



TWELFTH KERALA LEGISLATIVE ASSEMBLY

**COMMITTEE
ON
PUBLIC UNDERTAKINGS
(2006-2008)**

FORTIETH REPORT

(Presented on 10th March, 2008)

SECRETARIAT OF THE KERALA LEGISLATURE
THIRUVANANTHAPURAM
2008

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On

**Kerala Financial Corporation based on the Report of the
Comptroller and Auditor General of India for the
year ended 31-3-2004 (Commercial)**

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INTRODUCTION

I, the Chairman, Committee on Public Undertakings (2006-08), having been authorised by the Committee to present the Report on their behalf, present this Fortieth Report on Kerala Financial Corporation based on the Report of the Comptroller and Auditor General of India for the year ended 31st March 2004, (Commercial) relating to the Government of Kerala.

The Report of the Comptroller and Auditor General of India for the year ended 31-3-2004 (Commercial) was laid on the Table of the House on 5-7-2005. The consideration of the audit paragraphs included in this Report and the examination of the departmental witness in connection thereto were made by the Committee on Public Undertakings constituted for the years 2006-2008.

This Report was considered and approved by the Committee at the meeting held on 5-2-2008.

The Committee place on record their appreciation of the assistance rendered to them by the Accountant General (Audit), Kerala, in the examination of the Audit Paragraphs included in this Report.

The Committee wish to express their thanks to the officials of the Finance Department of the Secretariat and Kerala Financial Corporation for placing before them the materials and information they wanted in connection with the examination of the subject. They also wish to thank in particular the Secretary to Government, Finance Department and the officials of Kerala Financial Corporation, who appeared for evidence and assisted the Committee by placing their considered views before the Committee.

Thiruvananthapuram,
10-3-2008.

MANKODE RADHAKRISHNAN,
Chairman,
Committee on Public Undertakings.

REPORT

ON

KERALA FINANCIAL CORPORATION

AUDIT PARAGRAPH

Cash loss due to unauthorised waiver

Unauthorised waiver of principal amount of loan and expenses under the One Time Settlement Scheme resulted in cash loss of Rs. 3.33 crore.

The Corporation introduced (August 1994) One Time Settlement scheme (OTS) for realisation of Non-Performing Assets classified as 'Doubtful II'. The scheme was being reviewed from time to time and as per the latest modification (September 2002), the scheme was applicable only in respect of accounts classified as Doubtful II as on 1st April 2002 where loan amount sanctioned was up to Rs. 5 lakh and did not have any kind of securities/assets. Remittance of principal amount and miscellaneous expenses like suit expenses, insurance, security expenses, etc., was a pre-requisite for closure of account.

A test check of 760 cases of loans settled (June 1999 to December 2003) under the OTS scheme in the four branches of the Corporation at Kollam, Kottayam, Ernakulam and Trivandrum revealed that in 126 cases waiver of principal amount of loans (Rs. 3.18 Crore) and expenses (Rs. 14.81 lakh) was allowed deviating from the specific guidelines under the OTS.

Thus, the unauthorised waiver of principal amount of loan and expenses under the One Time Settlement Scheme resulted in cash loss of Rs. 3.33 crore. Failure to take remedial action on the above lapses despite provisions in the guidelines for subsequent verification of the settled cases by internal audit indicated deficiency in the internal control system on loan transactions.

The Management stated (March 2004) that in some cases the Corporation was not in a position to recover even the principal amount outstanding and in such cases the OTS amount was fixed below the outstanding principal resulting in waiver of principal and other expenses. The reply is not acceptable since the scheme itself as approved by the Board, was non-discretionary and the purpose of the scheme was defeated by allowing unauthorised waiver of principal amount and expenses leading to cash loss.

The matter was reported to Government (April 2004); their reply had not been received (September 2004).

[Audit Paragraph 3.17 contained in the Report of the Comptroller and Auditor General of India for the year ended 31-3-2004 (Commercial).]

Notes on Audit paragraph received from Government is given in Appendix II.

1. The Committee enquired about the circumstances under which the Corporation decided to settle 126 cases of loans, under OTS scheme by waiving principal amount of Rs. 3.18 crore and expenses of Rs. 14.81 lakh in contravention of the guidelines issued by Government. The witness replied that all cases were not referred to the OTS scheme and 91 cases have been settled in this way. The principal amount involved in these 91 cases was Rs. 518.62 lakh. Rs. 273.36 lakh has been collected under the OTS scheme and there has been a sacrifice of Rs. 245.26 lakh. The principal amount too have been written off because in many cases, there is no way by which these can be recovered. The Committee pointed out that the Corporation did not have the power to write off principal amount. The witness stated that according to the general guideline of OTS scheme, principal amount can not be waived. But some specific cases were taken one by one and sometimes the settlement was made below the principal amount. The Committee wanted to know the details of officials empowered to taken such a decision. The witness informed that there were committees at three levels namely, the Settlement Committee, Executive Committee and Board Committee. The Settlement Committee could take a decision. For amounts less than Rs. 7.5 lakh, For higher amounts, the Executive and Board Committees would take the decision. All cases of write-off of principal amount would come before the Board and all the cases included in the audit paragraph have been ratified by the Board, the witness added. The Committee pointed out that this information was not included in the statement given by Government to the audit objection. The witness clarified that as per the accounting system followed by the Corporation the remittance would first be adjusted towards interest and then to the principal amount because if accounted against the principal amount first the company would not be able to recover the interest. The witness stated that even in the OTS scheme, the Corporation had collected amount more than the principal amount outstanding. The Committee did not accept the justification of the witness as the amount being given as loan by the corporation were often borrowed by the Corporation from other sources and the Corporation had to pay interest for those loans.

2. The Committee opined that guidelines under OTS were issued only after considering the system of accounting followed by the Corporation and enquired the reason for waiving of principal and expenses amount of loan. The witness stated that in normal cases OTS is fixed on the basis of the principal amount outstanding, but in some cases the Company will not be in a position to recover the full amount of principal outstanding, due to the lack of sufficient securities. In such cases the OTS is fixed below the principal amount. The Committee remarked that being a re-financing agency, the waiving of principal amount at any circumstance is not favourable to the Corporation and it is also

the violation of guidelines. The Committee enquired whether it has been approved by the Board or Government. The witness replied that the 91 cases were settled with the approval of the Board and Government sanction has not been obtained. The Committee pointed out that the corporations officials were violating the Boards' direction that there should not be write-off of the principal amount. The witness stated that it was a general guideline and in specific cases Board would give direction for write-off.

Conclusions / Recommendations

3. The Committee finds that the Corporation is not impartial in its dealings with loanees and shows undue favour towards some of them. The Committee recommends that the Corporation should be impartial in all its dealings with loanees especially in the matter of collateral security and write-off of loans. The Committee opines that waiver of principal amount of loans and expenses was allowed deviating from the specific guidelines under the OTS and unauthorised write-off of principal amount is not acceptable and the Board's decision in this matter should be examined by Government in detail, and reported to the Committee urgently. The Committee desires to be given details of the cases of write-off of principal amount pointed out by Audit.

AUDIT PARAGRAPH

Unjustified payment of brokerage and underwriting commission

Corporation made unjustified payment of brokerage and underwriting commission amounting to Rs. 52.42 lakh to direct subscribers.

The Corporation is empowered under Section (1) of the State Financial Corporations Act, 1951 to borrow money for working capital by issue of bonds. As a part of resource mobilisation during the three years up to 31st March 2003, the Corporation floated notice for public issue of Statutory Liquidity Ratio (SLR) bonds at interest rates ranging from 6.75 to 11.33 per cent per annum; against which subscription was received for a total amount of Rs. 109.80 crore. Audit noticed that the subscription was received directly from the nationalised banks, co-operative banks, etc., and no agent, broker or underwriter was involved.

Despite being aware of the impropriety in paying brokerage and underwriting commission directly to subscribers, the Corporation paid brokerage and commission aggregating Rs. 52.42 lakh to 53 out of 63 direct subscribers during the three years up to 31 March 2003.

Thus, the payment of brokerage and underwriting commission amounting to Rs. 52.42 lakh to the direct subscribers of bonds was not justified.

Government/Management stated (June/July 2004) that the brokerage and commission was paid to get the full subscription or maximum subscription for bonds. The reply is not acceptable since at the time of deciding issue of the

bonds the Corporation was aware of the impropriety in paying brokerage and commission for direct issue of bonds. In fact the management of issue of bonds was taken over by the Corporation from State Bank of Travancore with a view to save the expenses on brokerage, commission, etc.

[Audit paragraph No. 3.18 contained in the Report of the Comptroller and Auditor General of India for the year ended 31-3-2004. (Commercial).]

Notes on Audit paragraph received from Government is given in Appendix II.

4. The Committee wanted to know the reasons for paying brokerage and underwriting commission of Rs. 52.42 lakh directly to the subscribers of SLR Bonds when no broker, agent or underwriter was involved. The witness explained that Kerala Financial Corporation is working as per the provisions of the State Financial Corporations (SFC) Act of 1951 and not as per Companies Act. Hence provisions of Companies Act and the guidelines of SEBI are not applicable to the Kerala Financial Corporation. The Committee pointed out that Kerala Financial Corporation was specifically notified by Government as a designated financial institution and that provisions of Companies Act 1956 and other applicable laws relating to the listing requirements of Stock Exchanges wherever applicable should be complied with by designated Financial Institutions. The witness stated that bonds were arranged by Reserve Bank of India and Kerala Financial Corporation was following the directions of the Reserve Bank of India. The SLR bonds issued by the Corporation are only promissory notes for a particular class of subscribers like LIC, Banks etc. and not public issue. To the Committee's query, the witness replied that SIDBI is the controlling authority of the Corporation and that they had taken up this issue with small Industries Development Bank of India who had informed that Kerala Financial Corporation is neither a listed company nor are the SLR bonds issued by Kerala Financial Corporation listed securities, and hence relevant SEBI guidelines regarding public issue are not applicable to Kerala Financial Corporation vide their letter No. 2249/DFID/SFCs/KFC.dated July 13, 2004 (Appendix—III).

Conclusions/Recommendations.

5. No Comments.

Thiruvananthapuram,
10-3-2008.

MANKODE RADHAKRISHNAN,
Chairman,
Committee on Public Undertakings.

APPENDIX I

Summary of main Conclusions/Recommendations

<i>Sl. No.</i>	<i>Para No.</i>	<i>Department Concerned</i>	<i>Conclusions/Recommendations</i>
1	3	Finance Department	The Committee finds that the Corporation is not impartial in its dealings with loanees and shows undue favour towards some of them. The Committee recommends that the Corporation should be impartial in all its dealings with loanees especially in the matter of collateral security and write-off of loans. The Committee opines that waiver of principal amount of loans and expenses was allowed deviating from the specific guidelines under the OTS and unauthorised write-off of principal amount is not acceptable and the Board's decision in this matter should be examined by Government in detail, and reported to the Committee urgently. The Committee desires to be given details of the cases of write-off of principal amount pointed out by Audit.

APPENDIX II

Notes furnished by Government on the Audit Paragraphs**I. AUDIT PARAGRAPH 3.17**

- | | | | |
|----|-----|---|--|
| 1. | (a) | Department | Finance |
| | (b) | Subject/Title of the Review/Paragraph | Kerala Financial Corporation
Cash loss due to unauthorised waiver
Unauthorised waiver of principal amount of loan and expenses under the One Time Settlement Scheme resulted in cash loss of Rs. 3.33 crore. |
| | (c) | Paragraph Number | 3.17 |
| | (d) | Report Number and Year | 2003-04 |
| 2. | (a) | Date of receipt of the Draft Paragraph/Review in the Department | 22-9-2004 |
| | (b) | Date of Department's Reply | 13-1-2005 |
- The Corporation introduced (August 1994) One Time Settlement scheme (OTS) for realisation of Non-Performing Assets classified as Doubtful II*. The scheme was being reviewed from time to time and as per the latest modification (September 2002), the scheme was applicable only in respect of accounts classified as Doubtful II as on 1st April 2002 where loan amount sanctioned was up to Rs. 5 lakh and did not have any kind of securities/assets. Remittance of principal amount and miscellaneous expenses like suit expenses, insurance, security expenses, etc., was a pre-requisite for closure of account.

As test check of 760 cases of loans settled (June 1999 to December 2003) under the OTS scheme in the four branches of the Corporation at Kollam, Kottayam, Ernakulam and Trivandrum revealed that in 126 cases waiver of principal amount of loans (Rs. 3.18 crore) and expenses (Rs. 14.81 lakh) was allowed deviating from the specific guidelines under the OTS.

3. Gist of Paragraph/Review

Thus, the unauthorised waiver of principal amount of loan and expenses under the One Time Settlement Scheme resulted in cash loss of Rs. 3.33 crore. Failure to take remedial action on the above lapses despite provisions in the guidelines for subsequent verification of the settled cases by internal audit indicated deficiency in the internal control system on loan transactions.

The Management stated (March 2004) that in some cases the Corporation was not in a position to recover even the principal amount outstanding and in such cases the OTS amount was fixed below the outstanding principal resulting in waiver of principal and other expenses. The reply is not acceptable since the scheme itself as approved by the Board was non-discretionary and the purpose of the scheme was defeated by allowing unauthorised waiver of principal amount and expenses leading to cash loss.

The matter was reported to Government (April 2004); their reply had not been received (September 2004).

4. (a) Does the Department agree with the facts and figures included in paragraph ?

No

- (b) If not, please indicate the areas of disagreement and also attach copies of relevant documents in support

The Corporation is following the cash system of accounting and whatever remittances received will adjust first towards interest and then to principal as per the disclosed set of orders. As such whatever remittances were made under OTS will first appropriated against the interest and the remaining part will be the principal. The remittances are made through the computer system and the write off was occurred due to the existing computer system of the corporation and the set off policy followed by the Corporation. Even in the OTS settlement, Corporation has collected more than the principal amount. Because of the set off policy followed in the Corporation while passing the final entry of closure of loans under OTS will lead to write off of principal dues. There were some discrepancies in accounting when the remittances were first credited in suspense account and then to party's loan account. In order to set right the matter, the board has decided to account the OTS remittance also in the normal way of appropriation.

5. (a) Does the Department agree with the Audit Conclusions ?

No

- (b) If not, please indicate specific areas of disagreement with reasons for disagreement and also attach relevant documents, where necessary
6. Remedial Action Taken
- In normal case OTS is fixed on the basis of the principal outstanding, but in some cases Corporation will not be in a position to recover the principal outstanding and in such cases the OTS amount is fixed below the principal amount. The total number of cases referred is 119 and not 126. Out of this 91 cases have been settled under OTS. The Principal involved is Rs. 518.62 lakh. The OTS settlement was for Rs. 273.36 lakh. There has been a sacrifice of Rs. 245.26 lakh against the Principal.
- The Board of the Corporation has taken a decision to appropriate the OTS remittances also in the normal gross recovery account to overcome certain accounting problems. Considering the observation of the Accountant General, a decision has been taken to open a separate account to book all remittances under OTS and appropriate the same at the time of passing the final entries. The account head is exclusively for the accounting of OTS remittances. The Corporation is going on ahead with recovery steps to realise the dues from 28 cases out of 119 which have not yet settled, in spite of the concession granted.

II AUDIT PARAGRAPH 3.18

- | | | |
|----|---|---|
| 1. | (a) Department | Finance Department |
| | (b) Subject/Title of the Review/Paragraph | <p>Kerala Financial Corporation</p> <p>Unjustified payment of brokerage and under writing commission.</p> <p>Corporation made unjustified payment of brokerage and underwriting commission amounting to Rs. 52.42 lakh to direct subscribers.</p> |
| | (c) Paragraph number | 3.18 |
| | (d) Report number and year | 2003-04 |
| 2. | (a) Date of receipt of the Draft Paragraph/Review in the Department | 7-5-2004 |
| | (b) Date of Department's Reply | 27-7-2004 |
| 3. | Gist of Paragraph/Review | <p>The Corporation is empowered under Section (1) of the State Financial Corporations Act, 1951 to borrow money for working capital by issue of bonds. As a part of resource mobilization during the three years up to 31st March 2003, the Corporation floated notice for public issue of Statutory Liquidity Ratio (SLR) bonds at interest rates ranging from 6.75 to 11.33 per cent per annum; against which subscription was received for a total amount of Rs. 109.80 crore. Audit noticed that the subscription was received directly from the nationalized banks, co-operative banks, etc, and no agent, broker or underwriter was involved.</p> |

Despite being aware of the impropriety in paying brokerage and underwriting commission directly to subscribers the Corporation paid brokerage and commission aggregating Rs. 52.42 lakh to 53 out of 63 direct subscribers during the three years up to 31st March 2003.

Thus, the payment to brokerage and underwriting commission amounting to Rs. 52.42 lakh to the direct subscribers of bonds was not justified.

Government/Management stated (June/ July 2004) that the brokerage and commission was paid to get the full subscription or maximum subscription for bonds. The reply is not acceptable since at the time of deciding issue of the bonds the Corporation was aware of the impropriety in paying brokerage and commission for direct issue of bonds. In fact the management of issue of bonds was taken over by the Corporation from State Bank of Travancore with a view to save the expenses on brokerage, commission, etc.

4. (a) Does the Department agree with the facts and figures included in paragraph ?

No

- (b) If not, please indicate the areas of disagreement and also attach copies of relevant documents in support

Section 4A of the Companies Act 1956 deals with the public financial institution. But Kerala Financial Corporation is governed by the SFC's Act 1951 and not by the Companies

Act. This matter has already been confirmed by SIDBI in its letter dated 17-6-2004. Therefore the provisions of the Companies Act are not applicable to the Corporation. The SLR Bonds issued by the Corporation is only a promissory note as per legal advice received by the Corporation. This is an instrument used for long-term borrowings. As such the guidelines 3.6 of SEBI is not applicable to the Corporation.

It is stated that the interest was comparable to the rate of similar issue in the market. But the timing of the issue is also important as the rate of interest. It was the practice that the SLR Bonds are given to the Corporation either along with the issue of the Government Bonds or subsequent to the issue of the Bonds by the Government. But the subsequent issue of the Corporation may or may not be a successful one. Moreover, the SLR Bonds of the Corporation is for particular class of subscribers viz. LIC, Banks, General Insurance, and PF Trusts.

SIDBI, when consulted, as informed the Government that Kerala Financial Corporation is neither a listed company nor are the SLR Bonds issued by Kerala Financial Corporation listed securities, and the relevant SEBI guidelines regarding public issue would not be applicable.

5. (a) Does the Department agree with the Audit Conclusions ? No

- | | |
|--|---|
| (b) If not, please indicate specific areas of disagreement with reasons for disagreement and also attach relevant documents, where necessary | As opined by SEBI, considering that KFC is neither a listed company nor are the SLR Bonds issued by KFC listed securities, the relevant SEBI guidelines regarding public issue would not be applicable. More over, terms or issue are decided by RBI and SEBI is kept informed of KFC's market borrowing programme. Copy of the letter from SIDBI is attached herewith. |
|--|---|

Remedial Action Taken

- | | | |
|---|--|--|
| 1 | Improvement in system and procedures including internal controls | Not necessary, as Kerala financial Corporation is no longer issuing such bonds |
| 2 | Recovery of overpayment pointed out by Audit | Not possible, this is not necessary also |
| 3 | Recovery of under assessment, short levy or other dues | Not applicable |
| 4 | Modification in the schemes and programmes including financing pattern | Kerala Financial Corporation is no longer issuing such bonds |
| 5 | Review of similar cases/ complete scheme/project in the light of findings of sample check by Audit | Not applicable |

APPENDIX III

SIDBI NO. 2249/DFID/SFCs/KFC

July 13, 2004.

Shri K. Jose Cyric,
Principal Secretary (Finance),
Government of Kerala,
Finance (PUA) Department,
Government Secretary,
Thiruvananthapuram-695001

Dear Sir,

**Kerala Financial Corporation-Issue of SLR
Bonds-Violation of SEBI guidelines**

Please refer to your letter No. 48612/PUA1/Fin. dated May 27, 2004 on the captioned subject. In this connection, we advise that, as opined by SEBI, considering that Kerala State Financial Corporation is neither a listed company nor are the SLR Bonds issued by KFC are listed securities, the relevant SEBI guidelines regarding public issue would not be applicable.

It may be mentioned here that, the terms of issue are decided by RBI and SEBI is kept informed of the SFCs market borrowing programme.

Yours faithfully,

(Sd)

(U. R. Tata)
General Manager