CHAPTER II

PERFORMANCE REVIEWS RELATING TO GOVERNMENT COMPANIES

2.1 OPERATIONAL PERFORMANCE OF TRAVANCORE TITANIUM PRODUCTS LIMITED

Highlights

Since inception (1946) the Company which is engaged in the manufacture of titanium dioxide was earning profit till 31 March 2005. It incurred loss of Rs.15.53 crore during 2005-06 mainly due to excessive cost involved for production beyond de-rated capacity, irrational price revision, fall in domestic sales, export at reduced rates to liquidate stock, unscientific incentive payment system and increase in raw material cost.

(Paragraphs 2.1.1 and 2.1.7)

Non-optimisation of the operation of calciners resulted in excess consumption of fuel valued at Rs.12.30 crore.

(Paragraph 2.1.11)

Non-utilisation of surplus capacity of sulphuric acid plant resulted in loss of potential revenue of Rs.2.75 crore.

(Paragraph 2.1.13)

Failure to control power consumption during peak hours and avail of the benefit of incentive for off peak hours resulted in avoidable expenditure of Rs.33.18 lakh.

(Paragraph 2.1.15)

Company's failure to enforce lifting of minimum assured quantity by the stockists and export of short lifted quantity at a lower price resulted in loss of revenue of Rs.6.06 crore.

(Paragraph 2.1.20)

The Company incurred extra expenditure of Rs.22.57 crore on salaries and wages due to non re-deployment of surplus staff (Rs.9.65 crore), overtime wages in departments having surplus staff (Rs.6.39 crore) and payment of Production Cum Motivation Allowance to employees not eligible for bonus (Rs.6.53 crore).

(Paragraphs 2.1.29, 2.1.30 and 2.1.31)

Viability of the Company's proposed expansion project would be affected since Kerala Minerals and Metals Limited, another State PSU, itself had been facing marketing constraints for rutile; technology absorption and marketability constraints.

(Paragraph 2.1.35)

The Company did not install the mineral separation plant to produce the basic raw-material though recommended by COPU in February 2003.

(Paragraph 2.1.37)

Introduction

2.1.1 Since inception (1946) the Company is engaged in the manufacture of titanium dioxide through sulphate process[*]. The main raw materials are Ilmenite and sulphuric acid. Ilmenite is procured from Indian Rare Earths Limited (a Central public sector undertaking) and sulphuric acid is produced in-house. Titanium Dioxide (TiO_2) is used in manufacture of paints, plastics, paper, printing and rubber products, etc. The Company was earning profit till 31 March 2005 but incurred a loss of Rs.15.53 crore during 2005-06.

The Management of the Company is vested in a Board consisting of seven directors including the Chairman and the Managing Director (MD). The day to day affairs of the company are managed by the MD who is assisted by the Executive Director, General Manager, Chief Production Manager, Chief Engineer, Chief Project Manager, Chief Manager (R&D), Chief Manager (Marketing and HR), Finance Controller and Chief Manager (Finance) & Company Secretary.

The working of the Company was last reviewed and the findings were included in the Report of the Comptroller and Auditor General of India for the year 1984-85 (Commercial). The report was treated as discussed by Committee on Public Undertakings.

Scope of Audit

2.1.2 The Performance review conducted during November 2006 to March 2007 covers the operational activities of the company at its lone manufacturing and operational unit at Thiruvananthapuram, for the five years up to 2006-07.

Audit objectives

2.1.3 The audit objectives of the performance review were to ascertain whether:

- the resources available were utilised productively to achieve maximum efficiency in operations;
- the top management regularly monitored the performance of the company and intervened/ensured continuous growth and improved financial results;
- efficiency of the marketing system was ensured for quality product at reasonable price to the consumer;
- the company is managed in a professional & scientific manner; and
- the Company complied with the norms for pollution control.

[*] In the sulphate process, ilmenite is first reacted with sulphuric acid to obtain titanyl sulphate from which hydrated titania is obtained by injection of steam. The hydrated titania is filtered, calcined in rotary kilns and milled to produce titanium dioxide in fine powder form.

Audit criteria

2.1.4 The following audit criteria were adopted:

- production, materials and sales budgets;
- procurement policy, procedures and consumption norms;
- sales policy, pricing policy, and procedures;
- pollution control norms/laws; and
- man power norms and project management systems.

Audit methodology

2.1.5 The audit adopted following mix of methodologies:

- review of agenda notes and minutes of the meetings of the Board of Directors;
- scrutiny of study reports, project reports and progress reports;
- scrutiny of cost audit reports and annual accounts;
- review of purchase and contract files, production, sales and materials budgets and actuals; and
- interaction with the Management.

Audit findings

2.1.6 Audit findings as a result of performance review were reported (May 2007) to the Management/Government and discussed in the meeting (30 July 2007) of the Audit Review Committee for State Public Sector Enterprises (ARCPSE), which was attended by the Joint Secretary, Industries Department, on behalf of the State Government and MD on behalf of the Company. The views expressed by the Management/Government have been taken into consideration while finalising the review.

Audit findings are discussed in succeeding paragraphs.

Financial position and working results

2.1.7 Company has finalised its accounts for the year 2005-06. The paid up share capital of the Company as on 31 March 2007 was Rs.1.77 crore held by the State Government (Rs.1.43 crore), Kerala State Industrial Development Corporation Limited (Rs.0.14 crore) and others (Rs.0.20 crore).

The financial position and working result of the Company during 2002-07 are summarised in **Annexure 9**.

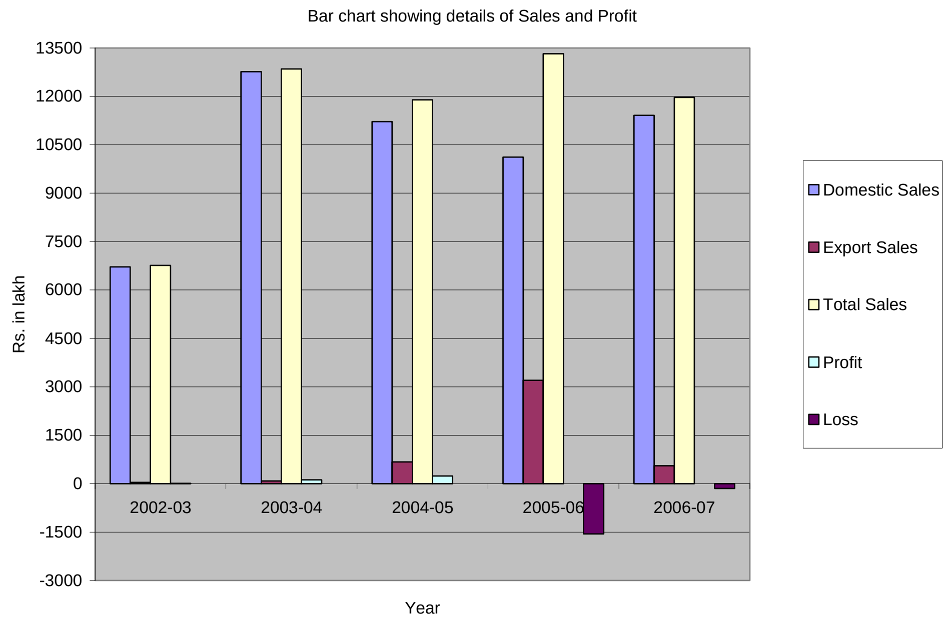
It would be seen from **Annexure 9** that

- The company's net worth declined from Rs.57.18 crore in 2002-03 to Rs.42.25 crore in 2006-07 mainly due to conversion of profit in 2002-03 into loss since 2005-06 onwards.
- Consumption cost of raw materials per unit of product increased from Rs.15545 in 2002-03 to Rs.20011 in 2006-07 due to increase in prices, uneconomical procurement and increase in consumption as discussed in paragraphs *2.1.10, 2.1.11 and 2.1.24 to 2.1.26 infra*.
- During 2002-07, Company has shown aggregate loss of Rs.13.35 crore; the loss would have been Rs.26.41 crore but for non-operating income.

It was further noticed that:

- In order to surmount the difficulties faced on account of world wide glut in the industry, imports from China, etc., the Government permitted (March 2003) the Company to sell its product through various stockists and directly to customers instead of routing the same through Kerala State Industrial Products Trading Corporation Limited (KSIPTC) and also allowed (March 2003) waiver of service charges and reduction in sales tax. Due to this, tax burden on the product was reduced (March 2003) from 30 to 4 *per cent* for inter-state sales. Government also waived (March 2003 to March 2004) service tax of Rs.5000 per MT of TiO_2. From 2004-05 onwards Company had not paid or provided for service charges even though no further waiver was allowed by Government. The loss of the Company came down by Rs 34.87 crore due to waiver/non-provision of service tax during 2003-07.
- The waiver of service charges was intended to effect reduction in the selling price. The Company, however, reduced the price from Rs.63500 to Rs.60000 per MT only once (April 2003), but increased it in subsequent periods (June/August 2003 and March/August 2004) without considering market trends. Further, pay revision was allowed (June 2003) effective from January 2001 involving additional annual liability of Rs.2.50 crore, disregarding working results.

Bar chart showing the details of sales and profit/loss of the Company during 2001-07 is given below:



Company's profit in 2002-03 turned into loss of Rs.15.53 crore in 2005-06 and Rs. 1.49 crore in 2006-07 due to abnormal production beyond de-rated capacity, pitfall in pricing, export at reduced rates and increase in raw material cost.

It can be seen from the bar chart that though the sales increased from Rs.68.02 crore in 2002-03 to Rs.133.88 crore in 2005-06 and 119.68 crore in 2006-07 but the profit in 2002-03 turned into a loss of Rs.15.53 crore in 2005-06 and Rs.1.49 crore in 2006-07.

The Management identified (March 2007) that increase in raw material cost and export sales at reduced rate to wipe out stock, were the reasons for loss. The main reasons for decline in profit as identified by audit were irrational price revision for domestic sales without considering market conditions, non-lifting of minimum assured quantity by stockists, high cost of production due to unscientific production incentive system resulting in exponential incentive payments, absence of appropriate marketing strategy, excessive cost involved for production beyond de-rated capacity, fall in domestic sales due to inappropriate pricing policy, export at reduced prices to liquidate stock, increase in raw material cost, etc., as discussed in succeeding paragraphs.

Planning process

2.1.8 The Finance wing of the Company prepares annual financial budgets based on the projections furnished by the production, materials, marketing and other departments. The annual production target is finalised by the Titanium Management Council headed by MD and comprising heads of all functional departments. The material procurement is managed by the Commercial Advisory Committee and marketing and pricing decision is taken by the Sales Promotion Committee. However, the Company did not have a system of preparing overall corporate plan other than the annual financial budgets. The deficiencies noticed in the financial budgets, production planning, procurement and marketing are discussed in succeeding paragraphs.

Production

Production planning

2.1.9 The installed capacity of the plant was 24500 MT per annum. The Wazir Committee appointed (January 1976) by the Government to study the under utilisation of plant capacity, observed bottlenecks in various stages of production and suggested (August 1976) the economic plant size as 15000 MT. The Company, however, prepared its annual production budget based on past performance. The table below gives the details of budgeted/actual production, sales and closing stock of TiO_2 during 2002-07.

(Metric Tonne)

Year	**Budgeted Production**	**Actual Production**	**Sales**			**Closing stock**
			Domestic	**Export**	**Total**	
2002-03	18000	11137	9521	70	9591	3402
2003-04	16000	16251	18132	154	18286	1367
2004-05	18000	18359	15225	1299	16524	3202
2005-06	20000	17111	13748	6013	19761	552
2006-07	20000	15767	14307	861	15168	1151

Source : Production budget and Annual accounts of the Company.

It would be seen from the table above that

- The company had budgeted its production above the suggested de-rated capacity of 15000 MT during all the five years despite glut in the industry and cheaper imports from China. The Company's efforts to produce above the de-rated capacity resulted in excess fuel consumption, payment of high production incentive/overtime as discussed in paragraph 2.1.11, 2.1.30 and 2.1.33 *infra* and difficulty in sales.
- The actual production was at variance with the budgeted production except during 2003-04 and 2004-05 indicating that the budgets did not serve the intended purpose.
- Since the actual production was not controlled on the basis of available stock and estimated off take, there was accumulation in stock.
- Despite increase in production the domestic sales recorded substantial decline on account of ineffective marketing and pricing strategy as discussed in paragraph 2.1.21 *infra*.

For liquidating the excessive production during the year 2004-05 and 2005-06 the company had to export 6013 MT at prices below the cost of production during 2005-06 resulting in loss of Rs.6.49 crore.

The Government accepted (June 2007) the audit observation that one of the reasons for loss was production beyond de-rated capacity. It was further stated that the export was resorted to find global market for rutile grade even though excessive stock holding was one of the factors. The reply is not tenable as the export was resorted to liquidate the accumulated stock arising from excessive production without planning.

Excess consumption of raw materials and utilities

2.1.10 The Company had fixed standards for consumption of raw materials (ilmenite, acid, iron scrap) and utilities (electricity) 20 years back. It did not revise the standards periodically with reference to actual consumption.

Consumption of raw materials and utilities was in excess of the norms by Rs.10.08 crore.

It is seen from **Annexure 10** that the actual consumption of raw materials and utilities per metric tonne of production of TiO_2 was much less than the standard fixed and the standard did not serve the purpose of control over consumption. The actual per MT consumption of raw materials varied from year to year. Considering the optimum level of consumption achieved (2001-02) by the company as norm the excess consumption of raw material and utilities during 2002-07 worked out to Rs.10.08 crore.

The Government stated (June 2007) that standard norms for consumption of raw materials was not updated since last twenty years and there was all round improvement in all areas due to learning curve of the employees. The reply shows that the Company though aware of improvement in production capacity vis-à-vis material consumption; did not revise the norms fixed before two decades; thus failed to exercise proper control over consumption of raw materials.

Excess consumption of fuel due to non-optimal operation of calciners

2.1.11 Calcination is the final process in the production of TiO_2 pigment for which the Company had three calciners. The exising calciner II in the old plant had a capacity of 13 Tonnes Per Day (TPD) and calciner III and IV in the new plant had a capacity of 32 TPD each. The Company usually operates calciner III and IV for production of anatase grade TiO_2 whereas calciner II was being run for the production of rutile grade pigment. Superior Kerosene Oil (SKO) is used in the calciners as fuel. Whereas, the calciners in new plant consume 12 kilo litre each of SKO, the calciner in the old plant consumes 6 KL of SKO for 24 hours operation. Based on the available capacity, by optimum operation of one of the calciners in new plant for 30 days, the Company could produce 960 MT of TiO_2. Considering the monthly production ranging between 543 MT (March 2002) to 1890 MT (October 2005) during the five years upto 2006-07, the Company had to operate one calciner to the full extent and the other partially for the purpose of optimum utilisation with a view to reduce fuel (SKO) consumption. The Company, however, did not ensure optimum use but operated both the calciners simultaneously irrespective of the quantity of feed processed during 2002-2007. Partial use of both the calciners when the operation of one calciner would have sufficed the requirement resulted in excessive consumption of 5766.24 KL of SKO valued at Rs.12.30 crore.

Non-optimal use of calciners resulted in excess consumption of fuel valued at Rs. 12.30 crore.

The Government stated (June 2007) that calciner operation could be optimised only through perfect planning and monitoring as there were many imbalances within the plants like shortage of raw materials, shortage of pulp, etc. The reply is not tenable as these imbalances were pointed out (1976) long ago by Wazir Committee. The Company, however, did not take any action for rectifying these imbalances. Further, excess consumption of SKO is caused by production beyond de-rated capacity without rectifying the imbalances in the plant.

Excess handling/grinding loss

2.1.12 The first stage in the process of manufacture of TiO_2 was digestion of ilmenite in sulphuric acid. For this purpose the Company had eight digesters having capacity of 10.5 MT each in the new plant and six digesters 5.5 MT each in the old plant. Audit analysis of the number of reactions carried out (April 2002 to March 2007) in the digesters with reference to the standard consumption of ilmenite showed that ilmenite was being consumed in excess of norm.

Loss due to consumption of ilmenite in excess of norm was Rs.24.36

Government stated (June 2007) that loss up to one *per cent* was normal in handling/grinding. Fact is that the value of loss in excess of the normal loss worked out to Rs.24.36 lakh and same required investigation since the Company had to compete with other companies and imports from China.

Non-utilisation of surplus capacity of sulphuric acid plant

2.1.13 The requirement of sulphuric acid for the production of TiO_2 was being met from company's Sulphuric Acid Plant (SAP) having installed capacity of 99000 MT per annum. The acid produced in the plant and available after captive consumption used to be sold in the open market. An analysis of production of acid, sales and contribution realised during 2002-06 is given in **Annexure 11**.

Non-utilisation of surplus capacity resulted in loss of potential revenue of Rs.2.75 crore.

It will be seen (**Annexure 11)** that the capacity utilisation of the plant for the four years ranged between 50.33 and 83.59 *per cent* of the acid plant. The Company sold 5091 metric tonne of sulphuric acid during 2003-2006. It was noticed that even though there was market potential for the product, the Company did not explore the market and even refused to supply when enquiries were made by prospective buyers (February 2004). The loss of potential revenue on this account during 2003-2006 worked out to Rs.2.75 crore.

The Government stated (June 2007) that there was no market for acid and firm orders for supply would affect availability of acid for TiO_2 production. The reply is not tenable since actual production of TiO_2 plant was always substantially lower than the installed capacity and the SAP was not running to full capacity. With proper planning it was possible for the Company to ensure a fixed volume of acid for sale. Further, Company itself had anticipated (March 2005) market for regenerated acid from the Acid Recovery Plant (ARP) under the expansion scheme.

Loss due to shortfall in generation of steam in sulphuric acid plant

2.1.14 As per the Basic Engineering Package for the acid plant, byproduct steam would be generated at the rate of 1.15 MT per MT of cent *per cent* concentrate sulphuric acid produced. The steam available for export* would be one MT per MT of acid, 0.15 MT of steam being used for captive consumption.

It was observed that steam availability for export at the rate of one MT per tonne of 100 *per cent* acid could be achieved only in two months (March 2004

* Transfer of steam from sulphuric acid plant to TiO_2 plant.

Shortfall in steam availability as per technical specification of the acid plant resulted in consumption of steam from boilers involving additional cost of Rs.3.19 crore.

and April 2006) though the plant generated steam at the rate of 1.17 MT/MT of 100 *per cent* acid. The short fall in the steam availability for export with reference to the technical specifications of the acid plant had to be made up by generation of steam from boilers. The additional cost on this account during 2002-07 worked out to Rs.3.19 crore reckoning the actual monthly percentage of consumption against export steam in TiO_2 plant in each year.

The Government stated (June 2007) that the steam produced from acid plant was captively used for running the turbine and keeping sulphur in molten condition. Government reply is not tenable since captive use of the steam in the sulphuric acid plant was more than the technical specification of the acid plant.

Avoidable payment of penal charges on electricity and non-availment of incentive.

Failure to control power consumption during peak hours and avail of benefit of incentive for off peak hours resulted in avoidable expenditure of Rs.33.18 lakh.

2.1.15 As per the tariff orders issued by KSEB, where the consumption of Extra High Tension (EHT) consumers during peak hours exceeded 10 *per cent* of total consumption, the consumer would be liable to pay penalty as 'Time of use charge' at the rate of 80 paise per unit and in case the consumption during off-peak hours exceeded 30 *per cent* of total consumption, consumer would be eligible for incentive at the rate of 25 paise per unit. During 2002-07, the Company paid Rs.1.09 crore as time of use charge. Due to extra peak hour consumption of 10.66 lakh units the Company incurred an additional expenditure of Rs.24.72 lakh and loss of off peak incentive of Rs 8.46 lakh. Thus, the failure of the Company to control its power consumption during peak hours and avail of the incentive for off peak hours resulted in avoidable expenditure of Rs.33.18 lakh.

The Government attributed (June 2007) factors such as production of TiO_2, sulphuric acid, absenteeism, etc., for poor power load management. The reply is not tenable since the Company itself had identified surplus manpower in the production department indicating that absenteeism could not be a valid reason being controllable. Further, power intensive machinery like grinding machines could be operated in off peak period with a view to reducing electricity charges.

Marketing

Marketing and Pricing Policy

2.1.16 Prior to March 2003 the Company's products were marketed by KSIPTC. At the point of first sale Sales Tax at 30 *per cent* and service charge of Rs.5000 per MT were being levied. State Government allowed (March 2003) direct marketing by the Company due to which the higher rate of Sales Tax burden and payment of service charges were eliminated providing more flexibility in product pricing. The Company has been selling its products through various stockists and directly to various customers. The selling price of the Company's product was fixed from time to time by a Sales Promotion Committee (SPC); chaired by the Managing Director. It consists of senior executives of marketing and finance departments; **constitution of the SPC did not have the approval of the BOD**. The Company had not adopted any long term Marketing and Pricing policy. It temporarily adopted (August 2002) the pricing policy of Kerala Minerals and Metals Limited (KMML), another PSU which was producing Rutile Grade TiO_2 for export. Variable cost plus twenty *per cent* minimum profit and forwarding charges, converted into equivalent US Dollars was fixed as the export price. The Company, however did not have any system of marginal costing for facilitating effective marketing and pricing decisions.

Even though the Company was mandatorily required to maintain cost records, the variable cost was not being compiled and used for the purpose of product pricing.

The Government admitted (June 2007) that the Company has not been updating records to compute the variable cost per tonne of the product and requested to accept the actual cost arrived from the records. The reply is not tenable since, in the absence of actual variable cost, the export price of the product as per the formulated policy was arbitrary.

Sales performance

2.1.17 The budgeted sales and actual sales realisation of the company during 2002-07 were as follows:

(Rupees in crore)

Year	Budgeted sales			Actual sales			Total shortfall
	Export	Domestic	Total	Export	Domestic	Total	
2002-03	0 (0)	134.34 (18000)	134.34 (18000)	0.43 (70)	67.17 (9521)	67.60 (9591)	66.74 (8409)
2003-04	2.55 (500)	122.08 (17000)	124.63 (17500)	0.82 (154)	127.68 (18132)	128.50 (18286)	(-) 3.87 {(-) 786.00}
2004-05	2.48 (500)	134.68 (17500)	137.16 (18000)	6.75 (1299)	112.17 (15225)	118.92 (16524)	18.24 (1476)
2005-06	40.48 (7500)	121.83 (15500)	162.31 (23000)	32.03 (6013)	101.16 (13748)	133.19 (19761)	29.12 (3239)
2006-07	17.60 (3000)	135.61 (17000)	153.21 (20,000)	5.56 (861)	97.70 (14307)	103.26 (15168)	49.95 (4832)
Total	**63.11 (11500)**	**648.54 (85000)**	**711.65 (96500)**	**45.59 (8397)**	**505.88 (70933)**	**551.47 (79330)**	**160.18 (17170)**

Source : Annual sales budget and Annual accounts of the Company.
Note: Figures in brackets show quantity in M.T.

The Company could not achieve the budgeted sales targets during 2002-07 except 2003-04. The aggregate short achievement of the budgeted sales target during 2002-07 was 17170 MT valuing Rs.160.18 crore. The shortfall in achievement of targets was due to irrational pricing system and short lifting of agreed quantity by stockists as discussed in paragraphs 2.1.20 and 2.1.21 *infra*.

Marketing of products

2.1.18 Since March 2003 the Company had been marketing TiO_2 through stockists. Separate agreements were being entered into with such stockists.

The stockists were required to lift an agreed minimum quantity monthly/annually. As of September 2006 the Company had engaged 39 stockists. It was noticed (February 2007) that the Company did not follow a marketing and pricing strategy in the best interest of the Company. The strategy followed was deficient and even the prescribed policies were flouted leading to heavy financial losses as discussed below:

Non-adherence to credit policy

2.1.19 As per the credit policy formulated (January 2004) by SPC and effective from January 2004, the Company relaxed the maximum credit limit of Rs.50 lakh. The stockists were given credit facility against post dated/ undated cheques in individual cases with prior approval of the MD. The credit period fixed was 45 days. SPC also decided (May 2005) that if the cheques issued by the stockists or the customer of the stockists bounced, any further orders from the same stockists/customer would be entertained only against DD/TT/cash payments/at par current cheques. No action was, however, envisaged against the stockists. Credit limit to stockists was reduced (September 2005) to maximum Rs 25 lakh after analysing the credit position.

Non-adherence to credit policy resulted in blocking up of funds amounting to Rs.42.67 lakh.

It was observed that in violation of the credit limit (Rs 25 lakh), the Company despatched (May 2006) 25 MTs of material valuing Rs 21.56 lakh against post dated cheques, when Rs 21.57 lakh was already outstanding (15 May 2004) from one of the stockists[*] thereby increasing the total outstanding dues to Rs 43.13 lakh. The two post dated cheques of Rs.42.67 lakh furnished by the stockist had bounced (September/November 2006) and an amount of Rs 42.67 lakh was outstanding (June 2007). The Company had not claimed Rs 5.76 lakh being penal interest at the rate of 0.25 *per cent* per week or part thereof for the excess debit balance from 16 May 2006. The stockist was not lifting material since June 2006. Thus non-adherence to the credit policy of the Company resulted in blocking of Rs 42.67 lakh.

The Government stated (June 2007) that the MD had the authority to take commercial decisions and allow special sanctions on credits in the overall business interests of the Company. The reply is not tenable as the relaxation lacked transparency and was in contravention of the laid-down credit policy and has eventually resulted in blocking up of funds which was not in the best financial interests of the Company.

Revenue loss due to short lifting of agreed quantity

2.1.20 As per agreement entered into between the Company and the stockists, the stockists were to purchase a minimum quantity of 18 MT of TiO_2 pigment per month and an aggregate minimum 250 MT per annum at the agreed price and on the prescribed terms and conditions during the currency of the agreement. Further, as per the agreement, in the event of the failure of the stockists to purchase the agreed minimum quantity, the agreement had to be terminated.

It was noticed that out of 39 stockists during the period 2004-06, only 9 stockists had lifted the minimum assured quantity whereas the off-take of

[*] Sita Paints Private Limited

remaining 30 stockists was either nil or below the assured quantity, their percentage off take ranging between 0 to 97.4 in 2004-05 and 0 to 78.8 in 2005-06.

As a result of short lifting by the stockists, the stock of TiO_2 started piling up (October 2004 -1897.475 MT) and reached an alarming level of 3202 MT (March 2005). Despite this, the Company did not take any steps to enforce the minimum off take by stockists in the domestic market. To clear the accumulated stock and liquidate the stock arising from excessive production without planning, the Company had to export 5463.575 MT of Anatase grade[*] TiO_2 and 549.025 MT Rutile grade[#] TiO_2 during 2005-06 at prices lower than domestic selling price; out of which 5650.42 MT represented quantity short lifted by the stockists.

Company's failure to enforce lifting of minimum assured quantity by stockists resulted in loss of revenue of Rs.6.06 crore.

Thus, the failure of Management to enforce lifting of minimum assured quantity of TiO_2 by stockists and export of the short lifted quantity at a lower price resulted in loss of Rs.6.06 crore which could not be recovered from the stockists due to absence of enabling clause in the agreements. The Company, however, neither terminated the agreement with these under-performing stockists nor did appoint fresh stockists.

The Government stated (June 2007) that due to the influx of cheap imports as well as liberal credit facilities offered by Company's domestic competitors, these stockists were facing tough competition in pushing up company's product. It was also stated that termination would affect representation in major consumption centres. The reply is not tenable as domestic sale through stockists was more than 10000 MT in all these years and the nine main stockists had shown substantial progress in their off take. Fixing off take limits and allowing the stockists to violate the limits is not the best commercial practice. Company should have incorporated enabling clauses other than termination to ensure lifting of agreed quantity.

Price revision and export of Titanium dioxide to Itochu Corporation

2.1.21 The Company instead of reducing its production cost by controlling raw material consumption, input consumption and rationalising production incentive payments to its employees, increased (August 2004) the domestic selling price of anatase grade TiO_2 from Rs 64500 to Rs.66000 per MT without analysing the market conditions on the ground of increase in raw material and fuel costs. This price revision had, however, a negative impact on domestic sales (August 2004 to March 2005). The average monthly domestic sales dropped from 1584.60 MT to 1012.95 MT during the post revision period (August 2004 to March 2005) leading to accumulation of stock to the tune of 3202 MT by the end of March 2005. At this juncture, the Company had the option either to reduce selling price to the pre-August 2004 level to recapture the lost domestic market or to regulate production at 900 MT per month during 2005-06. The Company, however, resorted to

[*] It is a mineral form of TiO_2 which has low density and used in the manufacture of paper, plastic, interior paint, etc., as pigment.

[#] It is a high quality form of mineral TiO_2 with high density and used mainly in the manufacture of interior and exterior paint.

indiscriminate production and committed (February 2005) export sale to Itochu Corporation (USA) for 5000 MT of ISI grade Anatase during March 2005 to December 2005, at the rate of 500 MTs per month, at US$ 1200 FOB Cochin (Rs.52572). Since the price was firm for the entire period of contract, the revised price (April 2005) for the export sale of anatase at 1300 US$ per MT could not be applied for this sale. There were no reasons on record for the decision to commit huge quantity for export at reduced prices to Itochu Corporation. The mode of selection of Itochu was also non-transparent without inviting competitive bids.

Company's decision to export TiO_2 to Itochu Corporation resulted in revenue loss of Rs.49.73 lakh.

The revenue foregone due to export, considering actual realisation and probable realisation from domestic market at pre-revised price during the year 2005-06 worked out to Rs.49.73 lakh.

The Government stated (June 2007) that in case the Company had not ventured into export, the loss would have been much higher for the financial year 2005-06. The reply is not tenable since the Company did not have any relevant cost data to substantiate that there was any contribution from exports at reduced prices after reckoning the increase in fuel cost on account of operating the plant above de-rated capacity.

Material management

System lapse in purchase

2.1.22 The Company had not framed any definite policy and formulated procedures for procurement of raw materials and chemicals required in bulk quantities with a view to reduce procurement cost. The Company used to make an assessment of the raw material requirements based on budgeted production for a year. Quotations were being invited from suppliers through advertisements in newspapers and enquiries to approved suppliers as per list maintained by the Commercial Department. Limited tender system was also adopted when source of supply was limited in the case of proprietory items and to meet urgent requirements. Purchase proposals based on offers received were approved by a Commercial Advisory Committee comprising General Manager, Chief Commercial Manager, Chief Production Manager, Chief Engineer, Marketing Manager and Finance Manager after pre-audit by Financial Controller and approval by MD.

Audit scrutiny revealed that the system had deficiencies as discussed below:

- Material management was unscientific and not related to de-rated capacity and budgeted production
- The Company did not enter into long term contracts or annual rate contracts even though raw material requirements could be assessed in advance.
- No formal contracts were entered into with suppliers. When suppliers failed to supply during the contract period, the Company could not enforce supply or initiate legal action.

- Security Deposit (SD) was either not collected or allowed to be adjusted from the first bill at the request of suppliers defeating the purpose of security for performance of contract.
- The Company was not deducting any 'Retention Money' from bills of contractors to ensure supply of quality materials.

The extra expenditure/losses arising from the absence of proper procurement policy and procedures are as discussed in succeeding paragraphs:

Procurement at extra cost

Purchase of short supplied material at higher rates resulted in additional expenditure of Rs.19.51 lakh.

2.1.23 The Company invited quotations (September 2002) for supply of 400 MT iron scrap per month for six months. Based on offers, purchase orders were placed with seven suppliers (September 2002-February 2003) for 1185 MT at the rate of Rs.8700 per MT and 300 MT at Rs.8250 per MT. Out of these only three suppliers supplied a total quantity of 121.885 MT against the ordered aggregate quantity of 600 MT. The short supply of 478.115 MT was purchased (May 2003) at the rate of Rs.12499 per MT involving additional expenditure of Rs.19.51 lakh.

Extra expenditure in procurement of scrap iron from traders

Purchase of iron scrap from traders instead of directly from manufacturers resulted in additional expenditure of Rs.17.38 lakh.

2.1.24 The Company had been meeting its requirement of scrap iron by purchase from traders and not manufacturers or importers. A test check of the invoices of supplies against four purchase orders placed (July 2005 and November 2005) with two suppliers for a quantity of 572.31 MT revealed that the traders were procuring the material from manufacturers or importers at lower rates involving a price difference ranging between Rs.2464 and Rs.3384 per MT. The extra expenditure incurred by the Company on this account worked out to Rs.17.38 lakh (356.69 MT at Rs.3384 per MT and 215.62 MT at Rs.2464 per MT).

Since average annual purchase of iron scrap of the Company was 3658 MT there could be substantial savings in purchase from direct sources. Company, however, did not make any attempt to procure scrap directly from such sources so as to reduce cost.

The Government stated (June 2007) that there was difficulty in direct procurement. The reply is not tenable as Company had not initiated any action for direct procurement with a view to reduce costs.

Loss due to contractual provision beneficial to the supplier

2.1.25 The Company invited quotations (December 2001) for supply of 6000 MT of sulphur with a condition to change the supply quantity by additional 10 *per cent* at the discretion of the Company. Orders were placed (January 2002) on the lowest tenderer, Mincore Resources (Pvt) Limited (MRL), at Rs.2719 per MT plus four *per cent* CST for 6000 MT of sulphur. In the purchase order the Company, however, changed the condition regarding additional 10 *per cent* supply from buyer's option to seller's option. Taking advantage of the change in the purchase order, MRL supplied (July 2002) only 5400 MT against the order quantity of 6000 MT.

It was noticed that the subsequent purchase (July 2002) of sulphur was also from the same supplier at a higher rate of Rs.3781 per MT plus four *per cent* CST indicating that the quantity short supplied (600 MT) was procured by the company incurring additional expenditure of Rs.6.63 lakh. In respect of the subsequent order (July 2002) for 6000 MT on the same firm at Rs.3781 per MT plus four *per cent* CST as well, the seller restricted the quantity to 5430 MT exercising option under the same clause of the purchase order. The balance quantity (570 MT) was procured (November 2002) at Rs.4890 plus four *per cent* CST resulting in extra expenditure of Rs.6.57 lakh.

Inclusion of purchase order provision beneficial to the supplier resulted in extra expenditure of Rs.13.20 lakh.

Thus, inclusion of a clause for supply of additional 10 *per cent* quantity at seller's option in deviation from the tender conditions resulted in avoidable extra expenditure of Rs.13.20 lakh.

The Government accepted (June 2007) the audit observation and stated that corrective action was taken in subsequent purchases.

Failure to procure sulphur available at low rates

2.1.26 Kochi Refineries Limited (KRL) offered (March 2002) to supply sulphur at the rate of 200 MT per month at ex-refinery price of Rs.2356 per MT. In subsequent months also KRL intimated their price indicating the validity of their offer. Company, however, initiated action on the offer only in November 2002. The order for supply at the rate of 200 MT per month was placed only in May 2003 i.e., after a delay of over 12 months. A comparison of prices offered by KRL and the procurement cost (April 2002 to April 2003) from MRL revealed that the procedural delay in considering the offer of KRL resulted in avoidable extra expenditure of Rs.38.51 lakh.

The Management admitted (February 2007) that there was delay of about one year in finalising the purchase but no reasons were given. Government did not give any specific reply to the observation.

Loss due to uneconomic mode of transportation

2.1.27 During 2002-06 the Company had been transporting 26,010 to 40,795 MT of ilmenite per annum from Manavalakurichi. The transportation was being undertaken in trucks and the unloading at site done by award workers engaged by the transportation contractor. As a measure of economy in transportation, BOD authorised (December 2002) MD to switch over to tipper lorry for transportation purposes. Accordingly tenders were invited (March 2004) for transportation of 50000 MT of ilmenite per annum from Manavalakurichi and Chavara for a period of three years and the work for transportation from Manavalakurichi awarded (August 2004) to Sree Sankara Transports, Kottayam (ST) and Karthika Transport, Kallambalam (KT) at Rs.218.43 per MT for truck and Rs.144 per MT for tipper respectively for 50 *per cent* of total quantity each. The contract period was one year extendable at the discretion of the company.

Saving in cost of Rs.39.09 lakh was forgone due to non-adoption of cost effective mode of transportation.

Audit noticed that the transportation by tipper was neither undertaken by the transporters nor insisted by the Company even though there was savings of Rs.74.43 per MT. During October 2004 to February 2006 (date of discontinuation of allocation) the Company procured 52514 MT of ilmenite from Manavalakurichi and the savings in expenditure forgone due to failure to deploy tippers worked out to Rs.39.09 lakh.

The Government stated (June 2007) that sanction was given for absorption of award workers in ilmenite and sulphur unloading section, so as to settle the issue while introducing tipper lorry system for transportation of ilmenite and sulphur and the action was in progress. The decision is not prudent since the absorption of award workers involving recurring expenditure would only result in additional expenditure when compared to the savings in transportation by engaging tipper lorries.

Excess holding of inventory

2.1.28 An analysis of the value of inventory held by the Company in relation to production requirement showed that the closing stock of raw materials ranged from 0.83 to 2.71 months requirement and closing stock of stores and spares ranged from 23 months to 27 months requirement during 2002-06.

The value of non-moving items (598 items) included in stores and spares since 2001-02 was Rs.65.73 lakh. Value of critical spares included in stores and spares was not available.

The Government stated (June 2007) that stores and stock constituted 18 months' consumption on an average and hence there is no excess holding. The reply is not acceptable. Working out average consumption clubbing together fast and slow moving spares gives a distorted picture of the inventory.

Manpower management

2.1.29 The position of manpower in the Company as of August 2002 was as follows:

Category	Sanctioned strength	Actual strength
Officers	209	190
Staff	306	329
Workmen	1092	819
Total	**1607**	**1338**

Pursuant to the Government directives (January 2002), the Company appointed (August 2002) an Internal Committee to ascertain the surplus manpower in various departments. The Committee suggested (September 2002) a reduction of 15 *per cent* in the sanctioned strength. The Company implemented a Voluntary Retirement Scheme (VRS) (September 2002) under which 106 employees retired (March 2007) from service. Thereafter the Company engaged (June 2003) TG Process and Project Consultants (TG), Thiruvananthapuram to identify the surplus manpower. The report submitted (May 2004) by TG identified the total essential manpower as 870 and the desirable level as 933 against the available man power of 1268. The total surplus manpower was 335 as of May 2004. TG recommended (May 2004) to make use of the vacancies arising out of normal retirement and VRS to redeploy the surplus staff in needy departments. The Company did not take any action and no redeployment was made (March 2007) even though 106 vacancies arose from VRS besides normal retirement vacancies. Salaries and wages paid (June 2004 to March 2007) to the surplus staff identified by TG worked out to Rs.9.65 crore. No specific reply on the observation was given by Government.

Payment of overtime wages

2.1.30 While the Company was having a total surplus staff of 174 on the rolls during June 2004 to March 2007, no action was taken to redeploy the personnel. Over Time (OT) wages aggregating Rs.8.08 crore was paid during 2004-07. Further audit scrutiny of the OT payment revealed that OT wages of Rs.6.39 crore was paid in departments like Personnel & Administration (administrative staff), Production (process operators and production staff), Engineering (workmen and staff), where surplus staff ranging between 6 and 259 *per cent* were identified.

The Government stated (June 2007) that a certain degree of overtime could not be avoided for the continuous working of the plant and machinery and that overtime posting is under strict control at present. The reply is not tenable as payment of overtime in departments having surplus staff indicated ineffective man power planning.

Unwarranted payment of production cum motivation allowance in lieu of bonus

2.1.31 As per Payment of Bonus Act, 1965, employee means any person employed on salary or wage not exceeding Rs.3500 per mensem. Government ordered (July 2006) that employees drawing salary above Rs.3500 were not eligible for any bonus or ex-gratia or incentive allowance except Special Festival Allowance (SFA). BOD, the Chief Executive and Head of Finance Wing of PSUs would be personally liable for any violations in this regard. In conformity with the above orders, the Company decided (August 2006) not to deviate from the guidelines especially in view of the huge loss sustained for the year 2005-06.

It was noticed that in the meeting (August 2006) convened (at the ministerial level), it was decided to pay Performance Cum Motivation Allowance (PCMA) at the rate of Rs.6000 to all employees of the Company in addition to applicable Bonus and SFA. The Company accordingly paid Rs.63.71 lakh as PCMA to the employees for the year 2005-06 in violation of specific Government orders prohibiting such payment. The payment for 2005-06 was ratified (June 2007) by the Government. It was observed that similar payments aggregating Rs.5.89 crore made during 2001-05 were ratified (February 2004 to June 2007) by the Government, indicating that the Government which issued guidelines prohibiting payment in lieu of bonus encouraged its violation by PSUs. The total payment of PCMA in violation of Government guidelines during 2001-06 worked out to Rs.6.53 crore.

In violation of its own directives, the State government ratified payments of PCMA of Rs.6.53 crore.

The Government stated (June 2007) that payment of PCMA had the approval of the BOD and ratification of Government. The fact, however, remained that the unwarranted payment was ratified by Government in violation of its own orders.

Additional expenditure on distribution of gifts

The Company paid Rs.23.30 lakh to employees during 2005-06 when there was huge loss.

2.1.32 As discussed in paragraph 2.1.9 *supra*, the Company had budgeted its production at 20,000 MT per annum during 2005-06 without considering the fall in domestic market sales and difficulty in marketing the product. During 2005-06 the excessive production was being exported below the domestic prices and the Company incurred a loss of Rs.15.53 crore. Without considering the poor financial performance and ignoring the fact that production incentive (Rs.3.62 crore) and over time allowance (Rs.3.07 crore) were to be paid for the year 2005-06, the Company on the basis of an announcement made (December 2005) by the then Minister of Industries decided (December 2005) to distribute gifts worth Rs.2000 each to all regular employees on the rolls of the company as a gesture of goodwill and in appreciation of their contribution in achieving record production, sales, etc. Based on the above decision the Company incurred an expenditure of Rs.23.30 lakh towards gift for better performance during the year 2005-06 when the loss for the year was Rs.15.53 crore.

The Government stated (June 2007) that the overall performance during the three years up to 2005-06 was appreciable enough to announce a suitable gift as a gesture of goodwill and appreciation. The reply is not tenable since the working results of the Company recorded a steady declining trend since 2003-04 and resulted in heavy losses at the time of taking the decision to announce the gift to the employees.

Defective production incentive system.

2.1.33 Centre for Management Development (CMD), Thiruvananthapuram at the behest of the Company prepared (October 1995) a report for payment of production incentive to employees of the Company. The report recommended payment of incentive beyond production of 900 MT per month at incentive rates varying from Rs.1.30 to Rs.4.30 per MT under various slabs of production determined on the basis of 12 month moving average basis.

Based on the above report the Company signed (March 1996) an MOU with trade unions reckoning a recovery efficiency level of 73 *per cent* of TiO_2. The MOU was effective retrospectively (March 1995) and valid for three years. The MOU which was required to be revised from March 1998 was not revised resulting in excess payments on various counts as discussed below:

- The recommendation of CMD for payment of incentive was based on previous 12 months moving average production giving due weight to production efficiency during these months and the per MT rates were also devised on this basis. Deviating from this the Company had been paying incentive on actual monthly production basis. This has resulted in payment of extra incentive of Rs 1.50 crore during 2002-07.
- At the time of entering into MOU (March 1996) the base level of production for determining eligibility for incentive was fixed as 900 MT per month for three years. The Company, however, revised (November 2005) the base level production to 1000 MT per month only after nine years. The extra payment of incentive due to delay in

revision of base level from 900 to 1000 MT per month for the period from April 2002 to November 2005 worked out to Rs.69.32 lakh.

Non-adoption of 12 month moving average, non-revision of base level production, efficiency level and profitability for calculation of incentive resulted in avoidable payments aggregating to Rs.4.87 crore.

- The base level of efficiency for additional incentive to direct group (production wing) was fixed at 73 *per cent* of the TiO_2 recovery in 1977. Although the overall efficiency increased manifold over the years, Management did not revise efficiency ceiling for additional incentive payment. The average overall efficiency during 2001-02, 2002-03, 2003-04, 2004-05 and 2005-06 was 84.58, 82.39, 83.43, 83.28 and 82.86 *per cent* respectively; the lowest overall efficiency being 80 *per cent* recorded in August 2002. Even though the MOU expired (March 1999) the recovery percentage was not reviewed and revised. Considering the normal attainable efficiency level of 80 *per cent* in August 2002 the additional incentive payment worked out to Rs 45.88 lakh during 2003-04 to 2006-07 (up to December 2006).
- As per Government order (April 1992) the incentive in appreciation of good performance should not be related to production alone but also with other aspects like cost reduction, marketing and profitability. It was noticed that during 2005-06 the company had to export 6012.4 MT of TiO_2 at prices lesser than the cost in order to clear the accumulated stock and in that process incurred a loss of Rs 15.53 crore. This aspect was ignored leading to avoidable payment of Rs.2.22 crore on production (6012.4 MT) corresponding to the above export.

The Government stated (June 2007) that the moving average system as suggested in the CMD report was not agreed to by the Unions and hence could not be included in the industrial relation point of view and that the agreement was formulated when cost of production was much less and achievable production was lower. It was also stated that export sales at less than cost price was in no way connected with the production incentive scheme. The reply is not tenable as the delay in arriving at an agreement with the employee Unions had resulted in financial loss to the Company. Further, payment of incentive on export made to clear accumulated stock arising from unwarranted production was against the spirit of the Government order of April 1992 linking incentive to profitability.

Implementation of Effluent Treatment Project

2.1.34 The Company manufactures TiO_2 through sulphate process generating acidic waste, which was being discharged in to sea. This became unacceptable with the advent of Water (Prevention and Control of Pollution) Act, 1974 and the establishment of Kerala Pollution Control Board (KPCB) in the same year. Efforts of the Company in establishing pollution control project commenced in 1977 and have not been completed so far (March 2007). The Committee on Public Undertakings (COPU) recommended (22nd Report - 2001-04) that pollution control activities should be combined with expansion programme and implemented as one package.

The Hon’ble High Court of Kerala directed (November 2003) the Company to set up an effluent treatment plant (ETP) within a period of 30 months i.e., by

April 2006, which was extended (April 2007) to December 2008. The Company engaged (June 2004) MECON Limited (MECON) as project management consultant. The package for pollution control and expansion involving the installation of Copperas Recovery Plant (CRP), Acid Recovery Plant (ARP), Neutralisation Plant (NP) and modernisation was proposed to be implemented in two phases (phase I - Rs.129.40 crore of which Rs.115 crore was for pollution control project and Phase II - Rs.126.70 crore of which Rs.100.95 crore was for pollution control) involving total projected expenditure of Rs.256.10 crore. Under phase I the plant capacity was proposed to be increased to 21500 TPA and under phase II to 33,000 TPA. The work relating to phase I involving Rs.129.40 crore was awarded (February/March 2006) to Chematur Ecoplanning Oy (CEP), Finland at a cost of Rs.68.65 crore and NP to VA Tech Wabag Ltd at Rs.32.56 crore apart from civil and structural work yet to be awarded. The works under phase I remained to be completed and phase II has not been taken up. The details of expenditure incurred on the work of Phase I as of March 2007 were as follows:

Name of plant	Contract amount (Rs in crore)	Actual expenditure incurred (Rs. in crore)	Latest position	Expected date of completion
Copperas Recovery Plant & Acid Recovery Plant	68.65	22.53	Work at site yet to commence	February 2008
Neutralisation Plant	32.56	6.28	Work commenced	March 2008

2.1.35 In the conceptualisation and implementation of the ETP, the following deficiencies were noticed:

- As per recommendations (May 1998) of an internal committee which considered the project proposal, a neutralisation plant alone with a meagre investment of Rs.10.81 crore was sufficient to meet requirements of KPCB and Court orders and ARP/CRP requiring foreign technology and huge investment was to be taken up later.
- The Company was aware of the fact that installation of CRP and ARP was not advisable due to lack of market and higher investments in view of foreign exchange component. Still both the plants were proposed at a huge investment of Rs.82.44 crore on the ground that Neutralisation Plant alone was suited only to small manufacturers. The Company should have met immediate requirement of pollution control through NP and taken up ARP/CRP later.
- The Company proceeded with ETP without obtaining firm commitment from financial institutions for loans resulting in delay and uncertainty in completion of the Project.
- The installed capacity of the existing TiO_2 plant was 24500 MT per annum and a capacity of 20,000 MT per annum was attainable with a capital investment of Rs.1.50 crore as per recommendations (October 2001) of the internal committee of the company. By the time the Company proposed (January 2005) the implementation of the

modernisation project, there were severe marketing constraints even at the existing de-rated capacity level of 15000 MT per annum. Since another State PSU, Kerala Minerals and Metals Limited (KMML) manufacturing rutile grade TiO_2 was facing marketing problems the decision to expand the capacity at the projected cost of Rs. 40.15 crore lacked justification.

Contractors of ARP exempted from providing know how.

- The Company did not have the know-how necessary for reuse of the regenerated acid produced by the proposed ARP, in the digesters of the existing TiO_2 plant at the required concentration level, in view of the fact that the contractors (CEP) were exempted from providing the necessary know-how. Hence in the absence of know-how for re-use of regenerated acid the project itself would prove to be counter productive.

Viability of the Company's proposed expansion project would be affected since KMML itself had been facing marketing constraints for rutile; technology absorption and marketability constraints.

- The financial viability of the project had been worked out by MECON on the assumption of completing Phase I (21000 MT per annum producing 40 MT per day of Anatase and 25 MT per day of surface coated rutile) within 18 months from zero date (May 2005) and Phase II within another 18 months. The Company did not possess the technology for manufacturing surface coated rutile. The technology was proposed to be acquired from KMML, a competitor in the public sector. Since KMML itself had been facing market constraints for rutile, technology absorption and marketability problems would affect the viability of the proposed expansion project.

- As per the agreement entered into with contractors, the stipulated time of completion of ARP/CRP was 12 months from the effective date of contract (EDC) and that for Neutralisation plant was seven months from the letter of award (31 March 2006). Liquidated damages were applicable from the 12^{th} month only. The execution of these contracts was delayed on the following grounds:

  As per contract with CEP for CRP and ARP, the Company had to open Letter of Credit (LC) for the contract amount for reckoning the effective date for determining scheduled completion date. The Company, however, failed to open LC for the full contract amount and the LC was restricted to 90 *per cent*. Due to incorrect understanding of the contract terms LC for balance 10 *per cent* amount was belatedly opened (September 2006). The delay in opening LC as contemplated in the contract entailed postponement of the effective date of commencement of contract by six months and corresponding postponement of scheduled date of completion.

  As per agreement with VA Tech Wabag for NP, the Company had to establish LC for 80 *per cent* of the contract price within 15 days of approval of Billing Schedule by the Company. The billing schedule forwarded to the Company (November 2006) was accepted only in January 2007. The Company did not open the LC even before expiry of the contract date (31 March 2007) on the ground of financial constraints.

- Audit noticed that the contract for indigenous package involving civil/structural works of the ARP/CRP had not been finalised so far (June 2007) even though shipping of equipments had commenced. MECON had also revised (June 2007) the project cost to Rs.414.40 crore. The main reasons attributed to increase in cost estimate based on 2004 prices were escalation of price, rise in interest rates, limited availability of bidders and addition/deletion of equipment. The Company has not yet finalised a financial package to meet increased cost. The Company did not obtain from MECON the revised estimates at the time of entering into contracts for ARP/CRP (February 2006) with a view to ascertain the financial viability of the Project.

Loss of interest due to payment against LC in advance amounted to Rs.36.47 lakh.

- While the new LC was opened (29 September 2006) and effective date of commencement of the contract was 29 September 2006, the Company made 30 *per cent* advance payment to the contractor in May and July 2006. By allowing the advance payment before the effective date of commencement of contract the Company had to make avoidable payment of interest of Rs.8.92 lakh on the bank loan availed for advance payment against LC for the period from 26 July 2006 to 29 September 2006 and loss of interest of Rs.27.55 lakh on term deposit closed for making the payment.

Implementation of cost reduction projects

Non-availing of benefit of captive power

2.1.36 The Kerala Power Policy, 1998 stipulated allotment of Mini Hydro-electric Projects to private agencies, public sector undertakings and Local Self Governments. As per Government Order (October 2002) tail race projects were not intended for captive consumers. The Company having a connected load of 5 MVA and a maximum demand of 3.5 MVA with an annual consumption of 24 Million Units was eligible to apply for Captive Power Plant (CPP). Implementation of CPP was expected to reduce the cost of production by Rs.1822.50 per MT. Out of four sites identified by Steel Industrials Kerala Limited, the consultant for the purpose, two (Thuvallar and Palchuram) were eligible for implementation by CPPs as notified by Energy Management Centre. The Company instead selected Upper Kallar and Peechad which were not available for captive power production.

Due to this, the Government did not consider the company's proposal as the project involved controlled waters or tailrace waters which were earmarked for KSEB only. Meanwhile, the Palchuram scheme for which the Company was eligible was allotted by Government to an Independent Power Producer as there were no CPPs.

Company lost the opportunity to implement a cost effective captive power project due to wrong selection of project.

Thus the failure of the Company to identify a project from the list of CPPs notified by Energy Management Centre for CPP denied the Company an opportunity to avail of the benefit of captive power and reduce cost of production by Rs 1822.50 per MT and aggregate annual saving of Rs.2.73 crore at de-rated capacity.

Government stated (June 2007) that KSEB identified projects other than tail race project where water availability would be erratic and unpredictable. Government reply is not tenable since the consultant had identified Thuvallar and Palchuram projects as viable which were not considered by the Company.

Mineral separation plant

The Company did not go ahead with the mineral separation plant to produce the basic raw-material despite recommendations of COPU.

2.1.37 Being a mineral based Company and solely dependent on Indian Rare Earths Limited for the requirement of raw material, ilmenite, the COPU had recommended (February 2003) that the Company should plan its own Mineral Separation Plant.

The Company's annual average requirement of ilmenite was 50000 MT and setting up of the plant at a projected cost of Rs.18 crore would have entailed a savings of Rs.6.32 crore per annum on account of higher grade ilmenite from Quilon having 58.5 *per cent* TiO_2 content as against 53 *per cent* of the Manavalakkurichy grade. Besides savings, other cost benefits were also expected. The Company, though, decided (2002-03) to go ahead with the project and authorised the MD to take further steps in the matter, no action had been taken so far (March 2007). There were no recorded reasons for non-implementation of the project.

Internal Control & Internal Audit

Internal control

2.1.38 Internal controls are the procedures and safeguards that are put in place by the management of an organization to ensure that its activities are proceeding as planned and objectives are achieved in an economic and orderly manner. Strict observance of these procedures/safeguards is vital in any organisation. The internal control system in the Company had deficiencies as discussed below:

- During 2002-07 there was wide variation ranging from 14 to 400 *per cent* in the actuals from budget in respect of production, sales, consumption of raw materials, manufacturing & other expenses and profit/loss. The variations between budget and actuals were not reviewed at Board level for timely corrective action.
- Minutes of the monthly meeting of Titanium Management Council (TMC) and Sales Promotion Committee (SPC) were not being placed before the Board for deliberations. Government stated (June 2007) that the Managing Director was empowered to take all commercial and technical decisions of the Company. The SPC and TMC were only advisory in nature and were not constituted by BOD. The reply is not tenable since the proceedings of the committees which take all the crucial decisions relating to the Company, were not brought to the notice of the full Board of Directors.
- Though required as per the agreement with stockists, the Company had not issued any directions for maintenance of records by stockists nor did the Company conduct any inspection with respect to price, quality of the product, stock held by the stockists, etc.

- Although BOD decided to price export at variable cost plus 20 *per cent*, the calculation of variable cost and its components lacked authenticity and base data were not available for verification.
- During 2002-07 the attendance of Board of directors in Board meetings varied between 100 *per cent* (2002-03) and 57 *per cent* (2006-07). Two Directors were continuously absent for six to eight meetings. The MD besides being a Government secretary had been holding the post of Chairman/Managing Director in two other companies and was also Director in ten other companies.

Internal audit

2.1.39 There was no separate internal audit wing in the Company. Internal audit was entrusted to a firm of Chartered Accountants. Half yearly Internal Audit reports were being submitted to the MD. The terms of reference included review of reliability and integrity of information, compliance with policies, plans and procedures, laws and regulations, safeguarding of assets, economic and efficient use of resources, review of operations and programmes, verification of inventory, etc.

Audit noticed that

- the areas referred for internal audit were only general in nature and not specific, the internal audit did not cover vital areas like production planning, consumption of raw materials and chemicals, pricing, etc;
- the half yearly reports received were neither placed before the Board nor any follow up action taken on various deficiencies pointed out therein;
- the internal audit was being taken up after a delay of three to eight months from commencement of the financial year;
- repeated observations like delay in updating transactions, lack of integration in different modules used to record accounting transactions/stores accounting/time office data, deficient store accounting, unreliable software used for accounting of cash transactions, delay in settlement of advances given to employees were appearing in the internal audit reports indicating inadequate action and monitoring.

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 Company suffered heavy loss mainly due to indiscriminate production without considering the marketability, resultant accumulation of stock and exports at reduced rates. Fixation of higher prices for domestic sales at the inappropriate moment contributed to fall in

domestic sales. Company had no dependable costing system. The norms fixed for consumption of materials were high and were counter productive to consumption. Consumption of raw materials was excessive when compared to actual optimum levels achieved earlier. The consumption of fuel was also not optimised through planned production. Minimum off take by stockists was not ensured by incorporating enabling provision in the agreement with the stockists. Mineral separation plant for recovery of raw material ilmenite was not taken up as recommended by COPU. The company had been incurring heavy expenditure on wages of surplus staff. Unjustified production incentive system and payment of overtime despite surplus staff contributed to high cost of production. Viability of the Company's proposed expansion project would be affected since another State PSU, from whom technology is to be obtained had been facing market constraints for rutile grade titanium dioxide; technology absorption and marketability constraints.

Recommendations

- **The Company has enough manufacturing experience and should commit itself to effective cost cutting on commercial practices.**
- **The Company should evolve an aggressive marketing strategy to improve its market share both domestic and foreign. Production should be based on market trend and demand.**
- **The Company should develop an effective costing system which should be reviewed monthly.**
- **The norms fixed for consumption of material needs to be revised keeping in view the past performance and process changes for controlling production cost.**
- **Minimum off take by stockists should be assured by incorporating enabling provisions in agreement with stockists and action taken against non-performers.**
- **Incentive payment needs to be rationalised taking into account productivity, marketability and profitability. At the same time surplus staff should be deployed else where to reduce cost.**
- **In order to ensure continuous availability of better quality ilmenite at reduced costs the company should ensure speedy implementation of the mineral separation plant.**
- **The Company should finalise financing arrangements to ensure timely completion of the effluent treatment project.**

2.2 THE CONTRIBUTION OF THREE COMPANIES IN THE STATE FOR DEVELOPMENT OF SCHEDULED CASTES, SCHEDULED TRIBES, CHRISTIAN CONVERTS, BACKWARD CLASSES AND MINORITIES

Highlights

Even though the three social sector companies were in existence for 12 to 34 years, they have not created micro level data base to identify size and magnitude of their respective target groups.

(Paragraph 2.2.1 and 2.2.8)

Out of the total population of 3.18 crore in the State as per 2001 census, Minorities and Scheduled Caste/Scheduled Tribes constituted 54.70 *per cent* and majority of the population belonged to backward classes. Against this, the Companies covered only 2.64 lakh (0.83 *per cent*) beneficiaries up to March 2007, which was not significant.

(Paragraph 2.2.7)

The funds available from national agencies were not fully channelised as there was short utilisation of Rs.4.66 crore by Kerala State Development Corporation for Scheduled Castes and Scheduled Tribes Limited (SC ST Corporation) and total non-utilisation of funds received from National Minorities Development and Finance Corporation by Kerala State Development Corporation for Christian Converts from Scheduled Castes and the Recommended Communities Limited (CC Corporation). Loan disbursements by the first company recorded shortfall of Rs.4.08 crore and the second company by Rs.1.35 crore during the period 2004-06 when compared with preceding two years.

(Paragraph 2.2.11 and 2.2.14)

Though the Companies had laid down specific norms for selection of beneficiaries, the deficiencies in norms and their unwarranted relaxations have enabled several ineligible applicants to avail of the financial assistance.

(Paragraphs 2.2.17, 2.2.19, 2.2.20 and 2.2.21)

Systems for monitoring loan utilisation and loan repayments were very weak in all the three Companies.

(Paragraphs 2.2.18 and 2.2.24)

Special loan schemes of National Agencies for empowerment of women and weaker sections *viz* New Swarnima, Mahila Samridhi Yojana and Micro credit were not adequately promoted and effectively implemented by these State Channelising Agencies.

(Paragraphs 2.2.16, 2.2.32 and 2.2.37)

Under one time settlement schemes SC ST Corporation and Kerala State Backward Classes Development Corporation Limited (BCDC) had

foregone Rs.0.80 crore and Rs.2.38 crore respectively from outstanding loans to the tune of Rs.3.53 crore and Rs.7.31 crore respectively.

(Paragraph 2.2.25)

The administrative cost being incurred by SC ST Corporation and CC Corporation were abnormally high due to low volume of disbursements. The Companies spent on administrative cost 36.06 paise (SC ST Corporation) and 24.35 paise (CC Corporation) respectively per rupee of loan assistance rendered.

(Paragraph 2.2.27)

The beneficiaries of Agricultural Land Purchase Schemes of SC ST Corporation and CC Corporation were not using the land for the stated purpose thereby defeating the social objective.

(Paragraphs 2.2.28)

BCDC disbursed Rs.10.29 crore under Micro finance Scheme, without ensuring the eligibility of ultimate beneficiaries. It also did not make sure that the loans were distributed by beneficiary NGOs at the interest rate stipulated by the National Agencies.

(Paragraph 2.2.37)

Introduction

2.2.1 With the objective of raising the economic status of Scheduled Castes, Scheduled Tribes, Backward Classes, Minorities, Christian Converts and other Recommended Communities, State Government set up the following companies:

Sl. No.	Name of the Company	Date of incorporation	Targeted section of population
1	Kerala State Development Corporation for Scheduled Castes and Scheduled Tribes Limited (SC ST Corporation)	7 December 1972	Scheduled Castes and Scheduled Tribes
2	Kerala State Development Corporation for Christian Converts from Scheduled Castes and the Recommended Communities Limited (CC Corporation)	3 December 1980	Christians converted from Scheduled Castes and other recommended communities
3	Kerala State Backward Classes Development Corporation Limited (BCDC)	28 February 1995	Backward Classes and Minority communities

These three companies mainly implemented different schemes of financial assistance among their respective target section of population. The fund requirements thereto are met out of equity contribution from the State/Central Government and soft loans from respective National Financial Institutions in social sector such as National Scheduled Castes Finance Development Corporation (NSFDC), National Scheduled Tribes Finance and Development Corporation (NSTFDC), National Backward Classes Finance and Development Corporation (NBCFDC), National Minorities Development and

Finance Corporation (NMDFC), etc. The concerned National Agencies had also recognised these companies as their State Channelising Agencies (SCAs).

Following major schemes were implemented by the three companies during 2002-07:

Sl. No.	SC ST Corporation	CC Corporation	BCDC
1	Self Employment Loan Scheme*	Self Employment Loan Scheme*	Self Employment Loan Scheme*
2	Housing Scheme#	House Construction Scheme/House Revamping Scheme#	House Renovation Loan Scheme#
3	Education Loan Scheme#	Education Loan Scheme#	Education Loan Scheme*
4	Marriage Loan Assistance Scheme#	Marriage Loan Assistance Scheme#	Marriage Loan Assistance Scheme#
5	Foreign Employment Loan Scheme#	Foreign Employment Loan Scheme#	Foreign Employment Loan Scheme#
6	Agricultural Land Purchase Scheme*	Agricultural Land Purchase Scheme#	Micro Finance Loan Scheme*
7	Micro Credit Loan Scheme*		
8	Transport Scheme*		

The Management of each of these Companies is vested in a Board of Directors (BOD) appointed by the State Government. The Managing Director (MD) is the Chief Executive of each Company who is assisted by Project Managers/ Regional Managers/District Managers at the field level.

Both SC ST Corporation and BCDC are having district level offices to reach out to the target population. CC Corporation is having loan outlets only in three[@] out of 14 districts in the State.

BCDC had registered (May 2003) itself with Reserve Bank of India as a Non-Banking Financial Company as required under sub-section (1) of section 45-1A of Reserve Bank of India Act,1934. The other two Companies have not complied with this statutory requirement.

There were arrears in finalisation of accounts in all the three companies. While SC ST Corporation had finalised the accounts up to 2003-04, BCDC and CC Corporation finalised their accounts up to 2000-01 and 1993-94 respectively. As per the latest finalised accounts of SC ST Corporation and CC Corporation their accumulated loss was Rs.0.48 crore and Rs.0.63 crore respectively as against paid up capital of Rs 48.46 crore and Rs 2.08 crore respectively. BCDC recorded accumulated profit of Rs.6.07 crore in its accounts for 2000-01.

A review on ‘Efficiency in Implementation of schemes by SC ST Corporation and CC Corporation’ was included in the Report of CAG for the year ended 31 March 1998 (Commercial), Government of Kerala. The

* National Agency Scheme
# Company scheme
@ Kottayam,Trivandrum and Kozhikode

review was discussed by COPU and the main recommendations contained in the Twentieth Report presented (February 2003) to the Legislature were:

- Proper field study should be conducted, beneficiaries identified and viability of the scheme assessed by SC ST Corporation before taking up schemes.
- SC ST Corporation should maintain detailed records of the loan disbursed, the amounts recovered, balance pending recovery, etc., and take effective steps for realisation of the dues.
- The huge arrears in finalisation of accounts of CC Corporation should be cleared on a war footing.
- CC Corporation should be merged with BCDC as they target the same segment of the population.

The Companies have not implemented the above recommendations as is evident from the audit findings *infra*.

Scope of Audit

2.2.2 This performance review conducted during December 2006 to March 2007 covers the activities of the Companies during 2002-07. The records at head offices of all the three Companies and 4 out of 12 district offices of SC ST Corporation, 5 out of 14 district offices of BCDC and one of the two district offices of CC Corporation selected on the basis of turnover, recovery efficiency, location and previous Inspection Reports, were examined.

Audit objectives

2.2.3 The audit objectives of the performance review were to ascertain whether:

- the companies had prepared a well rounded plan to cover the entire targeted population in a phased manner;
- the activities undertaken by the organisations were result oriented for sustained community development of the target population;
- the systems developed in the organisations were efficient enough to ensure optimum utilisation of funds placed at their disposal for fulfillment of the specified objectives at the minimum cost of administration;
- the machinery for selection of beneficiaries, disbursement and recovery of loans were efficient and the systems were transparent;
- the terms and conditions of financial assistance were compatible with the physical and financial capabilities of the target group;
- the companies had devised and put in place an effective system of oversight so as to ensure efficient implementation of the schemes assigned;
- the companies had made an objective assessment of the impact of various schemes so as to take remedial steps wherever required; and

- Internal control, Internal Audit and Corporate Governance systems in the organisations were effective.

Audit criteria

2.2.4 The following audit criteria were adopted:

- memorandum and articles of association of the companies;
- guidelines issued by the National lending Agencies/State Government and those internally formulated by Companies, policy decisions of BOD of respective companies,etc.;
- policy framework of the State Government for upliftment of weaker sections of the society;
- guidelines/norms for selection of beneficiaries, sanction and disbursement of funds; and
- laid down systems and procedures of recording transactions, collection of repayments, its custody and remittance to banks, internal check and internal control systems.

Audit methodology

2.2.5 The audit adopted the following mix of methodologies:

- detailed system-study in the respective organisations;
- detailed case studies of selective cases of loans disbursed;
- interviews with field level officers of the organisations;
- discussions with top management;
- examination of books of accounts and other records and study reports prepared by national institutes and other Government agencies, etc.

Audit findings

2.2.6 Audit findings emerging from performance audit were reported (June 2007) to the Management/Government and discussed in the meeting (31 July 2007) of the Audit Review Committee for State Public Sector Enterprises (ARCPSE). The meeting was attended by the Principal Secretary to the State Government, Scheduled Castes & Scheduled Tribes Development Department and MDs of BCDC and SC ST 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:

Performance evaluation

2.2.7 Fund aggregating Rs.570.71 crore was received by the three Companies since inception to 31 March 2007 from State/Union Government and National Financial Institutions by way of equity, subsidy and loans, as follows:

Sl. No.	Particulars	SC ST Corporation	CC Corporation	BCDC	Total
		(Rs.in crore)			
1	Equity/subsidy from State Government	95.23	20.30	50.56	166.09
2	Loan assistance from State Government	NIL	1.57	NIL	1.57
3	Loans from National Financial Institutions	65.37	10.54	295.51	371.42
4	Equity contribution from Union Government	31.63	NIL	NIL	31.63
	Total	**192.23**	**32.41**	**346.07**	**570.71**

The Companies had disbursed funds aggregating Rs.570.90 crore among 2,63,581 beneficiaries under various schemes of financial assistance upto 31 March 2007. The disbursements during 2002-07 was of Rs.296.81 crore, spread among 92,343 beneficiaries, as shown below:

Companies	Loans Disbursed			
	Since inception-March 2007		2002-07	
	No. of beneficiaries	Amount of loans (Rs.in crore)	No. of beneficiaries	Amount of loans (Rs.in crore)
SC ST Corporation	1,33,554	158.52	6,312	32.70
CC Corporation	10,556	20.69	3,204	8.53
BCDC	1,19,471	391.69	82,827	255.58
Total	**2,63,581**	**570.90**	**92,343**	**296.81**

In the absence of community-wise census, the exact population of target communities of the companies was not ascertainable. Out of the total population of 3.18 crore in the State as per 2001 census, 43.75 *per cent* belonged to minority communities and 10.95 *per cent* to SC & ST. Further, majority of the population in the State also belonged to backward classes. As such the coverage of 2.64 lakh (0.83 *per cent*) beneficiaries achieved by the three companies up to 31 March 2007 was not significant.

Planning

Non-identification of specific target group

Target groups of the Companies were not exactly identifiable.

2.2.8 As per norms fixed by the National Agencies, families belonging to target communities living below double the poverty line® from the specific target group are eligible for Companies' lending activity. However, in the absence of micro level research studies and census data on the income levels of the families belonging to target communities, no data base is available with the companies to identify and assess the size and magnitude of the target group for planning their activities. In the absence of reliable data, neither had any strategic plan formulated nor had annual physical targets fixed and achievements evaluated. No serious attempts have been made by the Companies to remedy this handicap.

® Having annual family income below Rs.31,952 in rural areas and Rs.42,412 in urban areas up to March 2003 and Rs.40,000 in rural areas and Rs.55,000 in urban areas from April 2003.

SC ST Corporation and BCDC agreed (August 2007) that there was no reliable data on target population.

Targets and achievements

2.2.9 As need based targets could not be fixed due to non-identification of target groups, the Companies did not follow a system of objective-based targeting of its performance. SC ST Corporation on regular basis and BCDC from 2005-06 onwards, however, followed the system of fixing financial targets based on fund availability. The annual achievements recorded in financial terms ranged between 37.71 and 74.78 *per cent* (2002-07) in respect of the former Company and 65 *per cent* (2005-06) and 98.15 *per cent* (2006-07) in respect of the latter.

Mobilisation of resources for implementation of schemes

2.2.10 Fund assistances from National Agencies were obtained based on Annual Action Plans (AAP) submitted by the Companies.

Details of AAP submitted by the three Companies, funds allocated and funds released by National Agencies during 2002-07 were as given in **Annexure 12**. Scrutiny of **Annexure 12** reveal that the financial projections made in the AAP were unrealistic, and allocation and release of funds by National Agencies also lacked consistency.

CC Corporation could not fully channelise funds available from National Agencies.

As against sanction of Rs.450.20 lakh (2001-02) by NBCFDC, CC Corporation utilised only Rs.50 lakh during the year. NBCFDC, therefore, restricted the disbursement for subsequent years (2002-03 to 2006-07) between Rs.50 lakh and Rs.1 crore by fixing a low absorption capacity for the Company. Due to this the Company could not channelise the indented funds (Rs.17.49 crore). The target community was, thus, deprived of the bulk share of assistance available for their welfare.

It was further noticed that there was retardation of growth in business volume, disruption in fund flow from National Agencies, disbursements without qualitative scrutiny, under exploitation of resources, non-promotion of special schemes, etc., as discussed below:

Retardation in business growth

None of the Companies registered steady growth in business.

2.2.11 None of the Companies could improve upon the quantum of assistance channelised towards beneficiaries on a steady basis and therefore no growth in business volume was recorded during 2002-07. There was also marked decline in quantum of assistance channelised by SC ST Corporation and CC Corporation during 2004-05 and 2005-06. The decline was to the extent of Rs.4.08 crore in respect of first company and Rs.1.35 crore in respect of second.

SC ST Corporation attributed (August 2007) the retardation in growth to non-receipt of share capital contribution from Government in time. Audit, however, observed that Government had released 93 *per cent* of the budgeted fund allocation during the period 2002-07 as mentioned in paragraph 2.2.17. The main reason for retardation in business growth was the inability of the

Company in making optimum use of the available capital base due to its failure in obtaining prompt repayments from loanees.

Disruption in fund flow

2.2.12 The flow of funds from National Agencies was not regular due to fund constraints on their part as well as non-provision/delay in provision of sufficient Government guarantee by the Companies. For want of necessary funds of their own, both SC ST Corporation and CC Corporation used to suspend the lending activities as and when the fund flow from National Agencies got disrupted.

BCDC, by virtue of its comfortable fund position could operate the schemes without such interruption from 2002-03 onwards. Such diversions from funds which could have been utilised for higher interest fetching own schemes have caused loss of interest to the extent of Rs.15.19 lakh on funds amounting to Rs.9.68 crore diverted during October 2006 to February 2007.

Disbursement without qualitative scrutiny

2.2.13 The funds of the National Agencies had to be utilised within 90 days of release, failing which, it attracted penal rate of interest of six *per cent* as against the normal rate of three *per cent* per annum. Most often the Companies processed the loan applications, only after receipt of funds from the National Agencies. As a result there was hasty disbursement of funds to adhere to time schedule. Qualitative scrutiny of loan applications could not be made on such occasions. Further, this disbursement system prompted the managements to draw the fund restricting it to easily achievable targets for disbursement, which adversely affected the business volume and growth potential. Had the Companies followed a system of selection of beneficiaries sufficiently in advance, based on action plans, the loan assistance under various schemes could have been optimised.

Under exploitation of resources

2.2.14 The fund availability from National Agencies was not exploited to its full potential by any of the three Companies, particularly SC ST Corporation and CC Corporation. The CC Corporation was channelising funds of only NBCFDC although funds were also available from NMDFC which had approved (October 1995) it as a channelising agency. The Company also did not channelise funds under 'Micro finance'[*] and 'New Swarnima Scheme'[©] (NSS) introduced by NBCFDC in 1998-99 and 2001 respectively, with very low rates of interest. It was also observed that the Company had to refund a sum of Rs.14.66 lakh to NBCFDC towards unutilised balance of funds drawn during 2004-06.

The Management attributed (November 2006) the refund to procedural delays in processing loan applications due to incompetence of its staff.

SC ST Corporation had been under utilising the funds allocated by National Agencies since its disbursement activities were curtailed during 2002-07 due

[*] Under this scheme, loans of small amounts upto Rs 15000 were disbursed to individuals.
[©] Under this scheme, financial aid up to Rs 50000 is given to women beneficiaries belonging to BPL category.

SC ST Corporation short utilised Rs.4.66 crore allocated by National Agencies.

to poor recovery performance of loans already disbursed. As against funds amounting to Rs.16.73 crore allocated by NSFDC during 2002-07, the Company could draw and utilise only Rs.13.97 crore (83.50 *per cent*). Similarly, Company could channelise only Rs.59.97 lakh (24 *per cent*) out of Rs. 2.50 crore allotted by NSTFDC for tribal population during 2002-07. While the tribal population of the State constituted 10.44 *per cent* of SC ST population, the loans distributed by the Company among them constituted only 4.92 *per cent* of its gross loan disbursements. When compared to the tribal population of 3.64 lakh as per 2001 census, the Company covered an average of 45 beneficiaries from the target group per annum representing only 0.01 *per cent* of the tribal population. Thus, the Company could not fulfill its social obligation to assist the tribal population to the desired extent.

The Management attributed (August 2007) the under utilisation to the inability of target group in furnishing necessary sureties/securities for availing of loan assistance as well as company's inability to reach out to tribal population on account of infrastructural and financial constraints.

The Company could have overcome the said constraints by implementing suitable micro credit schemes among target group, promoting SHGs/NGOs, which was proposed (April 2003) to be taken up as part of future plans.

Payment of non-utilisation charges

2.2.15 SC ST Corporation drew (March 2000) Rs.84.86 lakh from National Safai Karmachari Finance Development Corporation (NSKFDC) for implementation of different self employment schemes amongst SC's working as scavengers. Company had not adequately ascertained the scope and potential of distribution of funds before hand and could utilise only Rs.11.03 lakh for distribution among 44 beneficiaries. The balance amount of Rs.73.83 lakh was refunded (January 2002 and March 2004) to NSKFDC which attracted non-utilisation charges of Rs.14.86 lakh at the rate of 10 *per cent* per annum. After setting off the interest earned on term deposit of surplus funds, (at an average rate of 5 *per cent*[*]) Company suffered loss of Rs.7.43 lakh due to drawing of funds without adequate planning for utilisation.

The Management stated (August 2007) that the loan funds were in fact thrust upon them by NSKFDC who later on penalised the Company for non-utilisation. The reply was not tenable as the Company could have refunded funds drawn in excess of requirements.

Non- promotion of special schemes

2.2.16 BCDC did not give priority to special schemes introduced (2001) by National Agencies for empowerment of weaker sections amongst target group. NSS introduced for women beneficiaries living below poverty line, with concessional interest rate of four *per cent* against six *per cent* for other loans was not properly promoted in spite of high demand. As against the disbursement of Rs.7.75 crore (2,102 loanees) made during first three years the disbursements during next three years, were only Rs.2.78 crore i.e., 35.87 *per cent* (646 loanees). The scheme was suspended (April 2005 to

[*] Average interest rate on term deposit during 2000-04.

Schemes for women empowerment were not actively promoted by BCDC.

December 2006) by the District Offices at Alleppey and Thrissur for reasons not on record. The fact that Company also disbursed loans for self employment under the normal scheme to women beneficiaries, who were otherwise eligible for loans under 'New Swarnima', indicates that proper publicity of special schemes was not given. Likewise, the educational loan scheme was prioritised by national agency for women, physically impaired and dependents of war widows among target group. The application form prescribed by Company, however, did not contain any provision to indicate such special status of applicant meriting priority.

The Company stated (August 2007) that income certificates issued by revenue authorities were not dependable and therefore, it used to deny the loans to 'not so deserving' applicants. Company, however, added that steps to promote these schemes on priority basis are being taken on the basis of audit observation.

Identification and selection of beneficiaries

System deficiencies in selection of beneficiaries

2.2.17 As referred to in paragraph 2.2.8 *supra*, the schemes of the Companies were essentially meant for providing loan-assistance to families belonging to target communities living below double the poverty line. As per system followed in the organisations, an applicant has to furnish income certificate issued by village officer for determination of financial status of the applicant.

Systems prevailing in the Companies for selection of beneficiaries were not fool proof and transparent.

However, the income certificates given by village officers were not wholly reliable and contradictory. **In 13 out of 160 cases test checked, applicants had produced income certificates showing annual income below double the poverty line and at the same time, furnished their spouse/family members as sureties, who were employees in Government**. Ignoring the discrepancy, the Companies had sanctioned loans to these ineligible applicants. CC Corporation had facilitated production of such improper certificates of income by requiring (in the application form) the village officers to certify only the individual annual income of 'applicant' contrary to NBCFDC stipulation of considering the annual income of 'family'.

None of the three Companies had devised and put in place an efficient mechanism to cross check and ensure that the income certificates furnished were genuine.

- The system of recording the loan assistance in the ration cards of the beneficiaries so as to guard against drawing of assistance by more than one member of beneficiary family or from more than one lending agency was also not scrupulously followed except in the case of BCDC. **Audit also came across a specific instance of drawing of self employment loan by an individual loanee from both CC Corporation and BCDC.**
- Test checks disclosed that the CC Corporation Headquarters at Kottayam disbursed 51 *per cent* of the loans in Kottayam district itself. A further scrutiny disclosed that 81 *per cent* of the disbursements from head office were in Kottayam district with only 13, 3, 2 and 1 *per cent*

Fifty one *per cent* of loans disbursed by CC Corporation were confined to its Headquarters district.

in Idukki, Alappuzha, Ernakulam and Trichur districts respectively under its jurisdiction. Similarly, 65 *per cent* of the loan disbursements from Company's regional office at Trivandrum were in Trivandrum district whereas other districts of Pathanamthitta and Kollam served by it got a share of only 27 and *8 per cent* respectively. In respect of the other regional office at Kozhikode, 42 *per cent* of the disbursements were made in Kozhikide district, the share of other districts under it *viz*; Kannur, Wayanad, Kasargode, Malappuram and Palakkad being 29, 15, 11, 3 and nil *per cent* respectively. Thus the Company failed in effectively reaching out to its target group across the state and distributing the loan assistance in an equitable manner.

- The Management had also disclosed (February 2004) that 30 *per cent* of the beneficiaries under Agricultural Land Purchase Scheme were selected on the basis of recommendations of political and social workers implying that the selection was not transparent. The Company had also disbursed loans extending relaxations in age, annual family income, surety norms, etc.

- All the three Companies relaxed the surety norms on case to case basis by accepting sureties with net salary below the prescribed minimum and also having remaining service periods just sufficient to cover the repayment period without having adequate extended time to guard against possible defaults in repayment.

- As per terms of lending stipulated by NSFDC, loans under self employment schemes were meant for members of target communities who were not having proper means of livelihood, and therefore, existing entrepreneurs as well as those who have already availed of self employment loans from Company or any other Government agencies were not eligible for loan assistance under the scheme. No foolproof system was in place in SC ST Corporation to ensure that loan applicants under the scheme were not existing entrepreneurs or earlier beneficiaries. Audit also came across 3 cases out of 35 test checked in which self employment loans were disbursed to existing entrepreneurs. This in effect amounted to denial of loan assistance to other deserving members of the community as the loans were given on selection basis limiting the loanees to the targets fixed each time.

Absence of post disbursement monitoring

Utilisation of loans disbursed was not being adequately monitored.

2.2.18 Except in the case of a few of the schemes operated, the Companies have not been conducting any kind of post-disbursement monitoring of loan utilisation. The Companies as well as national agencies prioritised on low value loans of less than Rs.50, 000 under revised lending policy. Further the Companies relaxed the requirements of utilisation monitoring. According to the terms of lending fixed by National Agencies/Companies these loans did not require any pre disbursement scheme study or post disbursement field visits. It was only in cases of default when the field officers of these Companies used to conduct field visits and even when concrete cases of misutilisation of loan were reported, no action was taken to demand repayment of loan with interest at penal rates, as envisaged in the loan agreements. Out of 50 cases test checked, in three cases each in SC ST Corporation and CC

Corporation and four cases in BCDC, the companies failed to initiate recovery action.

SC ST Corporation admitted (August 2007) that absence of utilisation monitoring systems was the major drawback in its operational framework. The Company, however, attributed it to non-availability of required funds assistance from Government. In the opinion of audit, the available funds itself should have been utilised in such a way that the allocable share of expenditure on utilisation monitoring was spent for that purpose. The schemes did not envisage additional fund support for utilisation monitoring.

BCDC, however, confirmed (August 2007) the audit finding and assured to make the monitoring systems more effective by deploying additional manpower.

Specific cases of irregular loan assistances of higher amounts noticed in test check are discussed below:

Loans to co-operative societies

2.2.19 With the objective of aiding co-operative ventures promoted by target groups, SC ST Corporation disbursed (December 1978 and November 1998) loans aggregating Rs.70.48 lakh to 13 co-operative societies. All the societies defaulted repayments and accumulated (March 2007) arrears of Rs.1.24 crore. Manangement stated (August 2007) that most of the societies got liquidated after a short span of time due to mismanagement and political interference.

Improper loan assistance to a charitable society

SC ST Corporation could not realise dues amounting to Rs.31. 98 lakh from a co-operative society.

2.2.20 The MD of SC ST Corporation sanctioned (March 2001) a loan of Rs.1.70 lakh to Ambedkar Committee, a charitable society for starting a unit for making file boards, as a self employment venture, against security of machinery and other assets of the society and collateral security of members. The loan was disbursed (November 2001) at interest rate of seven *per cent*. The repayment of the loan was to commence from March 2002 at Rs.3450 per month. The loanee remitted only first three instalments and defaulted further repayments. The dues from the loanee as of March 2007 were Rs.2.43 lakh.

The following irregularities were noticed:

- Out of eight society members the President, Secretary and one member were from the same family with same residential address. Before disbursement of the loan, the Company was aware that the Secretary of the Society (main applicant) had defaulted in repayment of an earlier assistance from the Company. Fact is that defaulters were not entitled to a second loan.
- Despite default in repayment since June 2002, the Company did not take any action to realise the dues despite recommendation (July 2005) by Company’s Regional Manager to initiate RR action against the loanee. Further, one of the signatories to the memorandum on formation of the society alleged (July 2005) that she was not having any connection with the society and that her signature put in the memorandum was forged.

Irregular loan disbursements under foreign education scheme

2.2.21 The Foreign education loan scheme formulated (1998) by SC ST Corporation envisaged need based loan assistance upto a maximum of Rs.10 lakh to SC/ST students for pursuing higher studies abroad. The loan attracted interest at six *per cent* per annum for amounts up to rupees five lakh and 8.5 *per cent* for amounts in excess of rupees five lakh. Repayment of the loan was to commence after six months from the date of completion of educational course or on acquiring a job whichever was earlier.

Though the scheme was in existence for the last eight years, only three beneficiaries could be provided with the loan assistance so far (March 2007). The case studies also disclosed that all the three loans were disbursed by the Company relaxing terms and conditions, accepting invalid documents, and extending undue favours as discussed below:

Irregular loan assistance of Rs.16.62 lakh was granted under Foreign education scheme.

- Dr. Avinash Sudhakaran who applied (February 2003) for an assistance of Rs 7.50 lakh for acquiring MRCP/FRCS[♦] from London was disbursed the loan (Rs.7,12,500) by waiving the conditions as to beneficiary contribution (Rs.37,500), and payment was made directly to the applicant instead of the foreign educational institution as envisaged in the scheme. Further, the loan was granted before getting admission to the course of study. Enquires disclosed that the beneficiary did not actually pursue his proposed course of study abroad but returned to India after three months (July-September 2003) and joined Trivandrum Medical College. On confirming the misutilisation, the Company demanded (March 2005) repayment of the loan with interest accrued up to 31 March 2005 amounting to Rs.9.13 lakh. Based on a representation from loanee, the recovery was kept in abeyance as directed (April 2005) by the Government. Even though instalment facility was allowed, the loanee failed in making regular remittances. The action of the Company in extending the facility of monthly repayment and reduction of penal interest from four to two *per cent* was not justifiable in view of the breach of contract by the beneficiary.

The Management stated (August 2007) that the beneficiary paid Rs.2.58 lakh in May 2007 and the BOD had decided (June 2007) to recover the balance amount of Rs.8.05 lakh in lumpsum charging applicable penal interest, as recommended in Audit.

- Another beneficiary, Dr.M.Sureshkumar was granted (August 2000) loan of Rs.1 lakh for higher studies in United States of America. As per his loan application, the applicant was domiciled at Trichur since 1987. The loan was sanctioned (August 2000) accepting an outdated income certificate issued (1998) by village officer.

- In the case of Shri Sajan S J, the loan of Rs 8.50 lakh was granted (August 2000) relaxing conditions of educational qualification, annual family income and beneficiary contribution. The repayment of the

[♦] Member of Royal College of Physicians/Fellow of Royal College of Surgeons loan was to commence from June 2002 and to be completed by June 2007. There was default in repayment and the amount recoverable as of December 2006 worked out to Rs.7.88 lakh. Meanwhile, one of the sureties (mother of the loanee) for the loan retired (June 2005) from service. Apart from issuing demand notices to loanees/sureties, no firm action had been initiated by the Company to enforce the recovery.

The Management stated (August 2007) that the loanee has remitted (May 2007) Rs.5.70 lakh and the balance amount due was Rs.2.43 lakh.

Disbursement of loans to selected beneficiaries

2.2.22 All the three Companies followed the system of inviting applications for loan assistance, at periodical intervals, in anticipation of funds allocation by National Agencies. The applications were being invited through mass media. List of selected applicants was also being cancelled as and when funds allotted for a particular period were fully distributed.

Non-empowerment of target group

2.2.23 The basic objectives of these Companies also envisaged empowerment of the target group by conducting necessary awareness campaign and imparting training for skill development, simultaneously with the funds assistance. BCDC could conduct 25 number of training sessions whereas the other two companies did not undertake any such exercise. Since most of the beneficiaries were unable to make productive use of the funds assistance, repayment performance was very low against the schemes in operation.

Inefficient repayment monitoring systems

Repayment monitoring systems followed by Companies were weak.

2.2.24 The enforcement of systems in vogue for watching the repayment performance and its monitoring was deficient in all the three Companies. The Companies failed in keeping the loan ledgers up to date. CC Corporation did not prepare the Demand Collection and Balance (DCB) Statements on monthly basis. Audit scrutiny revealed that the figures in DCB prepared by other two Companies did not reflect the factual position of collection efficiency. The major short coming noticed was that the ‘demand’ did not include penal interest leviable on defaulted Equated Monthly Instalments (EMIs), whereas the ‘collection’ included recoveries including penal interest. Premature repayments were also being included in ‘collection’ although it did not form part of the ‘demand’. As a result, the DCB statements have been reflecting recovery efficiency (2002-07) ranging between 67.96 and 69.87 *per cent* on an annual basis for SC ST Corporation and 83.45 and 86.85 *per cent* for BCDC.

- The recovery efficiency of the district level offices showed wide variations. In respect of SC ST Corporation, the percentage of collection to demand varied between 52.83 and 87.79 among the different unit offices during 2002-07. In the case of BCDC, the variations were in the range of 73.16 *per cent* and 98.02 *per cent.* This indicated variations in quality of performance of different unit offices.
- The reason for the low rate of repayments was slack monitoring systems prevalent in the Companies. Although the Companies had stipulated time bound action for progressive follow up of repayments,

viz. issue of demand notices to loanees, action against sureties, RR action, etc., there were delays and inaction in initiating recovery action and follow-up. Test check conducted in this connection disclosed that in respect of loans like educational loan from SC ST Corporation, the Company failed to communicate the schedule of repayment for one to three years after completion of study. In the case of CC Corporation no recovery action was taken against 57 default cases test checked despite lapse of one to four years.

- Similarly action against sureties of defaulters was not initiated at the appropriate time. In 48 out of 115 cases test checked, such action was pending even after retirement of sureties when salary recoveries were no longer possible. The Companies, however, did not maintain any permanent record to watch the compliance of recovery from sureties with a view to systematise the demand and collection. In its absence there was huge pendency in initiating recovery action.
- The loanee defaulters of CC Corporation included three of its legal advisors during January 1999 to November 2003. One of the legal advisors settled his loan outstandings to enable his wife to avail of a self employment loan of Rs.47,500 in November 2003. No repayment was made by her and the balance outstanding (March 2007) amounted to Rs.59,662. The other legal advisors availed (November 1999 and March 2000) the loan during their period of service with the Company and the arrears in repayment recoverable from them as at the end of March 2007 amounted to Rs.31, 550.
- Action for enforcing recovery through RR measures had also not been successful. The success percentage was only about 27.36 in SC ST Corporation. In respect of BCDC it was 22 *per cent* and eight *per cent* respectively in the two district offices of Kottayam and Thrissur. Other district offices did not separately ascertain the recovery percentage. As regards CC Corporation there were no regular and systematic revenue recovery measures and no records were maintained to monitor the progress of such action. In the case of RR action taken against loanees under OLP schemes, the recoveries through RR were quite negligible as the properties furnished as security for the loans did not fetch values any where near to the values assigned to them at the time of loan disbursement.

Apart from the failures in recovery action mentioned above, the inadequacies in collection machinery existing in the organisations also caused poor repayment performance. The existing system of remittance of the loan instalments to the district offices/regional offices was inconvenient for loanees from far off localities in the district.

SC ST Corporation confirmed (August 2007) the audit finding and stated that efforts are being taken to strengthen the recovery measures by forming recovery cells at district office level. BCDC, however, maintained that its recovery performance was good and that the National Agencies had rated its performance as best. The fact, however, remained that the recovery percentages being projected by the Company in its DCB statements were erroneous as already stated, in reply to which the Company had also agreed to set right the mistakes.

One Time Settlement (OTS) of loans

SC ST Corporation and BCDC had to sacrifice Rs.3.18 crore for collection of Rs.10.84 crore.

2.2.25 In respect of loans disbursed by all the three Companies under old lending policy (OLP) of National Agencies, the Companies did not take regular follow-up action for obtaining repayments and thereby most of the loanees were rendered chronic defaulters. The securities accepted for these loans were also inadequate. The uncollected demands towards loan repayments in respect of SC ST Corporation and BCDC as of April 2002 were Rs.20.90 crore and Rs.9.65 crore respectively. As CC Corporation did not either maintain proper accounts of loans or DCB statements, the magnitude of arrears in collection were not ascertainable. In order to realise the old dues to the possible extent, SC ST Corporation operated (June 2004 to June 2007) OTS schemes for three spells[*] and recovered Rs.3.53 crore after waiver of penal interest and part of regular interest of Rs.0.80 crore in 3350 cases. BCDC operated (October 2002 to March 2007) OTS schemes in four spells[#] and recovered Rs.7.31 crore after waiver of penal interest of Rs.2.38 crore in 5366 cases.

Even after operation of OTS for such long durations, both SC ST Corporation and BCDC left uncollected (March 2007) outstanding due of Rs. 30.73 crore and Rs. 39.43 crore respectively as of March 2007. As against a total number of 2,820 OTS notices issued by SC ST Corporation during 2006, 398 notices were returned undelivered, indicating that there were loanees who were no longer traceable or disinterested in settling the repayments under OTS.

Absence of impact assessment

2.2.26 A constant system of post implementation impact assessment of the schemes was not in existence in any of the Companies. The absence was attributed to infrastructural and manpower constraints.

SC ST Corporation and CC Corporation spent 36.06 paise and 24.35 paise respectively per rupee of loan assistance.

High cost of service

2.2.27 SC ST Corporation had been spending 36.06 paise for every one rupee of loan assistance and in the case of CC Corporation it was 24.35 paise for every rupee. BCDC could, however, contain its service cost between 4 to 10 paise per rupee among the different district offices.

High rate of administrative costs at SC ST Corporation and CC Corporation was due to the very low volume of loan disbursements coupled with growth in administrative costs. While the loan disbursements by SC ST Corporation recorded a fall of 30.71 *per cent* during 2002-07 when compared to immediately preceding five years (1997-2002), there was growth in administrative cost to the extent of 49 *per cent*.

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[*] June 2004 to December 2005, August 2006 to January 2007 and February 2007 to June 2007.

[#] October 2002-December 2002, March 2004-June 2005, November 2005-March 2006 and December 2006-March 2007.

When the population of its target community was around 35 lakh (as per 2001 census) it could render assistance only to 6312 families during 2002-07, the gross amount of loans being Rs.32.70 crore as against Rs.47.19 crore disbursed during preceding five years (1997-2002) among 10,818 families.

In the case of CC Corporation average annual income during 2007 from lending activity was only Rs.31.01 lakh against its administrative cost of Rs.43.33 lakh per annum.

SC ST Corporation stated (August 2007) that measures were being taken to scale up the business volume so as to bring down the operational expenses to acceptable levels.

Agricultural land purchase scheme

2.2.28 The most popular loan assistance scheme of SC ST Corporation had been the traditional scheme for Agricultural Land Purchase (ALP). This scheme having unit cost of Rs.1.50 lakh, with loan and subsidy component in the ratio of 2:1 was being implemented by the Company since 1999-2000 replacing the earlier scheme of lending amounts in the range of Rs 10,000 to Rs.25,000. Funds were made available from national agency (NSFDC) since 2000-01 and by 2002-03, they were the major source of finance for loan portion.

Land purchased under Agriculture Land Purchase Scheme was not used for agricultural operation.

Out of Rs.24.20 crore, available towards subsidy for the scheme, the Company utilised only Rs.9.98 crore during 1998-99 to 2006-07 leaving an unutilised balance of Rs.14.22 crore. Due to poor repayment performance, the Company was constrained to restrict the loan assistance to the required minimum, to satisfy the sectoral allocation of funds by national agency which required 50 *per cent* of gross loan assistance for agricultural and allied projects. The repayment period of loan ranged between 8 and 12 years. The land purchased by the beneficiary was mortgaged to the Company as sole security for the loan, till its repayment was over. Most of the beneficiaries were, however, not using the land purchased through the scheme for agricultural operations.

Though the mortgage deeds pledged by loanees permitted the Company to realise the dues by selling the land, the Company totally failed in enforcing this provision in any of the cases of default. The Management proposed (September 2003) to obtain the services of an officer not below the rank of a Tahsildar to accelerate the recovery action of ALP Loans which constituted 53.01 *per cent* of loan disbursements. The proposal was not replied to by the Government (August 2007).

The following table provides details of repayment performance of ALP Schemes implemented by the Company.

(Rs. in lakh)

Schemes	Demand	Collection	Balance	Percentage of recovery
ALPS (Old Scheme)	1261.07	722.14	538.93	57.26
ALPS (NSFDC original scheme)	462.19	104.96	357.23	22.71
ALPS (NSFDC new scheme)	115.93	34.39	81.53	29.66
ALPS (State fund)	2.49	1.37	1.07	55.02
Total	**1841.63**	**862.86**	**978.77**	**46.85**

Recovery rate of ALP loans was only 22.71 to 57.26 *per cent.*

It would be seen from the table above that the modified scheme implemented from 1999-2000 onwards, with a view to improve its performance, did not yield the desired results since the recovery percentage was 29.66 as against 57.26 *per cent* for old scheme. The Company could not fulfill the social objective, on account of non-utilisation of land by the beneficiaries. Non-recovery of substantial amounts also weakened the financial viability of the Company.

Irregularities noticed in the scheme implementation are discussed below:

- As per the conditions of assistance, the documents of the property purchased were to be registered in the name of both husband and wife of the beneficiary family. In 14 out of 42 cases test checked the land was registered in the name of single individual.
- As the fund assistance was linked with subsidy of upto Rs.50,000 per loanee, the company had to ensure that beneficiaries did not part with the property acquired to derive undue financial gain by selling off the property. For this, the Company should have kept the property papers with it till the end of the repayment period, even if the loanees foreclosed the loan account. The Company, however, returned the documents in 53 such cases involving subsidy payment of Rs.25.81 lakh. The loanees in these cases closed their account within 19 to 86 months from drawing the loan.
- Out of 527 ALP loans amounting to Rs.58.98 lakh disbursed from Thrissur district, which were past their repayment period (12 years), it could recover only 8.07 lakh from the loanees and the balance amount of Rs. 1.84 crore (Principal Rs.0.56 crore and interest Rs.1.28 crore) was outstanding (March 2006). RR action was initiated only for 264 cases while as per the prescribed procedure RR action was required to be taken as and when the loanee defaulted five consecutive instalments. In 60 cases test checked in which loans were disbursed (March to August 2000), no repayments were received till the end of 2005-06. The Company did not initiate any RR action against these defaulters.

The performance of ALP scheme implemented by CC Corporation since inception was also very poor. Out of a gross amount of Rs 42.67 lakh disbursed under the old scheme between September 1985 and June 1995 only

Rs.6.40 lakh could be recovered upto 2005-06, towards principal, the overall position of arrears being as follows:

(Rs. in lakh)

<table>
<tr><th>Particulars</th><th>Demand</th><th>Collection</th><th>Balance</th></tr>
<tr><td>Principal</td><td>42.67</td><td rowspan="3">13.16</td><td rowspan="3">63.78</td></tr>
<tr><td>Interest</td><td>23.40</td></tr>
<tr><td>Penal Interest</td><td>10.87</td></tr>
<tr><td>Total</td><td>76.94</td><td>13.16</td><td>63.78</td></tr>
</table>

Out of 433 loanees, 126 loanees who were paid Rs.17.12 lakh did not make any repayment and only 24 loanees made the repayments in full (Rs.4.93 lakh).

ALP loans disbursed by CC Corporation were not properly utilised and repaid.

In spite of the high rate of default and the long pendency in loan settlement, the Company did not take any stringent action to realise the overdue amounts. It was reported (July 2000) that majority of loan applications were received from Kottayam and Alleppey districts for purchase of water logged paddy fields for which there were no buyers when offered for sale as per RR action. As the recovery rate of ALP loans continued to be discouraging, the Board decided (November 2002) to restrict the loans to cultivable land (dry land) alone. The decision was later amended (March 2005) allowing sanction of loans without strictly restricting it to dry lands, but giving priority to dry land.

It was, however, noticed that out of 227 loans sanctioned (2005-06) thereafter, 155 loans (68.28 *per cent*) were for purchase of wet land. The repayment performance of loans given on the security of wet land was also poor compared to that of dry land. The low rate of recovery was mainly attributable to improper pursuance. While the repayments were to commence 24 months after disbursement of loan, the beneficiaries were not even served with a repayment schedule either at the time of commencement or afterwards. Further, in the absence of records, the Company was not aware of the number of cases for which it lost its claim of recovery as per the Law of Limitation.

Individual case studies of ALP Loans revealed many cases of irregular sanctions and disbursement, as discussed below:

- ALP Loans amounting to Rs.15.75 lakh was paid to a group of 21 beneficiaries for purchase of two adjacent plots on sharing basis. The land value as assessed (December 2002) by Tahsildar was Rs.3000 per Are[*] (Rs.1220 *per cent*) at which rate the total value came to Rs.5.39 lakh. Without authority, the Administrative Officer of the Company assigned a higher value of Rs.2500 per Cent in 13 cases and Rs.3600 per Cent in 8 cases and the total value of land went up to Rs.15.75 lakh. Loans were disbursed adopting this higher valuation, even without limiting it to 80 *per cent* of value as required under the scheme. There was, thus, excess disbursement of loan to the extent of Rs.10.36 lakh. The beneficiaries defaulted repayment of the loans, the amount defaulted (January 2007) being Rs.3.03 lakh.

[*] One Are is equal to 100 square metres.

The matter was enquired (2004-05) by the Vigilance Department and they recommended appropriate action. No action had been initiated so far (May 2007).

- An applicant in her loan application (February 2000) had indicated her date of birth as 17 Febraury, 1946 and the age as 54 years. The age certificate submitted also certified her age as 55 years, which was the maximum age-limit prescribed for the loan. At the instance of the company, the applicant produced another certificate as issued by a Government Doctor without indicating date of issue, as per which, the applicant was aged 52 years. The fresh certificate was accepted (March 2003) for the purpose of sanctioning loan of Rs 75,000. Acceptance of invalid age certificate, when the applicant was actually aged 57 years and ineligible for loan, was irregular.

- Under the ALP Scheme implemented with funds provided by State Government, loan amount was to be restricted to 80 *per cent* of the cost of land or the maximum limit of loan, whichever was less indicating that 20 *per cent* of the cost of land was to be contributed by beneficiaries. In violation of this approved condition, the Company released 100 *per cent* of cost of land as loan assistance in respect of 329 loan applications sanctioned during the period 2000-01 to 2005-06, the excess payment being Rs.40.77 lakh.

In spite of the proven failure of the scheme both the companies (SC ST Corporation and C C Corporation) continued to implement it without any significant change, reasons for which were not on record.

Management of SC ST Corporation stated (August 2007) that it has taken serious note of the audit finding and the Company will continue to implement the scheme in a more scientific manner, imparting training to assisted beneficiaries in modern and innovative fields of cultivation like floriculture and horticulture.

Specific Audit findings

Kerala State Development Corporation for Scheduled Castes & Scheduled Tribes Limited

Educational loan Assistance

2.2.29 The Company formulated (January 2000) an educational loan assistance scheme under which students belonging to SC/ST with annual family income below rupees one lakh were eligible for loan of up to Rs.50,000 for higher studies within the state and Rs.10,000 outside the state. An amount of Rs.80.58 lakh was disbursed under the scheme to 180 beneficiaries up to 2006-07.

A review of 30 out of 180 cases revealed that:

- While payments under educational loans were to be made to respective educational institutions in order to ensure proper utilisation, the Company disbursed the loan amounts directly to the beneficiaries in all the 30 cases, involving Rs.13.09 lakh without insisting on proper utilisation certificates from the educational institution.

- Loans amounting to Rs.5.45 lakh were disbursed by Kollam District Office in lumpsum at the beginning of the course itself, instead of need based instalments as stipulated by the Head Office.
- While repayment schedules were to be fixed and communicated at the time of completion of course of study or on getting employment, whichever was earlier, in four cases at Thrissur District Office involving Rs.0.92 lakh, the repayment schedule was not fixed and communicated even after three to four years from the date of course-completion. Thus, repayments were not obtained from the beneficiaries.

Micro Credit Finance Schemes

2.2.30 NSFDC devised Micro Credit Finance Scheme for implementation from 2000-01 under which soft loan assistance was provided to members of scheduled castes living below double the poverty line to promote income generating activities of their own. The loan and subsidy content of the assistance initially fixed as Rs.5,000 each was enhanced from time to time and remained at a maximum of Rs.25,000 (Rs.15,000 as loan and Rs.10,000 as subsidy) with effect from 1 April 2003. The interest payable by the beneficiaries**,** was reduced (April 2003) from seven to five *per cent*. NSFDC informed the Company (December 2001) that there was no constraint in providing funds. Yet the Company could draw and utilise only Rs.3.34 crore during the five years up to 2006-07 as against Rs.4.53 crore targeted.

Micro credit scheme of SC ST Corporation suffered due to non-release of subsidy together with loan.

While the scheme envisaged payment of subsidy out of funds provided by State Government, the Company discontinued (November 2001) release of subsidy for want of assistance from the Government. Non-release of subsidy was one of the reasons for the lower demand for the loan since the loan component alone was inadequate for launching any successful livelihood activity. For the same reason, the rate of repayment of the loans disbursed under the scheme was also as low as 50.20 *per cent*, in spite of the lower rate of interest of 5 *per cent*. The under performance of micro credit schemes implemented by the Company was also due to absence of post-disbursement monitoring of loan utilisation.

The Management stated (August 2007) that the beneficiaries of the scheme belonged to most underprivileged group whose business acumen and competence was inadequate to run even a micro enterprise. It was also stated that reported instances of diversion of loan funds for other exigencies like marriage, hospital treatment, etc., were also attributable to poor scheme performance. The reply brings out the fact that the Company did not select beneficiaries having suitable entrepreneurship skills nor did impart proper training to them for empowerment. Company also failed to conduct post disbursement monitoring.

Mahila Samridhi Yojana.

2.2.31 During 2003-04 NSFDC introduced a special scheme named ‘Mahila Samridhi Yojana’ in the line of micro finance, exclusively for women

Special scheme of micro credit for women was not adequately promoted.

beneficiaries. As against the lending rate of five *per cent* fixed for micro scheme, it was four *per cent* for the new scheme. Based on population census, NSFDC notionally allocated funds aggregating Rs.76.91 lakh for the three years from 2004-05 to 2006-07. Out of this, only Rs.30.60 lakh was utilised as of March 2007. Thus, the Company short utilised an amount of Rs. 46.31 lakh allocated by National Agency, and also suspended (January 2006) the scheme implementation, when the allotment for first year was fully utilised and fresh allocation was awaited. The loan applications received during the interim period were sanctioned under the normal scheme of 'micro finance' at higher rate of interest in 6 out of 30 cases test checked in audit.

It was further observed that even after resuming (September 2006) the Mahila Samridhi Yojana, the Company had disbursed micro finance assistance to women applicants under the regular scheme, at higher rates of interest.

Thus, the company failed in channelising the due share of assistance to women beneficiaries and also did not give priority to the scheme despite lower rate of interest and better repayment performance (62.48 *per cent* as against 50.20 *per cent* for conventional scheme).

Non- release of subsidy

Non-release of subsidy portion by SC ST Corporation adversely affected scheme implementation.

2.2.32 The beneficiaries of the Company who belonged to Below Poverty Line (BPL) group, were eligible for subsidy amounting to 50 *per cent* of loan amount or Rs.50,000 whichever was lower, in respect of Company's lendings for income generating activities. As the fund allotments in State budgets were not being released on a regular basis, the Company discontinued payment of subsidy from November 2001. When the state Government released (March 2006) an amount of Rs.1.30 crore towards arrears of subsidy, the Company partly credited (August 2006) the amount of eligible subsidy in the respective loan accounts without ensuring proper utilisation of the loan amounts for the stated purpose and partly disbursed (2001-03) Rs.72.03 lakh to the loaneees who had already repaid the loans in full.

Non-release of subsidy along with the loan amounts had adversely affected the scheme performance as the loan amount itself was inadequate for successful launching of the activity. Release of subsidy after a delay of three to four years by adjustment against dues did not serve purpose of the scheme.

Kerala State Development Corporation for Christian Converts from Scheduled Castes and the Recommended Communities Limited

Vigilance cases against employees

2.2.33 Following complaints about irregular sanction of loans by the Company, the Vigilance and Anti-corruption Bureau, Kottayam investigated into the transactions of the Company from 1994 onwards and detected 65 instances of loan sanctions (Rs.53.81 lakh) based on forged documents. Cases were filed against employees and one former MD.

Out of 16 permanent employees of the Company, 8 were involved in cases under investigation among whom three were under suspension from June 2005.

Another case of disbursement of loan assistance of Rs.4.68 lakh to 17 nursing students to undergo paramedical course conducted by a private hospital, with guaranteed placements, was also under investigation by Vigilance. In this case, the scheme was implemented without obtaining Government approval and the course certificates were issued by the Company and not by the hospital.

Inadequate coverage of target group

2.2.34 Under the marriage loan assistance, the Company had been providing financial assistance upto a maximum of Rs.25000 at the concessional interest rate of 4 *per cent* and penal rate of 2.5 *per cent* per annum. The loan was repayable in 60 instalments. At the same time, BCDC from which Company's target community was also eligible for assistance had been operating marriage loan assistance levying interest at 8.5 *per cent* and penal rate of 18 *per cent*, the maximum loan amount being Rs.30,000.

It was noticed that despite lower rate of interest, the Company could disburse only 53 loans from its Headquarters at Kottayam as against 65 loans by the district office of BCDC at Kottayam during the three years upto 2005-06. The poor performance of the Company was mainly due to delay in processing and disbursement of loans.

Kerala State Backward Classes Development Corporation Limited

Non-utilisation of interest margin

2.2.35 With a view to strengthen the infrastructure of its State Channelising Agencies (SCA), NMDFC has been reimbursing additional interest margin equivalent to 25 *per cent* of the interest actually repaid by SCAs during previous year. The entitlement of a particular year could be availed during the succeeding two years failing which it lapsed. The said funds could be utilised by SCAs for infrastructure related expenses such as purchase of vehicles, computers, consultancy expenses for surveys, loan recovery related expenses and such other promotional expenses.

Out of the eligible rebate of Rs.27.47 lakh for 2004-05 the Company utilised only Rs.21.06 lakh during the next two years and the balance amount of Rs.6.41 lakh lapsed. There was no justification on record for foregoing the financial assistance in areas of infrastructure development, impact studies, engagement of recovery agents, etc.

The Management stated (August 2007) that the lapsed amount was earlier earmarked for purchase of new vehicles to replace old ones and delay in disposal of old vehicles, caused the non-utilisation. The reply is not tenable since the fund could have been utilised to meet expenditure towards loan recovery, impact studies and infrastructure development.

Cash Loss on implementation of Housing Finance Scheme

2.2.36 During the years 1998-99 and 1999-2000, the Company operated a housing finance scheme among Low Income Group (LIG) and Middle Income Group (MIG) of target community, availing finance from HUDCO. While the borrowings were at the rates of interest of 13 *per cent* per annum (LIG) and 15 *per cent* per annum (MIG) the lendings were at the rates of 13.5 *per cent* per annum and 16 *per cent* per annum respectively. The Company disbursed 882 loans under the scheme, amounting to Rs.6.38 crore.

As the interest rate charged by HUDCO was found to be quite high, the loan was short closed (December 2000) by availing of another loan from Union Bank at interest of 10.5 *per cent* per annum, which was later reduced (August 2004) to 7.5 *per cent* per annum. The rate of interest of Company's loans was correspondingly reduced to 10.5 *per cent* per annum in January 2003 and 8 *per cent* in August 2004, for both LIG and MIG.

The repayment performance of the loans was poor and it ranged between 71.04 *per cent* and 74.68 *per cent* during the five years up to 2002-07. The uncollected demand as at the end of 2006-07 was to the extent of Rs.2.22 crore.

According to the Management (August 2007), monthly repayment liability disproportionately higher than the income of beneficiaries coupled with unproductive nature of investments caused the high rate of defaults.

The Company introduced (October 2005) a scheme for settling the outstanding loan amount by waiving 100 *per cent* penal interest and up to 50 *per cent* of interest as determined on the basis of Adalat. Out of 882 loans the Company settled 141 loan accounts with outstanding balance of Rs.1.14 crore during the period January 2006 to May 2006 by accepting Rs.82.05 lakh after waiver of Rs.31.86 lakh.

BCDC suffered cash loss of Rs.23.24 lakh in closure of 141 loan accounts under Housing scheme.

It was further noticed that:

- The maximum interest margin that the Company collected under the scheme being only 0.5 *per cent* for LIG and 1 *per cent* for MIG, waiver of normal interest up to 50 *per cent* involved cash loss of Rs.23.24 lakh.
- The company under its old lending policy (prior to 1 June 1999) charged compound interest and credited the remittance from loanees, first against normal interest outstanding, then against principal and finally against penal interest. Under revised lending policy, the method of accounting was revised in the order of first charge to penal interest, then to interest and finally to principal, at simple interest rates. The repayments received under Housing Finance Scheme were to be adjusted as per Revised Lending Policy (RLP) system of adjustment. For the purpose of regularising the waiver given under OTS, the Company, however, reworked the loan balances adopting Old Lending Policy (OLP) and Rs.19.47 lakh already credited under 'principal' and 'interest' was withdrawn and treated as penal interest for the purpose of sanctioning the waiver in respect of 119 loan accounts settled in

Adalats. While doing so, the Company did not levy compound interest as was done for OLP loans.

Implementation of Micro Finance Schemes

A sum of Rs.10.29 crore was disbursed under Micro Finance Schemes without ensuring the credentials of end beneficiaries.

2.2.37 In order to reach out to the poorest of the poor among the target group, who were in need of loans of very small amounts but required it to be delivered quickly at their doorsteps, NBCFDC introduced (1998-99) the scheme of micro credit under which loan assistance were rendered to self help groups formed by target communities either directly or through Non-Government Organisations (NGOs). It was later decided (1999-2000) to involve SCAs also in implementation of micro credit schemes. Accordingly NBCFDC funds were available to SCAs for micro credit schemes from 2000-01 onwards. NMDFC also introduced (1998-99) micro credit schemes, initially through NGOs and later on (2001-02) through SCAs.

BCDC commenced (July 2001) implementation of micro credit schemes and disbursed (December 2006) a gross amount of Rs.7.04 crore with NBCFDC fund assistance and Rs.3.25 crore with NMDFC funds. These disbursements were made among 15 NGOs who were short listed on the basis of their applications and interviews. The Company was not involved in the distribution of funds by NGOs among SHGs.

The following deficiencies were noticed in the implementation of the scheme:

- The Company started implementation of the micro credit scheme in Malappuram district by distributing (July 2001) Rs.4.75 lakhs to Kudumbasree units. On finding the scheme successful, the company drew funds amounting to Rs.1.45 crore from National Agencies, during November 2001 to November 2002. Due to delay in identification of NGOs, the Company could utilise only Rs.34 lakh upto the end of March 2003. As further delay in utilisation of funds would have attracted levy of penal interest from lending institutions, the Management selected (March 2003) seven NGOs in a hasty manner without assessing their financial status and distributed Rs.1.15 crore without any tangible security. Eventually two[*] of the NGOs defaulted the repayments. The revenue recovery measures initiated against them failed and the arrears amounted to Rs.28.53 lakh as of March 2007. Another NGO [#] financed earlier (November 2002) also defaulted repayments to the extent of Rs.6.23 lakh as of March 2007.

The Management stated (August 2007) that it was mainly because of lack of experience in running the micro credit scheme that few of the NGOs selected and financed became defaulters.

The reply is not tenable since judging the financial soundness and credit worthiness of an agency was not such a complex task that required high expertise and long experience for a Company managed by professionals.

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[*] Bharat Sevak Samaj and Morarji Desai Charitable Society
[#] Chakkala Community

- Although the Board constituted (March 2006) a subcommittee consisting of Chairman, MD and three Directors to evaluate the utilisation and social impact assessment, functioning of SHGs etc., and to submit a report to the Board within three months, no action had been taken (March 2007).
- It was stipulated (1998-99) by National Agencies that the annual family income of the beneficiaries selected should be below double the poverty line and that priority should be given to families living below the poverty line and women beneficiaries. In respect of micro finance assistance rendered by the Company, no document to substantiate annual family income of end beneficiaries was mentioned in the utilisation statements furnished by NGOs, though required to do so. Further, in respect of SNDP[∇], who were given the maximum amount of Rs.4.75 crore, the income of all the 14496 beneficiaries whose loan details were test-checked in audit was below Rs.2000 per annum.
- The SCA should maintain separate books of accounts, including SHG-wise loan register, purpose-wise list of loans disbursed, etc. Such records were not maintained.
- The Company neither gave publicity for the interest rate charged on the target group with a view to eliminate the chances of NGOs charging higher rates of interest on the beneficiary SHGs, nor did investigate whether the NGOs were collecting interest at rates higher than stipulated rate of 5 *per cent* from the members of SHGs, in order to ensure that the objective of the micro finance schemes were fulfilled.
- Out of a gross amount of Rs.8.85 crore released by NBCFDC during 2001-06 for micro finance scheme, a net amount of Rs.1.86 crore was diverted by the Company to general lending schemes. No fund was utilised by the Company for micro finance scheme during 2003-04 though Rs.2.50 crore was released to it. A sum of rupees one crore received from NMDFC was also diverted for general schemes. Under the prevailing system, funds were being drawn from National Agencies in lump sum without proper planning of ultimate utilisation and the disbursements were made in distress, at the end of the time schedule fixed by National Agencies with a view to avoid penalties. The Company, therefore, did not give proper attention to the socio-economic aspects involved in the scheme implementation.

Special recognition by National Agencies

2.2.38 In spite of all the shortcomings and system deficiencies discussed above BCDC was rated by NBCFDC as its best performing SCA for 2001-02 and 2005-06 and second best for 2002-03 and 2004-05. Similarly NMDFC had also recognised it as second best among its 10 selected SCAs for 2004-05 for which cash award of rupees two lakh was also given.

[∇] Sree Narayana Dharma Paripalana Sangham

Internal Audit and Internal Control

2.2.39 Effective internal audit and internal control systems were not in place in any of the three Companies. Audit noticed following deficiencies in Internal Audit and Internal Control.

Internal Audit

- SC ST Corporation was having separate internal audit wing upto December 2004 and thereafter the internal audit was entrusted (January 2005) to a firm of Chartered Accountants. The scope of work of internal auditors was not defined. None of the unit offices had reported compliance to the internal audit reports for the year 2003-04. In respect of 2004-05, only four out of 11 units responded to the report issued in March 2006.
- CC Corporation was not having a regular system of internal audit till February 2006. The agency engaged for updating accounts and carrying out internal audit was mainly engaged in reconstruction of accounts of the Company.

Internal Audit and Internal Control Systems were deficient in all the three Companies.

- There was no internal audit system in BCDC, even though its level of operations and turnover were much higher compared to the other two Companies and the activities highly decentralised. Cases of defalcation of cash, manipulation of records, etc., were detected by the Company in their District offices due to inherent system deficiencies and inadequate internal control. A case of misappropriation of funds of Rs.14.10 lakh by a District Manager of the Company was detected (March 2000) and is under investigation. Similarly, a watchman of District Office, Alleppey made fraudulent entries in loanees ledger and tampered with (2002-05) 184 loan accounts and defalcation of cash worth Rs.2.69 lakh was brought out in internal investigation conducted by Company.

The Management stated (August 2007) that the internal audit systems were being introduced in accordance with a Board decision (March 2007) to that effect.

Internal control

- In CC Corporation, essential basic records for loan transactions were not being maintained. Other than cash book, none of the records available were complete and up to date. Daily collection registers containing repayment particulars were maintained only from 1997-98. The postings in loan ledgers were not up to date. There were no records for watching recoveries from sureties and through revenue recovery measures. There was absence of codes and manuals for various schemes as well as competent middle level officers.
- CC Corporation have been operating accounts and placing short term deposits aggregating Rs.40 lakh (31 March 2006) with a private bank, in contravention of the Government guidelines.
- Reconciliation of bank accounts was pending in BCDC from 2001-02 for want of updated accounts. The fund transfers between its Head

Office and District Offices were also not being regularly reconciled. Fixed Deposit Registers were not up to date. The deposits were not supported by proper certificates/ confirmation statements.

SC ST Corporation stated (August 2007) that it will review the present system of internal control and take steps to reorganise and strengthen it.

The above matters were reported to Government (June 2007); the reply had not been received (September 2007).

Acknowledgement

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

Conclusion

The three Companies in social welfare sector formed for economic upliftment of Scheduled Castes, Scheduled Tribes and Backward Communities in the State could not accurately identify their target group and provide assistance to the most deserving sections among them. These Companies failed in channelising the funds available from National Agencies to its full potential. The system of selection of beneficiaries, processing and distribution of funds assistance, monitoring of utilisation and repayment, etc., were deficient. There was lack of professionalism in management of all the three Companies. The cost of service incurred by SC ST Corporation and CC Corporation was abnormally high. Majority of the schemes implemented by these Companies failed to fulfill the desired social objectives. The Companies have not put in place proper internal control and internal audit due to which the systems are prone to fraudulent practices. The accounts of these Companies were in arrears for years together rendering it difficult to evaluate the efficiency and financial viability of operations on a regular basis.

Recommendations

- **The population of target group should be accurately identified by these Companies and assistance channelised to the deserving cases.**
- **Post disbursement studies should be conducted to evaluate the effectiveness of assistance rendered.**
- **The financial assistance provided should be made more accessible to genuine target group by making the loan processing activities more transparent and efficient.**
- **The target group ought to be provided with easier means for drawing assistance and repayment of instalments.**

- **The Companies should actively propagate micro finance schemes with a view to reach out to target population in a cost effective manner.**
- **The target group of Kerala State Development Corporation for Christian Converts from Scheduled Castes and the Recommended Communities Limited was one among the many communities that formed part of the target group of Kerala State Backward Classes Development Corporation Limited. Since the volume of business handled by the former was quite meagre, it is financially prudent to merge the two companies.**

2.3 JOINT VENTURE ACTIVITIES OF TOURIST RESORTS (KERALA) LIMITED

Highlights

Without inviting expressions of Interest from leading hotel groups or ascertaining best offer a joint venture (JV) agreement was entered with Taj Group for forming a JV Company through direct negotiation. As a result the Company could not get competitive terms.

(Paragraph 2.3.7)

Additional investment of Rs.11.17 crore was made in TKHRL, when its accumulated loss was Rs.21.75 crore and failure to float public issue/private placement of shares resulted in avoidable additional investment of Rs.6.67 crore

(Paragraph 2.3.11)

Out of 14 locations identified for tourism development, only four locations have been developed till date.

(Paragraph 2.3.12)

Investment of Rs.16.67 crore during the period 1992-2007 in TKHRL did not yield any return to the Company so far.

(Paragraph 2.3.13)

Taj Kerala Hotels and Resorts Limited incurred excessive operating expenses of Rs.25.61 crore during the six years up to 2005-06 when compared to All India average and there was shortfall of Rs.19.25 crore in operating profit up to 2005-06

(Paragraph 2.3.14)

Investment of Rs. 54.40 lakh by the company in Oberoi Kerala Hotels and Resorts Limited remained unproductive since 2002-03 due to non-materialisation of any of the two projects taken up by the joint venture Company.

(Paragraph 2.3.19)

Introduction

2.3.1 Kerala Tourism Development Corporation Ltd (KTDC), a State Government Company incorporated in 1965 had taken up a hotel project at Kochi in 1970. The project was held up for want of sufficient funds. The State Government, therefore, decided (April 1989) to form a new Company, with the intention of obtaining institutional finance. Accordingly, Tourist Resorts (Kerala) Limited (TRKL) was incorporated (August 1989) as a subsidiary company of KTDC primarily with the intention of completing the Kochi Hotel Project.

For completion of the hotel project, institutional finance was sought for and financial commitment was obtained (January 1990) from Industrial Finance

Corporation of India (IFCI) by TRKL. In the mean time, Taj Group of hotels expressed (July 1990) their willingness to promote tourism in the State. Based on the Memorandum of Understanding (MoU) entered into (October 1990) between State Government and Taj Group a Joint Venture (JV) agreement between TRKL and Indian Hotels Company Limited (IHCL) was executed (October 1990) and a new Joint Venture Company by name Taj Kerala Hotels and Resorts Limited (TKHRL) was formed (May 1991).

In November 1993, KTDC formed another Joint Sector Company named Oberoi Kerala Hotels and Resorts Limited (OKHRL) with East India Hotel Limited (EIH) of Oberoi Group to promote tourism in Kerala. Subsequently, TRKL was placed (December 1998) as the joint venture partner in place of KTDC.

Out of 11 Directors in the Board of TKHRL as on 31 March 2007, three were nominated by TRKL and eight were nominees of IHCL. The Board of Directors of OKHRL consisted of six directors – three each from TRKL and EIH.

Scope of Audit

2.3.2 This review conducted during April-May 2007 covers the performance of the Company in respect of joint venture activities which include formation of two joint venture companies (TKHRL and OKHRL), investment and returns from the JVs since formation to March 2007.

Audit objectives

2.3.3 The audit objectives of the performance review were to ascertain whether:

- selection of the joint venture partner was transparent and the joint venture agreements protected the interest of Government/TRKL;
- TRKL could exercise adequate control over the functioning of the JV Companies;
- the joint venture company could establish hotels and resorts in the State leading to substantial development of tourism and economic activity;
- JV Companies were managed efficiently and effectively ; and
- there was reasonable return on investment.

Audit criteria

2.3.4 The following criteria were adopted:

- provisions of the MoU between Government and JV partners;
- instructions issued by Government for the formation of joint venture companies;
- provisions of JV agreement and operating agreement; and

- Tourist statistics reports of Department of Tourism of the State Government.

Audit methodology

2.3.5 Audit adopted the following mix of methodologies:

- review of draft Council note at Government level;
- review of JV agreement and operating agreement ;
- review of performance of the Joint Ventures with reference to various statistical data; and
- scrutiny of Annual Report of JV companies and files and records maintained by TRKL.

Audit findings

2.3.6 Audit findings emerging from the performance review were reported (June 2007) to the Management/Government and discussed in the meeting (31 July 2007) of the Audit Review Committee on Public Sector Enterprises (ARCPSE). The Management was represented by the Manager (Finance) and Consultant Company Secretary. The State Government did not send a nominee to ARCPSE although invitation was issued (June 2007) to the Secretary to Government, General Administration Department. The views expressed by the Management have been taken into consideration while finalising the review.

The Audit findings as a result of the performance review are discussed in the succeeding paragraphs:

Taj Kerala Hotels and Resorts Limited (TKHRL)

Formation of the joint venture company

2.3.7 The projected cost of Kochi project as per the Detailed Project Report prepared by the financial consultant appointed by KTDC was Rs.5.90 crore (August 1989). TRKL initially proposed to complete the project by availing a loan of Rs.3.75 crore from IFCI and Tourism Finance Corporation of India (TFCI) and the State Government's contribution of Rs.2.15 crore. IFCI and TFCI agreed in principle (January 1990) to grant term loan of Rs.3.40 crore (IFCI Rs.2.04 crore and TFCI Rs.1.36 crore) and State Government was required to contribute Rs.2.60 crore. Loan agreement was also executed (January 1990) by TRKL with IFCI (being the leading lender) and an amount of Rs.50 lakh was availed of by TRKL during 1991-92. The project could have been completed directly by TRKL with the financial assistance of IFCI and the State Government.

While the assistance from IFCI/TFCI was on hand, the Government instead of providing its contribution approved (August 1990) the proposal to form a joint sector company with Taj group on the ground of financial difficulties in releasing the margin money (Rs.2.60 crore) to avail of the loan from IFCI/TFCI. The joint sector company, TKHRL, was formed (May 1991) after selection of Taj Group as the JV partner by the Government based on direct negotiation and MoU was signed (October 1990) between the State Government and the Taj Group. Deficiencies noticed in the formative stage of the JV Company are discussed below:

Expressions of Interest were not invited from leading Business groups before direct negotiation with Taj Group for joint venture.

- Taj Group was selected as JV partner by Government neither by giving adequate publicity nor after inviting Expression of Interest from other leading hotel groups in the country. The negotiation was conducted with Taj Group alone. Due to this, the Company could not get a competitive offer in terms of lease rent, margin on income, etc., so as to maximise its share in the profit of the JV Company. After the agreement, TRKL received a lot of enquiries for similar arrangement with other leading hotel chains which indicates that there was enormous scope for TRKL to choose a competitive joint venture partner.
- No criteria or guidelines were formulated by Government before taking the decision to select Taj Group as JV partner. No evaluation of the financial impact of the future dealings was conducted. Finally, the capital base provided by the State Government has eroded and IHCL has gained at the cost of TRKL as discussed in the succeeding paragraphs.

Joint venture agreement

2.3.8 JV agreement between TRKL and IHCL was executed in October 1990. The terms and conditions incorporated in the JV agreement were framed without any detailed study so as to protect the interest of the Government. Several terms of the agreement, executed by TRKL with IHCL were detrimental to the interests of the Government. This was despite Government's clear instructions to TRKL to safeguard the interest of the Government vis-a-vis the joint sector Company in the deal. The deficiencies noticed in the agreement and its impact are discussed below:

Absence of control on Joint Ventures

2.3.9 As per JV agreement, TRKL had only minority holding in the equity share capital of TKHRL. The shareholdings of TRKL, IHCL and public/private placement was fixed as 20, 40 and 40 *per cent* respectively. Thus, until such time as the public issue of JV company was made, the share capital had to be issued, allotted and paid by the partners in such a manner that at all times IHCL shall have twice the number of shares subscribed to by TRKL indicating that control over the Company would remain with IHCL implying handing over the valuable assets of the company in three locations.[*]

Since TRKL had only 20 *per cent* shareholding it could neither control the affairs nor have effective participation in the management of the JV Company so as to safeguard the interest of TRKL/Government. Due to minority shareholding, the representative Directors of TRKL could not effectively involve in the decision making process at the Board meetings of the JV company, despite huge investment made by the Company. Since public issue/private placement were not made as provided in the JV agreement,

[*] Kochi, Kumarakom and Varkala.

TRKL also could not exercise any joint control over TKHRL along with the public/private shareholders. JV agreement did not provide for the rights and obligations of the JV partners to deal effectively in such situation.

Non-monitoring of the agreement

2.3.10 As per the JV agreement, the Board of Directors (BOD) shall consist of not less than three and not more than twelve members. Subsequently, while forming JV Company, maximum limit was increased to 15 for which no justification was available with TRKL. TRKL and IHCL would have the right to nominate BOD in proportion to their investment subject to a minimum of one and maximum of four for each partner. The remaining directors were to be appointed and the size of the BOD was to be determined by mutual consent of TRKL and IHCL. TRKL had no records to show whether its consent was obtained in determining the size of the BOD and appointment of the directors.

In 2003-04, the subscribed and paid up share capital was increased from Rs.45.83 crore to Rs.50 crore and the shares held by TRKL and IHCL were Rs.16.67 crore and Rs.33.33 crore respectively. Though TRKL was eligible to nominate four directors to the Board of TKHRL, it nominated only three Directors. IHCL was also eligible for maximum four directors and the remaining three directors were required to be appointed with mutual consent of TRKL and IHCL. TRKL neither nominated its fourth director nor insisted for its consent for the appointment of remaining three directors (TRKL: 4, IHCL: 4 and mutual consent: 3) thereby denying its own rights and giving more rights for decision making to IHCL.

Additional investment

Additional investment of Rs.11.17 crore was made when the accumulated loss was Rs.21.75 crore.

2.3.11 TRKL had invested (1992-93 to 2006-07) Rs.16.67 crore in JV Company (being one-third equity) to match the contribution of Rs.33.33 crore by IHCL. This included a matching contribution of Rs.11.17 crore made during 2002-04, when the accumulated losses of TKHRL were ranged between Rs.18.05 crore to Rs.21.75 crore. As such, the additional investment during the above period of heavy accumulated loss lacked financial prudence. The investment was made despite the fact that the Company was having the option to refuse the additional investment vide clause 3 (e) of the JV agreement wherein it was stated that the intention of TRKL and Government is to contribute to equity in value equivalent to or less than the value of land and other existing assets that they will be transferring to the Company.

Failure to float public issue/private placement resulted in avoidable additional investment of Rs.6.67 crore

Further, had the public issue/ private placement made as provided in the joint venture agreement, TRKL was required to contribute Rs.10 crore only (20 *per cent*) towards share capital. The JV Company did not float public issue/private placement of shares due to which there was avoidable extra investment of Rs.6.67 crore by TRKL. It was not available on records whether the nominee directors of TRKL insisted on public issue/private placement with a view to reduce the liability towards share capital. The agreement was also silent about the time limit within which public issue/private placement of shares would be made, thus allowing IHCL to retain the control of TKHRL for indefinite period of time.

Transfer of assets

2.3.12 According to JV agreement, TRKL/State Government had to contribute equity equivalent to or less than the value of land and other existing assets that would be transferred to the JV Company.

Out of the 14 locations identified (October 1990) for transfer, it was decided (February/May 1992) to develop tourism centres in Ernakulam (Kochi), Varkala and Kumarakom. The total value of land (as fixed by the District Collector) and buildings (as per the valuation of mutually acceptable valuer/CPWD) was Rs.2.95 crore and Rs.2.51 crore respectively. The details of locations handed over, area, value of land, date of lease, etc., are as given below:

Sl. No.	Location	Area (acres)	Value of land (Rs.)	Value of buildings (Rs.)	Total value (Rs.)	Date of lease
1	Ernakulam (Kochi)	0.938	1,16,96,860	1,40,91,700	2,57,88,560	13.02.92
2	Kumarakom	12.210	3,82,388	9,67,300	13,49,688	13.07.92
3	Kumarakom – additional land	1.430	57,20,000	---	57,20,000	20.04.98
4	Varkala	1.560	1,17,00,000	1,00,02,000	2,17,02,000	01.07.92
	Total		**2,94,99,248**	**2,50,61,000**	**5,45,60,248**	

Out of 14 locations identified for tourism development, only four locations have been developed till date.

Even though the properties were transferred in 1992, the lease agreement had not been executed due to procedural delays arising from transfer of property in the name of TRKL by KTDC/State Department of Tourism. Further, out of the 14 locations identified for transfer to develop tourism, only three sites have been transferred to the JV Company and the remaining 10 locations (excluding one location developed by Taj themselves) are yet to be taken up by the JV Company for development even after a lapse of more than 15 years.

Operating agreement for TKHRL

2.3.13 As per the JV agreement (October 1990), IHCL had to be appointed as the hotel operator for TKHRL and the terms of the hotel operating agreement and technical services agreement were to be agreed to between TRKL and IHCL. Accordingly, TKHRL appointed IHCL as the hotel operator as per the JV agreement.

The Hotel Operating Agreement between IHCL and TKHRL was entered into in July 1999 by which IHCL was made the consultant and advisor. The agreement was effective for a period of twenty years commencing from 30 June 1994 i.e. with retrospective effect and could be extended as mutually agreed upon. As per the JV agreement, the terms of Hotel Operating Agreement were to be agreed to between IHCL and TRKL. No records in TRKL were available to show that terms and conditions of this agreement were finalised with the consent of TRKL. Scrutiny of records revealed that the operating fees payable to IHCL was fixed at very high level as discussed in paragraph 2.3.14 *infra* besides all reasonable expenses pertaining to the operation of the hotel and all reasonable costs incurred in maintaining the hotel was payable to IHCL on actual basis out of the receipts of the hotel. Audit noticed the following deficiencies in the operating agreement which resulted in undue favour to IHCL:

Investment of Rs.16.67 crore during the period 1992-93 to 2006-07 in TKHRL did not yield any return till date.

- As per the Operating Agreement, IHCL agreed to offer advice and guidance in directing, supervising and controlling the performance of all services for the efficient and proper operations of the hotel. The fee for the services covered by the operating agreement was three *per cent* of gross income and 10 *per cent* of gross profit. The payment of operating fees and reimbursement of expenses to IHCL was not linked to profitability. Therefore, IHCL was not made responsible for the profitable functioning of the company but could secure their returns by way of operating fees and reimbursement of expenses. At the same time, TRKL, which had an investment of Rs.16.67 crore did not get any return, as there was no profit available for distribution after charging expenses and fees. Since 1994-95 till 2006-07 TKHRL had paid to IHCL an amount of Rs.12.84 crore as operating fee and Rs.12.88 crore towards other expenses **(Annexure 13).**
- TKHRL paid the operating fees as contemplated in the Operating Agreement and also incurred expenses for operating the hotel business. Despite the payment of operating fees and reimbursement of expenses, the expected results of maintaining the progress in increasing productivity and profit could not be achieved as discussed in paragraph 2.3.14 *infra*.

This unfavourable situation could have been avoided by carefully drafting and taking precautionary measures while entering into joint venture agreement with a private partner.

Operational performance of JV Company

2.3.14 TKHRL started functioning in 1994-95 and till 1997-98, the Company booked profits. The accumulated profit as of March 1998 was Rs.99.88 lakh. Thereafter the Company suffered losses (1998-2003) and the accumulated loss as on 31 March 2007 was Rs.11.49 crore indicating erosion of more than 23 *per cent* of the equity.

The excessive operating expenses when compared to All India average amounted to Rs.25.61 crore for the six years up to 2005-06.

The operating and general expenses charged by the JV Company were very much on the higher side with reference to All India Average. It was noticed that the 'All India Average of Operating and General Expenses to Operating Income' was in the range of 58.80 to 74.10 *per cent* during 2000-06 whereas in the case of TKHRL it was in the range of 75 to 93 *per cent*. Taking into account the all India average rate, there was excess Operating Expenses of Rs.25.61 crore with consequent reduction of profit for the six years ended 31 March 2006 as indicated in **Annexure 14.**

As against accumulated profit of Rs. 42 crore based on All India average there was shortfall in operating profit by Rs.19.25 crore for the six years up to 2005-06.

As per All India Average, Operating Profit (before Interest and Depreciation) was in the range of 21.40 *per cent* to 36.50 *per cent* during 2000-06. Based on these norms there should have been operating profit of Rs.42 crore from 2000-06 against which TKHRL could earn operating profit of Rs.22.75 crore only, the shortfall being Rs.19.25 crore as on 31 March 2006.

Apart from the investment of Rs.16.67 crore by TRKL and loan of Rs.50 lakh transferred from IFCI/TFCI at the time of formation of JV Company, loan of Rs.19.50 crore was availed from IFCI/TFCI by TKHRL up to 1996-97. This was repaid in 1998-99 by availing term loan of Rs.25 crore from SBI. Thus, TKHRL availed of incremental credit of Rs.5.50 crore in the name of repayment of loan. Besides, inter corporate deposit of Rs.13.80 crore was also availed by TKHRL up to 2000-01. In the absence of control over the affairs of TKHRL as discussed in paragraph 2.3.9 *supra*, TRKL could not verify the genuineness of these borrowings and its utilisation.

The number of foreign tourists who visited the State increased from 69,309 in 1991 to 3,45,546 in 2003-04. Similarly, in the case of domestic tourists the number increased from 9,48,991 in 1991 to 59,72,182 in 2004. Despite favourable factors, IHCL was not operating the JV Company profitably but contributed to an accumulated loss of Rs.11.49 crore as on 31 March 2007.

Participation in the management of JV company

Ineffective participation in Board meetings

2.3.15 Despite tourism boom, engagement of efficient hotel operator (IHCL), availability of sufficient funds for working capital/other capital requirements, the JV Company was incurring losses. In this circumstance, TKHRL was informed (January 2006) by the Principal Secretary (Tourism), Government of Kerala (one of the nominee directors in TKHRL) that while the loss of the Company was accumulating, IHCL had unilaterally charged large amounts as Brand Common Costs♠ (Rs.1.02 crore) and Central reservation system expenses (Rs.70 lakh) etc. The poor performance of the company was, however, questioned by the nominee Directors of TRKL only in the Board Meetings held in December 2005/June 2006 when the excessive charging of Operating expenses was brought to notice of the Board of TKHRL by the Principal Secretary, which did not receive any response.

As minority shareholders, the Directors of TRKL could attend the Board Meetings and seek explanation for the poor performance of the JV Company. The nominee directors, however, did not actively participate in the meetings which was taken advantage of by the JV Company by charging excessive operating expenses.

In the 14th Annual Report of TKHRL (2004-05), under Related Party Disclosure (Note No.19), apart from IHCL and TRKL, another company Amanind Investment Limited (AIL) was also included. TRKL, the joint venture partner, was not aware of such an associate company and details of their shareholdings, if any, in TKHRL. The details of shareholdings of AIL in the JV Company, called for (November 2005) by TRKL, did not receive any positive response. The matter was also not pursued by the Directors of TRKL/State Government in the Board Meetings of TKHRL.

♠ the pro-rated cost of key central support services necessary for the working of the hotels.

Non-access to Books of Accounts

2.3.16 Despite the State experiencing a tourism boom, the JV Company was not able to earn profit. Therefore, as directed by the State Government, TRKL appointed (January 2005) a firm of Chartered Accountants to conduct a review of the performance of the JV Company for a period of five years. TKHRL, however, refused to provide the records on the plea that past performance of the Company was reported to Board and the Board had sufficient representation (three nominees) from TRKL. Hence TRKL was not able to conduct scrutiny and ensure correctness of accounts.

As TKHRL declined to provide records for scrutiny, TRKL sought (March 2006) legal opinion for termination of JV agreement and Operating Agreement. It was advised (March 2006) that since TRKL was holding 33.33 *per cent* share only and IHCL held the remaining 66.67 *per cent*, there was little chance of any resolution being passed which was opposed to the interest of IHCL. Thus, the failure to include suitable provisions in the JV agreement to have better control over the management despite huge investment resulted in dead investment of Rs.16.67 crore.

In this connection it is pertinent to add that as per section 233 A of the Companies Act, 1956, the Central Government could direct Special audit when the affairs of any Company are not being managed in accordance with sound business principles or prudent commercial practices. Since TKHRL refused to produce the records, the Company had the option to approach the Central Government for special audit of the affairs of the JV Company under Section 233 A of the Companies Act 1956.

TRKL failed to approach the Central Government/Company Law Board for special audit of accounts of the JV Company despite specific provisions in the Companies Act.

Oberoi Kerala Hotels and Resorts Limited

2.3.17 Oberoi Kerala Hotels and Resorts Limited (OKHRL), the JV formed (June 1994) between TRKL and Oberoi Group of hotels had authorised share capital of Rs.50 lakh which was enhanced to Rs.10 crore in 1997- 98. The issued, subscribed and paid up capital as on 31 March 2003 was Rs.2.72 crore. Of this, 20 *per cent* equity (shareholding as per JV agreement) amounting to Rs.54.40 lakh was contributed by TRKL during 1998-1999 to 2002-2003.

OKHRL had identified two locations for tourism development viz., Thekkady and Pathiramanal Island. These sites were, however, selected without any feasibility study. Both these projects did not materialise in view of non viability of large capacity hotels and protests by Nature Society resulting in blocking up of investment worth Rs.54.40 lakh and loss of Rs.6.16 lakh as narrated below.

Thekkady Project

2.3.18 The JV Company proposed (1997) to construct a hotel of fifty rooms at Thekkady and purchased (June 1998/March 1999) 9 acres and 10 cents of land at a cost of Rs.1.52 crore. In 2002, a firm was engaged to conduct feasibility study for a project of forty rooms. The consultants opined that the project of forty rooms was not viable/feasible. Hence the Company abandoned the project and is now in the process of disposing of the land.

Investment in hotel project before ascertaining its viability resulted in blocking up of Rs.54.40 lakh for eight years.

Thus, investment of Rs.54.40 lakh by the Company in OKHRL remained unproductive since 2002-03 due to non-materialisation of the project taken up by the JV Company.

Pathiramanal Island Project

2.3.19 The Company proposed to set up an eco tourism project of international standard at Pathiramanal Island near Thaneermukkom, Cherthala. For this, the State Government accorded (April 2000) sanction for the lease of island belonging to the Department of Tourism, for resort development. The company purchased (December 2002) 1.08 acres of land at Thaneermukkom to construct a boat jetty for the project and it was fenced at an additional cost of Rs.2.98 lakh. The project, however, could not be implemented consequent to the direction (January 2006) of Hon'ble Supreme Court to take a decision afresh in the matter in the light of issues raised by Nature Society. Hence, the State Government ordered to maintain status quo till a decision was taken by the Government on utilisation of land.

Audit noticed that an amount of Rs.6.16 lakh was spent by TRKL towards preliminary expenses of the JV Company during the period 1998-99 to 2003-04. The entire amount was not got reimbursed by TRKL but written off in its accounts (2005-06).

The above matters were reported to Government (June 2007); the reply had not been received (September 2007).

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

Without inviting Expression of Interest from leading hotel groups or ascertaining best offer, a joint venture (JV) agreement was entered with Taj Group for forming a JV company TKHRL. The JV agreement did not safeguard the financial interest of the State Government/TRKL and despite huge investments as well as transfer of assets, adequate control and participation in the management of the JV company was not ensured through suitable provisions in the agreement. IHCL, the JV partner, had absolute control over the JV Company and took major share of the revenue by way of operating fee and reimbursement of expenses. In the absence of control over the affairs of the JV company, TRKL could not verify the genuineness of the transactions. Even with the existing nominee directors of TRKL, adequate and effective participation in the affairs of

the JV company was not ensured. The Government investment in the JV company had not yielded any return for the last 15 years.

Recommendation

- **Commercial and professional practices should be followed in supervision, monitoring and management of JVs.**
- **Government/TRKL should redefine guidelines including model draft JV agreements for formation of JV companies.**
- **Equal share participation should be ensured for JV partners so as to have adequate control in the affairs of the JV Companies by appointment of equal number of directors by both JV partners and appointment of Chairman by rotation.**
- **Independent experienced agencies should be appointed as consultants and operators so as to avoid blocking up of funds and investment in equities.**

2.4 INFORMATION TECHNOLOGY AUDIT OF BRANCH AUTOMATION IN THE KERALA STATE FINANCIAL ENTERPRISES LIMITED

Highlights

Major Audit findings are as follows:

The application software though developed/ handed over in March 2001, the cash transactions at the Pilot study branches made online by August 2002 and the final acceptance of the Branch Automation Software (BAS) effected on 17 June 2004, the BAS, failed to stabilize even after 3 years from the date of acceptance.

(Paragraph 2.4.6)

Though the hardware and software for 66 branches were ready by April 2006, the Company failed in rolling out automation to the 56 branches as planned and the Hardware/Software costing Rs. 5.42 crore lay idle at these branches for more than one year. Further the expenditure to the extent of Rs. 8.95 lakh incurred against the Annual Technical Maintenance on software licenses procured for the 66 branches proposed to be made online became infructuous.

(Paragraph 2.4.6)

Inadequate validation controls enabled the sanctioning of multiple gold loans to customers on a given day, exceeding permissible limit and consequent loss of interest to the company.

(Paragraph 2.4.11)

The adoption of wrong logic for the computation of interest by the system resulted in excess payment of interest under sugama deposit scheme.

(Paragraph 2.4.13)

The Trial balance generated from the system varied widely with the manually generated trial balance at the Kesavadasapuram Branch due to incorrect legacy data capture.

(Paragraph 2.4.15)

Introduction

2.4.1 The Kerala State Financial Enterprises Limited (KSFE) was incorporated in November 1969 as a Government Company with a view to socialising Chitty* business in the State, so as to ensure safety, security and

* Chitty or kury is a transaction in which a person, known as Foreman, enter into an agreement with a number of persons, known as chittals, who shall subscribe a certain amount of money by periodical installments for certain definite period of time and that each in his turn, as determined by lot or auction, shall be entitled to prize amount payable in cash after deducting the foreman’s commission.

better service to the public thereby protecting them from exploitation by private financial institutions. The Company also provides other facilities such as Chitty Loan, Gold Loan, Fixed Deposit Loan, Reliable Consumer Loan, Trade Loan, Hire Purchase Loan, Loans under New Housing Finance Scheme and House Modernising Scheme, Special Car Loan, Sugama Savings Deposit, Akshaya Deposit, Kerala Golden Jubilee Chitty (KGJC) Scheme, etc to the public. The company with an authorized capital of Rs. 25 crore and paid up capital of Rs. 10 crore earned an operational profit of Rs. 44.12 crore based on an annual turnover of Rs 268.32 crore during 2005-06 as per the certified annual accounts.

With a view to overcome the threat of efficient customer service by financial institutions like banks, non banking financial institutions and other local chitty institutions with their computerised environment, the Company decided (1999), to go in for complete automation to be implemented in three phases starting with the front office automation of its branch offices. The company selected (July 2000), Accel Limited for analyzing the business requirement, preparing feasibility study of the project and for developing the application software for the Front Office automation of the branch offices. The branch automation software developed by Accel Limited., installed at the two branches, viz. Thrissur Main (November 2001) and Kesavadasapuram (August 2002) was accepted by the company on 17 June 2004 after testing and was rolled out to 12 out of 269 branches as on May 2007.

The Branch Automation Software (BAS) in use in the company has been developed in Red Hat Linux Enterprise edition 3 with Visual Basic as front end and Oracle 9i / 10g as back end.

As on date (May 2007) the total outlay on computerization inclusive of computer, accessories and software amounted to Rs 8.83 crore. The number of PC/ Desktop used in the Company was 620 (HO-98; RO-25; Branches-487 and SDT-10). The additional expenditure estimated for computerization of existing/expected new branches and development of new application software for the HO and RO is Rs. 20.74 crore.

Organisational Structure

2.4.2 The Managing Director, the Chief Executive of the Company, is assisted by a Business Manager and a Finance Manager at the Head Office (H.O.) located at Thrissur. The Senior Manager (IT) reports to both General Manager (Finance) and General Manager (Business) based on functions. The Company has five Regional Offices (R.O.) located at Ernakulam, Kollam, Kozhikode, Thrissur and Thiruvanathapuram, managed by respective Regional Managers and the business is carried out through a network of 269 branch offices (as on 30 April 2007) spread all over the State. The total staff strength of the Company as on 31 March 2006 was 4115, consisting of 1089 Officers, 2397 Assistants, 306 Subordinate Staff and 323 Part-time Employees.

Audit objectives

2.4.3 To increase efficiency and competence in all areas of operations and to overcome the threat of efficient customer services by other financial institutions by;

- Establishing connectivity between all the branches, regional office and head office
- Introducing internet remittance facilities in selected branches in tie up with selected banks to exploit business from NRI customers.
- Introducing debit cards and virtual branch concept.

Scope and Audit methodology

2.4.4 Considering the investment of Rs 8.83 crore and the anticipated expenditure of Rs 20.74 crore in the Automation of Business Critical Operations, audit felt it necessary to evaluate the IT governance framework of the project to assess the adequacy of General IT Controls and Application Controls using COBIT framework and Computer Aided Audit Techniques (CAAT).

The audit was conducted during the period March 2007 to May 2007. The branches located at Kesavadasapuram, Thrissur Main, Thrissur Evening and Patturaikkal, the Regional Offices at Ernakulam and Thrissur and the department of IT at Head Office were covered during the review. The detailed audit findings are as given in the succeeding paragraphs.

Audit criteria

2.4.5 The criteria considered for assessing the achievement of audit objectives were

- Targets set up and their achievements regarding project implementation
- Guidelines provided in the functional manuals in respect of chitties, loans etc.,
- Rules and procedures prescribed for the conduct of chitties and sanction, disbursement, follow up as well as recovery of loans.

Project implementation

Absence of IT strategy

2.4.6 The company decided (March 1999) to go in for full computerisation of its branches, to call open tender for providing consultancy services covering system study, programming, implementation etc., and to constitute an expert committee for monitoring the computerisation project. The expert committee selected Accel Limited, the lowest tenderer and awarded (25 July 2000) the firm, the work of conducting feasibility study, developing the most suitable software and implementing the software at the two branches selected for pilot study at their quoted rate of Rs. 10 lakh. The contract period stipulated was five months from the date of order (ie., software to be delivered by December 2000).

As per the original project plan the software developed for front office automation was proposed to be on trial run upto 15 March 2000 and the full automation was proposed to be achieved by 2002-03 including the development of upgraded software for the regional office and head office. The application software developed by Accel Limited was handed over in March 2001 and the cash transactions at Thrissur Main and at Kesavadasapuram were made online in November 2001 and August 2002 respectively. The final acceptance of the Branch Automation Software (BAS) was however effected only on 17 June 2004. Owing to the inordinate delay in acceptance of the 'Branch Automation Software', the initial plan for total computerisation by 2002-03 failed to materialise. The reasons attributable for the inordinate delay in freezing the software were

- Delay in procurement
- Fragmented implementation/testing of various modules in the software
- Incorrect/ delayed data capturing
- Frequent revision of user requirement specification.

It was observed in audit that

- Though the Board resolved (27 October 2004) to roll out the freezed software to 66 branches (inclusive of 35 existing branches and 31 new branches) and though the hardware and software were ready by April 2006, the company did not succeed in rolling out automation as planned and the Hardware / Software costing Rs 5.42 crore was kept idle at 56 branches for more than one year as on May 2007. The reasons attributable were the delay in procurement of hardware, site preparation, deciding on branches to be computerised and legacy data capture. Had the 36 new branches launched since June 2004 been automated at the beginning itself, the delay in automation due to the delay in legacy data capture could have been avoided.
- The company procured (January 2005) Oracle Enterprises License (50 User) for head office, Oracle Standard Licenses (355 user) for branches and regional offices, one copy each of Red Hat Linux (Advanced Server Premium) for head office and regional offices and Red Hat Enterprises Server standard Edition for branches at a total cost of Rs 49.63 lakh inclusive of Annual Technical Support fee. Owing to the delay in procurement of hardware (April 2006), its installation expenditure to the extent of Rs 8.95 lakh incurred against the Annual Technical Support fee on software licenses procured for 66 branches proposed to be made online became infructuous as the period of technical support expired by February 2006.
- As per the feasibility study and other management reports the manual operation and parallel run was expected to be concurrent only for 6 months and thereafter the surplus manpower was proposed to be redeployed at branches identified for computerisation in the next

phase. It has, however, been noticed that in all automated branches, except in Thrissur Main, parallel run and manual accounting are being continued including the four branches which were online for more than six months namely, Kesavadaspuram, Thrissur Evening, Patturaikkal and Kadakkavoor. As such, the envisaged benefit of 40 *per cent* reduction in employee cost failed to materialise.

- As per the agreement dated 28 September 2004 with Accel Limited the developer assured KSFE all technical support based on agreed rates for maintenance of the BAS and implementation in new office for three years. KSFE has not yet acquired the technical expertise to install, implement and maintain BAS and the agreement will expire by September 2007. As such the company will have to depend upon external agency to implement the BAS, which is legally the property of KSFE when it goes for implementation in other branches in future.

Management stated (September 2007) that the Ist Phase of Branch Automation covering 66 branches was over by June 2007 and that the warranty provided by Accel Limited was extended by one year from 1 August 2007 to 31 July 2008.

Improper testing, Acceptance of BAS

2.4.7 As per the work order (25 July 2000) issued to Accel Limited for the development of application software for the front office computerisation of branches, KSFE reserved the right to suggest necessary changes in the application software developed till trial runs are completed and the application software accepted finally. It was also specified that all modules of the software should be subjected to three level acceptance test. The time schedule for system analysis, prototyping, submission of interim reports, trials and final reports to be furnished by the supplier were however not decided upon and a test plan for acceptance of the software were not formulated.

The final user acceptance test of the Branch Automation Software was conducted at Thrissur Main branch (June 2004) and it was certified that the developed application software is user-friendly, agree with the systems followed by the company, contains sufficient security measures and controls to check manipulation as well as tampering of data, supports the company's information system processing and business requirements efficiently and effectively and that the system is ready to be deployed in other existing/ new branches. However on a scrutiny of change request pending clearance by the Developer, it was observed that certain modules were not developed according to business rules and that certain provisions essential for day to day operation were lacking in the software as detailed below:

- Fixed deposits pledged against chitties could not be closed to the chitty in default based on a previous effective date, though such closing was permitted by the Chitty Rules being followed.
- One Time Settlement and like schemes were not incorporated in the software.

- Every personal surety offered were considered new and consolidated figure for the total liability of a surety could not be traced out.
- Closing of Terminated chitty was not possible through the system
- Lack of log of modification/ deletion in operational accounts leading to possibility of deletion of an account after accounting collection.

These defects though pointed out to Accel Limited for rectification, are yet to be rectified (May 2007). It was reported that (February 2007) the developer was not clearing/ checking/ modifying the corrections at their end to the satisfaction of the end user.

Thus the Branch Automation Software installed at the pilot study branches, freezed after 4.5 years, and rolled out to other branches, failed to stabilize even after three years from the date of freezing.

General IT controls

2.4.8 The controls in IT process and services ie., the policies, procedures, practices and organizational structures designed to provide reasonable assurance that business objectives will be achieved and undesired events will be prevented or detected and corrected are referred to as General IT controls. Though the Company initiated their computerisation process in 1999, even till today, i.e., after eight years they have not formulated any IT strategy covering the investment/operation budget, funding sources, sourcing strategy, acquisition strategy and legal as well as regulatory requirements; defining how IT will contribute to the enterprise's strategic objectives (goals) and related costs and risks. They also do not have any

- IT Security policy,
- IT Password policy,
- Change Management Policy, and
- Version Control procedure.

Absence of these policies make the entire process of computerisation vulnerable.

Results of Data Analysis

Inadequate validation controls

2.4.9 Audit observed that the business rules of the company were not properly incorporated in the system. This resulted in inadequate inbuilt validation controls as follows.

Gold loan for public

2.4.10 The gold loan scheme of the company provides that where the total loan required is Rs 30,000 or below, the loanee is permitted to pledge the ornaments in two to three accounts. If the loan required is above 30,000 the pledge should be in one account and request for further loan, on the same day, should not be entertained. The rate of interest on Gold Loan for amount exceeding Rs. 50,000 applicable was simple interest of 11 *per cent* and

12 *per cent* (for default) w.e.f. 1 June 2005 vide Cir No. 82/2005 dated 27 May 2005.

A scrutiny of records at Kesavadasapuram branch and Patturaikkal branch revealed that the BAS did not have adequate controls to comply with the above two conditions as detailed below:

- The Kesavadasapuram branch had issued 423 gold loans to 157 customers, on a given day pledging the gold in more than one account, where the total amount of loan advanced to a single customer exceeded Rs. 30,000 in violation of gold loan scheme envisaged by the Company. The BAS did not have a control to prevent issue of loans pledging gold in 'more than one account' where the total loan amount advanced to a customer exceeded Rs. 30,000.
- User level selectable controls were introduced in the system only on 01 June 2005 for provision of control for higher rate of interest which provided for 11 *per cent* and 12 *per cent* for loan amount exceeding Rs. 50,000 per loan
- On an analysis of the BAS data in audit using CAAT it was noticed that where the total amount advanced per day per customer under gold loan scheme exceeded Rs. 50,000 it was paid as multiple loans enabling extension of undue benefit by application of lower rate of interest. The system did not have control measures to ensure pledging of gold in only one account when the total amount advanced exceed Rs. 30,000 and limiting the issue of multiple loans wherein the total amount paid to a customer per day exceeded Rs. 50,000 as higher rate of interest was due to the Company in such cases.
- Due to sanctioning of 271 multiple loans to 94 customers at Kesavadasapuram branch and 8 Multiple loans to 4 customers at Patturaikkal branches on a given day, wherein the advanced amount in total exceeded Rs 50,000 the Company has lost interest amounting to Rs 22,059 (Kesavadasapuram Rs. 20,725 and Patturaikkal Rs.1,334) where the interest installments were repaid by customers.
- At Kesavadasapuram branch it was observed that Gold Loan 12 numbers to Customer No 10,644 on 18 January 2007 and 15 numbers to Customer No. 10,023 totaling Rs.2,00,800 and Rs. 2,64,400 were issued on consecutive numbers and that on various dates issue of multiple loans to Customer No. 10,023, 10,644, 6,852 and 9,268 continued, where the total amount issued as loans exceeded Rs. 50,000, selecting the higher interest rate control.

The company stated (September 2007) that the flexibility to open more accounts has been provided in the BAS to bring about a judicial and practical flexibility in the conduct of Gold Loan business in a highly competitive environment. However, this was not supported by any management decision and the rules in force are being violated.

Gold loan to employees

2.4.11 As per the Gold Loan scheme operated in the Company, interest concession to employees of the Company is limited to an advance of Rs 50,000 at anytime at all branches taken together. Though the Company has developed application software, “Gold Loan Liability Verification” to verify the extension of reduced interest rates to employees and to limit per person liability to a specified level to outsiders the system has not been updated and is not in use. The Branch automation software developed for the automation in branches failed to incorporate such laid down controls in the programme and the employees/outsiders split the loans and accommodate themselves for lower rate of interest and higher amount of loan than entitled, even at the branches which are automated.

The Gold Loan Scheme in BAS does not have control to evaluate the amount outstanding to a single employee on a given date. Interest rate controls are limited to a single loan and this enables employees to draw multiple loans exceeding Rs. 50,000 at concessional rate of interest as the total amount outstanding is not considered for working out the interest.

Pre-closing of the deposit account against chitty default

2.4.12 As per the Handbook of schemes, at KSFE, “a chitty subscriber can offer fixed deposit at KSFE as security towards future liability against prized chitties. If default occurs in remittance of chitty installment, the subsequent FD interest credited to sugama account may be adjusted to chitty installments by forfeiting the dividend and charging penal interest. If the default exceeds three installments and the subscriber fails to respond to the registered intimation, such fixed deposit should be closed prematurely on the due date of the fourth defaulted installment itself. Even if such closure is actually done at a later date it should be given effect to retrospectively on the due date of the fourth defaulted installment”.

Normally, the pre-closing of FD to chitty installment due was not done on the due date of the fourth defaulted instalment. At Kesavadasapuram branch, as the ‘Branch Automation Software’ restricts premature closing of FD at a prior date, the closing is being done manually and the FD had been left open in the system. At the Thrissur Main branch penal interest is being charged on the dues and FD interest is being given till the date of FD closing, and the FD is closed through the system. Charging of penal interest on dues and payment of interest on FD for the periods beyond the due date of the defaulted fourth installments are beyond the scope of existing rules and regulations in the company and as such procedure followed is unauthorised.

Adoption of incorrect logic in computation of interest on Sugama Account

Interest computed in excess

2.4.13 Sugama Deposit scheme aims at providing a deposit facility similar to SB account in banks. Initial deposit and minimum balance to be maintained at any time should not be less than Rs.100. For interest eligibility a minimum amount of Rs.250 should be maintained by a customer other than KSFE employees (wherein the minimum balance amount required was Rs.100). Interest calculated at the rate notified by the board was credited twice in a year, on 30 September (interest relating to the period March to August) and 31 March (interest relating to the period September to February). The interest was calculated on the minimum balance maintained in the account between sixth and the last day of any month.

Audit scrutiny revealed that the system adopted wrong logic for computation of interest resulting in excess payment of interest on sugama amounting to Rs. 1,52,616. The calculation logic followed by the program (as informed by the management during September 2007) was **(A)** (Minimum Balance x Rate of Interest) / (12 x 100) as against the correct logic of (**B)** (Minimum Balance x Interest rate per annum x No. of Days in the Month) / (100 x No of days in a year). The importance of days in each month and in each year was totally ignored which has resulted in extending excess interest over the notified rate to customer in the month of February and months having only 30 days. The table only kept records in respect of minimum balance for the month arrived at and the date of reckoning of minimum balance was not captured in the table, as such the audit trail to check the functioning of the program was lacking.

Audit also observed that the system did not have proper control over computation of interest of account holders maintaining minimum balance of less than Rs 250 but more than Rs. 100 violating the scheme.

Incorrect data entry

Improper maintenance of Customer Register

2.4.14 Customer Register is the basic and most important part of the software in which the information about the appropriate facts and figure of a customer available to from Chitty Variola, Fixed deposit Application Form, Loan Application etc. is entered. All the fields in this register are to be entered correctly to enable classification of the customers based on their Age, Sex, Marital Status, Economical Status, Category, Social Status, Annual Income etc. in the MIS module of the Software. In case a Customer is already in the Customer Register modification of the Customer register for Address difference or any other reason shall be carried out avoiding duplicate entry. On an analysis of the data table following were noticed:

- The customer number though should have been generated by the system consecutively, without allowing gaps between two numbers, the register contained 114 gaps in case of Thrissur Main and 2 gaps in the case of Kesavadasapuram branch.
- The Dates of Birth entered in the table were erroneous in 5,939 out of 7,403 records in Thrissur Main, 9,174 out of 10,842 records in Kesavadasapuram and 4,529 out of 5,597 records in Patturaikkal branch. The incidence of erroneous Dates of Birth, which was on an average of 82 *per cent* largely occurred during legacy data capture due to lack of data validation. The wrong entry of date of birth has led to inability to compare the customer based on his age profile and to ensure whether any loan was given to minors.
- The column Electoral Id, Passport No, Driving License No, PF No, PAN which were incorporated in the customer register for unique identification of a customer based on documents issued by

government authorities were not validated with rule that 'at least one of them should not be blank' and this has resulted in more than 99 *per cent* customer remaining without unique identity

- The details of Date of Birth were erroneous in most of cases and the details of unique document number were blank in most cases out of 30 Employee customer accounts in Thrissur Main branch, Patturaikkal branch and 20 Employee customer accounts in Kesavadasapuram branch.
- More than one account was being maintained for the customers whose Name, Permanent Address and Communication Address entered in the Customer register table are identical. There were 241 customer records in Kesavadasapuram branch, 149 customer records in Thrissur Main branch and 45 customer records in Patturaikkal branch which were duplicates based on Name, Permanent address and Communication address fields.
- Actual duplication of customer records could not be quantified as the Names were recorded placing the initials before / after names or expansion / contracting of part of the name and variation in Permanent and Communication address due to expansion or contraction of part the address.

Non reconciliation of Sugama Balances

- Audit verified the *sugama opening account* in comparison with *sugama operative account*, *sugama non-operative account* and found that, the closing balance of sugama accounts as on 31 March 2006 did not tally with the balance appearing in the *sugama operative account*, *sugama non-operative account* due to the presence of negative balance in table *sugama opening account* as detailed in table below

Name of Branch	**Sugama opening account**	**Sugama operative account**	**Sugama non operative account**	**Total of Schedule**
(Amount in Rs.)	A	B	C	D =(B +C)
Thrissur Main Branch	1,39,88,519.22	1,68,16,712	56,170	1,68,72,882
Kesavadasapuram	(13,04,37,870.56)	1,94,74,671	71,071	1,95,45,742
Patturaikkal	1,67,45,480	1,67,10,112	35,368	1,67,45,480

- The balance of sugama operative account (Rs.1,94,74,671), sugama non-operative account (Rs.71,071) as per system did not tally with the audited trial balance of sugama operative account (Rs.1,93,05,089) and sugama non-operative account (Rs.71,081) at Kesavadaspuram.
- The difference was due to existence of negative balance of one record at Thrissur Main and 59 records at Kesavadasapuram and existence of duplicate records for 14 sugama account totaling Rs. 3,344 at Kesavadasapuram. The fact remains that there should not be negative balance in sugama, as it is a deposit account and customer is not allowed to overdraw.

Name of Branch	Positive balance of records in Sugama opening	Negative balance of records in Sugama opening	Sugama opening
	(Amount in Rupees)		
Thrissur Main Branch	1,68,72,882	(28,84,362.78)	1,39,88,519.22
Kesavadasapuram	1,95,49,086	(14,99,86,956.56)	(13,04,37,870.56)
Patturaikkal	1,67,45,480	nil	1,67,45,480

- As on 31 March 2006 there were 667 zero balance accounts at Kesavadasapuram, 533 zero balance accounts at Thrissur Main and 319 zero balance accounts at Patturaikkal branch in the table *sugama opening balance* and on an analysis of these zero balance with the table *sugama account closing* it was found that 254 accounts at Kesavadasapuram, 188 accounts at Thrissur Main and 199 accounts at Patturaikkal were not closed in system but were having Zero balance. The presence of negative balance in sugama scheme table maintained in BAS and difference in the balance of *sugama opening balance* with total of *sugama operative account and sugama non-operative account* points to fact that the BAS system is not self reconciling in respect of sugama

- Further though Kesavadasapuram branch was made online during August 2002 the table of *sugama interest amount* contained 3335 records relating to 280 sugama accounts pertaining to the period June 1990 to July 2002 and the interest on these accounts worked out to Rs 1,14,908 on minimum balance of Rs. 2,08,07,628. The fact remains that parallel manual accounting is being continued at Kesavadasapuram branch and the sugama account in total shows negative balance. The cause and effect of the working of interest as discussed above could not be ensured in audit.

Difference between the system generated and the manually arrived at Trial Balance

2.4.15 The Thrissur Main branch, Kesavadasapuram branch and Thrissur evening branch of the company were made online on 1 November 2001, 1 August 2002 and 1 April 2005 respectively. Parallel manual accounting is being continued at Kesavadasapuram and Thrissur evening branch and the same was lifted at Thrissur Main Branch. The Branch Automation software developed by Accel Limited based on the SRS prepared by Accel Limited was accepted by the company and declared production ready satisfying all documented requirements in line with the business objectives of the company on 17 June 2004. However the Trial balance as on 31 March 2006 generated from the system varied widely with the Trial Balance generated manually at the Kesavadasapuram branch. According to the company, the difference was due to errors in legacy data capturing.

Conclusion

The Company took up the front office automation of the branches as early as 1999 to overcome the threat of efficient customer services by other financial institutions by establishing connectivity between all branches, regional offices and head office, introducing internet remittance

facilities, debit cards and virtual branch concept. Even after a lapse of eight years branch automation alone was attempted to and that too was introduced only in 12 out of 269 branches (May 2007). The Branch Automation Software installed at pilot study branches at 2001 accepted after trial run for four and a half years and rolled out to 12 branches is yet to be stabilized even after three years from the date of freezing. Further the business rules were not mapped in the software properly. Since the head office, Regional offices and branch offices were not fully computerized, the company was not able to collect/generate the required reliable data for the effective control in respect of conduct of chitties and sanction, disbursement, monitoring and recovery of loans. Owing to the continuance of parallel manual accounting beyond six months as projected, at computerised branches, the envisaged labour efficiency of 40 *per cent* failed to materialize.

Recommendations

The company should

- **arrange to modify the BAS by suitably rectifying the defects occurred in mapping of Business Rules and incorporation of validation controls.**
- **arrange to test the software adopting a standard testing methodology before the expiry of AMC agreement with the vendor.**
- **frame strategies/policies as required for the implementation of BAS in the remaining branches.**