CHAPTER IV
CHIEF CONTROLLING OFFICER BASED AUDIT

INDUSTRIES DEPARTMENT

4.1 Chief Controlling Officer based audit of Directorate of Industries and Commerce

Highlights

Creation of a conducive environment is essential for the rapid industrialization of the State. The micro, small and medium enterprises (MSME) sector contributes significantly to the manufacturing output and employment opportunity in the country. The Directorate of Industries and Commerce aims at promoting MSMEs in the State. A Chief Controlling Officer based audit of the Directorate revealed the following deficiencies:

Deficiencies were noticed in monitoring of industrial plots allotted to entrepreneurs.

(Paragraph 4.1.7)

Delays ranging from four to 34 months were noticed in sanctioning of State investment subsidies.

(Paragraph 4.1.8.1)

Financial assistance by way of margin money loans, State investment subsidies and share capital contribution was disbursed without assessing the capability of the beneficiaries to utilize the amount for the intended purpose. No effective safeguards were put in place to recover the funds in case of non-adherence to the stipulated conditions. This resulted in very high default rates in repayment of loans and retirement of share capital contribution.

(Paragraphs 4.1.9 and 4.1.10)

The internal control mechanism in the Directorate was not effective.

(Paragraph 4.1.12)

4.1.1 Introduction

The Directorate of Industries and Commerce (Directorate) is the Chief Controlling Office of the 14 District Industries Centres of Kerala, the Common Facility Service Centres at Changanasserry and Manjeri and the Documentation Centre at Thiruvananthapuram. The Directorate is responsible for promoting/sponsoring, registering, financing and advising micro, small and medium enterprises (MSME) in the State. The MSMEs are the second highest employment providers in the State after agriculture. The vision of the Directorate is to make Kerala a hub for MSMEs. Its mission is to act as a facilitator, service provider and a catalyst for promoting and sustaining the MSMEs as well as the coir and handloom sectors of the State.

4.1.2 Organisational Set-up

The administrative head of the Industries and Commerce Department is the Principal Secretary to the Government. The Directorate of Industries and Commerce located at Vikas Bhavan, Thiruvananthapuram, is headed by the Director (Industries & Commerce). This is the functional arm of the department implementing various industrial activities and is responsible for promoting/sponsoring, registering, financing and advising Micro, Small or Medium Enterprise (MSMEs) industries in the State. The role of the directorate is to act as a facilitator for industrial promotion and sustainability of MSME and traditional industrial sector in the State. The directorate is the controlling office of the 14 District Industries Centres, Common Facility Service Centres at Changanacherry and Manjeri and a Documentation Centre at Thiruvananthapuram. The District Industries Centres are headed by General Managers and there are Taluk level officers under them for industrial promotional activities under their jurisdiction.

4.1.3 Audit Coverage and Methodology

A Chief Controlling Officer (CCO) based audit of the Directorate of Industries and Commerce was conducted during March – July 2011, covering the period from 2006-07 to 2010-11. During audit, the records of the Directorate, four[74] (out of 14) District Industries Centres (DICs), eight Taluk Industries Offices, one Common Facility Centre and two autonomous bodies viz. the Kerala Bureau of Industrial Promotion (K-Bip) and the Kerala Institute of Entrepreneur Development (KIED) were test-checked. The selection of DICs was made based on probability proportionate to size without replacement (PPSWOR) sampling. An entry conference was held (June 2011) with the Director of Industries and Commerce wherein the audit objectives, criteria, sample and scope of audit were explained. Audit findings were discussed in the exit conference held with the Secretary to Government, Industries Department in October 2011. The views of the Government/ Directorate have been taken into consideration for finalising the Audit Report.

4.1.4 Audit Objectives

The CCO based audit of the directorate was undertaken to assess whether:

- the financial management was effective, efficient and economical;
- scheme management was effective to achieve the annual plan targets; and
- the Directorate had adequate infrastructure to monitor the schemes and the monitoring system was operating effectively and efficiently.

4.1.5 Audit Criteria

The following audit criteria were adopted:

- Rules, notifications, guidelines and instructions issued by the Government;

[74] Ernakulam, Idukki, Kannur and Thiruvananthapuram.

- Departmental Manual/Policies/Rules and Regulations;
- State Financial Rules;
- Economic Review 2010, Planning Commission reports, etc.;
- Files, Registers and other documents of the Directorate.

Audit Findings

The important deficiencies noticed during audit are discussed in the succeeding paragraphs.

4.1.6 Financial Management

Funding for the functioning of the Directorate is done through provisions in the State budget for the Industries Department. The Kerala Budget Manual prescribes the manner in which departmental estimates are to be prepared and submitted in time for preparation of the annual budget in a realistic manner. Analysis of budget allotments and expenditure in audit revealed the following deficiencies:

4.1.6.1 Budget allocation and expenditure

Paragraph 14 of the Kerala Budget Manual states that estimates should always receive careful personal attention of the departmental officers who submit them and they should ensure that the estimates are neither inflated nor underpitched, but as accurate as practical. **Table 4.1** shows the allocation and expenditure under heads operated by the Directorate.

Table 4.1: Allocation and expenditure under heads operated by the Directorate

(₹ in crore)

Major head	2006-07		2007-08		2008-09		2009-10		2010-11	
	Plan	Non Plan	Plan	Non Plan	Plan	Non Plan	Plan	Non Plan	Plan	Non Plan
Total Allocation	42.57	20.86	15.54	22.80	43.19	22.99	40.46	24.93	39.58	27.73
Total Expenditure	31.12	18.41	12.93	20.25	39.64	22.60	39.84	24.32	37.72	26.28
Excess(+) Savings(-)	(-)11.45	(-)2.45	(-)2.61	(-)2.55	(-)3.55	(-)0.39	(-)0.62	(-)0.61	(-)1.86	(-)1.45

Source: Figures furnished by the Directorate.

During the year 2006-07, there were considerable savings. In the subsequent years i.e. 2008-09 to 2010-11, though there were savings, the utilization of funds was very close to the budget allotment, indicating good estimation of budget requirements.

4.1.6.2 Supplementary Grants

Paragraph 89 of the Kerala Budget Manual stipulates that the primary responsibility in respect of proposals for supplementary appropriations is that of the Chief Controlling Officer (CCO) who should, therefore, act with utmost precaution in submitting such proposals. The CCO is required to submit the proposals for supplementary grants only after ensuring that the expenditure could not be foreseen at the time of original estimates were framed and that the expenditure cannot, in the public interest, be postponed to the next financial year.

As seen from **Table 4.2**, supplementary grants were obtained but their utilization was 'Nil' indicating incorrect assessment of requirements.

Table 4.2: Details of Supplementary grants obtained

(₹ in lakh)

Year	Head of account	Original provision	Supplementary obtained	Actual expenditure	Savings (*per cent*)
2006-2007	2851-00-102-49-P	-	50	-	100
2006-2007	4858-60-190-86-P	-	756	-	100
2007-2008	4851-00-102-94-P	-	200	-	100
2007-2008	4859-02-190-96-P	-	1500	-	100
2010-2011	2851-00-102-45-NP	-	200	-	100

Source: Data compiled from Detailed Appropriation Accounts of AG (A&E)

4.1.6.3 Rush of expenditure

Paragraph 91(2) of the Kerala Budget Manual states that the flow of expenditure should be so regulated throughout the year that there is no rush of expenditure. It is contrary to the provision to spend money hastily or in an ill-conceived manner merely because it is available or just to avoid lapse of funds.

Table 4.3: Rush of Expenditure in March

Year	Head of account	Total expenditure (₹)	Expenditure during March (₹)	Percentage of expenditure in March
2006-2007	4851-00-102-96 Plan	19,95,102	8,37,602	42
2007-2008	2851-00-102-84 Plan	4,08,63,966	4,08,63,966	100
2009-2010	4851-00-102-96 Plan	2,73,99,706	2,73,43,706	100
2009-2010	2851-00-102-47 Plan	4,43,35,186	3,33,88,519	75

Source: Data compiled from Detailed Appropriation Accounts of AG (A&E)

As seen from **Table 4.3**, in each of the years from 2007-08 to 2009-10, there was huge expenditure in the month of March ranging from 42 to 100 *per cent*. The Directorate did not furnish any reasons for rush of expenditure for these items, despite requests for the same from Audit.

4.1.7 Infrastructure - Industrial Plots

Allotment of industrial plots is one of the main activities of the Directorate. The allotment is covered by rules framed for sale of land on hire purchase basis issued during August 1970, read with amendment to the delegation of powers issued in January 1992.

The General Managers (GMs) of DICs have powers to sanction allotment of plots in Development Areas/Development Plots (DAs/DPs) and vacant spaces in industrial plots.

4.1.7.1 Mortgaging of plots

According to rules for sale of land on hire purchase issued and delegation of powers, the GMs of DICs have power to give permission to allow mortgage only the super-structure put up by the allottees in the Government land to avail institutional finance. However, it was seen that the GMs of DICs with the concurrence of Directorate permitted mortgaging of land by the allottees to financial institutions in some cases mentioned in **Table 4.4**.

Table 4.4: Details of industrial land mortgaged

Name of DIC	No. of cases	Area mortgaged	Period of mortgage
Thiruvananthapuram	4	144.2 cents	November 2006 to May 2010
Ernakulam	3	173.25 cents	January 2007 to March 2010
Idukki	2	15 cents	May 2008 to November 2009

Source: Details collected from the DIC

Allotees mortgage their allotted industrial land to raise loan from financial institutions. When the allotees defaulted in repayment of loan, the financial institutions sold the mortgaged land in public auction to recover their dues. Details of such cases noticed in audit are given in **Table 4.5**.

Table 4.5: Details of industrial land mortgaged

(₹in lakh)

Name of unit and DIC	Area mortgaged	Auctioning agency	Amount for which auctioned[75]
M/s TK Chemicals, DIC Thiruvananthapuram	4.99 acres	Debt Recovery Tribunal	248.00
M/s Durgalakshmi Pipes, DIC Ernakulam	15 cents	Dy. Collector, Kerala Financial Corporation, Ernakulam	4.00
M/s Star Refineries, DIC Ernakulam	2 acres	Dy. Collector (RR), Ernakulam	29.50

Source: Details collected from the DIC

Thus, mortgaging the land for raising financial resources was irregular and resulted in loss of the land earmarked for industrial purposes.

As per the provisions contained in Government orders (August 1970), the Director has the power to resume the land in the event of a concern belonging to an industrialist being wound up. The basic objective of this stipulation is to allot the plot to other entrepreneurs. Audit scrutiny revealed that in 17 cases, the original allottees transferred (January 2006 to May 2011) the plots to new parties instead of returning the land to the DIC. The selection of the new parties was decided by the original allottees instead of the DIC. This would have resulted in financial gain to the original allottee.

4.1.7.2 Safeguarding of industrial land

As per the Kannur DIC records, the total extent of land in Andoor DP was 59.31 acres. Land measuring 8.35 acres was used for development of infrastructure and 44.97 acres was allotted to various industrial units. The remaining land of 5.99 acres valued at ₹ 26.39 lakh (as per the value, when it was purchased in 2003 by the department) was encroached upon due to failure of DIC to protect the land. The GM, DIC, admitted (June 2011) that the land was lost due to encroachment and re-survey would be conducted to identify the lost land.

4.1.8 State investment subsidy

The Government of India (GOI) introduced the Central Investment Subsidy (CIS) in 1971 to promote industries in the most backward districts of the country. In Kerala, this was first introduced in Alappuzha, and was

[75] Including superstructure

subsequently extended to Kannur, Malappuram, Idukki, Wayanad, Thrissur, Kasargode and Thiruvananthapuram. Since the CIS was prevalent only in a few selected districts, the Government decided to introduce a similar scheme for the other districts under the name of State Investment Subsidy (SIS) scheme. After the Government of India withdrew CIS in the year 1988, SIS was extended all over the State. The provisions for grant of subsidy are contained in the Manual for SIS (July 2000) and its amendments (January 2004). All claims received for grant of SIS are to be disposed of in three months from the date of receipt of completed applications.

4.1.8.1 Time limit for grant of SIS

All applications for subsidy for less than ₹ 10 lakh are to be considered and disposed of by the District Level Committees (DLCs) on SIS. Audit scrutiny revealed delays in sanctioning of SIS ranging from four to 34 months in 285 cases as detailed in **Table 4.6**.

Table 4.6: Details of delays in sanctioning SIS

District	Sanctioned	Cases for which details were available	Applications in which there were more than three months delays in sanctioning	Period of delay
Thiruvananthapuram	118	94	41	4 to 27 months
Ernakulam	457	269	138	4 to 34 months
Idukki	88	64	34	4 to 24 months
Kannur	129	120	72	4 to 27 months
Total	**792**	**547**	**285**	

Source: Details collected from the DIC

Cases involving subsidy of ₹ 10 lakh and more are to be considered and disposed of by the State Level Committee[76] (SLC) for SIS. The SLC sanctioned payment of subsidy to 19 cases during the period from 2008-09 to 2010-11. Delays ranging from three to 14 months were noticed in 12 cases. Audit observed that the delay in sanctioning of subsidy occurred due to reasons such as non-conducting of SLC/DLC meeting once in three months, acceptance of applications without scrutiny and non-availability of funds.

The Director stated (September 2011) that instructions had been issued to all the DICs to accept only those applications which are correct in all respects and efforts would be made to convene SLC/DLC meetings at least once in every three months.

4.1.8.2 Improper release of SIS

As per the provisions of the Manual of SIS (January 2004), industrial units should be working as on the date of release of subsidy. Audit scrutiny revealed that DIC Idukki released a subsidy of ₹ 25 lakh to M/s Cybele Herbals which was not functioning at the time of release of subsidy. The Director replied (September 2011) that the subsidy amount was released on the basis of instructions received from the Government. However, revenue recovery action had been initiated to recover the subsidy amount.

[76] SLC consist of Principal Secretary (Industries) as Chairman, Director of Industries and Commerce as member secretary and other official members.

4.1.9 Post-disbursement monitoring of units that were granted SIS

Post-disbursement monitoring of units that received SIS was ineffective

One of the provisions contained in the Manual for SIS (July 2000) stipulates that the industrial units which receive the subsidy will be under obligation to remain working for five years from the date of commencement of production. To monitor this condition, the standard agreement between the DIC and the industrial units that receive subsidy provides for submission of their annual audited statement of accounts to the DIC. In the selected districts, during the period of audit, 792 units were given SIS, of which 622 units were stated to have been checked by the DICs to ascertain whether they were functioning. However, such audited statements were not available in the DICs in support of this verification having been properly conducted. The following deficiencies were noticed in the verification process:

- No mechanism had been put in place to ensure that all the units were periodically visited and details like electricity bills, bank account statements, etc., of the units were collected to conclude that the units were in operation.
- Mortgaging of assets at the time of disbursement of subsidy would have facilitated speedy recovery of subsidy if they were not found to be operating during the stipulated period. This mechanism had not been adopted.

The Director stated (September 2011) that action would be initiated to strengthen the monitoring mechanism.

4.1.10 Margin money loans

In order to boost the growth of industries in the State, margin money loans (MML) subject to a maximum of ₹ 2.5 lakh were to be granted to all newly registered SSI units. MMLs were to be sanctioned on the basis of loans sanctioned by the financial institutions. The loans were to be repaid in 16 equal quarterly instalments and were to carry interest of six *per cent* per annum for loans sanctioned with effect from 27 July 2004. In cases of failure to repay MML, levy of penal interest of additional 2.75 *per cent* was also provided for.

Audit scrutiny revealed that during the period 2002-2007, in the four selected districts, ₹ 9.47 crore was paid as MML to 651 units whose repayment schedule commenced from 2006 onwards. Three hundred and thirty six such units which were paid ₹ 4.71 crore neither repaid the principal nor the interest. Further, 149 units which received MML of ₹ 2.17 crore, repaid only interest as shown in **Table 4.7**.

Table 4.7: Details of MML paid and recovered

District	Total loans disbursed		Units which had not repaid principal and interest (with percentage)		Units which had not repaid principal	
	Number of units	Amount (₹ in crore)	Number of units	Amount (₹ in crore)	Number of units	Amount (₹ in crore)
Thiruvananthapuram	153	1.77	106	1.16 (65.53)	21	0.29
Ernakulam	355	5.85	188	2.98 (50.94)	77	1.29
Kannur	75	0.97	24	0.36 (37.11)	28	0.35
Idukki	68	0.88	18	0.21 (23.86)	23	0.24
Total	**651**	**9.47**	**336**	**4.71**	**149**	**2.17**

Source: Figures collected from DIC.

Reasons for the high rate of defaults in repayment of MMLs were as follows:

Recovery mechanism for MML granted to entrepreneurs was ineffective

i. Absence of proper pre-disbursement verification to ensure disbursement of financial assistance to only genuine and capable entrepreneurs who could run the industries successfully.

ii. Adequate safeguards like hypothecation/pledge of the facility were absent. This was due to the laid down instructions that no collateral security or charge on assets of the unit shall be taken during the pendency of loans availed by the unit from the financial institution.

The Director stated (September 2011) that the mechanism for watching the progress of repayment of MMLs would be strengthened.

4.1.11 Share participation by Government in Industrial Co-operative Societies

Default in retirement of ₹ 1.23 crore paid towards Share Capital Contribution

The rules for share participation by Government in Industrial Co-operative Societies (March 1994) provide for share participation by Government in Industrial Co-operative Societies. The rules also stipulate that the share so contributed by the Government shall be retired after a period of 15 years.

Audit scrutiny revealed that there was no retirement of share capital contribution as provided in the rules in the four test-checked DICs as shown in **Table 4.8**:

Table 4.8: Details of share capital pending retirement

(₹in lakh)

District	Amount of Share Capital Contribution pending retirement
Ernakulam	6.94
Idukki	29.95
Kannur	58.09
Thiruvananthapuram	27.93
Total	**122.91**

Source: Figures collected from DIC.

The Director stated (September 2011) that the Industrial Co-operative Societies were faced with problems like lack of know-how in business management/ marketing, professional management, inadequate infrastructure, over-dependence on Government for financial assistance and restrictive provisions of co-operative laws. However, directions would be given to ensure collection of Government's share towards share capital contribution.

Further, in the exit conference (October 2011), the Joint Director stated that the Government would take over the assets of the defaulting industrial societies on their liquidation. This indicates inadequate assessment of the capacity of the beneficiary to run the business profitably at the time of initial release of financial assistance.

4.1.12 Internal Control Mechanism

4.1.12.1 Internal audit

Internal audit wing was almost defunct

Internal audit is a device through which an organisation is able to obtain independent feedback on its functioning. The internal audit wing of the Directorate headed by a Senior Finance Officer and supported by a Junior Superintendent and three Clerks had been entrusted with the task of conducting internal audit of the 14 District Industries Centres and 57 Taluk Industries Centres every year. The units audited during the years 2006 to 2010 were as shown in **Table 4.9**:

Table 4.9: Details of internal audit conducted by the Directorate

Year	Total units	Number of units audited	Shortfall in audit (percentage)
2006	73	3	95.89
2007	73	NIL	100
2008	73	7	90.41
2009	73	4	94.52
2010	73	2	97.26

Source: Figures collected from Directorate

Heavy pendency of more than 90 *per cent* in internal audit indicated that the internal audit wing was almost defunct. It had not conducted any risk analysis for selection of units to be audited.

The Director stated (September 2011) that the present staff strength was not sufficient for conducting regular internal audit and the Government had been approached for strengthening the internal audit wing.

4.1.13 Conclusion

Various schemes operated by the Directorate were basically confined to allotment of land and disbursement of financial assistance. The rules for allotment of land do not permit the allotees to mortgage the land to the financial institutions for raising loans. It was seen that the DICs permitted the allotees to mortgage the land to the financial institutions in violation of the allotment rules resulting in loss of control over industrial land. There were delays in sanctioning the State investment subsidy as the SLC/DLC meetings were not conducted within three months as required. There was failure to assess the capability of the entrepreneurs to run the business profitably. Monitoring of industrial land allotted was inadequate. Internal control of the Directorate was also found to be weak.

4.1.14 Recommendations

- The Government should take steps to prevent the allottees from mortgaging the land to the financial institutions for raising loans.

- The viability of the projects and financial capacity of the entrepreneurs should be properly assessed by the DICs before allotment of industrial plots and sanctioning of financial assistance to the entrepreneurs.
- The monitoring mechanism of the functioning of the industrial units needs to be strengthened.
- The internal control mechanism of the Directorate of Industries and Commerce needs to be strengthened.

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