Rs.72.50 lakh which was not accepted by the Corporation.

The following points were noticed during audit:

- the promoters and directors were matriculates and did not have any exposure in the hospital business. No technical/professional consultant was even engaged by the promoters. Thumb impression of the Managing Director in the agreement executed with the Corporation was not witnessed.
- The original project cost of Rs.1.56 crore was revised to Rs.1.02 crore and while proposing the additional loan (November 2000) the estimated cost was increased to Rs. 1.57 crore. This showed lack of proper professional expertise in conceiving the project and its implementation.
- The condition for inclusion of a qualified doctor (prescribed while granting the additional loan) in the Board of Directors was not insisted upon for compliance.
- Interest arrears amounting to Rs.4.99 lakh were adjusted against the loan disbursements, thereby, converting NPA into a standard asset. Due to such adjustment, the loanee did not get the benefit of full loan. The default was, thus, got regularised and the loanee became eligible for further loan. The Corporation was also accounting for interest income in such cases, in violation of RBI guidelines.

Lack of sufficient expertise, inadequate appraisal of project and non-adherence to conditions of loan resulted in accumulation of arrears of Rs.1.18 crore

Thus, lack of proper expertise on the part of promoters/directors of the company and proper appraisal of the project coupled with non-adherence to the conditions stipulated by the Corporation resulted in default of repayments amounting to Rs.1.18 crore.

The Management stated (August 2006) that scheme for financing hospital projects framed by the Corporation does not envisage that the promoters should be technically/professionally qualified and in this case qualified doctors were appointed before commencement of operation and sanction of additional loan. The reply is not tenable since qualified doctors were not appointed to the Board of Directors so as to ensure the viability and better performance of the hospital and the loanee ultimately turned out to be a defaulter.

Manjakalavilayil Hospital.

3.3.22 An amount of Rs.28 lakh was sanctioned (March 2002) and disbursed (April to December 2002) to Smt. M.Marykutty Baby, the chief promoter for constructing a hospital. The total cost of the project was Rs.44.55

lakh. Repayment period was to commence at the end of 12 months of drawal of first instalment of term loan and thereafter in 84 monthly instalments. The loanee defaulted 37 instalments of repayments and the loan outstanding was Rs.45.46 lakh (March 2006) with overdue principal and interest amounting to Rs.29.81 lakh.

The unit was taken over (April 2005) under section 29 of The SFC Act and it was found that the entire plant & machinery, hospital equipment/furniture had already been removed from the unit. A case was lodged with the police (July 2005). The taken over assets were advertised for sale (August 2005 and January 2006) but no response was received (June 2006).

Audit scrutiny revealed as follows :

Sanction of loan for hospital project to promoters having no professional qualification resulted in abandonment of the project after unauthorized removal of assets.

- the promoter and co-obligant were not professionally qualified for running a hospital and were having the qualification of SSLC and Pre Degree Course respectively. Though the willingness of two specialist doctors to assist in the project was produced, the Corporation did not ascertain the guarantee of their services. When the public protested (August 2004) regarding fake doctors, the promoter abandoned the hospital after removing all the equipments, furniture, etc., and the hospital has been closed since then. Thus, granting of loan to promoters without adequate knowledge/skill in the business resulted in the closure of the unit and default in repayment of loan.
- The upset valuation done (December 2005) revealed that value of security was Rs. 45.83 lakh (both primary and collateral). As against the loan outstanding of Rs.45.46 lakh the value of security excluding the assets removed by the promoter (Rs.11.64 lakh) amounted to Rs.34.19 lakh only.

The Management stated (August 2006) that since the promoter had managerial experience and there was enough back up service of qualified doctors they accepted the project and financed it and that, as per norms, professional qualification was not essential for the promoter. It was also stated that when the arrears mounted up the Corporation took possession (April 2005) of the collateral security and filed a criminal complaint against the promoter for removal of machinery. The reply is not tenable since adequate back up service of qualified doctors was not available in view of the fact that the doctors subsequently turned out to be fake and the promoter absconded after removing machinery.

Pranavam Modern Rice Mill.

3.3.23 The Corporation financed Pranavam Modern Rice Mill, (a proprietary firm) by granting a term loan of Rs.30 lakh (January to September 1999) and working capital loan of Rs.45 lakh (January 1999 to September 2000). The borrower defaulted in repayments and arrears amounted to Rs.1.67 crore as on March 2006.

It was noticed in audit that;

- the credit-worthiness of the borrower and co-obligant was not ascertained by the Corporation prior to sanctioning of loan;
- the borrower and the co-obligant were not in a position to raise funds (Working capital) other than the loan availed from the Corporation;
- the promoters neither had any experience nor any required skill in running such a business; and
- there were default in repayment of loan instalment since January 2000.

The Management stated (August 2006) that the loan was granted considering the vast experience of the promoters i.e., father and family in similar field and that the promoter and co-obligant had raised required capital for implementation and also for working capital. The reply is not acceptable as the promoter could not ultimately manage the business and the unit remained closed due to non-availability of working capital.

K.R.P Enterprises.

Ignoring the evaluation of the screening committee a granite export firm was sanctioned loan for trading in mango pulp resulting in non-recovery of Rs.53.02 lakh.

3.3.24 A short term loan of Rs.30 lakh was sanctioned (May 2000) to Shri. K.R.Prasad, the proprietor of K.R.P Enterprises, Trivandrum (KRP) engaged in the export of sized granite. The loan was intended for starting export of mango pulp for which an agreement was stated to have been entered into with one firm in Tamil Nadu for preparation and supply of required pulp on commission basis. The loan was disbursed (July 2000) on the personal guarantee of two co-obligants and collateral security of land with a building valued at Rs.46.57 lakh and owned by one of the obligants. The loan amount was to be repaid in twenty monthly instalments of Rs.1.50 lakh each commencing from 10 October 2000. Of the repayment made by KRP by way of 20 cheques of Rs.1.50 lakh each, only two cheques were honoured. Thereafter the loanee did not make any payment and had been absconding. The dues outstanding were to the tune of Rs. 84.63 lakh (March 2006). The land with residential building offered as collateral security was taken over (December 2003) but the Corporation could not dispose of the same in spite of repeated advertisements.

Audit scrutiny revealed the following :

- Though the Screening Committee deferred the proposal (May 2000) on the ground that the applicant had no experience in manufacturing of mango pulp and the activity proposed was mainly trading in nature with a firm in Tamil Nadu, the loan was sanctioned by the Managing Director.
- Originally, the collateral property was valued at Rs. 46.57 lakh but on revaluation (July 2004), the value of security was assessed at Rs.31.61 lakh.

Thus, sanction of loan to a firm having no previous experience in the intended business and without proper appraisal of loan application led to non-recovery of dues amounting to Rs.53.02 lakh (after taking into account the securities held worth Rs.31.61 lakh).

The Management stated (August 2006) that the short term loan was sanctioned by the Managing Director exercising the powers conferred, based on clarifications obtained from the applicant. It further stated that instead of filing criminal complaint against dishonour of cheques of the loanee, security offered was taken over since it was more effective. The reply is not acceptable as the dishonour of cheques given by the loanee, his subsequent absconding, etc., indicated that the Managing Director's decision, over-riding the recommendations of the screening committee, lacked justification.

Non- insistence on special conditions.

Pomsy Food Products (P) Limited.

3.3.25 The Corporation sanctioned (November 2001) a term loan of Rs.three crore to Pomsy Food Products (P) Limited (PFP) for setting up a biscuit manufacturing unit at Karunagapalli. The loan was secured by personal guarantee, *pari pasu* charge over fixed assets and first charge over collateral securities. The project was jointly financed by the Corporation and State Bank of Travancore (SBT), Ernakulam. The cost of the project was estimated at Rs.9.85 crore out of which Rs.3 crore was the loan component of the Corporation which was disbursed during the period November 2001 to March 2004.

Non- insistence of conditions on promoters' contribution and repayment of loans through escrow account rendered Rs.1.47 crore as NPA.

Subsequently, based on the request of PFP, the Corporation sanctioned (April 2002) and disbursed (April to July 2002) a bridge loan of Rs.24 lakh to support the promoter's contribution. PFP started (May 2002) commercial production, but defaulted repayment of principal and interest from the beginning itself. At the end of March 2006 an amount of Rs.3.66 crore was recoverable from PFP with Rs.1.47 crore as overdue. Action for attachment of property under Section 29 of the SFC Act, 1951 for realisation of above dues was yet (May 2006) to be initiated.

It was noticed by Audit that the loan sanction stipulated raising of promoters' contribution by PFP to the extent of Rs.4.85 crore from Rs.3.39 crore and an escrow account to be opened with SBT where in a particular percentage of turnover was to be credited for purpose of distribution to financial institutions in proportion to the term loan liability. These conditions, however, were not insisted upon for compliance and this resulted in conversion of dues amounting to Rs.1.47 crore into non-performing assets.

The Management stated (August 2006) that action was underway for opening escrow account at the earliest.

Disbursements

Disbursement of loans without ensuring sufficiency of promoters' contribution

3.3.26 The Corporation assesses loan eligibility based on the promoters' contribution and other criteria. Promoters' contribution ranges from 10 *per cent* to 50 *per cent* on the various schemes. Financing under 50 *per cent* promoters' contribution is applicable to only those units situated on own land (private land) for certain schemes. It was, however, noticed that in the following cases these conditions were not followed.

Cannanore County Club & Resorts (P) Limited.

3.3.27 A term loan of Rs.1.50 crore was sanctioned (November 2002) to Cannanore County Club & Resorts (P) Limited for setting up a hotel project at Cannanore. The project cost was Rs.3.11 crore with promoters' contribution of Rs.1.61 crore (51.71 *per cent*). The disbursement was made during the period from February 2003 to March 2004. In response to the loanee's request (April 2004) for an additional term loan of Rs.50 lakh to meet the increased cost of project due to major changes in civil construction and increased area, the Corporation sanctioned (June 2004) loan of Rs.45 lakh. At that time the project cost was assessed at Rs.3.90 crore with promoter's contribution at Rs.1.95 crore (50 *per cent*). The disbursement was made during August 2004 and February 2005.

The resort was inaugurated on 4 October 2004 and the loan position as on 31 March 2006 showed an overdue principal of Rs.24.72 lakh and interest of Rs.12.88 lakh.

It was observed in audit that at the time of sanction of the original term loan (Rs.1.50 crore) it was stipulated that 50 *per cent* of promoter's contribution should be brought in before disbursement. One of the special conditions prescribed was that the paid up capital be raised to Rs.1.61 crore (promoter's contribution at 51.71 *per cent*). As per the certified accounts (31 March 2001 and 31 March 2002) of the loanee company, the paid up capital was only Rs.one crore and promoter's contribution (Rs.1.61 crore) was worked out considering the unsecured loans brought in by the directors as well. At the time of sanction and disbursement of additional loan of Rs.45 lakh also the promoter's contribution worked out to 25.64 *per cent* only. Thus, the loans were sanctioned and disbursed without ensuring the promoter's contribution at 51.71 *per cent* and the contribution was not maintained even at the required minimum level of 33.33 *per cent*.

Mas Motels

3.3.28 Smt. Nazeema Beevi, proprietor, Mas Motels (MM) approached (July 1998) Corporation for a Term Loan of Rs.45 lakh for construction of hotel building and equipping the same. Total cost of the project was

Rs.1.45 crore out of which Rs.84.06 lakh was stated to have been spent by MM towards cost of land (Rs.73 lakh) and development/building (Rs.11.06 lakh).

Without verifying the correctness of the amount claimed to have been spent by MM, the Corporation assessed the adequacy of promoter's contribution and sanctioned (September 1998) a loan of Rs.33 lakh. At the time of accepting the land of 53.5 cents offered by MM as security, the Corporation itself valued the same land at Rs.19 lakh (47.5 cents on measurement) as against the original value of Rs.73 lakh accepted for purpose of promoters contribution to make MM qualify for the loan. The loan of Rs.33 lakh disbursed (February 1999 to January 2001) was defaulted. Despite the sick status of MM a further loan of Rs.73 lakh was disbursed (December 2002 to March 2003) and out of which, funding of interest amounting to Rs.12.71 lakh was allowed.

The Corporation took over the asset (January 2002) and released (December 2002) it as a part of revival programme. The Corporation subsequently took over the asset (February 2004) for the second time and offered one time settlement at Rs.56 lakh (October 2004) which did not materialise. In January 2005 the Corporation released the charge over 10 cents of the securitized property on accepting Rs.13.50 lakh. An amount of Rs.42.78 lakh was overdue (March 2006) from MM with total amount recoverable at Rs.69.09 lakh.

Audit scrutiny revealed as follows:

Over valuation of land by Rs.54 lakh was accepted to make up for promoters contribution and eligibility for the loan.

- the Corporation accepted the over valuation of land by Rs.54 lakh to make MM eligible for the loan by making up the promoters' contribution.
- solvency of the party was not assessed properly and the hotel project was lying idle for two years for want of additional funds/working capital.
- additional loan was sanctioned irrespective of the fact that the project was a failure and at that stage rehabilitation as a hotel was not feasible.

The Management stated (August 2006) that as per financing norms and guidelines the land cost had been limited to 15 *per cent* of project cost and that the solvency of the proprieters and co-obligant was assessed as per affidavits filed by them. The reply is not acceptable since the valuation of land was not limited to 15 *per cent* at the time of appraisal of the loan there by inflating promoters' contribution, other wise the application would have been rejected. Later at the time of acceptance of security the land cost was assessed at Rs.19 lakh only much below the original projection given by the promoter. Acceptance of affidavit without verification was also not correct.

Plaza International.

3.3.29 The Corporation sanctioned (March1998) and disbursed a term loan of Rs.60 lakh to Plaza International for the construction of a hotel project. When the project building was nearing completion, the loanee submitted (February 2000) an application for an additional term loan of Rs.30 lakh for starting three star hotel with bar facility. The revised cost of the project was assessed at Rs.1.50 crore with the promoter's contribution at Rs.60 lakh (40 *per cent*). The additional loan was sanctioned (March 2000) and Rs.21 lakh was disbursed (August 2000 and March 2001).

At the time of disbursement of second instalment of additional loan the eligibility as per promoter's contribution was only Rs.7.10 lakh against which Rs.16 lakh was disbursed. Thus, the Corporation relaxed the conditions of loan and disbursed the amount even though the promoters had not invested as per the requirement.

Failure of the Corporation to ensure investment of promoters contribution resulted in accumulation of over dues amounting to Rs.1.37 crore.

Though the hotel started functioning with effect from November 2003, the total repayment made towards the two loan accounts was Rs.37.50 lakh only. The party had defaulted the repayment and the amount to be realised amounted to Rs.1.53 crore (March 2006) with overdue of Rs.1.37 crore (both principal and interest) falling under doubtful –II category of NPA. The unit was taken over (April 2005) under section 29 of the SFC Act and advertised for sale thrice (August 2005, March 2006 and July 2006). The sale had not materialised (September 2006).

Thus, the failure in ensuring investment to be made by the promoters resulted in accumulation of dues of the Corporation.

The Management stated (August 2006) that the condition regarding promoters' contribution was relaxed eventhough the promoter had not invested the required contribution for the speedy implementation of the projects and since they had already released substantial amount by way of loan. The attempt to sell the taken over unit did not materialise in the absence of sufficient bidders. The fact, however, remains that the undue favour of relaxation of promoters' contribution for the second loan in the name of speedy implementation did not serve the purpose and only increased the arrears.

Diversion of loans

Indiana Panels.

3.3.30 Indiana Panels applied for a term loan (working capital) of Rs.1.50 crore (December 2000) for procuring raw materials in bulk quantity. The unit was in existence since 1994 and engaged in the manufacture of veneers from imported timber. After considering the loan proposal, the standing committee sanctioned (March 2001) Rs.1.50 crore for procurement of raw materials and disbursed (April 2001/March 2003) Rs.1.35 crore in two instalments.

The party was not regular in paying instalments and the loan account had fallen under doubtful–II category of NPA. An amount of Rs.2.71 crore was outstanding (March 2006) with Rs.2.47 crore as overdue towards principal and interest. The unit was not in operation and Revenue Recovery action was in progress (June 2006).

Disbursement of loan for purposes other than for which it was sanctioned rendered the amount of Rs.2.47 crore as NPA.

It was noticed in audit that though the loan of Rs.1.50 crore was sanctioned for procurement of raw material, major portion of the same was utilised by the loanee for clearing the cash credit/arrears of an earlier loan taken by the loanee from the bank. This resulted in the firm utilising only 33 *per cent* of the amount released, for intended purposes. Thus, sanctioning of a loan for a particular purpose and utilisation of the same for other purposes resulted in failure of the project, rendering an amount of Rs.2.47 crore as NPA.

The Management stated (August 2006) that the borrower requested the Corporation to release Rs.91 lakh direct to the bankers for clearing the loan availed for working capital and getting documents released. It was also stated that an amount of Rs.25.04 lakh was realised from sale of plant and machinery of the loanee. The reply is not tenable since the loan from bank was already availed by the loanee at the time of submission of application to the Corporation in December 2000 and by disbursing the loan sanctioned for import of raw materials, for liquidating the then existing liabilities of the loanee defeated the purpose of sanction.

Adjustment of loans against overdues

Krishna Gardens Regency (P) Limited

3.3.31 The Corporation sanctioned (June 2000) a term loan of Rs.1.25 crore to Krishna Gardens Regency (P) Limited for construction of a hotel. The loan was sanctioned on the security of assets of the company and collateral security of property valued at Rs. 1.12 crore which was already accepted as collateral security for a loan of Rs.74.58 lakh availed by Anugraha Complex (AC) a sister concern of the promoters. One of the conditions for sanction and disbursement of the term loan was that the outstanding dues of AC would be adjusted from the disbursement of the term loan. Banking on the same security, another term loan of Rs.50 lakh was sanctioned (February 2001) and disbursed (May 2001) for completion of the hotel building and equipping the same. A Short Term Loan of Rs.22 lakh was also sanctioned (September 2002) and disbursed (October 2002). Thus, against a collateral security of Rs.1.12 crore the Corporation disbursed an aggregate Term Loan of Rs. 1.75 crore and short term loan of Rs.22 lakh during the period from June 2000 to October 2002.

The aggregate amount outstanding against the above term loans and short term loans as on 31 March 2006 was Rs. 2.68 crore (Principal Rs. 1.83 crore and interest Rs.85 lakh). The overdue principal and interest amounted to Rs.1.80 crore.

Audit scrutiny revealed the following:

Out of Rs.1.75 crore disbursed for hotel project Rs.67.89 lakh was adjusted against the dues of a sister concern.

- Out of the term loan of Rs.1.75 crore sanctioned and disbursed for constructing and equipping the hotel Rs.67.89 lakh was adjusted against the dues of the sister concern of the company.
- at the time of appraisal of the short term loan of Rs.22 lakh it was recorded that the loan account of the party was in heavy arrears and that the unit did not fully satisfy any of the five eligibility criteria for sanction of short term loan. In spite of this, the loan was sanctioned by the Managing Director. The loanee did not settle the short term loan account even after a delay of 18 months (March 2006).
- though the purpose of the loan (short term loan Rs.22 lakh) was to meet the bar license fee of Rs.15 lakh and working capital requirements, the Company had already availed Rs.14 lakh from Federal Bank for meeting bar license fee which indicated the fact that the loanee was availing loans from different financial institutions for the same purpose and also not meeting the commitments.

The Management stated (August 2006) that the amount sanctioned for constructing and equipping the hotel was released as re-imbursement against value of assets created by the principal firm and adjusted against the dues of sister concerns and this had not affected implementation of the project. The reply is not acceptable since the amount sanctioned as loan for implementation of the project was adjusted directly against dues of the sister concerns and the Corporation did not have any mechanism to verify whether the principal firm was implementing the project against funds borrowed from other sources.

PNM Hospitals, Kattakada

3.3.32 The Corporation sanctioned (January 2001) a term loan of Rs.1.80 crore to PNM Hospitals, Kattakada (PNM). The disbursements started with effect from February 2001. An additional loan of Rs.1.47 crore was also sanctioned (September 2002). It was noticed in audit that an amount of Rs.68.78 lakh was adjusted towards principal and interest dues outstanding against various earlier loans out of Rs.3.27 crore disbursed to the loanee up to June 2004. In February 2005 another loan of Rs.three crore was sanctioned for expansion works. The disbursements commenced from April 2005 and an amount of Rs.1.56 crore was disbursed (up to March 2006). From these disbursements also, the Corporation adjusted Rs.30.45 lakh against the arrears in earlier loans.

Thus, out of the total loan disbursement of Rs.4.83 crore made (up to March 2006) to PNM, Rs.99.24 lakh (20.56 *per cent*) was adjusted towards principal and interest dues outstanding against five other loan accounts. The over dues as on March 2006 amounted to Rs.2.81 lakh (Rs.1.52 lakh plus Rs.1.29 lakh).

Out of Rs.4.83 crore disbursed for the project, Rs.99.24 lakh was adjusted towards dues of other loan accounts of the loanee and rebate for prompt payment allowed.

But for the adjustment of Rs.99.24 lakh out of disbursement of earlier loans the over dues would have been Rs.1.02 crore.

Thus, the loanee received Rs.3.83 crore only in cash out of the total requirement of Rs.4.83 crore. Since the loans sanction and disbursements were made for specific purposes based on requests supported by progress in work and/or acquisition of assets, adjustment of releases against arrears deprived the loanee of sufficient funds and affected the implementation of projects and defeated the purpose of financial assistance made.

The release of assistance and adjustment of dues also resulted in increased recovery of principal, accounting of interest income out of own funds and categorisation of the sub-standard/doubtful NPAs into standard category making loanees eligible for fresh loans.

It was also noticed in audit that the Corporation allowed interest rebate of one *per cent* for prompt payment of interest/principal. Based on Corporation's own money re-channeled as interest/principal remittances in the above case, Rs.0.28 lakh (January 2004) and Rs.0.38 lakh (March 2005) were granted as interest rebate by adjusting the interest dues (Rs.3.45 lakh and Rs.4.53 lakh) against the disbursements.

The Management stated (August 2006) that pre-operative expenses of the loanee in their project cost included interest element on loans and adjustment of such interest at the time of release of instalments had not deprived the loanee of sufficient funds and affected implementation of the project. The reply is not tenable since the adjustment against release included both principal and interest amount and such adjustments were being made regularly from the disbursement of loans from February 2001 onwards to wipe off the over dues of the loanee and make it eligible for further loans.

Internal Control

Corporate Governance

3.3.33 Corporate Governance is the system by which companies are directed and controlled by the management in the best interest of the shareholders and others ensuring greater transparency and better and timely financial reporting. The Board of Directors are responsible for governance in the Companies.

The following deficiencies were noticed in this regard:

Board Meetings

3.3.34 The attendance of the Government nominee directors in the Board Meetings was quite inadequate during 2002-03 to 2005-06. During 2002-03 Government directors did not attend any of the meetings and during 2003-04 only two meetings were attended. During the remaining two years up to 31 March 2006 the attendance was about 40 *per cent* only.

There was absence of active participation by Government directors in the Board meetings.

The absence of active participation by the Government nominees indicated that Government involvement in the affairs of the Corporation was insignificant despite 90.51 *per cent* (31 March 2006) share holding in the Corporation.

The minutes of the meetings of the Board of Directors of the Corporation held (15 January 2001, 15 February 2001 and 26 March 2001) were not authenticated by the Chairman.

Audit Committee

3.3.35 The Audit Committee is an important tool for the Board of Directors to discharge their functions effectively for proper management of the Company.

Audit Committee was constituted late and did not hold meetings to ensure sound Corporate Governance.

As per paragraph 9A of Non Banking Financial Corporation's prudential Norm (Reserve Bank Directions 1998) the Corporation had to constitute an Audit Committee. The Corporation, decided (May 2002) to constitute an Audit Committee for discussing Internal Audit Reports, scope and coverage of Internal Audit system, examining the financial statements, reviewing risks and uncertainties in the business operation and discussing all significant issues raised during the Audit, etc. The Audit Committee comprising of three directors (a Government nominee director, a nominee director from SIDBI and one from SBI/LIC) was formed only in September 2005 for want of co-opted directors on the Board of Directors of the Corporation. Thereafter no meeting of the Committee was held (January 2006). Due to non-holding of meetings of the Audit Committee, the very purpose of setting up the Audit Committee could not be achieved.

The Management stated (August 2006) that they were aware that the Audit Committee constituted in the Corporation was not very effective and would take steps to improve the effectiveness of such committees.

Internal Audit

3.3.36 The Corporation had an Internal Audit and Inspection Wing (IA&IW) which was headed (July 2006) by an Assistant General Manager (AGM) instead of a Deputy General Manager as provided in the Manual of Procedure of Internal Audit and Inspection Wing.

The Internal Audit was supplemented by concurrent audit of 16 branch offices and the head office of the Corporation by Chartered Accountants appointed annually. Quarterly Audit Reports were submitted to IA&IW, which in turn was forwarded along with remarks to the concerned branch offices for compliance/rectification of mistakes. Even though verification of loan sanction and disbursement was entrusted to the concurrent auditors their report did not contain any significant observation in this regard. It was noticed in audit that similar lapses/mistakes/omissions repeatedly occurred indicating that the corrective steps taken were inadequate. Concurrent Audit of all branches for the quarter ending 31 March 2006 had been completed (July 2006), but compliance for the earlier quarter (September/December) was awaited from five branches.

The Management stated (August 2006) that there was constraint of not having persons in the requisite cadre and the Deputy General Managers of the Corporation were posted in the areas which were more critical for the functioning and at present persons having sufficient experience were being posted. Review of status of Concurrent Audit/rectification of mistakes, etc., on a periodical basis by the Audit Committee was also stated to be taken up to improve effectiveness of concurrent audit.

Vigilance Set up

3.3.37 The Corporation had a Vigilance Cell headed by a Deputy Superintendent of Police appointed (June 2005) on deputation with no supporting staff. The duties and functions of the wing were to conduct enquiry/investigation on areas specifically referred by the Managing Director and provide all assistance to branch office/head office personnel for taking over a unit. Verification of antecedents of promoters and submission of report to the MD in respect of specific cases referred to it was also entrusted to the Vigilance Cell. The Corporation did not entrust the verification of credit-worthiness/technical expertise as mentioned in the appraisal memoranda and the genuineness of the documents pledged for loan on selective basis, to the Vigilance Wing with a view to sanctioning loans only to genuine entrepreneurs.

The Vigilance Officer was required to submit confidential reports to the MD about the overall functioning of the branch offices, discipline, public grievances, etc. It was, however, noticed that no such reports were being submitted. Documentation giving the year-wise details of cases referred to, disposed of and pending were also not maintained.

These matters were reported to Government in August 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 Corporation did not prepare the Business Plan and Resource Forecast in time nor did it analyse the variances with actuals. Substantial portion of the funds mobilised were utilised for repayment of borrowings. Actual sanctions of loans were much lower than the target. There was considerable decline in the disbursements with reference to actual sanction. Non-adherence to prescribed norms and procedures for sanction and disbursements of loans led to heavy default and non-recovery of dues. Loans were sanctioned without proper appraisal of projects and without ensuring managerial efficiency of entrepreneurs. Loan assistance was granted without ensuring adequate collateral security even to loanees who were chronic defaulters, etc. There was over valuation of securities resulting in difficulties in realisation of dues after take over and sale of securities. Disbursements were made before ensuring sufficiency of promoter's contribution. Due to adjustment of disbursements against dues the actual purpose of providing assistance to industrial units was defeated and the NPA status of loanees often changed rendering them eligible for further assistance. A sound Corporate Governance system was not in place in the Corporation and Vigilance Set-up was weak.

Recommendations

- ***Business Plan and Resource Forecast should be prepared in time so as to serve as a bench mark for activities of the ensuing year. The overdues should be given due importance while sourcing funds.***

- ***The system of appraisal before sanctioning of loans should be strengthened by strictly adhering to the prescribed procedures.***

- ***Effective procedure for verification and acceptance of securities and valuation of assets should be introduced to ensure genuineness of documents accepted and avoid over-valuation.***

- ***Adjustment of loan amounts released against over due arrears should be avoided since it defeats the purpose of granting loans.***

- ***Corporate Governance and Vigilance need to be strengthened.***

3.4 ROLE OF KERALA INDUSTRIAL INFRASTRUCTURE DEVELOPMENT CORPORATION IN THE DEVELOPMENT OF INDUSTRIAL INFRASTRUCTURE IN THE STATE

Highlights

The Corporation is not having definite policy for purchase/acquisition of land required for development of Industrial Parks for various sectors/groups with the result that major portion of land (1335.56 acre out of 2750.14 acre) acquired during January 1995 to December 2005 remained undeveloped.

(Paragraph 3.4.8)

Due to lack of adequate planning and study the Corporation failed in its task of setting up an industrial township and decision to set up a technically and commercially unsuitable Industrial Infrastructure Development Centre resulted in blocking up of funds.

(Paragraphs 3.4.9 and 3.4.11)

Land costing Rs.3.65 crore acquired on behalf of a private entrepreneur had been lying unutilised and interest due there against amounted to Rs.2.83 crore.

(Paragraph 3.4.10)

Despite specific terms and conditions, the Corporation failed to demand and recover from entrepreneurs enhanced compensation of Rs.seven crore paid to land owners towards cost of land.

(Paragraph 3.4.12)

Delay in collection of lease premium entailed interest loss of Rs.61.29 lakh and undue concession granted to a private group resulted in loss of revenue of Rs.90.86 lakh.

(Paragraphs 3.4.17 and 3.4.19)

Due to failure to first identify adequate water availability the investment of Rs.1.25 crore in water treatment plant had been lying idle and additional expenditure of Rs.4.09 crore had to be incurred on alternate water supply scheme.

(Paragraph 3.4.21)

Introduction

3.4.1 The Kerala Industrial Infrastructure Development Corporation (Corporation) was set up in February 1993 under the Kerala Industrial Infrastructure Development Act, 1993 (Act) to provide for the establishment of industrial areas, organisation of industrial growth centres and for setting up infrastructural facilities for industries. The main activities of the Corporation are;

- to develop, establish and maintain industrial areas selected by the Government;
- to identify appropriate industrial sites, acquire them and tie-up the required infrastructure facilities like power, water, roads, communications, etc; and
- to allot the developed plots to entrepreneurs on terms and conditions as may be determined by the Corporation.

The allotment of developed/undeveloped land to prospective entrepreneurs was being made on lease basis for a period of 90 years after collecting lease premium amount and annual lease rent and service charges thereafter.

As on 31 March, 2006, the Corporation had three associate companies* engaged in the business of export promotion, textile apparels and film and video as well as eight Industrial Infrastructure Development Centres (IIDCs). The Corporation also entered into agreement for five Joint Ventures**.

The management of the Corporation vests with a Board of Directors consisting of eleven members with the Chief Secretary to Government of Kerala as Chairman. The Managing Director is the Chief executive of the Corporation. There were no members representing professional bodies and financial institutions as contemplated under Section 5 of the Act *ibid.*

Scope of audit

3.4.2 The performance review conducted during January to May 2006 covers the activities of the Corporation in the development of infrastructure for industries during the five years ended 31 March 2006.

Seven IIDCs and three Associate companies and three Joint Venture Companies[@] which had taken up development works for infrastructure and allotment to entrepreneurs were covered in the present study.

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* Kinfra International Apparel Park, Kinfra Film and Video Park and Kinfra Export Promotion Industrial Park.

** Rubber Park India (P) Limited, ICICI-KINFRA Limited, Western India KINFRA Limited, Marine Products Infrastructure Development Corporation Limited, Care-KERALAM Limited.

@ IIDCs at Thiruvananthapuram, Mazhuvannur, Koratty, Malappuram, Wayanad, Thalassery, Kasargod. Associate companies Kinfra International Apparel Park, Kinfra film and Video Park, Kinfra Export Promotion Industrial Park. Joint Venture Companies: ICICI-KINFRA, Western India KINFRA Limited and Marine Products Infrastructure Development Corporation.

Audit Objectives

3.4.3 The objective of the performance review was to examine the role of Corporation in the development of industrial infrastructure in the State with a view to ascertain whether:

- there was a clearly laid down plan for purchase and development of land;
- land procured was developed by establishing infrastructure facilities like roads, power, water supply, communication etc.;
- the funds received from Central and State Government by way of grants and loans were utilised in an economic, effective and efficient manner;
- land developed was alloted to industrial entrepreneurs and the terms and conditions of lease were conducive to industrial development and lease rent fixed was optimum;
- there was proper co-ordination of various government departments and agencies to ensure timely and qualitative facilities; and
- the Corporation could ensure availability of adequate infrastructure to the entrepreneurs.

Audit Criteria

3.4.4 The Audit Criteria used for assessing the achievement of audit objectives were as follows:

- Industrial policy of the State Government and directives issued relating thereto.
- Targets fixed for selection of areas for development of infrastructure.
- Detailed studies made to establish whether industrial entrepreneurs were willing to acquire the areas if infrastructure development was carried out.
- Cost efficiency of plots allotted in various industrial parks.
- Performance of industries with regard to working results and employment opportunities created.
- Performance of associate companies particularly with reference to their intended objectives.
- Agreements with Joint Venture Companies and return on such investments.

Audit Methodology

3.4.5 The Audit methodology adopted involved;

- examining the industrial policy of the State Government and ascertaining whether the infrastructure development was in conformity with the policy and directions of the Industries Department/ Ministry;

- scrutiny of Government Orders, minutes of the meetings of the Board of Directors, Project Implementation Committee, Pricing Committee, etc;
- review of tender files, work contracts, payment vouchers, etc., and scrutiny of records of associate companies and Joint Venture Companies;
- review of documents relating to award of contracts, their execution and norms for provision of facilities, fixation of lease premium, rent of Standard Design Factories and its realisation; and
- review of Progress reports and administrative reports sent to Industries Department/Government.

Audit findings

3.4.6 Audit findings as a result of test check were reported to the Corporation/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, Industries Department and Managing Director of the Corporation. The views expressed by the members were taken into consideration while finalising the review.

Audit findings are discussed in the succeeding paragraphs:

Industrial Policy

3.4.7 The State Government announced (1998, 2001 and 2003) the Industrial Policy which provided an overall approach towards development and upgradation of infrastructure to enable optimum utilisation of the State's resources. As per the 1998 policy the Government identified 100 *per cent* Export Oriented Unit (EOU) and tiny, small, medium or large units in sectors like Information Technology, Tourism, Agro based business including food processing, Readymade garments, Ayurvedic medicines, Mining, marine products, light engineering, bio-technology and rubber based industries as thrust Sectors. Specialised industrial parks with state-of-the-art infrastructure were to be developed for each of the above thrust sectors.

Under the industrial Policy of 2001 and 2003 the Corporation was expected to 'kick start' infrastructure development in the State and to bring about revolutionary changes in the availability of quality infrastructure. The salient features of the policy included:

- Revival of Kerala State Export Promotion Council to cater to the needs of export community.
- Announcement of a new export policy by constituting an Export Promotion Committee with the Corporation as a nodal agency.
- Setting up transparent methods for private participation in infrastructure in public interest.
- Setting up industrial parks for various sectors and groups including women.

- Development of industrial areas under Build, Operate and Transfer (BOT) and Build, Own, Operate and Maintain (BOOM) basis.
- Development of road and water transport with private participation.
- Provision of educational and research institutions of international standards related to business/ industry.
- Creation of a separate fund by the Corporation to take up preliminary/feasibility studies.
- Implementation of the Special Economic Zone (SEZ) policy and establishment of Industrial Development Zones.
- Constant co-ordination with Government of India for ensuring higher central investment in Kerala.

Out of the various activities indicated above, the Corporation had taken up the setting up of industrial parks for various sectors and groups.

Purchase/Acquisition of Land

3.4.8 For the purpose of establishing industrial parks by providing infrastructural facilities the Corporation had been purchasing/acquiring land. The land acquisition was made through the District Collector and in some cases purchases were made directly from other departments/institutions. The Corporation, however, did not have any definite policy for selection of land for purchase/acquisition with reference to the nature of industries and suitability for creation of infrastructure facilities. The procurement/purchases were being made merely on the basis of availability of land.

During January 1995 to December 2005, the Corporation acquired/purchased 2750.14 acres of land at 17 locations. **Annexure 20** gives details of area acquired/purchased, cost of land and cost of development of various industrial Parks. The total cost of 2384.34 acres of land (excluding 240 acres assigned by the State Government free of cost and 125.80 acres for which valuation was yet to be made) was Rs.81.75 crore. The cost of land ranged from Rs.1.13 lakh to Rs.7.53 lakh per acre depending on the location except the cost of land procured at the rate of Rs.28.01 lakh per acre at Kochi during 2005.

The industrial infrastructure development (IIDC) schemes envisaged development of industrial areas with infrastructure facilities within two years. Out of the total area of 1914.98 acres (**Annexure 20**) of land in 13 industrial parks, development works were undertaken in an area of 1032.52 acres only keeping an area of 882.46 acres without commencing development works. In respect of the balance area of 835.16 acres of land under “Other Parks” development works were undertaken only in 382.06 acres leaving a balance of 453.10 acres of undeveloped land. This included 164.22 acres of land acquired for a private party as discussed in para 3.4.10 *infra*.

The deficiencies noticed in the purchase/acquisition of land and its utilisation are discussed in the succeeding paragraphs:

Land assigned for Industrial Township

3.4.9 The Corporation identified an area of 300 acres of land owned by Hindustan Machine Tools Limited in the prime locality at Kochi and submitted (May 1999) its proposals to the State Government for establishment of an Integrated Industrial Township (IIT) through a suitable Joint Venture Partner who was to be identified. The Government, accordingly, assigned and allotted (June 1999) 250 acres of land which was taken over by the Corporation in November 1999. The proposed IIT was to comprise of KINFRA ITPO Exhibition-cum-Convention Centre (40 acres), KINFRA Export Promotion Industrial Park – Free Trade Zone (135 acres) and Hi-tech Park (75 acres). It was noticed during audit that the Corporation had not undertaken any feasibility study for the establishment of an industrial township in the area and no Joint Venture partner could be identified till date (August 2006). Thus, even after the lapse of over five years the Industrial Township had not been started. The only activity undertaken on the land was commencement (April 2005) of civil construction work for a Biotechnology Incubation Centre building in an area of 40 acres. The Corporation further transferred 10 acres of land to the National Institute of Legal Studies without lease rent for 90 years as directed (August 2005) by the Government. The balance area of 190 acres has been lying idle since November 1999.

The Management stated (July 2006) that several attempts made from June 2000 onwards to find a private sector participant for Hi-Tech Park through the process of newspaper advertisements were not fruitful since there was no demand for land at that time. The reply indicated that the Corporation had sent the proposal for setting up of an Industrial Township without adequate planning and study.

Acquisition of land for a Private Entrepreneur

3.4.10 On the direction of the State Government, the Corporation entered into (December 1997 and May 2000) an agreement with a private entrepreneur viz. Kannur Power Projects (KPP) to provide land to him for setting up a 500 MW thermal power project by KPP. The Corporation acquired and took possession (July 2000) of an area of 164.22 acres of land in Kannur District at a cost of Rs.3.65 crore. As per the terms of the agreement, the private entrepreneur (KPP) had to bear all the liabilities arising out of acquisition proceedings and also to refund to the Corporation the amount along with the interest at the rate of 16.5 *per cent* per annum.

Land costing Rs.3.65 crore acquired on behalf of a private entrepreneur had not been utilised and interest due there against amounted to Rs.2.83 crore.

Audit scrutiny revealed that KPP did not comply with the terms of the agreement and the land measuring 164.22 acres was kept in the possession of the Corporation. The Corporation paid Rs.3.65 crore towards the cost of land. Besides there were 62 land acquisition reference cases to be decreed by the Court. The total amount due (including interest of Rs.2.83 crore) worked out to Rs.6.48 crore. The Corporation could not take any legal action for the realization of these dues from KPP in the absence of any clause in the agreement to this effect.

The Management stated (July 2006) that the agreement with KPP was still subsisting and hence Corporation cannot unilaterally withdraw from the agreement and cannot make use of the land for any other purpose as this would jeopardize the smooth process of recovery of dues from KPP and that it was seeking the Government's direction for realization of the amount.

The reply is not tenable since no specific provision was included in the agreement with KPP for utilisation of land for some other purposes by the Corporation in case of any default by KPP. Further the Corporation did not have any viable proposals for the utilisation of this land.

Land acquired at Kunnamthanam

3.4.11 The Corporation got transferred (March 2000) an area of 14.48 hectares (37.5 acres) out of 35.48 hectares of land acquired (February 1999) by the State Government at Kunnamthanam, Pathanamthitta District for setting up an Industrial Growth Centre. The Corporation paid Rs.87.31 lakh to the State Government in February 2004 for taking possession of this land. The area had earlier been abandoned (November 1996) by Kerala State Industrial Development Corporation (KSIDC) on the ground that setting up of an Industrial Centre was technically and commercially not viable. Petitions filed by the land owners in the Hon'ble High Court against acquisition proceedings were also pending at the time of transfer. In spite of this, the Corporation got possession (February 2001) of the land and also obtained approval (December 2001) from the Government of India for setting up of an IID Centre at a cost of Rs.5.05 crore. The development works could not be carried out since the land owners obtained stay order from the Hon'ble High Court. The Government of India cancelled (December 2005) the approval for IID Centre at Kunnamthanam.

Decision to set up the IID centre which was not technically and commercially suitable resulted in blocking up of Rs.87.31 lakh

Since the land had been abandoned by KSIDC, the Corporation was aware of the unsuitability of the location for IID centre even prior to taking over the land. The decision of the Corporation to set up IID centre in a location which was not technically and commercially suitable resulted in non-establishment of an industrial park and blocking up funds to the extent of Rs.87.31 lakh spent for land acquisition.

The Management stated (April 2006) that the Hon'ble Supreme Court had finally decided (December 2005) the cases against acquisition, in favour of the Corporation and the development work of the park had begun (April 2006). Since GOI assistance was available only for one year as per the scheme, the Corporation proposed to meet the expenditure from the State Government's share of assistance.

Payment of enhanced compensation

3.4.12 As per the license agreement/lease deed (Clause 3) the premium payable by an individual entrepreneur would be enhanced proportionately if additional compensation had to be paid as a result of any court order pursuant to provisions of Land Acquisition Act. The land owners (1029 nos.) of eight centres* had filed (April 2000 to March 2006) cases before the Court's claiming enhanced compensation for a total area of 1971.10 acres of land.

The Corporation failed to demand and recover from entrepreneurs enhanced compensation of Rs.seven crore paid to land owners towards cost of land.

The Corporation paid Rs.seven crore in respect of 380 cases settled and 649 cases were still (April 2006) pending in various courts. In spite of specific terms and conditions to this effect in the license agreements and lease deeds, the Corporation had not demanded the proportionate share of enhanced compensation from the industrial entrepreneurs who were allotted land during the period April 1998 to March 2006.

The Management stated (July 2006) that they propose to recover enhanced compensation by fixing the cut off period as 31 March 2006 and then periodically till complete cases were finally disposed of. It was, however, noticed in audit that the Corporation had not claimed (July 2006) the enhanced compensation even after the proposed cut off date.

Allotment of Land

3.4.13 The Corporation framed (December 1993) rules and regulations as per Sections 49 and 50 of the Kerala Industrial Infrastructure Development Act, 1993 which are pending approval of the State Government (August 2006). Further, as per section 50 of the KIID Act 1993, the Corporation framed (February 1996) Land Disposal Regulations to deal with matters relating to allotment of land and the same were still (August 2006) pending approval from the State Government. The land at the the industrial parks of the Corporation is to be allotted on lease for a period of 90 years under these Regulations. The State Government constituted (May 1999) the Pricing Committee and Land Allotment Committee for dealing with fixation of lease premium and allotment of land for each area. During April 1998 to March 2006, the Corporation allotted an area of 408.76 acres of land in 238 cases. Licence agreements were executed in 191 cases for an area of 170.59 acres in 10 industrial parks and 52** entrepreneurs had executed lease deed for a total area of 165.02 acres in nine industrial parks.

The deficiencies noticed in the allotment of land and execution of lease agreements/ deeds are discussed below:

Delay in execution of licence agreements/lease deeds.

3.4.14 Land Disposal Regulations provide for allotment of land to the entrepreneurs within 30 days of application followed by execution of a licence agreement within 15 days thereafter on payment of a minimum of 50 *per cent* of lease premium amount. The entrepreneurs have to execute a lease deed within two years from the date of licence agreement upon payment of full lease premium and commencement of commercial production.

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* KIAP/IIDC, Trivandrum; KEPIP, Ernakulam; IIDC, Thalasery; IIDC, Kasargod; IIT, Palakkad; IIDC, Adoor; Kannur Power Project, Kannur and Rubber Park, Irapuram

** Includes seven cases where direct lease deed (without licence agreement) has been executed for an area of 118.98 acres.

Audit scrutiny disclosed the following

- Of the 238 cases where allotment letters were issued during April 1998 to March 2006, licence agreements were executed within the prescribed period of 15 days in 28 cases only. The delay in executing licence agreements in the other cases ranged between two and 1348 days involving amounts ranging between Rs.0.22 lakh and Rs.82.84 lakh.
- Of the 191 cases in which licence agreements had been executed, the lease deeds were executed in 45 cases only. A test check of 35 cases out of these 45 cases revealed that in 21 cases lease deeds were executed within the prescribed period of two years, while in the remaining 14 cases, the delay ranged from one month to 35 months.
- In respect of 55 cases involving an area of 59.53 acres of land as on 31 March 2006, the mandatory period of two years from the date of licence agreement had already expired but no lease deed had been executed so far, even after delays ranging between one month to 84 months after expiry of the two year period. An amount of Rs.1.64 crore (lease premium Rs.1.46 crore and interest Rs.18 lakh) was outstanding from the parties. No action was taken by the Corporation to revoke the agreement and to restore the land after forfeiting the EMD as per Clauses 5 and 7 of the licence agreement.

Deviations from the provisions of Land Disposal Regulations

3.4.15 The Corporation deviated from the provisions of Land Disposal Regulations in adhering to the period prescribed for allotment of land, execution of licence agreement/ lease deed etc. The deviations resulted in undue favour to the entrepreneurs and cases of loss by way of interest on lease premium as suffered by the Corporation are discussed in succeeding paragraphs:

Allotment to Kairali Group

3.4.16 The Corporation acquired (1999-2002) 340 acres of land near Walayar in Palakkad district (cost Rs.7.61 crore) for setting up an industrial township as per orders (October 1998) of the State Government. Out of this an area of 79.40 acres of land was allotted (November 2002 and February 2003) to Kairali Herbal Cures (P) Limited (KHC) on lease for a period of 90 years to set up a full fledged herbal cure centre, at a total lease premium of Rs.2.41 crore. The lease deed was executed in May 2005.

Deviating from the Land Disposal Regulations, the Corporation allowed instalment facility over a period of two years for payment of premium without entering into licence agreement resulting in loss of interest amounting to Rs.39.09 lakh and extension of undue favour to the party.

Delay in collection of lease premium amount in time entailed interest loss

Further land measuring 98.80 acres was allotted (June 2005) to another firm (Kairali Heritage Centre (P) Limited) of the same group. This firm paid (August 2005) only the EMD (Rs.25.61 lakh) and the lease premium of Rs.2.31 crore has not been paid so far (June 2006). The delay in receipt of lease premium entailed loss of interest of Rs.17.22 lakh for the period August 2005 to March 2006 since licence agreement was not executed.

The Management stated (July 2006) that the execution of agreement might be dispensed with if the Corporation decided to grant a direct lease. The reply is not tenable since the Corporation collected the lease premium over a period of two years in instalments without reckoning the appreciation accrued in the value of land.

Loss due to non-execution of license agreement

3.4.17 KINFRA Small Industries Park (KSIP), Thalassery allotted (March 2001) five acres of developed land at a lease premium of Rs.13.25 lakh per acre to Rubco Sales International (RUBCO) for setting up a canvass shoe manufacturing unit. RUBCO remitted (December 2001) Rs.44.75 lakh. Instead of adjusting the amount against 50 *per cent* lease premium payable for five acres of land allotted, Rs.39.75 lakh was adjusted against full lease premium for three acres of land, EMD for balance two acres of land (Rs.2.65 lakh) and EMD for 1.61 acres of land in respect of their sister concern Rubco Huat Woods (Rs.2.35 lakh). The lease deed was executed (December 2001) for three acres of land only.

Delay in intimating allotment and adjustment of full lease premium against lease value of a portion of the land allotted resulted in interest loss of Rs.61.29 lakh.

Audit scrutiny revealed that as against the prescribed time limit of 45 days there was delay of 18 months from May 2000 to December 2001 in intimating the allotment of land to RUBCO and for execution of licence agreement. Since the Corporation could charge interest only after execution of licence agreement the delay entailed loss of Rs.22 lakh by way of interest for the period from June 2000 to December 2001.

In respect of the balance two acres of land allotted to RUBCO and 1.605 acres to Rubco Huat Woods, the interest loss on the balance aggregate lease amount of Rs.47.63 lakh, arising from non-execution of lease agreement, worked out to Rs.39.29 lakh for the period up to March 2006.

Undue favour to an entrepreneur

3.4.18 KINFRA Export Promotion Industrial Park (KEPIP) allotted (July to December 2000) 8.513 acres of land to Kerafibretex International Private Limited (KF) for setting up a PVC Coir manufacturing unit. KF executed (January 2001 to April 2002) the licence agreement and lease deed (May 2005) after paying (March 2004) the full lease premium. Due to delay in execution of licence agreement beyond the prescribed period of 15 days from the date of allotment, the Corporation lost Rs.4.28 lakh as interest on the balance premium from the date of down payment (July 2000/January and February 2002) of 50 *per cent* lease premium to the date (January 2001/April 2002) of licence agreement. Further, the Corporation had to waive aggregate interest amount of Rs.11.33 lakh payable by KF during the period from January 2001 to March 2004 on account of failure to provide power supply in time (Rs.2.21 lakh) and undue concession by way of non-levy of interest (Rs.9.12 lakh) on full lease premium deviating from the normal practice.

The Management stated (July 2006) that KF could be provided power only in April 2001 due to delay in commissioning of sub-station and KF being a major exporter, the Corporation could persuade prospective investor to come to KEPIP. The reply is not tenable since the loss due to waiver of interest totalling Rs.15.62 lakh was incurred in violation of the terms and conditions of Land Disposal Regulations.

Allotment of standard design factories

3.4.19 Since there were no allottees for the land developed by the Corporation at the KINFRA International Apparel Park (KIAP) the Corporation constructed (December 1999) three Standard Design Factories (SDF) each with a plinth area of 17500 sq feet at a total cost of Rs.4.09 crore. The entire facility was let out (May 2002) to Leela International Limited, Mumbai (LIL).

Based on negotiation conducted with LIL, the then Managing Director recommended (February 2002) to Government a lease rent of Rs.1.81 per sq.ft. per month for the first two years with 12 *per cent* increase every two years thereafter till tenth year. The basis of fixation of this rate was, however, not available. These rates were approved (April 2002) by the Government.

Undue concession granted to a private group resulted in loss of revenue of Rs.90.86 lakh.

Audit scrutiny revealed that the Pricing Committee being the designated authority had fixed (March 2002) the rent at Rs.2.95 per sq feet per month during the first two years with 12 *per cent* increase every two years and Rs.4.79 per square feet per month in the ninth and tenth year and thereafter Rs.17.42 per square feet per month till the 30th year so as to recover the actual capital cost of Rs.4.09 crore in 30 years. The Corporation, however, did not enhance the rent to Rs.2.95 per sq.ft. but continued to charge at the rate of Rs.1.81 per sq.ft. The undue concession granted to LIL resulted in revenue loss of Rs.27.36 lakh to the Corporation till April 2006 and a future loss of Rs.63.50 lakh up to April 2012.

The Management stated (July 2006) that there were no takers for SDFs in the Apparel Park. As a result of a one to one meeting and regular interaction Leela Group was persuaded and got the rate revised by the Government. The reply is not tenable since the Corporation had not made any study regarding viability for establishment of an Apparel Park in this area and construction of SDF was undertaken outside the scope of function of creation of infrastructure when it was not viable.

Delay in providing infrastructure facilities

Construction of 33/11 KV Substation

KINFRA incurred avoidable expenditure of Rs.62.80 lakh on construction of sub-station due to improper estimation of power requirement.

3.4.20 KINFRA Techno Industrial Park (KTIP) at Kakkanchery, Malappuram (unit of the Corporation) estimated (November 1995) its power requirement as 4 MVA at 11 KV and applied to Kerala State Electricity Board for providing supply through two 11 KV feeders. The estimates for power requirements were changed too frequently and the Corporation finally availed (August 2003) 3 MVA power through ‘Looping in and Looping out’ arrangement from 33 KV line after constructing (February 2003) a substation in the park at a cost of Rs.62.80 lakh.

Audit scrutiny revealed the following:

- The guidelines issued for setting up IIDC with access to adequate source of power was not complied with in this case resulting in delayed implementation of the project for more than seven years.
- In Corporation's other parks, except KEPIP, Kochi (an electricity licensee) the required power at 2MVA to 5 MVA was obtained at 11 KV. The decision to change power requirement from 11 KV to 33 KV was without any valid ground. In the absence of proper study on the rating of power requirement, KINFRA incurred extra expenditure of Rs.62.80 lakh on the construction of the 33/11 KV substation.

The Management stated (July 2006) that they obtained power at 33 KV because of the urgency to provide the same to entrepreneurs who had already been allotted land and obtaining power at 11 KV would have taken around three and a half years. The reply is not tenable in view of the fact that the power requirement at the required rating could have been obtained at 11 KV directly from the Chelari substation, two kilometers away, commissioned in October 2002 well before the completion of the substation of KINFRA and energisation of the park in August 2003. The present requirement of the park is 0.75 MVA only. The expenditure of Rs.62.80 lakh necessitated due to improper estimation of power requirement was avoidable.

Failure to first identify adequate water availability for an Industrial Park

3.4.21 The Corporation decided (March 1995) to locate the Kinfra Techno Industrial Park (KTIP) in 70 acres of land in Malappuram district. The park comprised of a food zone in 60 acres of land and water availability was one of the primary requirements for functioning of the zone. The project report for the park identified the water requirement of the park at five million litres per day (MLD) which was to be met from the ground water source available by incurring expenditure of Rs.two crore.

During implementation of the project the actual ground water availability was found to be only 0.5 MLD and an alternate location at Kadalundi river basin was identified (1997) at a distance of 13 km from the Park. This scheme also fell through due to social and political problems. The source of water was finally identified (November 2003) at Chaliyar river 17.50 km away. The contract for new external water supply scheme had been awarded (July 2005) at Rs.7.62 crore and the work was in progress (June 2006). The total expenditure incurred on water supply arrangements as on 31 March 2006 amounted to Rs.6.09 crore.

In connection with the provision of water supply for the park, the Corporation had entrusted (October 2002) the construction, commissioning and maintenance of a water treatment plant (WTP) to Shriram Engineering and Construction Company Limited, Chennai (SEC). This plant completed

(September 2004) at a total cost of Rs.1.25 crore was lying idle. The failure of the Corporation in identifying adequate sources resulted in undue delay in providing basic infrastructure facility for water supply. Due to this entrepreneurs had to resort to alternate sources of water for their requirements.

Water Supply Scheme for Mazhuvannur

3.4.22 The Pre-feasibility/Project Report of KINFRA Small Industries Park (KSIP), Mazhuvannur provided that the water requirements would be met from ground water sources. Eventhough, the Corporation constructed (May 2002) two bore wells and four open wells at a total cost of Rs.33.27 lakh, sufficient water was not available. Consequently for availing separate water connection the Corporation paid (July 2005) Rs.49 lakh to Kerala Water Authority and the work was in progress (April 2006). The construction of an external water supply scheme for KSIP at an estimated cost of Rs.1 crore was also being considered (July 2006).

Thus, failure of the Corporation to identify proper water supply sources resulted in not providing infrastructure facility of water to the entrepreneurs in the park.

The Management stated (July 2006) that it was not possible to estimate the water requirement in any park in initial stages since the details of the units being established are not known. The reply is not tenable since the feasibility study shows that the entire requirement of water was available from ground water sources. Lack of planning and strategy in conceiving and implementing the projects by the management resulted in excessive project cost which was subsidised by the Government.

Avoidable/extra expenditure in providing infrastructure facilities

3.4.23 The Corporation incurred avoidable/extra expenditure in providing infrastructure facilities as discussed in following paragraphs:

Delay in getting KSEB Licensee status

3.4.24 On the basis of the decision taken (July 1998) at the instance of the Chairman, KSEB, the Corporation submitted (January 2000) an application for licensee status for power distribution at Kinfra Export Promotion Industrial Park (KEPIP). A 110 KV sub-station was constructed (August 2000) and 110KV double circuit lines were drawn at a total cost of Rs.seven crore. Even though a draft licence agreement was prepared and forwarded (April 2000) to the State Government by the Chief Electrical Inspectorate, no formal orders were issued. In the meantime, Kerala State Electricity Board took over (February 2001) the power distribution system and operation of the sub-station. The Board, however, insisted on payment of operation and maintenance expenditure by KEPIP even though as per provisions (Clause 19 (e)) of regulations relating to the Conditions of Supply of Electrical Energy issued by KSEB under Section 79 (j) of the Electricity (Supply) Act 1948, such charges were to be borne by the Board from the date of take over of distribution system.

Subsequently, the Government declared (May 2003) KEPIP as an Electricity Licensee. KSEB allowed (July 2003) licensee status and handed over (January 2004) the power distribution system to the Corporation. The operation and maintenance charges of Rs.28.48 lakh were paid to KSEB up to January 2004.

The delay of four years (January 2000 to January 2004) in getting licensee status and the unnecessary payment of Rs.28.48 lakh indicated lack of co-ordination among the Corporation, KSEB and the State Government in the project implementation process despite the fact that the Principal Secretary to State Government was the Chairman of the Corporation and Chairman, KSEB a member in the Board of Directors of the Corporation.

The Management stated (July 2006) that Kerala State Electricity Board refused (February 2001) to grant licensee status and further there was undue delay on the part of the Government in issuing orders. The reply is not tenable since the Corporation was aware of the fact that Kerala State Electricity Board was not the authority to grant licensee status and the Board of Kinfra consisted of Chairman, Kerala State Electricity Board and Chief Secretary to the Government as directors.

Loss of energy

3.4.25 During 24 months from January 2004 to December 2005, KEPIP, as electricity licensee, purchased 412.15 lakh units of power from KSEB and sold 397.29 lakh units to industrial consumers. Own consumption of the Corporation was 1.13 lakh units. The difference of 13.73 lakh units between quantity purchased and quantity sold/consumed represented energy loss, which varied between 0.51 *per cent* and 7.27 *per cent* per month. At the purchase rate of Rs.2.60 per unit the loss worked out to Rs.35.70 lakh.

There was abnormal distribution losses valued at Rs.35.70 lakh.

The Management (July 2006) attributed it as a 'technical loss' in the nature of Transmission and Distribution Loss. However, KEPIP had not analysed the reasons for the abnormal variance in loss from 0.51 to 7.27 *per cent* per month reckoning the fact that energy was being distributed to units within the park itself.

Development of Industrial Infrastructure Development Centres (IIDCs)

3.4.26 The Government of India launched an Integrated Infrastructure Development Scheme in March 1994 for small scale industries in rural and backward areas with the following objectives:

- Promotion of cluster of small scale and tiny units with a view to create employment opportunities and develop exports.
- Promotion of stronger linkages between agriculture and industry.
- Providing common service facilities and technological backup services in the selected centres.
- Creation of infrastructural facilities like power, water, communication, etc., in the industrial areas.

The scheme was included in the eighth five year plan proposals. The salient features of the scheme were as under:

- The Government of India and Small Industries Development Bank of India (SIDBI) would contribute to each centre an amount not exceeding Rs.five crore in the ratio 2:3 and cost in excess of Rs.five crore per centre would be met by the State Government.
- The State Government would provide necessary land for the centres the cost of which was to be recovered from the project authorities.
- SIDBI would advance funds to the extent of Rs.five crore to the implementing agencies in instalments and claim simultaneously 40 *per cent* thereof subject to ceiling of Rs.two crore from Development Commissioner (SSI) as grant.
- The State Government was to be entrusted with the task of implementing the proposed scheme through a public sector corporation having sound financial position.

The Corporation, the nodal agency for the implementation of the scheme in Kerala during 1994 to 2006 undertook the development of IIDCs at eight locations* at a projected cost of Rs.40.61 crore excluding cost of land of Rs.13.58 crore. The establishment of IIDCs were on the basis of availability of land in each district and there were no plan/proposals for setting up the centres in the districts. The establishment of these IIDCs were on the basis of sanction from the Development Commissioner (SSI) for which a grant of Rs.two crore each was sanctioned. The State Government contributed matching contribution and met the shortfall if any in the project cost. The development works were taken up and allotment of plots commenced in seven centres. The following deficiencies in the implementation of the scheme were noticed in audit:

- the completion of development works in the centers were delayed for periods ranging from 16 to 60 months beyond the period of 18 months envisaged in the scheme.
- the delay in completion of electrical and water supply works with reference to land development and building works ranged from 11 to 21 months and from eight to 26 months respectively which showed non-synchronization of works.
- due to low occupancy, a high capacity (650 KVA) diesel generator set installed (April 2004) at IIDC Malapuram centre was not found economical during power failure and remained idle.
- as against 2469 small or tiny industrial units envisaged under the project reports, the number of units with whom licence agreement for allotment of plots entered into up to March 2006 was only 160 (6.5 *per cent*).
- out of 295.14 acre of land acquired, the corporation could lease out only 111.57 acre (37.8 *per cent*), including 18.43 acre sold as undeveloped land (IIDC Thalassery).

* Menamkulam (Trivandrum), Koratty, Wayanad, Kakkanchery (Malappuram), Adoor, Thalassery, Kasargod, and Mazhuvannur

- contrary to the spirit of the scheme large area upto 23.43 acre was allotted to single entrepreneur. (IIDC Thalassery).
- out of the total 153 allotments, 66 allotments only were for an area up to 25 cents. Further allotment to 20 units was not in conformity with the directives of IIDC scheme, since their investment was more than Rs.1 crore.
- as against the estimated direct employment for 13500 persons the employment generated (March 2006) was only for 2596 persons (19 *per cent*).

Audit scrutiny further revealed that the Corporation had not undertaken the following activities envisaged in the scheme:

- Providing technological back up service to the entrepreneurs and industrial units.
- Designing of entrepreneurship development/skill upgradation programme to synchronise with the project work to obviate idle capacity/low occupancy
- Concurrent and *post facto* evaluation studies about the industrial units established.
- Periodical assessment about the financial and operational details of the units for evaluation and report to top management/Government.
- Scheme of reservation or training for SC/ST and women entrepreneurs.

Thus, the very objective of the scheme primarily meant for creation of small scale industries in rural/backward areas with a view to provide employment opportunities, was defeated.

The Management stated (July 2006) that there were no demand for smaller plots of 10 cents area and delays occurred due to unforeseen circumstances. Employment potential depended on size of the industries, investment and technologies adopted.

The reply is not tenable since the expenditure on setting up of IIDCs could not contribute to employment potential which was the main objective of the scheme.

Marketing

3.4.27 The creation of Infrastructure by the Corporation for development of industries would attain the desired objective only if industrial plots, where facilities were created, were allotted or sold to entrepreneurs. The Corporation, however, has not so far (August 2006) evolved a policy for the marketing of land in various parks where facilities had been created.

The following points were noticed in audit :

- the pre-feasibility and feasibility reports on the setting up of industrial parks were being prepared by the Corporation and these reports seldom contained any viable proposals about the marketing policy to be pursued.

- the top management responsible for a policy decision in this regard had not considered this subject in any of the meetings of the Board of Directors, even though the difficulties faced in leasing of the land due to comparatively higher prices, labour problems, delayed infrastructure development, etc., were reported.
- in the absence of proper marketing strategy even the "special offer scheme" introduced in one park after creation of infrastructure facilities ended up in payment of Rs.29.49 lakh by way of rebate to 12 initial investors without attracting new entrepreneurs.
- no independent study was being undertaken as to the viability in developing an industrial park in a specified area.
- an expenditure of Rs.2.50 crore was incurred on advertisement, publicity and promotional expenses during the five years ended 31 March 2006. This represented advertisement charges on the Corporation's activities in special edition of various magazines, souveniers, diaries, etc., contribution for various seminars, workshop, etc., which included advertisement, entertainment and other sales promotion expenses. In the absence of any marketing strategy the expenditure did not serve the purpose.
- the Corporation does not have an independent marketing cell for monitoring the land disposal activities.

Monitoring and Evaluation

3.4.28 In order to ensure that the infrastructure created by the Corporation had been productively utilised and the units which were allotted land in various parks were established and functioning well, the Land Disposal Regulations of the Corporation and the licence agreement executed by the entrepreneurs prescribed (Clause 1) various post-allotment responsibilities such as;

- land would be handed over to the allottees on execution of the licence agreement.
- the entrepreneur should, within three months from the date of agreement, submit detailed plans and drawings for the construction of buildings.
- within eight months from the date of agreement, commence construction of the buildings; and
- within 20 months of the date of agreement, complete installation of Plant and Machinery and within 24 months from the date of agreement commence commercial production. On completion of construction, licensor shall execute lease deed for a period of 90 years.

It was noticed in audit that there was no system in the Corporation to monitor the above activities with reference to the schedule fixed and to report the lapses thereon to the top management with a view to take either corrective measures or invoke penal provisions.

3.4.29 Further, the activities relating to the development of infrastructure facilities like water, power, roads communications, etc., were to be completed within a period of 18 months from the date of acquisition/purchase of land as prescribed under IIDC scheme. It was, however, noticed in audit that there was no system to ensure that the works in connection with the infrastructure development were completed within the prescribed limit and no progress reports in this regard were prepared and considered in the meetings of Project Implementation Committee/Board of Directors.

3.4.30 The IIDC scheme announced (March 1994) by Government of India, envisaged various activities the Corporation was required to undertake to have an evaluation about the overall performance of the industrial units set up. It was, however, noticed that the Corporation had not undertaken any of these activities to ensure that the funds by way of grants/loans from Government were properly utilised for achieving the declared policies.

Promotion of Joint Venture Companies

3.4.31 As part of development of infrastructure facilities, the Corporation has from time to time formed Joint Ventures (JVs) with parties with capacity to bring in capital and administer projects. The Corporation has so far (June 2006) formed five Joint Venture Companies (JVC). The details thereof are as under:

Sl. No.	Name of Joint Venture Company	Nature of activity	Date of incorporation	Total share capital of Joint Venture Company (Rs. in crore)	Investments by the Corporation		Dividend received	
					Amount (Rs. in crore)	Percentage	Amount (Rs. in lakh)	Year
1.	Western India Kinfra Limited (WI-KINFRA)	Infrastructure development	October 1994	5.55	2.77	50	…	…
2.	Marine Products Infrastructure Development Corporation (P) Limited (MIDCON)	Marine products infrastructure development	March 1999	5.00	2.50	50	…	…
3.	ICICI-KINFRA (I-KIN)	Project consultancy	February 1996	1.55	0.37	24	0.75	July 2001
4.	Rubber Park Limited	Rubber based industries	December 1997	20.00	10.00	50	…	…
5.	Care-KERALAM Limited	Ayurvedic research	October 2004	3.00	2.00	67	…	…
	Total			**35.10**	**17.64**		**0.75**	

Investment of Rs.17.64 crore in five Joint Venture companies over a period of 12 years yielded a return of Rs.0.75 lakh only.

Even though the Corporation's investment in the JV companies was substantial, necessary provisions were not included in the Joint Venture agreements to ensure effective control over their affairs. The total investment valued Rs.17.64 crore in five Joint Venture companies as on 31 March 2005 did not yield any return (other than Rs.0.75 lakh received as dividend from one company (Sl.No.3 above) in 2000-01).

In respect of investment made in Joint Venture companies, the following points were noticed during audit:

- Western India-KINFRA Limited (Sl.No.1 of above table) was formed for establishing and developing a modern Integrated Industrial Township at Kanjikode in Palakkad district. The Corporation acquired 750 acres of land for this project, out of which 200 acres were transferred (December 1999) to the JVC. The interest on the cost of land (Rs.75 lakh) from the date of acquisition to the date of transfer, and enhanced compensation paid to the ex-owners till April 2004 (Rs.43.62 lakh), totalling Rs.1.19 crore were not reckoned/included in the value of 200 acres of land transferred. The balance area of 550 acres of land (cost Rs.six crore) acquired for this JVC was lying without use for the past 10 years resulting in blocking of investment. The Corporation could not utilise this land for any other purpose since it was acquired exclusively for the JVC.

  It was further noticed that the Western India KINFRA Limited had a huge amount of Rs.3.36 crore in fixed deposits as on 31 March 2005 indicating that funds were kept at the disposal of the co-promoter who was empowered to use the funds under the agreement, while the Corporation did not have any control over the affairs of the JVC.

- MIDCON (Sl.No.2 of above table) the JVC of the Corporation and MPEDA formed (July 2001) another JVC Seafood Park India Limited (SPIL) with 10 seafood exporters. MIDCON disbursed (September 2001 to October 2004) loans to the extent of Rs.4.62 crore to SPIL at seven *per cent* per annum with quarterly rest. There was no repayment against the loan and the same had been treated as a non-performing asset by MIDCON. SPIL had not yet (July 2006) formally commenced commercial operations. Thus, the JVC created by the Corporation with an investment of Rs.2.50 crore acted as a conduit in siphoning off the investment to 10 private entrepreneurs.
- The Corporation disbursed Rs.31.20 lakh to I-KIN (Sl.No.3 of the table) out of Rs.one crore received from the State Government as revolving fund for conducting techno-economic and feasibility studies on potential projects. Though the JVC collected the success fee from the bidders, the amount was not reimbursed to the Corporation.

Internal audit and Internal Control

Internal audit

3.4.32 The Corporation does not have its own Internal Audit wing. Internal audit was being got done by external Auditors. No Internal Audit Manual exists prescribing the areas to be covered/aspects to be examined during internal audit. The Internal Audit reports were also not being placed before the Board of Directors and there was no system of reporting the deficiencies contained in the Internal audit report to the top management. Irregularities of persistent nature like non-maintenance of land register with details of addition and disposals from time to time and the details of interest remitted to the court due to delay in remittance of additional/enhanced compensation in Land Acquisition Reference cases, were not reported regularly by the Internal auditors to the management.

Internal Control

3.4.33 The following deficiencies were noticed in Internal Control System.

- Internal Control procedures were not formulated by the Corporation. The rules and regulations for giving effect to the provisions of the KIID Act had not been framed so far (April 2006).
- The Board of Directors met only 11 times during the five years ended 31 March 2006. Formation of committees to decide policy matters and project implementation aspects was pending approval (April 2006) of the State Government.
- Fixed Asset registers indicating the location, value, number of items, date of purchase, depreciation charged from time to time, etc., were not maintained properly. No physical verification of assets had been undertaken.

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 Corporation at various stages of conducting the performance audit.

Conclusion

Kerala Industrial Infrastructure Development Corporation, formed with the objective of creating infrastructure facilities for development of industries in the State, did not have any policy for selection of land for purchase/acquisition with reference to nature of industries. The Corporation had taken up the establishment of industrial parks for various sectors and groups. Since a major portion of the land where infrastructure facilities were created remained unalloted the Corporation could not fully achieve its envisaged objective. The Rules and Regulations framed by the Corporation under KIIDC Act were not approved by the Government even after twelve years. The Corporation acquired land without any definite plan for development of specific categories of industry in specified areas. There was undue delay in intimating allotment of land to entrepreneurs, execution of licence agreements and lease deeds. There was no marketing strategy for leasing of developed land. The creation of infrastructure was carried out without proper planning and scheduling and units in various Parks of the Corporation could not be provided adequate power, water facilities etc., in time which contributed to excessive costs. No system was in existence for monitoring and evaluation of the performance of units in various parks with a view to assess the extent to which huge funds spent for creation of industrial infrastructure contributed to development and creation of employment opportunities. The Internal Audit, entrusted to outside agencies did not have adequate coverage and there was no effective internal control system in the organisation.

Recommendations

- ***Proper planning should be made and definite marketing strategy formulated before acquisition of land for creation of infrastructure.***
- ***Selection of land and development of parks by creating infrastructure should be based on needs and in consonance with the industrial policy of the Government. Expert committee needs to be appointed for dealing with this.***
- ***The Corporation ought to introduce post allotment monitoring and evaluation to assess the extent of industrial development and creation of employment opportunities. Periodic Report and Management Information System to be introduced.***
- ***Funds received should be productively utilised for the intended purpose.***
- ***Data base should be created in respect of acquisition of land, allotment, post allotment performance of units, employment generation, etc. Proper internal control system should be introduced.***
- ***Internal Audit system should be strengthened by providing adequate coverage.***