

## CHAPTER III

### **PERFORMANCE AUDIT RELATING TO STATUTORY CORPORATION**

### **WORKING OF KERALA FINANCIAL CORPORATION**

**PERFORMANCE AUDIT RELATING TO STATUTORY CORPORATION**

**3. Working of Kerala Financial Corporation**

**Executive Summary**

*1. Disbursements were made without ensuring that the IRR of the project to be financed was significantly higher than the interest chargeable on the loan.*

*2. The professional competence/commitment to success, of the promoter to run the business was not properly assessed before sanctioning loans.*

*3. Disbursement of funds was not synchronised with the progress of projects being financed.*

*4. While rescheduling the loans, the viability of the projects under revised repayment obligation was not assessed. Consequently, the immediate impact of faulty rescheduling was inflated income / profit shown in accounts.*

*5. The Corporation had to forgo amounts to the tune of ₹297.73 crore due to faulty disbursements. Government and financial*

*institutions also had to suffer financial loss of ₹105 crore towards write off of accumulated losses against their equity contribution.*

*6. Delayed action under Section 29 of SFC Act led to non-disposal of 57 units. There were no takers for the assets taken over, indicating that the assets financed did not have business potential.*

*7. Recovery under RR Act suffered due to intervention of Corporation/Government/Hon'ble Ministers.*

*8. Non-conformity with legal requirements resulted in the borrowers exploiting the situation to thwart recovery proceedings by seeking legal redressal.*

*9. Internal audit was ineffective. It failed to point out serious lapses in the disbursement and recovery stages.*

**Introduction**

**3.1** Kerala Financial Corporation (Corporation) was established in December 1953 under the State Financial Corporations Act 1951 (SFC Act). The basic business objective of the Corporation is lending to industries and to support sustained industrial growth of the State with special attention to Micro, Small and Medium Enterprises (MSMEs). Provisions of the SFC Act as amended in the year 2000, control and guide the functions of the Corporation.

### Organisational set up

**3.2** The Board of Directors (BoD) of the Corporation consists of four members nominated by the Government of Kerala (GoK), two by Small Industries Development Bank of India (SIDBI) and one each by Life Insurance Corporation of India and State Bank of Travancore. Policies approved by the BoD are being implemented through the Chairman and Managing Director (CMD) who is the Chief Executive Officer. The CMD is assisted by a Corporate Secretary, three General Managers and a Financial Controller. The activities of the Corporation are being carried out through three Zonal Offices and sixteen Branch Offices.

### Scope of Audit

**3.3** The present performance audit on the working of the Corporation conducted during March to July 2012 covers the period of five years from 2007-08 to 2011-12. This involved scrutiny of records at Head Office and eight out of sixteen branch offices, selected based on random sampling. We have taken into account the data for four years ending 2010-11 for the purpose of selecting the sample as the figures for 2011-12 were not available then. We have also covered the sanction and disbursement of loan up to the year 2011-12. Of the 1590 loans disbursed during the last five years in these eight branches, we scrutinised 138 cases based on materiality.

### Audit Objectives

**3.4** MSME sector is fast emerging into a major income generating and employment providing sector in our economy. Main objectives of the performance audit were to ascertain whether the Corporation was able to achieve its defined objectives and whether:

- the Corporation achieved its objectives efficiently, effectively and economically;
- there was proper financial planning and management to achieve maximum efficiency in operations;
- adequate policies, procedures and systems were formulated for sanction and disbursement of financial assistance and were complied with;
- an adequate system of internal control with regard to sanction, disbursement and recovery of dues was in place and operative;
- the system of recovery of dues and action taken in case of default was efficient for prompt realisation of over dues; and
- One Time Settlement (OTS) schemes were implemented in accordance with the approved policies.

### Audit Criteria

**3.5** The audit criteria derived from the following were adopted to assess the performance of the Corporation:

- Annual Budgets including Performance Budget, Annual Accounts of the Corporation, Manuals and Resolutions of the Board;
- Laid down policies, procedures and guidelines of the Corporation related to financial management, sanction of financial assistance, disbursement and loan recovery, relevant provisions of the SFC Act, 1951, guidelines of SIDBI and Reserve Bank of India (RBI);
- Norms fixed for categorisation of loan/asset classification issued by SIDBI and RBI;
- OTS policy, delegation of powers and canons of financial propriety;
- Various orders and circulars issued by the State Government, SIDBI and RBI from time to time; and
- Policies, guidelines and reports prescribed for/by Management Information System/ internal control/internal audit and Corporate Governance.

### Audit Methodology

**3.6** The following mix of methodology was adopted for attaining audit objectives:

- Review of Board Minutes, Agenda Notes, Minutes of various Committee meetings;
- Review of Business Plan and Resource Forecast (BPRF) including budgets and annual accounts of the Corporation;
- Examination of relevant provisions of SFC Act 1951 and guidelines issued by State Government, SIDBI and RBI from time to time;
- Examination of Economic Review published by State Planning Commission, information from official websites of Government of India (GoI) and GoK and other Government institutions;
- Review of sanction and disbursement procedures, loan ledger/ records;
- Scrutiny of loan sanction and follow up files pertaining to loanees/ MIS;
- Examination of files pertaining to OTS schemes;
- Test check of loan files at selected branch offices and head office.

### Financial Position

**3.7** Share capital of the Corporation as on 31 March 2012 was ₹211.97 crore held by GoK (₹205.74 crore), SIDBI (₹6.13 crore), Life Insurance Corporation of India (₹0.07 crore), State Bank of Travancore (₹0.02 crore) and other private parties (₹0.01 crore). The financial position for the period from 2007-08 to 2011-12 and important liquidity ratios derived from the financial statements for the corresponding period are given in *Annexure 15*.

### Working Results

**3.8** The Corporation had finalised its annual accounts up to 2011-12. Comparative details of working results for the last five years up to 2011-12 and important profitability ratios pertaining to the corresponding period are given in **Annexure 16**. While the working of the Corporation resulted in loss of ₹28.15 crore in 2007-08 and ₹76.36 crore in 2008-09, it showed profit in subsequent years in 2009-10 (₹33.73 crore), 2010-11 (₹36.40 crore) and 2011-12 (₹45.65 crore). The profit during these years was mainly due to financial restructuring/rescheduling of loans as subsequently explained.

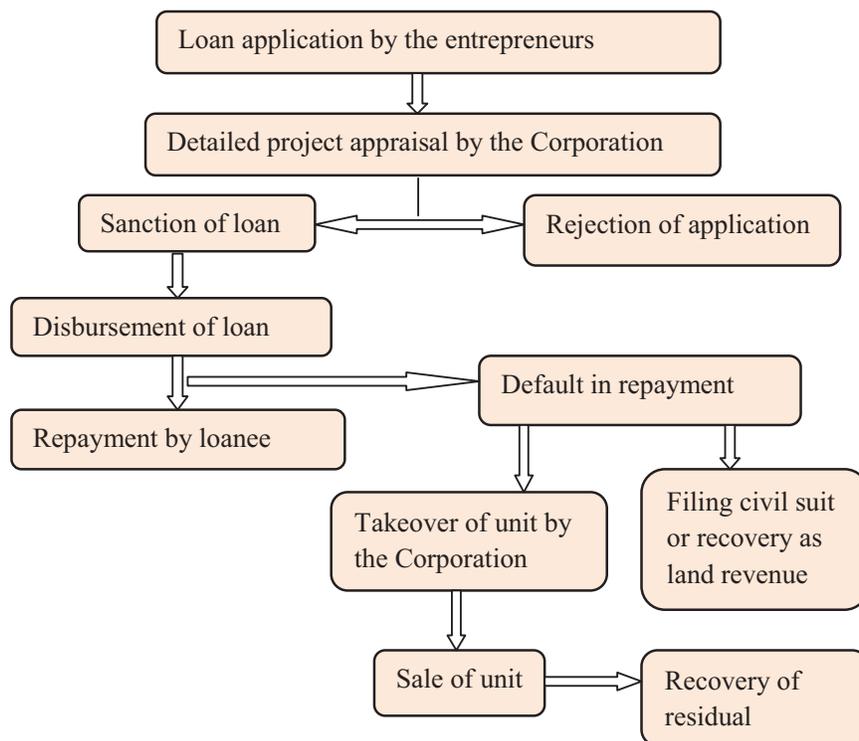
### Audit Findings

**3.9** The audit objectives, audit criteria and scope of the performance audit were explained to the Management in an Entry Conference (May 2012). Audit findings were reported to the Government/Management (August 2012) and discussed in Exit Conference (September 2012), which was attended by Special Secretary, Finance Department of Government of Kerala and CMD of the Corporation. The Corporation replied (August 2012) to the performance audit report. The replies from the Government are awaited (November 2012). The views of the Management have been considered while finalising the report.

### Functioning of the Corporation

**3.10** As per Section 28(d) of the SFC Act, financial assistance is given to any industrial concern in respect of which the aggregate of the paid up share capital and free reserves does not exceed ten crores of rupees or such higher amount not exceeding thirty crores of rupees as the State Government, on the recommendation of the SIDBI, may, by notification in the official gazette, specify. Further as per provisions of Section 26(i) and (ii) of the Act, the exposure limit is ₹5 crore for private/public limited companies, co-operative societies and ₹2 crore for others. This limit is relaxable up to ₹20 crore and ₹8 crore respectively with prior approval of SIDBI. As per loan policy 2007-08, Committees constituted at Branch Offices are competent to sanction loans up to ₹1 crore. Financial assistance above ₹1 crore and upto ₹2 crore is sanctioned by Zonal level Committees, loans above ₹2 crore and upto ₹3 crore by Committees at Head Office, loans above ₹3 crore and upto ₹5 crore by Managing Director with recommendation of Head Office Committee and loans above ₹5 crore by Executive Committee. The maximum limit was enhanced to ₹2.5 crore, ₹5 crore, ₹7.5 crore, ₹10 crore and above ₹10 crore respectively during the year 2011-12. Sanctioned loans are to be disbursed in instalments considering the agreed debt equity ratio and progress in implementation of projects.

**3.11** Recovery of principal is to start after initial moratorium period ranging from six months to two years and recovery of interest from the next month of disbursement of loan. Rules and procedures governing sanction and disbursement of loans (Loan Policy) were formulated in August 2005. Similarly, the Corporation had formulated a recovery policy in 2007-08 and these policies were subject to changes from time to time. The process involved in sanction, disbursement and recovery of loans is given below:



### Business Performance

**3.12** The details of achievements against targets fixed by the Corporation for the last five years up to 2011-12 were as follows:

(₹ in crore)

Year	Sanction			Disbursement			Percent age of disbursement to sanction	Recovery		
	Target	Achievement	Per cent	Target	Achievement	Per cent		Target	Achievement	Per cent
2007-08	192	245.56	128	180	186.44	104	76	250	221.82	89
2008-09	350	350.21	100	275	293.94	107	84	316	269.25	85
2009-10	1000	615.92	62	800	419.56	52	68	500	299.50	60
2010-11	850	507.39	60	650	443.52	68	87	366	354.22	97
2011-12	1080	539.01	50	815	464.57	57	86	410	467.15	114

(Source: Business Plan and Resource Forecast(BPRF))

**3.13** The achievement of the Corporation was more than the target fixed for sanction and disbursement of loan during 2007-08 and 2008-09. During the subsequent three years, achievements against the targets for sanction and disbursement varied from 50 to 62 per cent and 52 to 68 per cent respectively. We observed that the annual BPRF were unrealistic as the plan documents

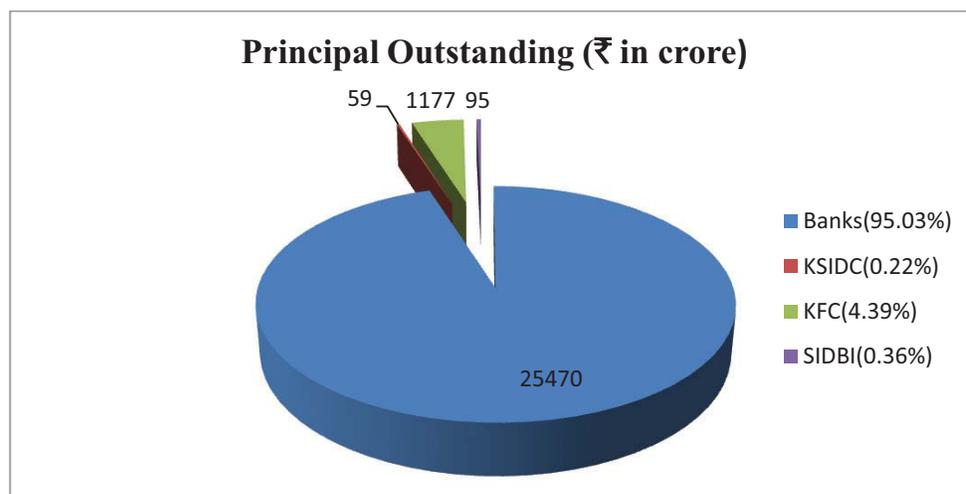
have been prepared without obtaining data on actual requirement of branch offices.

**3.14** As against ₹2930 crore targeted for sanction during last three years, the actual (net) applications received was for ₹1798.59 crore only. This indicated inadequacy of marketing of its products by the Corporation.

### Role of the Corporation in financing MSME sector

**3.15** As per 4<sup>th</sup> All India Census Report published in April 2011 by Development Commissioner of MSME, GoI, there were 13.18 lakh unregistered and 1.50 lakh registered units in Kerala as on 31 March 2007. New units registered during 2007-2012 were 0.43 lakh. During the same period, the Corporation provided financial assistance to 2706 units.

**3.16** The State Level Bankers Committee, Kerala also reported (March 2012) that total outstanding against advances provided to the MSME sector as on December 2011 by banks and other financial institutions was ₹26801 crore in 7.62 lakh accounts. Other than the Corporation, major players in the field of financing MSME sector were banks, SIDBI and Kerala State Industries Development Corporation Limited (another State PSU). The diagram below shows the position of advances provided by the above agencies and the Corporation:



### Financial Planning

**3.17** Financial planning of the Corporation involves estimation of requirement of funds, decision on sources of borrowing and appropriate investment activities. As part of better financial planning, the Corporation has to raise funds in most economic manner and deploy it in the most efficient manner.

### Rescheduling of loan accounts and financial restructuring

**3.18** As per SIDBI guidelines if interest and/or installment of principal remain due for more than 90 days, loans are classified as Non Performing Asset (NPA). Immediately before or after slippage into NPA category, the Corporation had been rescheduling such loan accounts with revised repayment schedule. As a pre-condition for rescheduling, the Corporation insisted settlement of interest arrears either by remitting or by funding the same.

**3.19** As per the accounting policy adopted for income recognition, the interest on loans under standard category was accounted on accrual basis and interest on NPAs, on cash basis. As per RBI guidelines, no account was to be taken up for rescheduling unless alteration/changes in the original loan agreement were made and financial viability was established. This would require reassessment of the feasibility of the project. Without undertaking such an exercise, the loans were rescheduled and classified as standard assets.

**3.20** During the last five years up to 2011-12, NPAs of ₹297.19 crore was rescheduled and upgraded to standard category. We observed that 842 borrowers defaulted in repayment of ₹24.78 crore even after rescheduling. But for this rescheduling/grant of OTS, the assets could have been immediately taken over under Section 29 of the SFC Act. The immediate impact of this faulty rescheduling was inflated income/profits being shown in the accounts despite uncertainty of realisation.

The Corporation stated (August 2012) that for upgradation of NPAs it followed the guidelines on prudential norms and asset classification issued by the RBI/SIDBI from time to time. We, however, observed that the Corporation had not been following the RBI/SIDBI guidelines for rescheduling of loans as stated above.

**3.21** The Corporation had written off loans amounting to ₹117.58 crore during 2008-09 and the corresponding provision for doubtful debts of ₹84.32 crore was reckoned as income. As part of restructuring, the GoK had permitted (March 2009) the Corporation to write off accumulated loss against the share capital. Accordingly, in the annual accounts for the year 2008-09, the Corporation had written off accumulated loss of ₹105 crore against share capital. Thus the Government and other share holders had to sacrifice 58.64 per cent of their equity.

**3.22** The working results of the Corporation for the last three years ended March 2012, showed a profit of ₹115.78 crore. This was after reckoning ₹76.63 crore being recovery of principal amount of the loans written off up to March 2009 as income. Thus the capital restructuring resulted in vitiating the working results of the Corporation by ₹76.63 crore.

Thus the positive working results were mainly due to rescheduling and restructuring.

The Corporation while concurring with the audit observation stated that the financial restructuring enabled them to set off its accumulated loss and reduce its NPA level.

**Government/  
FIs suffered a  
loss of ₹105  
crore due to  
financial  
restructuring**

## Borrowings

**3.23** The Corporation prepares, every year, Business Plan and Resource Forecast, the plan document which indicates resource mobilisation and its utilisation. The summarised position of actual cash flow for the last five years up to 2011-12 is given in *Annexure 17*.

**3.24** We observed that when disbursement of loan increased from ₹186.44 crore in 2007-08 to ₹464.57 crore in 2011-12, the corresponding increase in recovery was ₹221.82 crore to ₹430.15 crore only. The short fall in cash inflow due to insufficient recovery as well as increase in demand for loans was compensated by additional borrowings, which increased from ₹75.95 crore to ₹394 crore during the corresponding period.

### Refinance from SIDBI

**3.25** During the period under review, financial assistance from SIDBI had reduced substantially from 54 *per cent* of loans disbursed (2008-09) to 17 *per cent* (2011-12). To overcome the financial crunch, the Corporation availed ₹401 crore from commercial banks during 2010-2012 at interest rates varying from 9 to 12.75 *per cent*. As per Section 8 of the SFC Act, the Corporation can accept public deposit with prior approval of RBI. The request of the Corporation to accept public deposit was turned down (November 2009) due to poor working results for the previous three years, higher level of NPA and absence of credit rating from approved rating agencies.

### Borrowings from Commercial banks

**3.26** The Corporation had to resort to expensive borrowings from banks instead of low cost public deposits. The additional expenditure towards interest on account of this worked out to ₹8.23 crore<sup>1</sup> for the years 2010-11 and 2011-12.

The Corporation stated that acceptance of public deposit would result in asset liability mismatch and the performance of the Corporation had improved to become eligible to accept public deposit. The Corporation had also approached (August 2012) SIDBI. The contentions of the Corporation contradict each other.

### Loan from HUDCO

**3.27** Housing and Urban Development Corporation Limited (HUDCO) sanctioned (March 2011) a loan of ₹100 crore to the Corporation.

We observed that:

- A decision was taken to mobilise funds through issue of bonds in April 2010 to meet the target fixed for 2010-11. The bonds, however, were issued only in December 2011, after a lapse of 1½ years. The delay was attributed to get a better credit rating.
- Loan availed from HUDCO carried interest rate of 11.5 to 13 *per cent* as against 10.74 *per cent* payable on bonds. The delay in issue of bonds necessitated expensive borrowing from HUDCO.
- Since the Corporation did not provide government guarantee in the prescribed format, HUDCO charged one *per cent* additional interest which worked out to ₹0.15 crore.

<sup>1</sup> The excess of interest paid on bank borrowings over interest (@ 10.25% per annum) payable on public deposits.

- The Corporation did not assess the actual requirement before getting the loan sanctioned. The Corporation actually availed loan of only ₹25 crore. This necessitated payment of ₹0.55 crore towards front end fee on sanctioned amount as against ₹0.14 crore payable on the loan of ₹25 crore actually availed.
- The Corporation pre-closed (December 2011) the loan account by utilising funds raised through issue of Non SLR Bonds and as a result had to pay ₹0.49 crore towards pre-payment charges.

The Corporation replied that the issue of bond was delayed due to delay in getting credit rating and the pre-payment charges on the closure of loan had not been paid. The reply was not acceptable as the pre-closure, within six months, of a loan availed for a period of ten years indicated poor financial planning. Besides, HUDCO had already appropriated (February 2012) ₹0.49 crore from payment made by the Corporation.

### Temporary parking of surplus funds

**3.28** Section 34 of the SFC Act, permits the Corporation to invest its surplus funds in accordance with applicable guidelines and prudential norms and in such securities as the Board may decide from time to time. As per GoK circular (November 1997) all Public Sector Undertakings (PSUs) were directed to deposit the surplus/Reserve Funds with them in Government Treasuries only. The Guidelines issued (December 1994) by Department of Public Enterprises (DPE), GoI stipulated that there should be no element of speculation on the yield in respect of investment of surplus funds by PSUs. It was clarified that PSUs would not be allowed to invest their surplus funds in Unit Trust of India and other public and private mutual funds as they were inherently risky. It was further clarified (November 1999) that the Non-Banking Financial Companies may be allowed to invest surplus funds in call money deposits after taking individual approval from Reserve Bank of India.

**3.29** The Corporation, in the absence of any approval in this regard, parked surplus funds in Mutual Funds. The Corporation commenced transactions in mutual fund in September 2008 and during the period up to March 2012, average holding varied from ₹2.70 crore to ₹26.05 crore. The decision (July 2008) to invest in liquid fund/Fixed Maturity Plans by the Board was against the guidelines issued by GoI/GoK. The mutual fund transactions of the Corporation, however, resulted in lesser returns than the cost of borrowings by ₹0.81 crore.

The Corporation stated that the investment in Mutual Funds used to give better return than Fixed Deposits in banks and during the last three years Corporation earned an income of ₹38.87 crore. The reply of the Corporation was incorrect as on further verification, we, however, noticed that the actual income earned as per the annual accounts during the above period was ₹3.14 crore only as against ₹38.87 crore claimed by the Corporation. Further, the Board's decision was contradictory to the guidelines of DPE/RBI and the provisions of the SFC Act.

### Sanction and disbursement of loans

**3.30** Loan application received along with Detailed Project Report (DPR) and other documents were to be evaluated by Technical/ Legal sections at Branch Offices. Appraisal Notes were to be prepared stating the nature of activity for which financial assistance was requested, project cost and its source of finance, promoter's contribution to be brought in, marketing and financial viability, managerial ability of the promoters and their expertise in the field etc.

**3.31** Since inception in 1953, the Corporation had disbursed ₹4169 crore in 40703 loan accounts. During the last five years up to 2011-12, the amount of loan disbursed was ₹1808 crore (in 3458 accounts), which worked out to 43 *per cent* of total disbursements made so far. Principal outstanding as on 31 March 2012, was ₹1481 crore. A comparative statement showing applications for loans received and loans sanctioned for the last five years up to 2011-12 is given in *Annexure 18*.

**3.32** An analysis of the actual disbursements in various sectors *vis a vis* the exposure limits fixed by the Corporation revealed that disbursements to Hotel and Tourism sectors constituted 60 *per cent* of the total disbursements. Further in 2008-09 it also crossed the exposure limit of 65 *per cent* (*Annexure 19*).

**3.33** With a view to safeguarding the interest of the Corporation, an effective and efficient system of sanction and disbursement of loans would involve the following:

- The Internal Rate of Return (IRR) of the project proposed to be financed should be significantly higher than the rate of interest chargeable on the loan so as to give a reasonable return to the promoters.
- Professional competence of the promoter to run the business on profitable lines ensures success of the project.
- Sufficient collateral security free of encumbrance ensures safety.
- Willingness on the part of the promoters to part finance the project indicates his commitment to ensure success of the project.
- The release of funds by the Corporation after the initial expenditure is met by the promoter is an additional safeguard.
- Disbursement of funds in a phased manner linked to progress of work addresses the risk of diversion of funds.

The Corporation stated that it had been following various safeguards to ensure quality of the assets. Further, the value of the prime securities as on date was considerably high as compared to outstanding amount. We, however, observed that the Corporation did not ensure the quality of the asset as evident from the succeeding paragraphs:

#### *Loan to a charitable trust*

**3.34** The Corporation disbursed (2007-2009) two loans of ₹17.21 crore to a charitable trust *viz.*, Malabar Province OCD. Out of ₹17.21 crore, ₹4.48 crore was for construction of a spirituality centre and ₹12.73 crore for a multipurpose commercial complex.

**IRR was far below the interest rate of loan**

- Loan of ₹4.48 crore was disbursed although the projected IRR of 3.08 *per cent* for Spirituality Centre was far below the rate of interest of 12.50 *per cent* of loan. This indicated that the Corporation did not safeguard its financial interest.
- Loan sanctioned and disbursed exceeded the exposure limit of ₹8 crore fixed by the Act and as approved by SIDBI.
- The financing of the total project was in the ratio of 0.99:1 by the promoter and the Corporation. The Corporation disbursed the loan without ensuring that the initial 50 *per cent* investment was met by the promoter.
- Though the trust defaulted in repayment and arrears amounted to ₹10.82 crore (August 2012), the Corporation did not invoke Section 29 of the SFC Act to recover the dues.

The Corporation replied that the IRR was more than the interest rate and the trust had cleared (August 2012) all the arrears. The reply was not correct as the IRR (3.08 *per cent*) calculated in respect of Spirituality Centre was far below the interest rate (12.5 *per cent*). Further the total loan outstanding as on 31 August 2012 as per ledger of the Corporation was ₹21.71 crore including arrears of ₹10.82<sup>2</sup> crore.

#### *Loan to a glass bottle manufacturing unit*

**3.35** The Corporation provided (February 2011) a loan of ₹7.25 crore to Excell Glasses Ltd. (a Somania group company).

We observed the following:

**Viability of project/track record of borrower not considered**

- No Detailed Project Report was submitted and the Corporation did not work out IRR.
- The past track record indicated failure of the promoter to run the business profitably.
- As per the Corporation's own assessment, the project was unviable and the promoters were not creditworthy.
- Despite the above, the Corporation did not obtain the personal property of the Managing Director of the loanee company as collateral security.
- Escrow account to facilitate appropriation of a portion of sale proceeds towards repayment of loan was not opened as stipulated while sanctioning the loan.
- The outstanding loan was ₹8.01 crore including arrears of ₹0.77 crore (August 2012).

The Corporation replied that DPR had been submitted and IRR was calculated. After appraisal of the project it was found that the project merited financing and personal guarantee of Managing Director was also obtained. The loan was sanctioned at the instance of Hon'ble Ministers of GoK (Finance and

<sup>2</sup> ₹9.49 crore in respect of multi-purpose commercial complex and ₹1.33 crore in respect of Spirituality Centre.

Industries), which was initially denied (August 2009) by the Branch Level Screening Committee of the Corporation on the ground of non-viability of the project. We, however, observed that the reply was not correct as the loanee did not produce DPR and the Corporation did not compute IRR. Personal guarantee of the Managing Director was also not obtained.

#### ***Loan to a Hospital run by Co-operative Society***

**3.36** The Corporation disbursed (December 2007) a loan of ₹1.25 crore to Peravoor Co-operative Hospital at Kannur for construction of a new block. The total project cost was ₹4.27 crore. Time required for commissioning the project was 18 months and repayment was to be made in 96 monthly installments, after a moratorium of 24 months.

We observed the following:

- The rate of interest was 13.5 *per cent*. For project appraisal the annual income reckoned was ₹2.92 crore as against ₹2.34 crore projected in DPR resulting in inflated IRR of 13.87 *per cent*. Adjusting the IRR after giving margin for adverse business conditions, the project was not creditworthy.
- Considering the existing assets (₹1.49 crore) the maximum eligible amount of loan was ₹0.75 crore (50 *per cent* of ₹1.49 crore). The Corporation disbursed ₹1.25 crore and in fact had sanctioned a higher amount of ₹2 crore.
- The loan was to be disbursed in proportion to the progress in implementation. The Corporation, however, disbursed (November/December 2007) the amount even before the party had obtained the building permit. The work had not even commenced (August 2012).
- The borrower started defaulting in repaying the loan after remitting interest of ₹1.33 lakh in January 2008 and the amount outstanding as on August 2012 stood at ₹1.91 crore including arrears of ₹1.09 crore. The Corporation, however, did not invoke Section 29 of the Act to recover the dues.

The Corporation stated that the loanee proposed to settle the loan account under compromise settlement after disposal of the hospital properties. The account is yet to be settled (August 2012).

#### ***Loan to a partnership firm***

**3.37** The Corporation disbursed a loan of ₹1.50 crore to Haritha Investments during January to May 2009 and an additional loan of rupee one crore in December 2009.

We observed the following:

- The promoter did not have experience in running such a business.
- The project report submitted by the promoter showed IRR of 6.83 *per cent*. The income generated during 2009-10 was only ₹0.04 crore as against the projected income of ₹1.65 crore.

- The promoter failed to establish marketing tie up with established tour operators and non-consideration of the locational disadvantages resulted in project failure.
- Prior approval of SIDBI as required under Section 26 (ii) of the SFC Act was not obtained.
- The firm defaulted in repayment and as on 31 August 2012, the outstanding amount was ₹3.04 crore including arrears of ₹0.94 crore.

The Corporation stated that the promoter had prior experience in hotel industry. It was also stated that the total asset value of the unit stood at ₹5.23 crore and it was expected that the account would be closed shortly. We, however, observed that the promoter had no experience in the relevant field as per the bio-data furnished. Further, the above lapses indicated that the appraisal of the project itself was wrong.

#### *Loans to an existing hotel group*

**3.38** The Corporation disbursed a loan of ₹4 crore to Kanichai Hotels (P) Limited during March 2007 to March 2009 for upgrading Hotel Lucia from the existing four star to five star category.

We observed:

- The borrower's track record in running the business was poor as they had defaulted an earlier loan necessitating giving relief under OTS. So it was a fit case for outright rejection.
- The past track record of another firm of the same management was also poor. Two loans of ₹4.28 crore disbursed (July 2003 and August 2004) were also under default.
- As against the total project cost of ₹8.24 crore financing to the tune of ₹4.24 crore was to be done by the promoter. Initial funding of the 50 *per cent* cost by the promoter would have been a clear indication of his commitment to the success of the project. However, the funds were released without the promoter doing the initial funding.
- The Corporation assessed the utilisation of the earlier loan of ₹1.20 crore (disbursed during March to May 2003) only in July 2006, after a lapse of three years and prior to disbursement of fresh loan of ₹4 crore.
- The loan was under default and the outstanding amount was ₹3.92 crore including arrears of ₹1.52 crore (August 2012).

The Corporation replied that the loans were disbursed in accordance with the Debt Equity Ratio (DER) (i.e. 1:1) of the project. The reply of the Corporation was not correct. As per the financial statements of the loanee, the DER was at an adverse position of 12.09:1.

#### *Loans to the same group of companies*

**3.39** The Corporation disbursed (May 2005 to March 2009) a loan of ₹2.08 crore to Southern Hospitalities (P) Limited for construction of a three star hotel. The project was to be completed within ten months from the drawal of

first installment i.e, by March 2006. The project was not completed so far (August 2012).

We observed that:

**Disbursement of funds was not synchronised with progress in implementation**

- When the Corporation disbursed the above loan, completion of an earlier project (a three star apartment hotel) for which a loan of ₹3.50 crore was disbursed (September 2003 to December 2005) was pending. The second loan of ₹2.08 crore should have been declined considering the failure of the promoter to successfully complete the first project.
- The Corporation further disbursed (December 2009 to August 2010) a loan of ₹2.50 crore to Guardian Builders and Realtors (P) Ltd., a company promoted by the same group, though their track record was unreliable.
- The Corporation instead of waiting for the successful completion of the earlier two projects and repayment of earlier loans as per the terms and conditions disbursed further loan of ₹2.50 crore.
- The borrower had also violated building rules for the first project and deviated from the approved plan resulting in cancellation (May 2011) of the permit.

The Corporation stated that the first project could not be implemented within time frame due to third party litigation and that the loan had since been closed (August 2012). The fact, however, remained that the two loans were under default and the outstanding amount was ₹4.03 crore including arrears of ₹0.86 crore (August 2012).

### *Loans to two hotels in Thrissur District*

#### *Kangappadan Residency*

**3.40** The Corporation disbursed a term loan of ₹3.50 crore (October 2008) to the above unit by taking over an existing bank loan (₹2.07 crore) for completion of construction of three star hotel. The scheduled completion period was seven weeks from the date of drawal of first installment (October 2008). Following lapses were noticed in sanction and disbursement of the loan.

**Commitment of promoter by way of initial investment was not ensured**

- Assessment of viability is a very critical stage before disbursement of loan. There was failure to carry out such an exercise.
- Out of the total project cost of ₹5.96 crore, the promoter was to contribute ₹2.46 crore whereas the actual contribution was only ₹0.20 crore.
- Without ensuring commitment of the promoter by way of initial investment, the Corporation disbursed the loan. Non-contribution by the promoter indicated lack of his confidence in the profitable operation of the business.
- Though the commercial operation of the hotel started in August 2009, the party defaulted (April 2010) in repayment and the outstanding amount was ₹3.58 crore including arrears of ₹1.08 crore (August 2012).

The Corporation replied that it was decided to fund the project after detailed appraisal of the project and disbursements were made in installments after ensuring promoters contribution. Reply is not acceptable as there was failure in

assessing expected income in a realistic manner and the promoter had contributed ₹0.20 crore only as equity against the required amount of ₹2.46 crore.

*Dale and Carrington Investment (P) Ltd.*

**3.41** The Corporation sanctioned and disbursed (August 2009 to March 2012) a term loan of ₹4.81 crore for construction of a three star hotel.

We observed that:

- The initial part of expenditure should have been from the promoter for ensuring the successful completion of the project. The Corporation did not ensure investment of promoters contribution of ₹2.65 crore before disbursement.
- First installment of ₹0.15 crore was disbursed in August 2009. The Corporation released subsequent installments without ascertaining the utilisation of earlier installments.
- Out of ₹4.81 crore disbursed, the Corporation adjusted (November 2009 to March 2012) ₹1.48 crore (including ₹0.36 crore of a sister concern) towards arrears of interest. This indicated poor repayment behaviour of the borrower.
- The borrower defaulted and the outstanding amount was ₹5.30 crore including arrears of ₹0.58 crore (August 2012).
- The project scheduled to be completed by September 2010 still remained to be completed (August 2012).
- The Corporation did not invoke Section 29 of the SFC Act.

The Corporation while justifying the delay stated that the project was likely to be commissioned by September 2012. Reply was silent about inadequacy of promoter's contribution and irregular adjustment of disbursement amounting to ₹1.48 crore against arrears of interest.

*Loan to a new hotel project*

**3.42** The Corporation disbursed (December 2006 to March 2010) ₹11.40 crore to Gold Coast Hotels (P) Ltd. in two loan accounts for construction of a four star hotel.

We noticed that:

- As per the Act (Section 26) loans exceeding ₹5 crore required prior approval from SIDBI. The Corporation, however, sanctioned first loan of ₹5.85 crore and an additional loan of ₹5.55 crore without complying with the said provision.
- As against the required contribution of ₹11.40 crore, the actual contribution by the promoter was only ₹6 crore. The promoter not making his part of investment indicated that he did not have confidence in the success of the project. Ignoring this, the Corporation disbursed ₹11.40 crore.

- The Corporation sanctioned the second loan for additional plinth area not envisaged in the original project. The loan should not have been sanctioned. The Corporation should have insisted the borrower to meet the funds required for additional construction from own sources.
- The Project scheduled to be completed by April 2010 remained incomplete (August 2012).
- The outstanding loan amount as on August 2012 stood at ₹11.95 crore including arrears of ₹6.16 crore and the unit was taken over (Section 29 of SFC Act) by the Corporation.

The Corporation stated that the value of land was limited to the document value and if the actual cost was considered the investment would be substantial. Reply was not tenable. As per the valuation policy of Corporation, the market value could not be considered for valuation. The project failed mainly because of inadequate cash flow and increase in plinth area.

#### *Loan to EVM group*

**3.43** The Corporation disbursed (2008-2011) loan of ₹4.12 crore for two projects of same promoters, EVM Fuels Pvt. Ltd. (hotel at Guruvayur- ₹3.08 crore) and EVM Reclamations Pvt. Ltd. (Reclaimed Rubber production unit- ₹1.04 crore).

We observed the following:

- The Corporation failed to ensure in advance that the investment by the promoter had been made before disbursement of the loan. Thus the Corporation disbursed ₹3.08 crore as against the eligible amount of ₹2.86 crore, being 50 *per cent* of investment of ₹5.71 crore (June 2011) as agreed upon.
- The project scheduled to be completed in February 2010 remained (August 2012) incomplete.
- The Corporation without waiting for the completion of the first project and assessment of the promptness in repayment by the borrower, sanctioned (August 2010) another loan of ₹1.50 crore for setting up a rubber reclamation plant with a total cost of ₹2.38 crore.
- Considering the past track record of the borrower, the loan application should have been wisely scrutinised to safeguard its financial interest.
- The Corporation disbursed ₹0.54 crore. The borrower had utilised only ₹0.18 crore out of the first installment of ₹0.50 crore disbursed in September 2010. This indicated that the disbursement was not linked to the progress in implementation of the project so as to take care of the risk of diversion of funds.
- The project to be completed by February 2009 remained incomplete (August 2012) and the outstanding amount of loans stood at ₹3.30 crore (August 2012) including arrears of ₹0.09 crore.

The Corporation stated that the excess disbursements were made relaxing the DER as per the then existing loan policy. The reply ignored the fact that as per

loan policy promoter's contribution could be relaxed only on the basis of additional collateral security which was not obtained.

### *Loan to Apartment Complex*

**3.44** The Corporation disbursed a term loan of ₹0.68 crore (January to August 2008) to Shri. Abi T J of Smart Homes for construction of two storied apartment complex.

We observed that:

- The Corporation did not ascertain the viability of the project before sanctioning the loan.
- The loanee violated the conditions of sanction and constructed third floor without permission of the Corporation.
- Credit rating of the unit was wrongly projected as 72 per cent (very good) as against the actual credit rating of 28.75 per cent (did not merit for financing).
- The Corporation sanctioned 65 per cent of the project cost as loan instead of 50 per cent eligible as per loan policy.
- The Debt Service Coverage Ratio (DSCR) and IRR of the project was not calculated and considered.
- The outstanding balance as on August 2012 was ₹0.47 crore including arrears of principal of ₹0.35 crore. The Corporation did not invoke Section 29 of the SFC Act.

The Corporation replied that the value of mortgaged property was sufficient to cover the dues and recovery action under RR would give the desired result than take over under Section 29 of the Act. The reply, however, was silent about the irregularities occurred in sanction of loan.

### **Recovery Performance**

**3.45** Recovery can be good only if the project is viable and the promoter shows his commitment to the project by funding initial part of the investments from own funds and offer security. These basic requirements were missing resulting in high default rate and NPAs. Percentage of NPAs was as high as 52 in 2007-08 as shown in the table below:

(₹ in crore)

Particulars	2007-08	2008-09	2009-10	2010-11	2011-12
Standard Assets	359.41	624.69	809.72	1036.06	1199.26
Non-Performing Assets					
-Sub Standard Assets <sup>3</sup>	61.24	75.61	53.18	57.72	46.66
-Doubtful-I Assets <sup>4</sup>	42.46	41.66	30.67	37.10	48.23
-Doubtful-II Assets <sup>5</sup>	44.40	35.29	26.77	23.37	44.58

<sup>3</sup> Assets remained as months NPA for 3 to 21.

<sup>4</sup> Assets remained NPA for 21 to 57 months.

<sup>5</sup> Assets remained doubtful for more than 57 months.

-Loss Assets <sup>6</sup>	246.79	194.59	174.81	155.73	141.96
Total NPA	394.89	347.15	285.43	273.92	281.43
Total Loans and Advances	754.30	971.84	1095.15	1309.98	1480.69
<b>Percentage of NPA to total loans</b>	<b>52</b>	<b>36</b>	<b>26</b>	<b>21</b>	<b>19</b>

**3.46** During the period from 2007-08 to 2011-12, the loans and advances had increased by ₹726 crore whereas the standard assets had increased by ₹840 crore. Basically the increase in standard assets should not be more than that of total loans and advances. The increase in standard asset compared to loans and advances were attributable to rescheduling of loans. Rescheduling of loans resulted in conversion of NPAs to standard assets. The large scale loan write off (₹191.03 crore during April 2008 to March 2012) had also attributed to substantial reduction in NPA.

#### *Extension of OTS*

**3.47** All doubtful loans and loss assets continuing in the same category as on the date of approaching for OTS/Compromise Settlement (CS) are eligible for settlement under the scheme. The other conditions are that the default should not be willful and the borrower did not involve in any fraudulent practice. Thus the benefit of OTS is meant for *bonafide* borrowers only. The fact that the borrowers took loans despite the projects being not viable and/or without making the initial funding indicated that they were not *bonafide* borrowers. Extension of OTS to such category of borrowers was therefore objectionable. But the benefit of OTS/reschedulement of loans was extended to all defaulting borrowers.

- During the review period, in respect of 1179 loan accounts with a total outstanding amount of ₹416.67 crore (March 2012), the Corporation gave a massive benefit of ₹297.73 crore to the defaulters.
- In respect of 431 loan accounts with a total outstanding amount of ₹202.45 crore agreed to be settled under the scheme for ₹105.90 crore, recovery of ₹61.20 crore (March 2012) was pending which worked out to 58 *per cent* of ₹105.90 crore.
- While granting OTS only interest is to be waived and not principal. But we noticed that in respect of 120 loan accounts undue benefit of waiver of ₹12.26 crore was given in principal.
- OTS is a mechanism to be resorted to as a last measure before RR action is initiated. In 339 loan accounts securities to the tune of ₹141.03 crore were available. Takeover of these assets under Section 29 of the Act would have been appropriate. Instead the defaulters were given benefits under OTS by reducing their obligation to ₹56.16 crore as against the outstanding amount of ₹130.50 crore.

**Principal amount of loan to the tune of ₹ 12.26 crore was waived in OTS**

Reply of the Corporation that willful defaulters were excluded from OTS scheme was not acceptable as a test check revealed that in three cases the Corporation had allowed OTS to willful defaulters also.

<sup>6</sup> Nil value assets.

57 units taken over under section 29 of SFC Act was not disposed of

### *Recovery from taken over units*

**3.48** As on 31 March 2012, the number of units taken over by the Corporation and pending disposal was 57 and amount outstanding against them as on that date was ₹92.14 crore (principal ₹9.81 crore and interest ₹82.33 crore). The performance with regard to recovery under Section 29 of the SFC Act was very poor as detailed below:

- During the period under review, the Corporation disposed of only 24 units out of 81 units taken over. This leads to two inferences. Firstly, the Corporation had financed assets which had poor marketability. Secondly, delayed action under Section 29 of SFC Act reduced the value of assets to prospective buyers.
- Out of total 57 units pending disposal, settlement in respect of 26 units (46 *per cent*) was pending for more than ten years and the amount outstanding against such cases was ₹49.02 crore ( principal ₹3.46 crore and interest ₹45.56 crore).
- As per details furnished by three branches (Alapuzha, Pathanamthitta and Kasargod) in seven cases, the value of assets in hand (₹0.48 crore) was even less than the principal amount outstanding (₹0.88 crore) whereas the total amount outstanding was ₹6.36 crore.
- The pending cases in Thiruvananthapuram, Alapuzha and Kattapana alone constituted 51 *per cent* of total units taken over by the Corporation.

The Corporation replied that invoking Section 29 was done only as a last resort and the number of units pending disposal after takeover had reduced from 300 to 57. We, however, observed that the delay in invoking Section 29 reduces the realisability of the assets to be taken over and majority of units taken over were yet to be disposed of, which included cases pending disposal for more than ten years.

### *Recovery under RR Act*

**3.49** The Corporation had been initiating action under Kerala Revenue Recovery Act, 1968 to recover arrears in repayments. The amount recovered was ₹74.71 crore during the years 2010-11 and 2011-12. As on 31 March 2012, an amount of ₹104.21 crore towards principal and ₹1495.54 crore towards interest was pending in respect of 1142 cases.

As per the details furnished by eleven branches (out of sixteen) the age-wise pendency of RR cases as on 31 March 2012 were as follows:

(₹ in crore)

Period of pendency	Cases having security			Cases having no security	
	Nos.	Asset value	Principal outstanding	Nos.	Principal outstanding
Up to five years	53	46.43	18.06	7	0.58
Five to ten years	125	85.57	20.71	52	7.50
More than ten years	76	18.19	6.68	252	18.62

The Corporation replied that the reduction in recovery under RR Act was due to settlement of more D3 (loss assets) cases under CS scheme. The reply did not reflect our observation about huge volume of RR cases pending, which includes 329 cases involving ₹135.06 crore stayed by the State Government and the Corporation itself.

### Case study

#### Protection to defaulters from recovery proceedings

**3.50** We observed that the defaulting borrowers were favoured by the Corporation (306 cases of ₹114.55 crore) and Hon'ble Ministers/Government (23 cases of ₹20.51 crore) halting recovery of dues. The details are given in the table below:

Sl. No	Name of the borrower	Amount Disbursed	Dues as on 31 August 2012	Deficiencies in recovery	Further observations
		(₹ in crore)			
1.	Jayalakshmi Builders Pvt. Ltd.	1.50	13.26	<ul style="list-style-type: none"> <li>Release of property on two occasions without collecting dues even after invoking Section 29 of SFC Act.</li> </ul>	<ul style="list-style-type: none"> <li>Personal guarantee of promoter/directors was not obtained.</li> <li>No action was taken to maintain the quality of asset taken over in October 2006. Hence the quality deteriorated heavily due to passage of time.</li> <li>Disposal of the taken over asset was stayed by the then Finance Minister in 2007.</li> </ul>
2	Supreme Milk Ltd.	2.15	10.90	<ul style="list-style-type: none"> <li>Though Section 29 of the SFC Act was invoked, the property was not sold.</li> <li>On two occasions, the then Revenue Minister imposed stay.</li> </ul>	<ul style="list-style-type: none"> <li>The promoter was absconding and the property was leased out without the knowledge of the Corporation. The Corporation did not file criminal case against the promoter.</li> <li>The Corporation sanctioned (March 2008) OTS which was extended four times up to June 2010. No amount had been remitted till date (March 2012).</li> </ul>

3	Chaithram Cares Pvt. Ltd.	1.86	5.09	<ul style="list-style-type: none"> <li>Section 29 of the SFC Act was not invoked.</li> <li>RR action initiated (November 2009) was stayed (February 2012) by the then Chief Minister.</li> <li>Personal property of the promoters was not attached.</li> </ul>	<ul style="list-style-type: none"> <li>The original schedule of repayment was up to March 2009 and it was rescheduled in February 2005 extending the repayment period up to August 2011. However, the loanee did not make any payment.</li> </ul>
4	Fathima Foods and Proteins Pvt. Ltd.	0.93	1.33	<ul style="list-style-type: none"> <li>Section 29 of the SFC Act was not invoked.</li> <li>Revenue recovery initiated (January 2010) was set aside due to Government intervention.</li> </ul>	<ul style="list-style-type: none"> <li>The loanee had submitted 42 postdated cheques of closed bank account indicating that the loanee had no intention to repay.</li> <li>Despite this, the Corporation did not file criminal case against the loanee.</li> </ul>
5	Bentek Cables Pvt. Ltd.	0.39	1.29	<ul style="list-style-type: none"> <li>Section 29 of the SFC Act was not invoked.</li> <li>RR action was stayed by the then Finance Minister.</li> </ul>	<ul style="list-style-type: none"> <li>OTS was offered for ₹0.60 crore against which the loanee remitted only ₹0.17 crore.</li> </ul>
6	Salih Industrial Enterprise Pvt. Ltd.	0.60	9.05	<ul style="list-style-type: none"> <li>Though Section 29 of the SFC Act was invoked, the property was not disposed of.</li> </ul>	<ul style="list-style-type: none"> <li>The property taken over (February 1997) was not disposed of even after twelve years (October 2009).</li> <li>The property was returned (October 2009) to the loanee due to Government intervention.</li> <li>Though the Corporation agreed for the OTS amount of ₹0.63 crore offered by the loanee, the loanee paid only ₹10 lakh.</li> <li>The Corporation failed to recover the dues even after twenty five years</li> </ul>

The Corporation replied that action under RR was more desirable than takeover of the defaulted unit under Section 29 of the Act and agreed that intervention of the State Government had delayed the recovery under RR Act. The Corporation did not contest the other observations and the fact remained that in the above cases the Corporation failed to recover the dues by initiating coercive action.

**3.51** Deficiencies in recovery process resulted in the borrowers being able to thwart recovery through courts (124 cases of ₹32.48 crore). We also noticed serious deficiencies in other cases as detailed below:

Sl. No	Name of the borrower	Amount Disbursed	Dues as on 31 August 2012	Deficiencies in recovery	Further observations
		(₹ in crore)			
1	Rukmoni Memorial Devi Hospital	6.64	9.54	Section 29 of the SFC Act was not invoked	<ul style="list-style-type: none"> <li>No collateral security was obtained.</li> <li>Additional loan of ₹2.08 crore was disbursed when previous loan of ₹4.57 crore was under default.</li> <li>Utilisation of funds was not ensured, thereby funds were diverted.</li> <li>No mechanism was evolved to ensure recovery through remittance of daily collection from the hospital</li> </ul>
2	Palanattil Construction Company Ltd.	1.80	5.48	Unable to take action under Section 29 of the Act.	<ul style="list-style-type: none"> <li>The loan was towards working capital assistance for completion of over bridge for Public Works Department.</li> <li>The collateral security accepted was not disposable. The land accepted was located in a highly elevated rocky place which was not even accessible.</li> <li>Though land was valued (2000) at ₹2.71 crore, the upset value fixed (2007) was only ₹1.62 crore indicating inflated valuation.</li> <li>The Corporation did not file criminal case against borrower though one of the post dated cheque was dishonoured. Remaining two cheques were not presented on due date, thus favouring the borrower.</li> </ul>
3	Moolan Modern Rice Mill	0.99	4.39	Section 29 of the SFC Act invoked was not fruitful.	<ul style="list-style-type: none"> <li>The property was taken over (2003) by Revenue Authorities and sold (2007) to recover sales tax dues.</li> <li>The Collateral security remained in the possession of the Revenue Authorities despite lapse of eight years.</li> </ul>
4	Panchami Exporters Pvt. Ltd.	1.45	9.70	Section 29 of the SFC Act invoked was not fruitful.	<ul style="list-style-type: none"> <li>Though the unit was taken over (March 2001) it was not sold. The Revenue Authorities attached (January 2004) and sold (July 2007) the industrial land to recover the sales tax dues.</li> <li>The collateral security was under the custody of official liquidator.</li> <li>Despite this the Corporation sanctioned two loans (₹1.40 crore and ₹1.20 crore) to the sister concern (Panchami Pack Kerala Pvt. Ltd.).</li> </ul>
5	St Mary's Properties .	1.50	18.96	Section 29 of the SFC Act invoked was not fruitful.	<ul style="list-style-type: none"> <li>Hon'ble High Court of Kerala ordered (October 2002) for winding up and the official liquidator sold (March 2008) properties of sister concerns for ₹17.10 crore. The claims of all creditors were settled except that of the Corporation.</li> <li>The Corporation filed claim petition for ₹15.05 crore only in December 2010.</li> <li>The loan account has not been settled so far.</li> </ul>

The Corporation stated that it was difficult to take over hospitals under Section 29 of the Act and in other cases the Corporation had initiated action to take over the units, wherever it became possible. The fact, however, remained that the Corporation failed to recover the dues.

### Internal/Concurrent Audit

**3.52** The Internal Audit team consisting of officers from general, legal and technical sections was reporting to the Deputy General Manager (IA&IW), who in turn reported directly to the Chairman and Managing Director. The periodicity of internal audit was generally six months and days allotted ranged from two to five days. The system of internal audit was replaced with concurrent audit from December 2011 onwards. The Chartered Accountants appointed as Concurrent Auditors do the audit of branch offices as per directions given by the Board of Directors. Manager Accounts and Head of Department (Internal Audit) co-ordinate the concurrent audit and initiate follow up action on the recommendations of the Concurrent Auditors.

**3.53** As discussed above, we noticed significant deviations from the approved loan policies, loan recovery policies, OTS/CS guidelines and provisions of the SFC Act (in 48 loan cases in 8 branch offices). The major lapses noticed were sanction of loans to ineligible units, exceeding the exposure limit in loan sanctions, disbursements without matching contribution by promoter, sanction of loan based on wrong credit rating, wrong IRR, DER, DSCR, inadequate security and unauthorised constructions etc. None of the above lapses were reported in the internal/concurrent audit reports, except some minor observations such as missing of Field Officer report, monitoring cards, preliminary screening report etc and statistical information regarding RR cases, undisbursed credit cases etc. This indicated that either the Internal Auditors lacked professional competence or they did not have freedom to comment on serious deficiencies in decisions taken at higher levels of management.

### Conclusions

**Recovery can be effective only if the project is viable and the promoter shows his commitment to the project by funding the initial part of the investments from own funds and offer security. These basic requirements were not ensured resulting in high default and NPAs. The Corporation had to forgo ₹297.73 crore due to defective disbursements. Rescheduling of loans etc, resulted in overstated profit/income shown in the accounts despite uncertainty of realisation. Due to poor performance of the Corporation, the Government/financial institutions also had to suffer to the tune of ₹105 crore by agreeing to adjust losses against their equity contribution. Belated action under Section 29 of SFC Act resulted in non disposal of 57 units taken over. Deficiencies were found in rescheduling of loans. The recovery under RR Act suffered due to intervention of Government/Hon'ble Ministers. Deficiencies in recovery process also resulted in borrowers being able to thwart recovery through Courts. Internal Audit lacked professional approach and failed to point out the major deficiencies in disbursement and recovery stages.**

## **Recommendations**

- **The Corporation should adhere to the prescribed rules/regulations/procedures while sanctioning and disbursing the loans.**
- **No disbursement should be made unless the IRR is significantly higher than the rate of interest charged, the promoters have professional competence to run business on profitable lines, sufficient collateral security free of encumbrance is obtained and promoter indicates his commitment to ensure success of the project by financing the initial investment of the project.**
- **The disbursement of funds should be done in a phased manner linked to progress of work to address the risk of diversion of funds.**
- **Despite taking all safeguarding measures as mentioned above, if the borrower defaults in payment, there should be immediate action by invoking Section 29 of the SFC Act as any delay reduces the prospects of finding takers for the asset.**
- **Recovery mechanism needs to be effective to generate resources for funding new projects without having to depend on expensive external borrowings.**
- **There should be no lack of commitment in prompt recovery under RR Act. The procedures adopted should be in consonance with legal requirements to deny the opportunity to the borrowers to shield themselves from recovery proceedings by taking legal recourse.**
- **Sanctions and disbursements involving serious irregularities may be investigated.**
- **Internal Audit should be professional in their approach and should not hesitate to point out deficiencies in the working.**