

CHAPTER V

Operational Performance and Control Issues

5.1 Operational Performance

5.1.1 Table 9 below shows the important performance indicators of the five HFCs:

Table 9: Important Performance Indicators of the HFCs

(Amount: Rupees in crore)

Financial Indicators	2001-02	2002-03	2003-04	2004-05	2005-06
HUDCO					
Housing Loan disbursements during the year	1825.00	2311.00	1287.00	1066.00	1105.00
Growth rate of disbursements over previous year (in percentage)	-	26.63	(-) 44.31	(-) 17.17	3.66
Housing Loans outstanding at the end of the year	10442.43	10418.50	9693.57	8301.53	8148.61
NPA at the end of the year	1233.46	886.66	762.08	1119.52	1258.05
NPA to total loan assets (in percentage)	11.81	8.51	7.86	13.48	15.44
Income from Housing Operations	1361.13	1354.36	1194.56	1036.42	728.71
BOBHFL					
Housing Loan disbursements during the year	170.54	211.41	60.00	1.00	0.04
Growth rate of disbursements over previous year (in percentage)	-	23.97	(-) 71.62	(-) 98.33	(-) 96.00
Housing Loans outstanding at the end of the year	464.24	601.74	484.90	366.83	283.13
NPA at the end of the year	12.12	22.38	42.11	70.30	55.55
NPA to total loan assets (in percentage)	2.61	3.72	8.68	19.16	19.62
Income from Housing Operations	52.71	64.01	53.83	40.11	30.31
CBHFL					
Housing Loan disbursements during the year	71.43	85.95	98.69	60.30	12.71
Growth rate of disbursements over previous year (in percentage)	-	20.33	14.82	(-) 38.90	(-) 78.92
Housing Loans outstanding at the end of the year	270.13	312.64	357.32	365.77	322.19
NPA at the end of the year	19.60	19.78	46.72	84.63	63.66
NPA to total loan assets (in percentage)	7.26	6.33	13.07	23.14	19.75
Income from Housing Operations	32.92	35.46	34.04	30.58	30.43

IHFL					
Housing Loan disbursements during the year	-	-	112.24*	544.87	734.51
Growth rate of disbursements over previous year (in percentage)	-	-	-	-	34.80
Housing Loans outstanding at the end of the year	-	-	485.20	922.58	1516.93
NPA at the end of the year	-	-	9.91	14.34	19.50
NPA to total loan assets (in percentage)	-	-	2.04	1.55	1.29
Income from Housing Operations	-	-	44.62	54.90	100.40
PNBHFL					
Housing Loan disbursements during the year	267.62	255.65	284.71	297.83	393.02
Growth rate of disbursements over previous year (in percentage)	-	(-) 4.47	11.37	4.61	31.96
Housing Loans outstanding at the end of the year	521.30	643.59	776.22	898.67	1099.69
NPA at the end of the year	20.97	23.61	32.18	69.24	38.79
NPA to total loan assets (in percentage)	4.02	3.67	4.15	7.70	3.53
Income from Housing Operations	66.89	80.23	89.83	86.41	102.05

* from October 2003 onwards

5.1.2 Two discernible trends noted from the above data are negative growth in housing disbursements and poor quality of assets *i.e.*, rising level of the NPA in HUDCO, CBHFL and BOBHFL, while PNBHFL and IHFL performed well on these two performance benchmarks. Audit reviewed these aspects and observed the following:

5.2 Decline in disbursement of housing loans

5.2.1 HUDCO's disbursements of housing loans decreased from Rs.1825 crore in 2001-02 to Rs.1105 crore in 2005-06 which led to a fall in income from housing operations from Rs.1361.13 crore in 2001-02 to Rs.728.71 crore in 2005-06. One of the major reasons for declining trend was decline in business from State Agencies and HUDCO's failure to diversify its housing portfolio by tapping retail home loan business. A detailed analysis of its housing portfolio revealed the following:

- (i) Seven of HUDCO's Regional Offices showed severe decline in disbursements of loans over the five years ending 31 March 2006 with meagre housing loan disbursements of less than Rs.10 crore (**Annexure XIV**) ranging from nil (Jammu and Kashmir) to Rs.8.12 crore (Manipur). There was nothing on record to indicate any remedial steps taken by the Management based on a periodical review of its non-performing Regional Offices.

HUDCO stated (May 2007) that the State Agencies in these regions did not come forward to take loans from the Company due to non-availability of State Government guarantees. However, action to increase its retail business in these regions by HUDCO to make them profit centres was not on record.

Recommendation No.4

HUDCO should put in place a system for periodical review of its non-performing Regional Offices.

- (ii) HUDCO launched (1998) a retail finance scheme under the name of 'HUDCO Niwas' (HN) to sanction housing loans to individuals and bulk loan to State Governments, para-statal bodies of the State Governments and PSUs for granting house building advances to their employees. A table indicating the sanctions, disbursements, default position and NPA during 2001-02 to 2005-06 under the HN scheme is shown in **Annexure XV**. Sanctions and disbursements under this scheme started declining from the year 2003-04 onwards and disbursements during the year 2005-06 were very low at Rs.52.23 crore as compared to disbursements of Rs.973.89 crore during 2002-03.

HUDCO attributed (May 2007) the declining trend to competitive interest rates and aggressive marketing by other players in the industry. The reply is not tenable as the interest rates of the Company were comparable with other players in the market. The inadequate marketing efforts coupled with a weak support structure to meet the challenges posed by a competitive market led to this negative trend. HUDCO further stated (October 2007) that in view of the competition in the market, the norms were gradually being made flexible and customer friendly, the impact of which would be seen in future.

Recommendation No.5

HUDCO should strengthen its housing finance portfolio through HUDCO Niwas scheme to ensure greater coverage of the low-income and the poorer sections of the society.

- (iii) HUDCO did not fix separate targets for the HN business and as a consequence, requisite focus was not provided by the Regional Offices on developing the retail business. Moreover, HUDCO did not resort to wide publicity to promote the HN scheme.

HUDCO stated (May 2007) that the Regional Offices could not make the publicity expenditure for want of budgetary approval from the Board. The reply clearly showed that no marketing strategy existed in the Company to enhance its reach to prospective borrowers in a highly competitive market. Further, it was noted in audit that HUDCO was over dependent on State Government Agencies and the retail finance to individual borrowers was not given priority. Consequently, as soon as the State Government Agencies stopped availing housing loans the business under the HN scheme fell drastically from the year 2003-04 onwards.

- (iv) Higher penal interest rate clauses led HUDCO to lose business to its competitors. On a test check of the records of 2355 loan accounts under its Thiruvananthapuram Regional Office, it was noticed that 507 loan accounts involving a portfolio of Rs.13.24 crore were taken over by other HFCs from HUDCO during the period from 2001-02 to 2005-06 which accounted for 21.53

per cent of the total loan disbursements during this period in the region. HUDCO stated (May/October 2007) that take over of loans is a common phenomenon in the dynamic market and added that it has now rationalised its penal interest rate.

5.2.2 BOBHFL showed continuous decline in disbursements from Rs.211.41 crore in 2002-03 to Rs.0.04 crore in 2005-06 and the main reasons as noticed in audit were competition from its parent bank which was operating its branches from the same premises of the Company, high cost of borrowings; inadequate staff strength; and the decision to merge the Company with the parent bank.

5.2.3 PNBHFL showed a rising trend in disbursements from Rs.267.62 crore in 2001-02 to Rs.393.02 crore in 2005-06 but its achievements were far below the targeted level of business except in the year 2005-06. Its achievement of targets ranged between 50.11 and 63.27 *per cent* during the years 2001-02 to 2004-05. However, during the year 2005-06 the target was revised downward and fixed at Rs.390 crore which was achieved.

5.2.4 In **CBHFL**, disbursements showed a rising trend up to 2003-04 but declined thereafter. Reason for decline in business from 2004-05 was stated to be slowing down of business due to an alarming increase in NPA and the Company's focus on recovery of old loans rather than sanctioning fresh ones. CBHFL stated (May 2007) that for the year 2007-08, the Company has already fixed targets for its branches under different parameters and would concentrate on fresh sanctions and disbursal of loans. It added (October 2007) that new loan and recovery policies have been formulated and approved by the Board in June 2006.

5.2.5 Disbursements by **IHFL** in the first year (2003-04) of its operations, after take-over from Tata Home Finance Limited (private HFC), declined by 32 *per cent* but grew in the subsequent years. Management attributed (December 2006) this growth to virtual rebirth of the Company.

Recommendation No.6

- (i) ***The HFCs should review and on the basis of the review redefine and implement operational strategies to arrest the declining trend in their business in a rapidly rising market driven by expanding levels of prosperity and growth in the demand for housing.***
- (ii) ***The HFCs should consider establishing such innovative lending schemes that cover the various segments of the urban and rural population including the adoption of a more pragmatic approach in their credit appraisal norms.***

5.3 Quality of Assets

The level of the NPA indicates the quality of assets. The quality of assets is a primary consideration while assessing credit risk in a finance company. Audit evaluated the HFC's approval procedures, collection procedures, management information systems that allowed monitoring to address potential credit problems and loss mitigation strategies, asset diversity in terms of assets classes, geographical distribution, delinquency level, write offs and recovery levels to assess the quality of assets.

As per the Housing Finance Companies (NHB) Directions, 2001, a loan asset in respect of which interest or instalment remained overdue for 90 days with effect from 31 March 2005 (180 days as on 31 March 2004) was to be classified as the NPA. Since interest

accrued on the NPAs could not be recognised as income in the accounts, higher level of the NPA would amount to low revenue. The level of the NPA as a percentage to the loan assets of the HFCs is discussed in the following paragraphs:

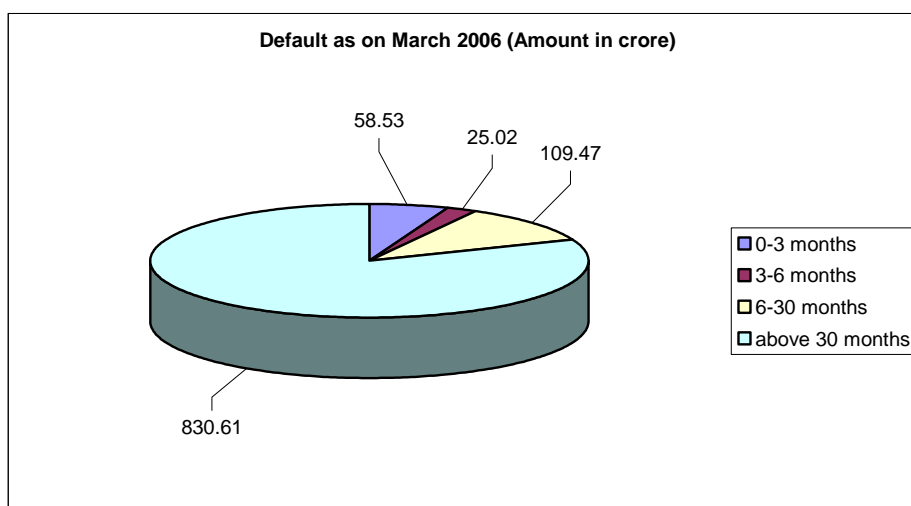
5.3.1 HUDCO

5.3.1.1 The percentage of the NPA to total loan assets in HUDCO was very high and stood at 15.44 *per cent* as on 31 March 2006 when compared to that of PNBHFL which was 3.53 *per cent*. HUDCO had not effectively controlled its NPA resulting in higher provisioning with lower profits. It is pertinent to note that though loans outstanding had decreased by 21.97 *per cent i.e.*, from Rs.10442.43 crore (2001-02) to Rs.8148.61 crore (2005-06), HUDCO's NPA increased from Rs.1233.46 crore (2001-02) to Rs.1258.05 crore (2005-06), showing that the quality of a portion of its loan portfolio was becoming bad. HUDCO stated (October 2007) that its NPA was high as its housing loans included the loans to State Governments and other agencies which had much higher individual exposure than individual borrowers; as such, its NPA level should not be compared with other HFCs which were lending to individual borrowers only. The NHB's norms however, do not differentiate NPA between the business segments.

5.3.1.2 Forty-three borrowing agencies accounted for Rs.906.52 crore (*Annexure XVI*) of the total NPA of Rs.1258.05 crore as on 31 March 2006. A review in audit revealed that these accounts turned NPA mainly on account of deficiencies during appraisal and sanction. HUDCO stated (October 2007) that defaults in 29 cases were either resolved or close to resolution and in the remaining cases the process of resolution was in progress.

5.3.1.3 The age-wise details of defaults in HUDCO during the years 2001-02 to 2005-06 are given in *Annexure XVII*. The age-wise defaults as on 31 March 2006 is given in Chart 2.

Chart 2



It would be seen that defaults which were more than 30 months old (Rs.830.61 crore) accounted for 81 *per cent* of the total amount of defaults (Rs.1023.63 crore) as on 31 March 2006; indicating that there was higher risk of non-recovery of this amount. Scrutiny further revealed that an amount of Rs.288.40 crore pertaining to 38 agencies was

lying in default for more than 10 years of which Rs.133.68 crore was the default of 17 agencies in the Gujarat region alone relating to cooperative societies.

HUDCO had initiated legal action and the cases were under finalisation at various stages in the Debt Recovery Tribunal. HUDCO stated (May/October 2007) that recovery efforts were being made. However, HUDCO would not have faced such huge NPAs had due care been taken at all stages when the loans were appraised, sanctioned and disbursed.

5.3.2 The NPA in **CBHFL** increased from Rs.19.60 crore (2001-02) to Rs.63.66 crore (2005-06). The over-dues exceeding 12 months had increased from 64.93 *per cent* (2001-02) to 88.16 *per cent* (2005-06). The Company slowed down disbursements of housing loans in 2005-06 and 2006-07 and concentrated on recovery of outstandings. CBHFL stated (October 2007) that it was in the process of liquidating the NPA by resorting to action under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interests (SARFAESI) Act, 2002 and it had taken over the assets in 529 cases involving NPAs of Rs.17.71 crore and disposed off assets in 215 cases realising an amount of Rs.5.95 crore during the period 2004-05 to 2006-07.

5.3.3 **BOBHFL**'s NPA increased from 2.61 *per cent* to 19.62 *per cent* during the five years ending 31 March 2006. The increase in NPA was mainly on account of control failures in sanction and monitoring of loans. The Company had written off Rs.4.65 crore during 2005-06 to improve its quality of assets before takeover by its parent bank.

5.3.4 **PNBHFL**'s NPA level was low and stood at 3.53 *per cent* during 2005-06. The sudden growth to 7.7 *per cent* during 2004-05 was on account of change in the NPA provisioning norms. PNBHFL effectively controlled its NPA by taking over the mortgaged assets of the defaulters under SARFAESI Act. During the period 2004-05 to 2005-06 it had taken over the assets in 494 cases involving NPA of Rs.26.43 crore and disposed off assets in 221 cases realising an amount of Rs.12.39 crore.

5.3.5 **IHFL**'s NPA position at 1.29 *per cent* as on 31 March 2006 was comparable to the levels of private sector HFCs.

Recommendation No.7

- (i) ***The HFCs should draw up time bound plans to take immediate legal steps (including recourse to the SARFAESI Act) for recovering the overdues.***
- (ii) ***The HFCs should encourage disposal of their non-performing assets by evolving an objective system of determining the sale price of mortgaged assets.***

5.4 Control failures causing higher level of NPA

The NPAs referred to in this report mainly arose out of the loans sanctioned in the earlier years. The main reasons for these loans becoming NPAs were attributable to control failures at various stages of appraisal, sanction, disbursement, monitoring and recovery. Audit analysed these controls in the five HFCs and the findings are discussed in the following paragraphs:

5.5 Appraisal and Sanction Level Controls

Each HFC had laid down guidelines to be observed while appraising the loan applications for sanctioning the loans. Audit reviewed the implementation of the control system in this regard and major audit findings are discussed below:

5.5.1 HUDCO

- (i) The Company did not maintain any database at corporate level regarding the number of applications received, processed, sanctioned and rejected by Regional Offices in respect of HUDCO Niwas scheme. In the absence of such a database, the Corporate Office was not in a position to effectively monitor the main functions at the level of the Corporate management.
- (ii) Credit worthiness and track record of a private party (M/s C.R. Patil, Surat) was not verified independently by HUDCO before sanction (March 2002) of loan amounting to Rs.17.25 crore. An amount of Rs.6.80 crore was disbursed though the fact of the party being a defaulter was in the knowledge of HUDCO. The party defaulted and the loan amounting to Rs.3.48 crore was outstanding (March 2007). HUDCO stated (May 2007) that the loan was sanctioned and released based on the security of the registered mortgage of the property and the Board of Directors was informed about default of the party. It added (October 2007) that HUDCO had filed (June 2006) a joint recovery application in the Debt Recovery Tribunal, Ahmedabad. The outcome of the same was awaited (October 2007).
- (iii) A loan amounting to Rs.59.41 crore was sanctioned and disbursed (March 1999 to May 2001) to Jalgaon Municipal Corporation without the project site having been identified and assessing the financial viability of the project. Subsequently the project site was disputed by the public and the project was not completed. The total loan became a NPA and as on 31 March 2006, it stood at Rs.63.96 crore (including interest and other charges of Rs.4.15 crore). Though the loan has been in default since September 2005, HUDCO was yet to initiate legal action (September 2007). HUDCO stated (May 2007) that the sanction and disbursement were made based on the certificate given by the Principal Officer under the Maharashtra Municipality Act; and added (October 2007) that it was pursuing with the Government of Maharashtra for settlement of default and that legal option would be exercised as the last resort. The actual recovery however, was awaited (September 2007).
- (iv) HUDCO sanctioned a loan of Rs.100 crore to a private party for a housing project without ensuring 'No Objection Certificate' from the Ministry of Environment & Forest and approval from the local authorities regarding land use.

HUDCO stated (May/October 2007) that the scheme has since been closed. However, though the amount was not disbursed ultimately, the scheme involving a major financial commitment was sanctioned without the Company having actually verified that clearances had been obtained and that the party had a clear title to the land.

- (v) Under Thiruvananthapuram Region, HUDCO converted (March 2003) the existing scheme-based loans of Kerala State Housing Board (KSHB) totalling Rs.410.68 crore (including interest), at average rate of interest of 13.95 *per cent*, into bulk loan under the HN scheme at 10 *per cent* rate of interest, which in February 2005 was further reduced to 8.25 *per cent*. The conversion was not covered by the HN guidelines which permitted loans to State Government/PSUs for onward disbursement of house building advances to their employees. Further, the conversion to bulk loan and reset of interest was subject to submission of utilisation certificates and fresh Government guarantee, which had not been

fulfilled by KSHB. Hence, resetting of interest rates in contravention of its guidelines was an undue benefit to KSHB and the financial impact on the resetting of interest, as worked out in audit, was about Rs.144.89 crore for the period of ten years from April 2003 to March 2013. In spite of these concessions, KSHB again defaulted in repayment and the default amount stood at Rs.50.96 crore as on 31 March 2007.

HUDCO stated (May/October 2007) that the conversion of scheme based loans to the HN scheme was made in the interest of the Company otherwise it would have lost this portfolio to other Financial Institutions/ Banks.

5.5.2 BOBHFL

(i) Under Baroda Area Office, loans amounting to Rs.71.75 lakh were sanctioned to eight borrowers (October-November 2002) for purchase of shops *i.e.*, for non-housing purposes, at Timba, Gujarat which ultimately turned bad. In respect of these loans, the following lapses were noticed:

- The loan amount was disbursed directly to the builder without any authority letter or written requests from the borrowers.
- The market value of the land at the time of sanction or disbursement of loan was not assessed.
- There was no business activity in the so-called shops.
- Genuineness of income tax returns and credit worthiness of the borrowers was not verified.

BOBHFL could not recover the loan amount and ultimately wrote off the loan (March 2006) resulting in a loss of Rs.71.75 lakh

(ii) The original registered sale agreements in 11 loan accounts, share certificates in 12 loan accounts and lien-noting confirmations from the Co-operative Housing Society in 12 loan accounts were not obtained before sanction and disbursement of loans by Mumbai Area Office during the period March 1995 to October 2002. These loans amounting to Rs.95.05 lakh have ultimately become NPAs.

(iii) Baroda Area Office did not conduct site verification of the building and the building completion certificate furnished by the borrower was subsequently found to be false. In this case an amount of Rs.56.89 lakh was disbursed (August 2002 to January 2003) to the Builder & Secretary of Sobha Park Housing Co-operative Society and this account became NPA.

(iv) Instances of incomplete applications were also noticed in audit. In Pune Area Office in 40 cases test checked it was found that in six cases, the basic information in the loan application *i.e.*, name of employer, designation of employee, father's name and date of birth were not filled up properly. Further the genuineness of the salary certificates and identity proofs were not verified before disbursement of loan amounts. These cases involving Rs.17.13 lakh became NPAs.

5.5.3 CBHFL

- (i) During the period 2002-03 to 2003-04, sanctions and disbursements were target oriented only and CBHFL did not carry out the requisite pre-sanction and disbursement checks. This was proved by the fact that 44.70 *per cent* of the loan accounts involving Rs.29.46 crore of this period became NPAs.
- (ii) In Bilaspur, Bhopal and Jabalpur branches of this HFC, proof of residence of the borrowers was not obtained in 65 cases and the total amount of Rs.1.60 crore disbursed became NPA.
- (iii) Essential documents like the salary or income certificates were not properly analysed by four branches of CBHFL while sanctioning loans amounting to Rs.1.47 crore to 49 borrowers. In these cases, a sum of Rs.1.40 crore has become NPA.
- (iv) In Jabalpur branch, Rs.6.90 lakh were shown outstanding against two borrowers who disclaimed receipt of loan. In Bilaspur branch, one borrower denied taking a loan of Rs.1.60 lakh and had not paid any installment. In these cases the loan amounts were disbursed directly to builders without the consent of the borrowers.

CBHFL (October 2007) accepted that the loans were sanctioned in these cases without proper verification. Stating that checks and control system had since been introduced to enhance the quality of assets, it added that legal action had been initiated against the defaulters, besides disciplinary action against 16 officers.

5.5.4 PNBHFL

Total NPA at Hyderabad branch was Rs.18.21 crore consisting of 402 cases as on 31 March 2006. In 187 cases, the Company invoked the provisions of SARFAESI Act, 2002, took over the assets, disposed them off and realised Rs.8.74 crore against the outstanding amount of Rs.11.77 crore thus incurring a loss of Rs.3.03 crore. The reason for this loss, as examined in audit, was found to be overvaluation of assets in 175 cases. The recovery proceedings in respect of the remaining 215 cases were in progress (March 2007).

PNBHFL assured (April 2007) that such incidents would not happen in future and added that fresh instructions were issued to all the branches for meticulous appraisal, pre-sanction appraisal, legal scrutiny, valuation, post-disbursement and follow-up.

5.5.5 IHFL

Sixty-nine borrowers were sanctioned housing loans amounting to Rs.4.78 crore, though as per the eligibility limit, they were entitled for Rs.4.41 crore only, thus resulting in excess sanction of Rs.0.37 crore.

5.6 Disbursement System Controls

5.6.1 Each HFC had issued guideline for disbursing loans. Audit reviewed the control system in this regard and observed the following deficiencies:

- (i) As per the guidelines laid down in Financing Patterns (internal orders indicating, *inter-alia*, the rate of interest and terms and conditions for disbursement) of HUDCO, no fresh releases should be made to defaulting agencies unless default amount was recovered. An analysis of records relating to 760 releases made to 56

agencies during the five years ending 31 March 2006 revealed that HUDCO made 73 releases to 14 defaulting agencies amounting to Rs.323.98 crore in violation of its own guideline (*Annexure XVIII*). HUDCO stated (May 2007) that the condition of default for release of loans to Government agencies was waived in November 2002 and added (October 2007) that in some cases releases were made pending realisation of past repayment or on merits. The fact is, however, that such concession was withdrawn in May 2003 and the amount of Rs.323.98 crore was released to the defaulting agencies during the period when condition of default was in force.

- (ii) As per the para No. 28 of Chapter III of the NHB Directives 2001, no HFC shall lend to (a) any single borrower exceeding 15 *per cent* of Net Owned Funds (NoF) and (b) any single group of borrowers exceeding 25 *per cent* of their NoF. An audit analysis revealed that in respect of advances to 13 agencies (*Annexure XIX*), HUDCO violated the norms prescribed by the NHB by exceeding the total exposure limit. The exposure to these agencies was allowed year after year with the actual exposure as on 31 March 2006 being in the range of 16.67 to 42.52 *per cent* of NoF. HUDCO, through its administrative Ministry, approached (February 2005) the NHB for exemption from this exposure limit which was not agreed to by the latter. However, HUDCO was yet to take corrective action to limit the exposure within the prescribed norms (September 2007).

HUDCO stated (May/October 2007) that if this exposure limit was strictly adhered to, there would be major constraints on the business of the Company. The reply is not tenable as the NHB had prescribed the exposure norms for all HFCs to avoid any major liquidity problems on account of default by agencies.

5.7 Monitoring Controls

An effective monitoring mechanism requires a well established communication and information system to collect and analyse data of the loans sanctioned and/or disbursed. The loans are required to be regularly monitored to ensure that they are actually utilised for the purpose they were sanctioned. During the currency of the loan, requests for re-scheduling of the loan, reset of interest rate due to change in the market condition, *etc.*, received from the borrowers, need to be attended to timely to ensure continued business and to ensure regular repayment. Weaknesses and failure in monitoring the loan accounts could lead to pre-closure of loans or the loan turning to NPA. All the HFCs prescribed broad guidelines for resetting of interest and rescheduling of loan. Audit reviewed the implementation of the control system in this regard and observed following deficiencies:

5.7.1 HUDCO

- (i) HUDCO's guidelines provided for resetting of interest on scheme-based loans only and not for loans disbursed under the HN scheme till January 2005, though resetting of interest rates was a common phenomena in the financial market. In the absence of such a policy for the HN loans till January 2005, the Company could not retain the eight loan portfolios amounting to Rs.1146 crore.

HUDCO stated (May/October 2007) that it did not have the reset policy at the time (till January 2005) of prepayment of these loans and did not consider resetting interest rate below the base cost. The reply is not tenable when viewed in the situation that HUDCO has been operating in the market for a very long time and should have put in place a

proper reset policy duly accounting for movements of interest rates so as to ensure timely intervention to avoid loss of its portfolio to other FIs/ HFCs.

- (ii) HUDCO sanctioned (November 1999 – October 2000) eight loans amounting to Rs.481.25 crore to Orissa Rural Housing and Development Corporation Limited (ORHDCL) for onward disbursement of loan to various beneficiaries for reconstruction of houses in the cyclone-affected districts of Orissa. A sum of Rs.364 crore was disbursed between March 2000 and March 2003. ORHDCL defaulted in repayment of loan and the default amount stood at Rs.421.76 crore (including interest) as on 31 March 2006. An audit analysis revealed that HUDCO continued to disburse loans, though the implementation of the scheme was behind schedule and recoveries from the ultimate beneficiaries were not forthcoming to ORHDCL. Due to improper monitoring of the implementation of the scheme by HUDCO, the loan became a non-performing asset. HUDCO stated that the entire default was cleared by ORHDCL as on 31 March 2007.

HUDCO admitted (May 2007) lack of monitoring and stated that the Company could not conduct the site inspection of housing units before release of funds due to shortage of staff and subsequently added (October 2007) that best possible efforts were being made to ensure monitoring of schemes.

- (iii) HUDCO had not integrated its Financial Accounting and Loan Accounting System at Regional Offices, though a proposal for the integration was made as early as in October 2001. In the absence of this online integration, it mainly depended on banks to ascertain its fund position on daily basis. The Management stated (October 2007) that efforts were being made to integrate Loan Accounts with Financial Accounts to effectively monitor the disbursements and the repayments.

5.7.2 BOBHFL

During the period 2001-02 to 2005-06, out of 13217 loan accounts sanctioned for Rs.449.45 crore, 12760 loan accounts of Rs.255.91 crore representing 56.94 *per cent* of the total sanctioned amount, were pre-closed by borrowers. While market interest rates were coming down, the Company could not reset its high interest rates forcing the loanees to migrate to other HFCs.

5.7.3 CBHFL

CBHFL decided to automate the process of loan accounting and recovery, maintenance of books of accounts, and generation of MIS reports at a cost of Rs.63 lakh with completion date fixed for May 2001. Though it incurred an expenditure of Rs.88 lakh up to May 2006, the computerisation project was yet to be completed (September 2007). CBHFL informed (October 2007) that legal action against the vendor was being initiated. The outcome of the same was awaited.

5.8 Recovery Controls

For a company engaged in financing, recycling of funds is of utmost importance; therefore, it needs to regularly monitor the timely receipt of amounts due. In view of increase in the NPAs with consequential loss incurred by the financial institutions, the GOI enacted the SARFAESI Act, 2002, empowering commercial banks, financial institutions, *etc.*, to take over assets financed by them to recover their dues. The HFCs

were included in the list of eligible institutions in November 2003. The effectiveness of the recovery mechanism and application of this Act was reviewed in audit and following weaknesses were noticed:

5.8.1 HUDCO did not have any system to analyse the actual amount recovered against the amounts due for recovery and analysis of old and current dues. The Loan Accounting software did not generate the requisite data on these aspects, in the absence of which, the Management was not in a position to assess the recovery performance as evidenced from the fact that over-aged dues were accumulated abnormally. During the period from 2003-04 to 2005-06, the over-aged dues increased from Rs.932.53 crore to Rs.1023.63 crore. Despite the SARFAESI Act having come in to force for HFCs in 2003, it was only in December 2005 that HUDCO decided to take recourse to the Act but no constructive action had been taken by it (September 2007) to liquidate its NPAs. HUDCO while admitting the delay in recoveries stated (October 2007) that more than 80 *per cent* of its NPAs were due to Government sector lending and most of these loans had Government guarantees. It attributed the slow recovery of the NPA to the long time taken by various courts, as almost 76 *per cent* of the default amount involved in various law suits was aged more than one year.

Recommendation No.8

- (i) ***HUDCO and its administrative Ministry need to work in tandem to establish a suitable mechanism to monitor and ensure early recovery of the outstanding amounts guaranteed by State Governments.***
- (ii) ***The GOI should consider establishing a suitable mechanism, as suggested by HUDCO, for recovery of the overdues backed by the Government guarantees and/or the commitment of budgetary support by way of adjustment in the funds to be provided by the GOI to the State Governments.***

5.8.2 CBHFL did not recover even the first Equated Monthly Instalment from 200 borrowers in respect of loans disbursed during June 2000 to February 2005 against which the amount outstanding, as on 31 March 2007, stood at Rs.4.57 crore indicating poor recovery monitoring mechanism. CBHFL stated (May/October 2007) that it had since initiated action under the Negotiable Instruments Act, 1881 and the SARFAESI Act, 2002 to recover the overdues.

5.8.3 In respect of following cases in **BOBHFL**, the action to recover the overdues was pending:

- (i) Under the SARFAESI Act, 2002, Pune Area Office issued notices for possession to 124 borrowers out of 188 NPA accounts and Nasik Area Office issued notices to 39 borrowers out of 242 NPAs. However, no further action was taken.
- (ii) Mumbai Area office had taken possession of the mortgaged assets in 29 cases up to 31 March 2006, but action to dispose of the properties to realise the dues was pending (September 2007).
- (iii) Baroda Area Office sanctioned loans of Rs.46.40 lakh to six borrowers (March 2000 to March 2002), which became NPA (December 2002). Through the Hon'ble Gujarat High Court's order of December 2003, BOBHFL had taken the

possession of these six flats; it was yet to sell them to realise its dues (September 2007).

5.9 Fraudulent transactions

Cases of fraudulent advances made by Noida branch of PNBHFL have been reported vide Para No. 2.1.1 of the Report of the Comptroller and Auditor General of India (Commercial) No. 12 of 2006. Further, at Hyderabad branch, 23 fraudulent transactions involving Rs.1.45 crore, as on 31 March 2006, were noticed relating to (i) loan from multiple institutions (nine cases), (ii) forgery or fake documentation (three cases), and (iii) impersonation of vendors (11 cases).

Recommendation No.9

The HFCs should further review and strengthen their internal control mechanisms to ensure accountability at all stages of the operations (receipt of applications and their appraisal, sanction, disbursement, recovery, follow up of a loan including immediate legal recourse under the SARFAESI Act, 2002) and for improving the credit delivery mechanism (i.e., reducing the time lag between loan sanction and disbursement).

5.10 Internal Audit

Internal audit involves a systematic examination of the organisation's business processes with a view to provide assurance regarding the adequacy and effectiveness of internal controls. It was seen in audit that while in IHFL and PNBHFL the internal audit system was generally functioning well, in respect of other HFCs the following weaknesses were observed:

- (i) The internal audit wing in **HUDCO**, headed by an Executive Director, covered examination of sanctions, disbursements and final closure of accounts and internal audit of loan accounts was outsourced to a firm of Chartered Accountants. However, the Asset Liability Management Reports were not audited by the internal audit though HUDCO's policy stipulated it. HUDCO stated (October 2007) that a representative of the internal audit is a member of the Asset Liability Management Committee and the strengthening of the internal audit wing was under consideration (October 2007). The reply is however silent as to why the Asset Liability Management Reports were not audited by the internal audit.
- (ii) **CBHFL** had neither set up an internal audit wing nor prepared an internal audit manual (August 2007). Internal audit was carried out by firms of Chartered Accountants but the specific checks to be exercised by them were not prescribed. A review of several reports of the internal audit disclosed that these reports were silent on important issues like verification or availability of legal documents, loan appraisal and disbursement procedures, verification of opening balances of all accounts and overdues, NPA and interest calculations. In the absence of a focused internal audit, the possibility of errors and omissions in transactions could not be ruled out. CBHFL stated (May/October 2007) that it had appointed (December 2006) one internal auditor to look after the audit of all branches and has framed an internal audit manual which has been put up to the Audit Committee in September 2007.

- (iii) **BOBHFL** had neither set up an internal audit wing nor prepared any internal audit manual. Internal audit of the various area offices and the Corporate Office was conducted annually by the Zonal Inspection Centres of the parent bank. Due to absence of any independent auditor and the internal audit manual, the internal audit was ineffective as is evident from the deficiencies noticed in appraisals, sanctions and disbursements as discussed in this Report.

5.11 Audit Committee

- (i) In HUDCO, an Audit Committee was constituted in accordance with the provisions of Section 292A of the Companies (Amendment) Act, 2000. The Audit Committee consisted of three directors – a whole time director, a part-time official director and a part-time non-official director. The Audit Committee did not have sufficient number of independent directors. The matter had been taken up by HUDCO with the GOI for reconstitution of the Committee in line with the requirements of Clause 49 of the Listing Agreement, but orders of the GOI were awaited (September 2007). Major findings of the internal audit were reported to the Audit Committee, whose recommendations were implemented. The matter regarding strengthening of the internal audit was yet to be considered by the Board of Directors. HUDCO stated (October 2007) that one more part-time official director has been included and that it was regularly pursuing with the administrative Ministry for induction of sufficient number of independent directors on the Board for re-constitution of the Audit Committee.
- (ii) In other four HFCs, the Audit Committees were meeting at regular intervals. In their meetings, the internal audit reports were reviewed and requisite recommendations to strengthen internal audit were issued from time to time.