

## CHAPTER III ECONOMIC SECTOR (PUBLIC SECTOR UNDERTAKINGS)

### 3.1 Overview of State Public Sector Undertakings

#### Introduction

**3.1.1** The State Public Sector Undertakings (SPSUs) consist of State Government Companies and Statutory Corporations. The SPSUs are established to carry out activities of commercial nature keeping in view the welfare of the people. In Sikkim, the SPSUs occupy an insignificant place in the State economy. As on 31 March 2017, there were 16 SPSUs (including 13 Government Companies and 3 Statutory Corporations). None of the companies were listed on the stock exchange and no company was closed down during the year. The details of the SPSUs in Sikkim as on 31 March 2017 are given below.

**Table 3.1.1**  
**Total number of SPSUs as on 31 March 2017**

Type of SPSUs	Working SPSUs	Non-working SPSUs <sup>1</sup>	Total
Government Companies	10	3	13
Statutory Corporations	2	1	3
<b>Total</b>	<b>12</b>	<b>4</b>	<b>16</b>

The working SPSUs registered a turnover of ₹ 185.64 crore as per their latest finalised accounts as of September 2017. This turnover was equal to 0.98 *per cent* of State Gross Domestic Product (GDP<sup>2</sup>) of ₹ 18,852.00 crore for 2016-17. During 2015-16, however, the contribution of turnover (₹ 178.81 crore) of working SPSUs was higher at 1.05 *per cent* of State GDP (₹ 16,954.00 crore). During 2016-17, the working SPSUs had incurred an aggregate loss of ₹ 331.21 crore as per their latest finalised accounts as of September 2017. In comparison, during 2015-16 they had incurred aggregate loss of ₹ 80.21 crore as per their latest finalised accounts as of September 2016. The increase in the aggregate loss of working SPSUs was mainly on account of heavy losses (₹ 315.10 crore) incurred by one power sector SPSU<sup>3</sup>. The working SPSUs had employed 871 employees as at the end of March 2017.

The total investment in 12 working SPSUs was ₹ 15,457.76 crore. The Return on Equity (RoE) in respect of seven<sup>4</sup> out of twelve working SPSUs was negative {(-) 0.23 *per cent*} as per their latest finalised accounts as on 30 September 2017. The accumulated losses

<sup>1</sup>Non-working SPSUs are those which have ceased to carry on their operations.

<sup>2</sup>Source: Department of Economic, Statistics, Monitoring and Evaluation, Government of Sikkim. For the year 2012-13 to 2013-14, actual GDP figures have been adopted. For 2014-15 to 2016-17, the GSDP estimates (provisional figures) were yet to be approved by Government of Sikkim.

<sup>3</sup>Serial No. A-8 of Appendix 3.1.1. The audit of this company was entrusted to Comptroller and Auditor General of India during the year 2015

<sup>4</sup>Sl. no. A4, A5, A6, A7, A10, B11 and B12 of Appendix 3.1.1

(₹ 634.58 crore) of the remaining five<sup>5</sup> working SPSUs had completely eroded their share capital (₹ 21.46 crore) as per their latest finalised accounts. Hence, RoE of these five SPSUs was not workable.

As on 31 March 2017, there were four non-working SPSUs with total investment of ₹ 56.17 crore (Paid up capital: ₹ 55.63 crore and long term loan: ₹ 0.54 crore). This was a critical area as the investments in non-working SPSUs did not contribute to the economic growth of the State.

### **Accountability framework**

**3.1.2** The Companies Act 1956 as well as the New Companies Act, 2013 had not been extended to the State of Sikkim. Out of 13 Government Companies in Sikkim, 11 were registered under the 'Registration of Companies Act, Sikkim 1961'. The accounts of these 11 State Government companies are audited by Statutory Auditors (Chartered Accountants) who are directly appointed by the Board of Directors (BoDs) of the respective companies. In addition to the statutory audit conducted by the Statutory Auditors, supplementary audit of these companies had also been taken up by the Comptroller and Auditor General of India (CAG). This was done on the request of the Governor of the State under Section 20 (1) of the Comptroller and Auditor General's (Duties, Powers and Conditions of Service) Act, 1971.

**3.1.3** During the year 2015-16, one State Government company<sup>6</sup> acquired 51 *per cent* of equity share capital of Teesta Urja Limited (TUL). TUL, a Company registered under the Companies Act 1956, is the holding company of another State Government Company namely, Teesta valley Power Transmission Limited (TPTL). Hence, both the companies (TUL and TPTL) were governed by the provisions of the Companies Act, 1956/Companies Act, 2013. The accounts of these two companies are audited by Statutory Auditors (Chartered Accountants) who are appointed by the CAG. In addition, supplementary audit of these companies had also been taken up by the CAG under Section 143(6)(a) of the Companies Act 2013<sup>7</sup>.

**3.1.4** There are three Statutory Corporations in the State, namely, State Bank of Sikkim, State Trading Corporation of Sikkim and Sikkim Mining Corporation established under the proclamation of the erstwhile Chogyal (King) of Sikkim. The accounts of these Corporations are audited by the Chartered Accountants directly appointed by the Board of Directors (BoDs) of the respective Corporation. Supplementary Audit of these Corporations was taken up by CAG under Section 19(3)<sup>8</sup> of the CAG's (Duties, Powers and Conditions of Service) Act, 1971.

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<sup>5</sup> Sl. no. A1, A2, A3, A8 and A9 of **Appendix 3.1.1**

<sup>6</sup> Sikkim Power Investment Corporation Limited

<sup>7</sup> The audit of accounts of the Government Companies from the financial year 2014-15 onwards is governed by the Companies Act, 2013.

<sup>8</sup> Based on the entrustment/request for the audit of the accounts of these corporations from the Governor of the State from time to time.

### Stake of Government of Sikkim

**3.1.5** The State Government has huge financial stake in these SPSUs. This stake is of mainly three types:

- **Share Capital and Loans-** In addition to the Share Capital Contribution, State Government also provides financial assistance by way of loans to the SPSUs from time to time.
- **Special Financial Support-** State Government provides budgetary support by way of grants and subsidies to the SPSUs as and when required.
- **Guarantees-** State Government also guarantees the repayment of loans with interest availed by the SPSUs from Financial Institutions.

### Investment in SPSUs

**3.1.6** As on 31 March 2017, the investment (capital and long-term loans) in 16 SPSUs was ₹ 15,513.93 crore as per details given below.

**Table 3.1.2**  
Total investment in SPSUs

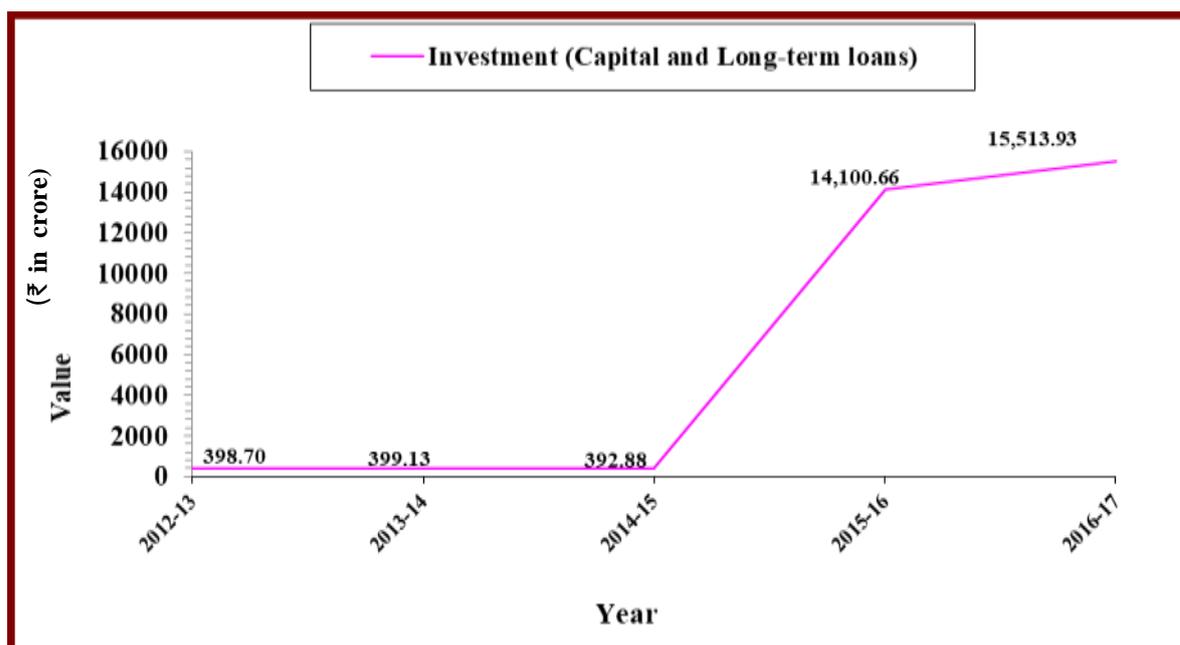
Type of SPSUs	Government Companies			Statutory Corporations			Grand Total
	Capital	Long Term Loans	Total	Capital	Long Term Loans	Total	
Working SPSUs	3037.43	12239.94	15277.37	2.14	178.25	180.39	15457.76
Non-working SPSUs	43.13	0	43.13	12.50	0.54	13.04	56.17
<b>Total</b>	<b>3080.56</b>	<b>12239.94</b>	<b>15320.50</b>	<b>14.64</b>	<b>178.79</b>	<b>193.43</b>	<b>15513.93</b>

(₹ in crore)

Out of the total investment of ₹ 15,513.93 crore in SPSUs as on 31 March 2017, 99.64 per cent was in working SPSUs and the remaining 0.36 per cent was in non-working SPSUs. This total investment consisted of 19.95 per cent in capital and 80.05 per cent in long-term loans. The investment had increased significantly by 3791.13 per cent from ₹ 398.70 crore (2012-13) to ₹ 15,513.93 crore (2016-17) as shown in **Chart 3.1.1**. The increase (₹ 15,115.23 crore) in the total investment was mainly due to investment aggregating ₹ 14,956.60 crore (capital: ₹ 2,974.10 crore; long term loans: ₹ 11,982.50 crore) in respect of three power<sup>9</sup> sector companies. These companies were added under the audit purview of CAG during the year 2015-16.

<sup>9</sup> Sikkim Power Investment Corporation Limited (SPICL), Teesta Urja Limited (TUL), a subsidiary of SPICL; and Teestavalley Power Transmission Limited (TPTL), a subsidiary of TUL.

**Chart 3.1.1**  
Total investment in SPSUs



**3.1.7** The sector wise summary of investments in the SPSUs as on 31 March 2016 is given below:

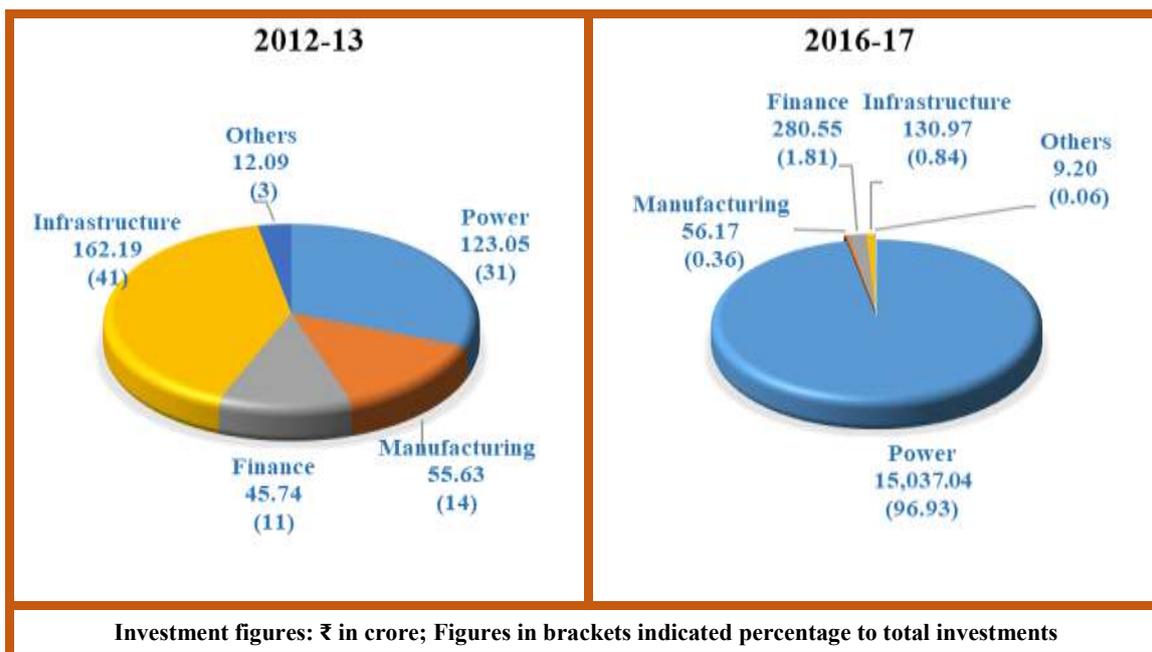
**Table 3.1.3**  
Sector-wise investment in SPSUs

Name of Sector	Government/Other <sup>10</sup> Companies		Statutory corporations		Total	Investment (₹ in crore)
	Working	Non-Working	Working	Non-working		
Power	4	0	0	0	4	15037.04
Manufacturing	0	3	0	1	4	56.17
Finance	1	0	1	0	2	280.55
Service	1	0	1	0	2	8.07
Infrastructure	1	0	0	0	1	130.97
Agriculture & Allied	3	0	0	0	3	1.13
<b>Total</b>	<b>10</b>	<b>3</b>	<b>2</b>	<b>1</b>	<b>16</b>	<b>15,513.93</b>

The investment in five significant sectors and percentage thereof at the end of 31 March 2013 and 31 March 2017 are indicated in *Chart No. 3.1.2*.

<sup>10</sup> 'Other Companies' as referred to under Section 139(5) and 139(7) of the Companies Act, 2013

Chart 3.1.2  
Sector wise investment in PSUs



It could be noticed from *Chart No. 3.1.2* that during 2016-17, the thrust of SPSU-investment was mainly in power sector companies<sup>11</sup>, which constituted more than 96 per cent of the total investment (₹ 15,513.93 crore) in SPSUs. During the period of five years from 2012-13 to 2016-17, investment in SPSUs increased in three out of five sectors (viz. finance, manufacturing and power sector). The investments in power sector SPSUs, however, had increased significantly by ₹ 14,913.99 crore from ₹ 123.05 crore (2012-13) to ₹ 15,037.04 crore (2016-17). As mentioned under **paragraph 3.1.6** *supra*, the significant increase in the power sector investments was mainly on account of investments relating to three power sector companies (SPICL, TUL and TPTL).

### Special support and returns during the year

**3.1.8** The State Government provides financial support to SPSUs in various forms through annual budget. The summarised details of budgetary outgo towards equity, loans, grants/subsidies, loans written-off and interest waived along with the position of guarantee in respect of SPSUs are given in *Table 3.1.4* for three years ended 2016-17.

Table 3.1.4  
Details regarding budgetary support to SPSUs

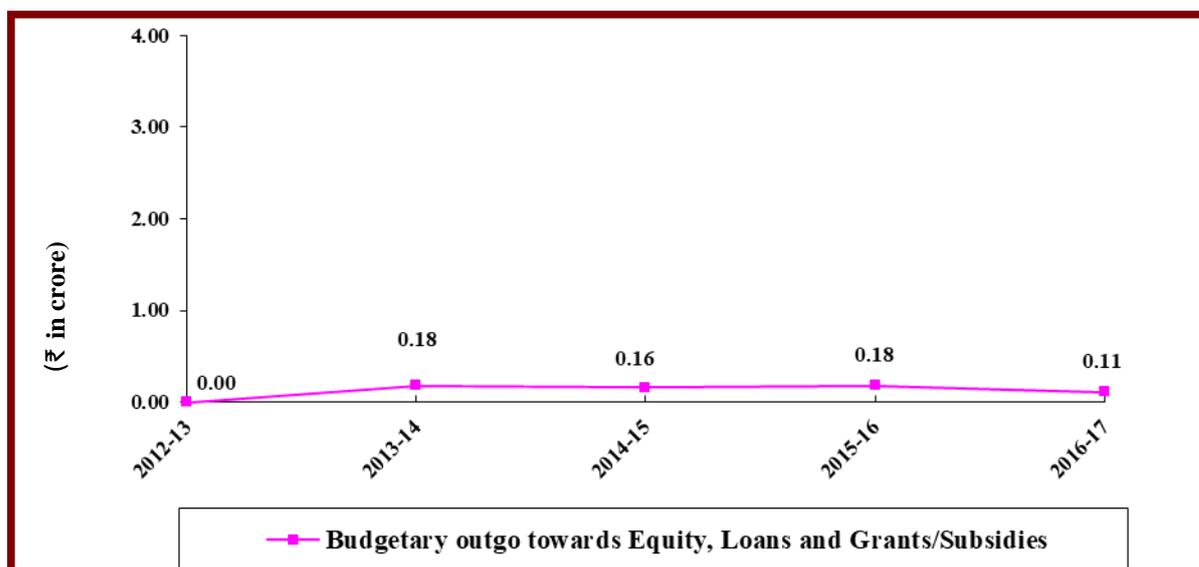
Sl. No.	Particulars	2014-15		2015-16		2016-17	
		No. of SPSUs	Amount	No. of SPSUs	Amount	No. of SPSUs	Amount
1.	Equity Capital outgo from budget	0	0	0	0	0	0
2.	Loans given from budget	0	0	0	0	0	0
3.	Grants/Subsidy from budget	1	0.16	1	0.18	1	0.11
4.	<b>Total Outgo (1+2+3)</b>	<b>1</b>	<b>0.16</b>	<b>1</b>	<b>0.18</b>	<b>1</b>	<b>0.11</b>

<sup>11</sup> Serial No. A-6,7,8 and 9 of *Appendix 3.1.1*

Sl. No.	Particulars	2014-15		2015-16		2016-17	
		No. of SPSUs	Amount	No. of SPSUs	Amount	No. of SPSUs	Amount
5.	Waiver of loans and interest	1	0.06	1	0.05	1	13.41
6.	Guarantees issued	1	96.57	1	84.50	2	65.78
7.	Guarantee Commitment	2	109.50	2	91.02	3	81.83

The details regarding budgetary outgo towards equity, loans and grants/ subsidies for the past five years are given in **Chart 3.1.3**.

**Chart 3.1.3**  
Budgetary outgo towards Equity, Loans and Grants/Subsidies



While no budgetary outgo was provided to any SPSU during 2012-13, during the next four years (2013-17), State Government has provided the budgetary outgo aggregating ₹ 0.63 crore to one SPSU (Sikkim Poultry Development Corporation Limited). As can be noticed from **Table 3.1.4** above, the Guarantee commitment during 2014-17 had shown a decreasing trend mainly due to repayment of Government guaranteed loans by one SPSU<sup>12</sup>. As on 31 March 2017, the Guarantee commitment stood at ₹ 81.83 crore against the three SPSUs<sup>13</sup>

### Reconciliation with Finance Accounts

**3.1.9** The figures in respect of equity, loans and guarantees outstanding as per the records of SPSUs should agree with that of the figures appearing in the Finance Accounts of the State. In case the figures do not agree, the SPSUs concerned and the Finance Department should carry out reconciliation of differences. The position in this regard as at 31 March 2017 is given in **Table 3.1.5**.

<sup>12</sup> serial no. A-5 of **Appendix 3.1.1**.

<sup>13</sup> serial no A-4, A-5 and B-12 of **Appendix 3.1.1**

**Table 3.1.5**  
**Equity, loans, guarantees outstanding as per Finance Accounts vis a vis records of SPSUs**

(₹ in crore)

Outstanding in respect of	Amount as per Finance Accounts	Amount as per records of SPSUs	Difference
Equity	87.87	88.28	0.41
Loans	37.03	2.03	35.00
Guarantees	79.85	81.83	1.98

\* SPSU-wise figures of loans/guarantee not available in the finance accounts of the State.

Audit observed that the differences in equity investment<sup>14</sup> occurred in respect of nine<sup>15</sup> SPSUs. While the un-reconciled differences in respect of equity of SPSUs decreased by ₹ 0.45 crore from ₹ 0.86 crore (2015-16) to ₹ 0.41 crore (2016-17), the differences in respect of loans to SPSUs remained unchanged at ₹ 35.00 crore during the two years. Further, the un-reconciled differences in respect of guarantee outstanding of SPSUs had decreased to ₹ 1.98 crore (2016-17) from ₹ 18.48 crore (2015-16). The Accountant General had pursued the issue regularly with the Principal Secretary (Finance), Government of Sikkim and the heads of the SPSUs concerned for early reconciliation of long pending differences. The Government and the SPSUs concerned should take concrete steps to reconcile the differences in a time-bound manner.

### Arrears in Finalisation of accounts

**3.1.10** The Companies Act, 1956/Companies Act, 2013 have not been extended to the State of Sikkim. The Government Companies in Sikkim are registered under the Registration of Companies Act, 1961 while the Statutory Corporations are governed by the proclamation of the erstwhile Chogyal (King) of Sikkim. During 2015-16, two power sector companies {Teesta Urja Limited (TUL) and its subsidiary, Teesta Valley Power Transmission Limited (TPTL)} which were registered under the Companies Act, 1956 became subsidiaries of one state owned company namely, Sikkim Power Investment Corporation Limited (SPICL) by virtue of acquisition of majority equity stake of TUL by SPICL. The **Table 3.1.6** provides the details of progress made by working SPSUs in finalisation of their accounts as of 30 September 2017.

**Table 3.1.6**  
**Position relating to finalisation of accounts of working SPSUs**

Sl. No.	Particulars	2012-13	2013-14	2014-15	2015-16	2016-17
1.	Number of Working SPSUs	8	8	9	12	12
2.	Number of accounts finalised during the year	10	5	3	8	14
3.	Number of accounts in arrears	18	21	27	31	29
4.	Number of Working SPSUs with arrears in accounts	7	8	9	8	9
5.	Extent of arrears (numbers in years)	1 to 4	1 to 5	1 to 6	1 to 7	1 to 8

The arrear of accounts of working SPSUs had shown an increasing trend during four years (2012-16) due to less number of accounts finalised by working SPSUs during these

<sup>14</sup> SPSU-wise figures of loans/guarantee not available in the finance accounts of the state

<sup>15</sup> Serial No. A-2, A-4, A-5, A-8 to A-10 and C-13 to C-15 of **Appendix 3.1.1**

years. As on 30 September 2017, total 29 accounts of 9 working SPSUs were pending for finalisation, of which, 16 accounts (55 per cent) pertained to 2 SPSUs<sup>16</sup>. The delay in finalisation of accounts of these 2 SPSUs was mainly due to delay in compilation/adoption of accounts by the Board of Directors of the respective SPSUs. The administrative departments of the SPSUs concerned have the responsibility to oversee the activities of these entities and to ensure that the accounts are finalised and adopted within the stipulated period. The departments/ministries concerned were informed regularly (on quarterly basis) of the arrears in finalisation of accounts by these SPSUs. No significant improvement was, however, noticed in the position of arrears of accounts of the working SPSUs.

**3.1.11** The State Government had invested ₹ 0.29 crore in one SPSU (Sikkim Poultry Development Corporation) by way of Grant in 2015-16.

The said SPSU had finalised accounts upto 2008-09 and accounts for subsequent eight years (2009-10 to 2016-17) were pending finalisation.

### **Placement of Separate Audit Reports**

**3.1.12** The position depicted in *Table 3.1.7* shows the status of placement of Separate Audit Reports (SARs) issued by the CAG (up to 30 September 2017) on the accounts of Statutory Corporations in the State Legislature.

**Table 3.1.7**  
**Status of placement of SARs in Legislature**

Sl. No	Name of Statutory Corporation	Year up to which SARs placed in Legislature	Year for which SARs not placed in Legislature	
			Year of SAR	Date of issue to the Government
1.	State Bank of Sikkim	2012-13	2013-14 to 2015-16	08 September 2017
2.	State Trading Corporation of Sikkim	2015-16	-	-

### **Impact of non-finalisation of accounts**

**3.1.13** The delay in finalisation of accounts pointed out in *para 3.1.10 to 3.1.11* may result in risk of fraud and leakage of public money apart from violation of the provisions of the relevant statutes. In view of the above state of arrears of accounts, the actual contribution of SPSUs to the State GDP for the year 2016-17 could not be ascertained and their contribution to State exchequer was also not reported to the State Legislature.

**It is, therefore, recommended that:**

- **the Government may ensure preparation of accounts by SPSUs to clear arrears in accounts and set targets for individual SPSU which could be monitored.**

<sup>16</sup> Sl. No A-1 and A-2 of *Appendix 3.1.1*

### Performance of SPSUs as per their latest finalised accounts

**3.1.14** The financial position and working results of working Government companies and Statutory Corporations are detailed in **Appendix 3.1.1**. A ratio of SPSU turnover to State GDP shows the extent of SPSU activities in the State economy. **Table 3.1.8** provides the details of working SPSU-turnover and State GDP for a period of five years ending 2016-17.

**Table 3.1.8**  
Details of working PSUs turnover vis-a vis State GDP

Particulars	2012-13	2013-14	2014-15	2015-16	2016-17
Turnover	143.91	147.55	149.28	178.81	185.64 <sup>17</sup>
State GDP <sup>18</sup>	12,338	13,862	15,407	16,954	18852
Percentage of Turnover to State GDP	1.17	1.06	0.97	1.05	0.98

The year-wise contribution of working SPSU-turnover to State GDP during 2012-17 had shown a decreasing trend from 1.17 *per cent* (2012-13) to 0.98 *per cent* (2016-17) of the State GDP for the respective years.

**3.1.14.1 Erosion of capital due to losses:** The paid up capital and accumulated losses of 12 working SPSUs as per their latest finalised accounts as on 30 September 2017 were ₹ 3,030.40 crore and ₹ 742.23 crore respectively (**Appendix 3.1.1**). Analysis of investment and accumulated losses of these SPSUs revealed that the accumulated losses (₹ 634.58 crore) of five<sup>19</sup> working SPSUs had completely eroded their share capital (₹ 21.46 crore) as per their latest finalised accounts.

Of these five SPSUs, the primary erosion of paid up capital was in respect of two SPSUs, namely, Sikkim Power Investment Corporation Limited (paid up capital: ₹ 0.01 crore; accumulated losses: ₹ 547.39 crore) and Sikkim Power Development Corporation Limited (paid up capital: ₹ 20.30 crore; accumulated losses: ₹ 83.77 crore).

Accumulation of huge losses by these SPSUs had eroded public wealth, which was a cause of serious concern.

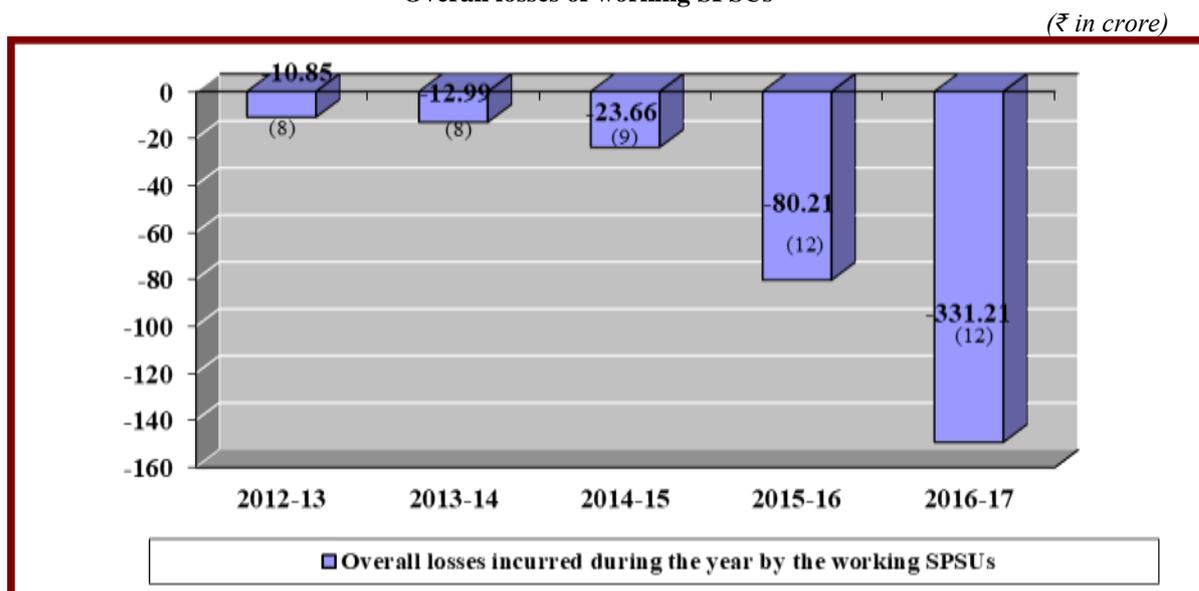
**3.1.15** Overall losses incurred by working SPSUs during 2012-13 to 2016-17 are given in **Chart 3.1.4**.

<sup>17</sup> Turnover of working SPSUs as per the latest finalised accounts as of 30 September 2017

<sup>18</sup> Source: Department of Economic, Statistics, Monitoring and Evaluation, Government of Sikkim, For the years from 2014-15 to 2016-17, the GSDP (provisional figures) estimates are pending for approval by Government of Sikkim (September 2017).

<sup>19</sup> Sl. no. A-1, A-2, A-3 A-8 and A-9 of **Appendix 3.1.1**

**Chart 3.1.4**  
Overall losses of working SPSUs



(Figures in brackets show the number of working SPSUs in respective years)

As per the latest finalised accounts of twelve working SPSUs as on 30 September 2017, three<sup>20</sup> SPSUs earned profit of ₹ 8.47 crore and nine SPSUs incurred loss of ₹ 339.68 crore. The major contributor to profit was State Bank of Sikkim (₹ 6.79 crore). The heavy losses were incurred by Sikkim Power Investment Corporation Limited (₹ 315.10 crore) and Sikkim Power Development Corporation Limited (₹ 9.22 crore). As could be noticed from **Chart 3.1.4** above, the overall losses incurred by working SPSUs showed an increasing trend during the five years from 2012-13 to 2016-17. The loss had increased from ₹ 10.85 crore (2012-13) to ₹ 331.21 crore (2016-17). The significant increase in the overall losses of working SPSUs during 2016-17 was attributable to the losses of ₹ 315.10 crore (2016-17) incurred by Sikkim Power Investment Corporation Limited. The audit of the Corporation was entrusted to CAG during December 2015.

**3.1.16** Some other key parameters of SPSUs for last five years (2012-13 to 2016-17) as per their latest finalised accounts as on 30 September of the respective year are given in **Table 3.1.9**.

**Table 3.1.9**  
Key Parameters of State PSUs

(₹ in crore)

Particulars	2012-13	2013-14	2014-15	2015-16	2016-17
Return on Capital Employed (Per cent)	4.30	4.36	3.91	10.34	9.57
Debt	279.07	273.89	273.25	8936.15	12225.77
Turnover <sup>21</sup>	143.91	147.55	149.28	178.81	185.64
Debt-Turnover Ratio	1.94:1	1.86:1	1.83:1	49.98:1	65.86:1
Interest Payments	87.49	90.15	88.16	1235.63	1659.22
Accumulated losses	90.29	97.92	117.72	328.72	794.95

<sup>20</sup>Serial No. A-5,10 and B-11 of **Appendix 3.1.1**

<sup>21</sup>Turnover of working SPSUs as per their latest finalised accounts as on 30 September of respective year.

From the Table above, it can be noticed that the Debt-Turnover Ratio of SPSUs has increased significantly after 2014-15 mainly due to addition of three power sector companies<sup>22</sup> under the audit purview of CAG during 2015-16. During 2016-17, the said three SPSUs had significant debts aggregating ₹ 11,982.51 crore as per their latest finalised accounts as on 30 September 2017.

**3.1.17** The State Government had not formulated (October 2017) any dividend policy regarding payment of minimum dividend by SPSUs. As per their latest finalised accounts as on 30 September 2017, three<sup>23</sup> SPSUs earned aggregate profit of ₹ 8.47 crore, however, no SPSU declared dividend during the year.

### Winding up of non-working SPSUs

**3.1.18** There were four non-working SPSUs (three Companies and one Statutory Corporation) as on 31 March 2017. The audit of accounts of three<sup>24</sup> out of these four SPSUs had been entrusted to CAG for five years upto 2016-17. The audit of the fourth<sup>25</sup> SPSU was, however, entrusted to CAG for five years upto 2017-18. All the SPSUs mentioned above were under closure (April 2011) under the order of the Government. The Government Companies in Sikkim are registered under the Registration of Companies Act, 1961 while Statutory Corporations are governed by the proclamation of the erstwhile Chogyal (King) of Sikkim. There was, however, no prescribed procedure for liquidation of Government Companies/Statutory Corporations under their respective governing Act/Statute. The details of non-working SPSUs at the end of each of the last five years are given in *Table 3.1.10*.

**Table 3.1.10**  
Non-working SPSUs with entrustment

Particulars	2012-13	2013-14	2014-15	2015-16	2016-17
No. of non-working companies	6	6	5	3	3
No. of non-working corporations	1	1	1	1	1
<b>Total</b>	<b>7</b>	<b>7</b>	<b>6</b>	<b>4</b>	<b>4</b>

**3.1.19** The stages of closure in respect of non-working SPSUs are given in *Table 3.1.11*.

**Table 3.1.11**  
Closure of Non-working SPSUs

Sl. No.	Particulars	Companies	Statutory Corporations	Total
1.	Total No. of non-working SPSUs	3	1	4
2.	Of (1) above, the No. under			
(a)	liquidation by Court (liquidator appointed)	0	0	0
(b)	Voluntary winding up (liquidator appointed)	0	0	0
I	Closure, i.e. closing orders/instructions issued but liquidation process not yet started.	3	1	4

<sup>22</sup> Serial no A-6, A-7 and A-8 of *Appendix 3.1.1*

<sup>23</sup> Serial No. A-5, A-10 and B-11 of *Appendix 3.1.1*

<sup>24</sup> Serial No, C-13, C-14 & D-16 of *Appendix 3.1.1*

<sup>25</sup> Serial No, C-15 of *Appendix 3.1.1*

The assets of the three out of four non-working SPSUs (all companies) had been disposed of and the proceeds remitted (December 2012) to the Government of Sikkim. The liquidation of the fourth non-working SPSU (Sikkim Mining Corporation) was approved (October 2016) by the Department of Mines, Minerals and Geology, Government of Sikkim and its liabilities (₹ 6.85 crore) were also waived (October 2016).

### Accounts Comments

**3.1.20** Six working companies forwarded their nine audited accounts to Accountant General during the year 2016-17 (October 2016 to September 2017). Six out of nine accounts pertaining to four companies which were selected for supplementary audit had received qualified certificates. Supplementary audit of remaining three accounts of three companies was in progress (November 2017). The details of aggregate money value of comments of statutory auditors and CAG for last three years (2014-17) are given in **Table 3.1.12**.

**Table 3.1.12**  
**Impact of audit comments on working Companies**

(₹ in crore)

Sl. No.	Particulars	2014-15		2015-16		2016-17	
		No. of accounts	No. of accounts	No. of accounts	Amount	No. of accounts	Amount
1.	Decrease in profit	Nil	Nil	1	0.01	1	2.92
2.	Increase in loss	1	0.01	2	6.57	2	6.38
3.	Non-disclosure of material facts	1	0.02	1	1.22	1	2.03
4.	Errors of classification	Nil	Nil	Nil	Nil	Nil	Nil

During the year, 2016-17, two working Statutory corporations<sup>26</sup> had submitted five years accounts to the Accountant General for supplementary audit. The audit of all the five accounts was completed and Separate Audit Reports also issued (June/September 2017). All five accounts of two Statutory corporations received qualified certificates.

### Response of the Government to Audit

#### Performance Audits and Paragraphs

**3.1.21** For the present chapter of Report of the Comptroller and Auditor General of India for the year ended 31 March 2017, Government of Sikkim, one performance audit report involving Finance, Revenue and Expenditure Department (FRED) was issued to the Secretary of the Department with request to furnish replies within six weeks. However, reply was awaited from the State Government (November 2017).

### Follow up action on Audit Reports

#### Replies outstanding

**3.1.22** The Report of the CAG represents the culmination of the process of audit scrutiny.

<sup>26</sup> State Bank of Sikkim and State Trading Corporation of Sikkim

It is, therefore, necessary that they elicit appropriate and timely response from the executive. According to instructions issued by the FRED, Government of Sikkim, all the administrative departments concerned were required to furnish explanatory notes on the paragraphs/performance audits included in the Audit Reports of the CAG of India. The explanatory notes were to be furnished within a period of three months of Report's presentation to the Legislature, in the prescribed format without waiting for any questionnaires from the Public Accounts Committee.

**Table 3.1.13**  
Explanatory notes not received (as on 30 September 2017)

Year of the Audit Report (Commercial/PSU)	Date of placement of Audit Report in the State Legislature	Total Performance audits (PAs) and Paragraphs in the Audit Report		Number of PAs/ Paragraphs for which explanatory notes were not received	
		PAs	Paragraphs	Pas	Paragraphs
2012-13	28 June 2014	0	2	0	1
2013-14	17 March 2015	1	4	1	3
2014-15	28 March 2016	0	2	0	0
2015-16	18 March 2017	1	1	1	1
<b>TOTAL</b>	-	<b>2</b>	<b>9</b>	<b>2</b>	<b>5</b>

From the *Table No. 3.1.13*, it could be seen that the explanatory notes to 5 paragraphs and 2 performance audits pertaining to six Companies/Corporations<sup>27</sup> and Department (Energy and Power Department) were not received (November 2017).

### Discussion of Audit Reports by Public Accounts Committee

**3.1.23** The status as on 30 September 2017 of performance audits (PA) and paragraphs relating to SPSUs that appeared in State Audit Reports and discussed by the Public Accounts Committee (PAC) was as detailed in *Table No. 3.1.14*.

**Table 3.1.14**  
Performance Audit/Paragraphs relating to SPSUs appeared in Audit Reports vis-à-vis discussed as on 30 September 2017

Period of Audit Report	Number of PAs/paragraphs			
	Appeared in Audit Report		Paragraphs discussed	
	PAs	Paragraphs	PAs	Paragraphs
2011-12	1	4	Nil	2
2012-13	0	2	Nil	Nil
2013-14	1	4	Nil	Nil
2014-15	0	2	Nil	Nil
2015-16	1	1	Nil	Nil
<b>Total</b>	<b>3</b>	<b>13</b>	<b>Nil</b>	<b>2</b>

### Compliance to Reports of Public Accounts Committee

**3.1.24** Action Taken Notes (ATNs) to seven recommendations pertaining to three Reports of the Public Accounts Committee (PAC) presented to the State Legislature as of March 2017 had been received (October 2017) as indicated in **Table No. 3.1.15** below.

<sup>27</sup>Serial No. A-1, 4, 5, 9, B-11 and B12 of Appendix 3.1.2

**Table 3.1.15**  
**Compliance to Reports of Public Accounts Committee**

Year of the PAC Report	Total Number of PAC Reports	Total No. of Recommendation in PAC Report	No. of Recommendations where ATNs not received
2008-09 (AR 2005-06)	1	2	Nil
2009-10 (AR 2006-07)	1	3	Nil
2010-11 (AR 2007-08)	1	2	Nil
2013-14 (AR 2008-09)	1	Nil	NA
2015-16 (AR 2009-10)	1	Nil	NA
2016-17 (AR 2010-11)	1	Nil	NA
<b>TOTAL</b>	<b>6</b>	<b>7</b>	<b>Nil</b>

**It is recommended that the Government may ensure:**

- (a) furnishing of replies/explanatory notes to Draft paragraphs/Performance Audits and ATNs on the recommendations of PAC as per the prescribed time schedule;
- (b) recovery of loss/outstanding advances/overpayments within the prescribed period; and
- (c) revamping of the system of responding to audit observations.

#### Coverage of this report

**3.1.25** This Chapter contains one performance audit report on “Functioning of State Bank of Sikkim” which falls under the administrative control of FRED. The investment, turnover, equity, return and percentage of Return on Equity (RoE) in respect of State Bank of Sikkim as per its latest finalised accounts as on 30 September 2017 are given below:

**Table 3.1.16**  
**Key parameters of the SPSUs covered in the Report**

Name of the PSU	Investment	Turnover	Equity <sup>28</sup>	Return <sup>29</sup>	RoE (Per cent)
	(₹ in crore)				
State Bank of Sikkim	0.53	147.91	18.25	6.79	37.21

Source: Annual Accounts of the SPSU for 2015-16

#### Disinvestment, Restructuring and Privatisation of SPSUs and any reforms in power sector

**3.1.26** As part of the power sector reforms introduced (May 2003) in the Country, separate companies were to be formed to look after the activities of generation, transmission and distribution of electricity in the State. The activities relating to

<sup>28</sup> Equity represents paid up equity capital plus free reserves plus accumulated profits minus accumulated losses.

<sup>29</sup> Net profit after tax.

generation, transmission and distribution of electricity in the State of Sikkim, however, continued to be managed and controlled by the Energy and power Department, Government of Sikkim (November 2017).

## STATE BANK OF SIKKIM

### 3.2 Functioning of State Bank of Sikkim

*State Bank of Sikkim (SBS) was established under the State Bank of Sikkim Proclamation, 1968 by the then Chogyal of Sikkim for providing banking facilities, to mobilise capital for economic development and to stimulate trade and industry in the State of Sikkim. At present, State Bank of Sikkim carried on the business of banking including accepting of deposits, borrowing, lending or advancing money. Performance Audit on the functioning of State Bank of Sikkim covering the period 2012-13 to 2016-17 revealed weaknesses in planning, banking operations, and internal control mechanism of SBS. They led to high levels of non-performing assets and losses on account of write offs of notional interest on loans and advances as bad debts. The following are the main highlights of the audit:*

#### Highlights

**State Bank of Sikkim had not framed any General or Specific Lending Policy or Credit Policy to regulate and safeguard the credits extended by it.**

(Paragraph 3.2.8.3)

**SBS did not have any established comprehensive procedure for post sanction monitoring of credit facilities. Regular follow-up and negotiation with loan defaulters to secure the financial interest of the bank was missing**

(Paragraph 3.2.8.4)

**The percentage of Gross Non-Performing Assets of SBS showed a declining trend during 2011-16. However, it was still quite high at 46.39 per cent at the end of 2015-16 in comparison to the Gross NPA of Public Sector Banks (9.30 per cent) as on that date.**

(Paragraph 3.2.8.5)

**All the eight ATMs of State Bank of Sikkim were lying shut down from 9 November 2016 to 7 November 2017 thereby causing hardship to the customers and damaging the trust of customers of the bank.**

(Paragraph 3.2.8.6)

**As on 31 March 2017, an amount of ₹ 490.68 crore was lying unreconciled on account of inter-branch transactions.**

(Paragraph 3.2.8.7.1)

**Non-compliance with the provisions of the State Bank of Sikkim Proclamation, 1968 were noticed.**

**(Paragraph 3.2.8.11)**

### **3.2.1 Introduction**

State Bank of Sikkim (SBS) was constituted (September 1968) under the State Bank of Sikkim Proclamation, 1968 (Proclamation) by the then Chogyal (King) of Sikkim. It was established for providing banking facilities in the State of Sikkim including accepting of deposits for the purpose of lending or investment, repayable on demand or otherwise and withdrawable by cheques, draft, order or otherwise and also to mobilise capital for economic development and to stimulate trade and industry and various other public purposes. Section 19(1)(a) of the Proclamation further empowered SBS to act as Agent of the Government of Sikkim (GoS), to accept moneys on GoS's behalf and make payments upto the amount standing to the credit of GoS's account and carry out GoS remittances, besides other banking operations, like the management of the public debt of the GoS. As per the notification issued (September 1968) by GoS, the SBS was to act as Bankers and Agent of GoS with effect from 9 September 1968.

As per Section 3(2) of the Proclamation, SBS shall be a body corporate by the name of the State Bank of Sikkim having perpetual succession and a common seal and shall by the said name sue and be sued. During 2012-17, the entire paid-up share capital (₹ 0.53 crore<sup>30</sup>) of SBS was held by GoS and accordingly, SBS was treated as a State Statutory Corporation. The audit of SBS was conducted by the CAG under Section 19(3) of the CAG's (Duties, Powers and Conditions of Service) Act, (as amended) 1971 based on the request of the Governor of the State of Sikkim. However, SBS is neither a Company<sup>31</sup> nor a Co-operative bank<sup>32</sup> as defined in the Banking Regulation Act, 1949.

By the Constitution (Thirty-sixth Amendment) Act, 1975, Sikkim became a State of the Union of India with effect from 26 April 1975. A new article, 371F was inserted in the Constitution stipulating special provisions with respect to the State of Sikkim. As per Article 371F(k) of the Constitution of India, all laws in force immediately before the appointed day (viz. 26 April 1975) in the territories comprised in the State of Sikkim or any part thereof shall continue to be in force therein until amended or repealed by a competent Legislature or other competent authority. As such, the State Bank of Sikkim Proclamation 1968, being an old law of Sikkim was protected under the new Article 371F(k) of the Constitution of India.

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<sup>30</sup>Excluding the paid up value (₹ 0.05 crore) of 10,000 shares (partly paid @ ₹ 50 per share) held by United Bank of India (UCO bank), which were surrendered by UCO bank and amount refunded (June 2006) by SBS. The paid up share capital of SBS was, accordingly, reduced (2014-15) by SBS to that extent.

<sup>31</sup>'Company' means any company as defined in section 3 of the Companies Act, 1956 and includes a foreign company

<sup>32</sup>'Co-operative bank' means a state co-operative bank, a central co-operative bank and a primary co-operative bank.

The Banking Regulation Act, 1949 (Banking Regulations) notified (March 1949) by the Government of India (GoI) was extended (15 January 1976) to the State of Sikkim. The same was to come into force in the State from the appointed date (viz. 15 December 1987). As such, the SBS was required to comply with the provisions of the Banking Regulations with effect from the appointed date (15 December 1987) when the said Regulations were made applicable to the State of Sikkim.

As per clause (1) of section 7 of the Banking Regulations, no company other than a banking company shall use as part of its name or in connection with its business, any of the words ‘bank’, ‘banker’ or ‘banking’ and no company shall carry on the business of banking in India unless it uses as part of its name at least one of such words. Section 22 of the Banking Regulations further stipulated that no company shall carry on banking business in India unless it holds a license issued by the Reserve Bank of India. It was, however, observed that the SBS, despite being covered (15 December 1987) under the purview of the Banking Regulations, did not comply with the provisions of the said Regulations so far (October 2017). It was noticed that SBS used the word ‘Bank’ as part of its name for all purposes including in connection with its banking business. Further, it carries on the business of banking without holding a license issued by the RBI in violation of the provisions of the Banking Regulation Act, 1949.

### 3.2.2 Organisational set-up

As per section 8(1) of the Proclamation, the general superintendence and direction of the affairs and business of the bank vested in the Board of Directors (Board) of the SBS. The composition of the Board as on 31 March 2017 was as follows:

**Table 3.2.1**  
**Composition of Board of Directors of SBS**

Name	Designation	Position in the Board
Shri. K. B. Chamling,	Member, State Legislative Assembly	Chairman, nominated by GoS
Shri. R. S. Basnet,	Principal Secretary to Hon'ble Chief Minister, GoS	Director, nominated by GoS
Shri. M. G. Kiran,	Principal Secretary, Finance, Revenue and Expenditure Department, GoS	Director, nominated by GoS
Shri. S. K. Pradhan,	Secretary (P), Home Department, GoS & MD, Sikkim Industrial Development and Investment Corporation	Director, nominated by GoS
Shri. Hem K. Chhetri	Member, Sikkim Civil Services	Managing Director appointed by GoS

Section 9 of the Proclamation stipulated the composition and maximum number of members on the Board of SBS. Under the proclamation, the maximum number of members (including the Chairman and the Managing Director) on the Board of SBS was fixed at seven. Section 9 of the proclamation empowered the GoS and United Commercial Bank Limited (now UCO bank) to nominate two directors and one director respectively to the Board of SBS. The power of nominating the Chairman was, however, vested with GoS. The Board was empowered to appoint the Managing Director with the

consent of UCO Bank. The remaining two directors were to be elected by the shareholders of SBS other than the GoS and UCO.

Out of the total issued share capital of ₹ 0.63 crore (63,384 shares of face value of ₹ 100 each) of SBS as on 31 March 2014, UCO bank was holding 10,000 shares with partly paid up amount of ₹ 50 per share. The said shares were, however, surrendered (June 2006) by UCO Bank and the entire paid up amount of ₹ 5.00 lakh was refunded (June 2006) by SBS. SBS had, accordingly, reduced its share capital by ₹ 5 lakh during the financial year 2014-15. The GoS was the sole owner of SBS after the UCO Bank surrendered (June 2006) its entire shareholdings in SBS. Therefore, the requirement of the Proclamation regarding nomination of two directors (including the Managing Director) by UCO Bank and other two directors by the shareholder of SBS other than UCO Bank and GoS became redundant. Accordingly, all the five directors (including the Chairman and the Managing Directors) on the Board of SBS as on March 2017 had been nominated by GoS. The Board of SBS did not have any member with professional qualification or technical expertise/experience in the banking sector.

The entire management of SBS operations rested with the Board and no GoS Department was entrusted with any supervisory role in the functioning of SBS. The Managing Director (MD) who was a whole-time officer of SBS, was responsible for the general management of the business of SBS. As on 31 March 2017, SBS had a total of 39 branches across the State including the main branch, which was located in the head office of SBS at Gangtok.

Performance Audit (PA) on the functioning of SBS was taken up in view of the existence of high level of Gross Non-Performing Assets (GNPA) aggregating ₹ 469.64 crore as on 31 March 2017. The GNPA represented 45.75 *per cent* of the total receivables of SBS (₹ 1,026.54 crore) against the outstanding loans & advances.

### **3.2.3 Audit Objectives**

The audit objectives of the PA were to ascertain whether:

- effective plan and strategy for functioning of SBS were in place;
- the banking operations of SBS were taken up efficiently, effectively and economically; and
- the monitoring and internal control mechanism were effective.

### **3.2.4 Audit Criteria**

The criteria adopted for assessing the achievement against the above mentioned audit objectives were drawn from the following sources:

- State Bank of Sikkim Proclamation, 1968 and other applicable Laws/Rules/Regulations.
- Prescribed policies/procedures for regulating its banking operations of SBS.

- Sikkim Public Demands Recovery Act, 2006.
- Banking Regulation Act, 1949
- Good Practices in Banking Sector.
- Guidelines issued by Ministry of Finance, Department of Financial Services, Government of India (GoI) and Reserve Bank of India from time to time.

### 3.2.5 Audit Methodology

The methodology adopted for attaining the above audit objectives involved:

- Explaining the scope, audit objectives, audit criteria, etc. to the Management of SBS during the Entry Conference (06 June 2017),
- Analysis of data/records with reference to audit criteria,
- Raising of audit queries; and
- Issuing of the draft audit report to SBS/GoS for comments.

The draft audit report was also discussed with the representatives of SBS/GoS in the Exit Conference (09 October 2017). The formal replies (2 November 2017) of SBS to the draft report as well as the views expressed by the representatives of SBS and GoS in the Exit Conference have also been taken into consideration while finalising the Report. Formal replies of GoS to the draft audit report, however, had not been received (November 2017).

### 3.2.6 Scope of Audit

Audit reviewed the banking operations of SBS for a period of five years from 2012-13 to 2016-17. The review assessed SBS's performance in credit appraisal, sanction process, post-sanction monitoring and follow-up for credit recovery. The internal control framework of SBS and compliance with the regulatory framework (including compliance with the provisions of State Bank of Sikkim Proclamation, 1968) were also reviewed.

Out of 39 branches of SBS, 10 branches were selected for detailed examination using 'judgemental and random sampling' technique so as to draw a fair representative of the population. Further, out of the total 16,301 cases of loans and advances involving total receivables of ₹ 1,026.54 crore, 261 cases (1.6 *per cent*) involving the receivables aggregating ₹ 534.90 crore (52.11 *per cent*) were also selected for scrutiny. The period covered in audit for review of loans sanctioned was for five financial years from 2012-13 to 2016-17. As regards review of Non-Performing Assets (NPAs), the NPAs of SBS as on 31 March 2017 that included loans sanctioned during the period prior to 2012-13 were also examined.

### 3.2.7 Acknowledgement

Audit wishes to acknowledge the cooperation extended by the Management of State Bank of Sikkim and Government of Sikkim at each stage of the audit process.

### 3.2.8 Audit Findings

The Audit findings relating to the PA are discussed in the succeeding paragraphs.

#### 3.2.8.1 Planning

Planning is a management process for defining the goals of an entity and determining the future direction, missions and resources to achieve the said goals. Strategic planning in a bank is a process for framing long term objectives and strategies at organisational level for the development and pursuit of the fundamental purpose of the bank. Strategic planning helps in reducing various banking risks and places the bank in a position that makes it possible to anticipate any change, and to prepare it for timely reaction. Examination of the records of SBS revealed that SBS did not formulate any long term strategic plan during the 49 years of its existence. However, for each of the years 2012-13 to 2016-17 covered under audit, SBS had been preparing the annual budgets specifying the annual targets for projected income, expenditure, and profitability which were then approved by the Board of SBS. The summarised details of the targets for various activities, as set by SBS in the year-wise annual budgets for the last five years and achievements there against have been presented in **Table 3.2.2** below:

**Table 3.2.2**  
**Targets and Achievements**

Year	2012-13		2013-14		2014-15		2015-16		2016-17	
	Budget	Actual*	Budget	Actual*	Budget	Actual*	Budget	Actual*	Budget	Actual**
<b>Particulars</b>										
<b>Interest &amp; Discount Earned</b>	121.46	130.87	130.00	134.65	150.00	154.46	130.96	147.91	170.00	161.72
<b>Other Incomes</b>	7.54	1.91	8.09	10.88	11.23	11.56	12.81	13.53	16.73	14.77
<b>Total Income (A)</b>	<b>129.00</b>	<b>132.78</b>	<b>138.09</b>	<b>145.53</b>	<b>161.23</b>	<b>166.03</b>	<b>143.77</b>	<b>161.44</b>	<b>186.73</b>	<b>176.49</b>
<b>Interest Expenses<sup>33</sup></b>	93.61	103.57	99.87	112.74	120.00	125.95	108.06	114.40	134.11	124.84
<b>Other Expenses</b>	20.43	20.44	22.26	22.33	24.05	23.31	23.94	28.34	32.60	34.02
<b>Total Expenses (B)</b>	<b>114.05</b>	<b>124.01</b>	<b>122.13</b>	<b>135.06</b>	<b>144.05</b>	<b>149.25</b>	<b>132.00</b>	<b>142.74</b>	<b>166.71</b>	<b>158.87</b>
<b>Net Profit (A) – (B)</b>	<b>14.95</b>	<b>8.77</b>	<b>15.96</b>	<b>10.47</b>	<b>17.18</b>	<b>16.78</b>	<b>11.77</b>	<b>18.70</b>	<b>20.02</b>	<b>17.62</b>

\* Source: Audited Financial Statements; \*\*Provisional unaudited figures

From **Table 3.2.2** above, it can be noticed that the SBS had earned profits during all the five years from 2012-13 to 2016-17 covered under the audit. However, it can also be noticed that except 2016-17, the year-wise achievements of 'Interest & Discount Earned' as well as the 'interest expenses' were significantly higher than the budget. As a result, the actual 'total income' and 'total expense' during these years (2012-13 to 2015-16) had exceeded the targeted figures. This indicated that the year-wise targets fixed for 'interest income' and 'interest expenses' during 2012-13 to 2015-16 were not realistic. Further, although the SBS had earned profits during all the five years, it could not achieve the year-wise targets fixed for the 'net profit' during four out of the five years (excepting 2015-16). In 2015-16, the net profits targets were fixed at comparatively lower level.

SBS stated (November 2017) that it was completing its five decadal existence and an organisation cannot survive this long without strategy and planning. It was further added

<sup>33</sup>Pertains to interest paid to depositors

that SBS introduced annual budgeting and targets setting system during the last five years and the net-worth of SBS changed from negative to positive.

The reply was not tenable as there was no documentary evidence on record to establish that SBS had ever prepared any long-term or strategic plan. Further, the claim regarding improvement in the net worth was also unrealistic considering the fact that improvement in the net worth was achieved mainly due to short provisioning against the substandard assets as discussed in the subsequent paragraphs.

### 3.2.8.2 Financial Position and Working Results

The summarised details of the ‘net profits’ earned by SBS during the five years from 2012-13 to 2016-17 have been presented in **Table 3.2.3** below:

**Table 3.2.3**  
Net Profits of SBS

Particulars	(₹ in crore)				
	2012-13	2013-14	2014-15	2015-16	2016-17*
<b>Total Income (a)</b>	132.78	145.53	166.03	161.44	176.49
<b>Total Expenses (b)</b>	124.01	135.06	149.25	142.74	158.87
<b>Net Profit (a – b)</b>	<b>8.77</b>	<b>10.47</b>	<b>16.78</b>	<b>18.70</b>	<b>17.62</b>

\* Provisional unaudited figures

From **Table 3.2.3** above, it can be seen that the net profits of SBS had shown an increasing trend during the five years of 2012-17 excepting a marginal decrease in 2016-17. Examination of the records of SBS, however, revealed that the above profit had been arrived at by SBS without creating mandatory provisions as required under the ‘Asset Classification and Provisioning Guidelines’(Guidelines) approved (March 2014) by the Board of SBS. As per the said Guidelines discussed in detail under paragraph 3.2.8.5 *infra*, the provisions should be created for Loss Assets (100 *per cent* provision), Doubtful Assets (100 *per cent* provision of unsecured portion and minimum 25 *per cent* on secured portion), Substandard Assets (15 *per cent* provision) and Standard Assets (0.40 *per cent* provision). SBS, however did not create any such provisions for different categories of assets in contravention of the Guidelines. Instead it had created general provision for bad and doubtful debts at 7.5 *per cent* of the net profit for the respective year. It was noticed that the reported profits of SBS for all the five years from 2012-13 to 2016-17 would turn into losses, even if the short provisioning in respect of only Substandard assets of SBS are taken into account, as per the details given in **Table 3.2.4** below:

**Table 3.2.4**  
Net Profits of SBS for 2012-17 to 2016-17 after considering the short provisioning against Substandard Assets

Year	(₹ in crore)				
	2012-13	2013-14	2014-15	2015-16	2016-17*
Net Profit as per the financial statements (a)	8.77	10.47	16.77	18.7	17.62
Substandard Assets	175.40	368.26	397.58	438.27	467.68
Provision to be created (15 <i>per cent</i> of Substandard Assets) (b)	26.31	55.24	59.64	65.74	70.15
Provision created @ 7.5 % <i>per cent</i> on Profit( c)	0.66	0.79	1.26	1.40	1.32
Short Provisioning (d)=(b-c)	25.65	54.45	58.38	64.34	68.83
Net Profit/(Loss) after considering the short provisioning against Substandard Assets (a – d)	(16.88)	(43.98)	(41.61)	(45.64)	(51.21)

\* Provisional unaudited figures

From **Table 3.2.4** above, it is clear that although the financial statements of SBS reflected profits during all the five years, the SBS had actually incurred losses considering the requirement of the Asset Classification and Provisioning Guidelines on provisioning against the Substandard assets only.

The summarised details of the financial position of SBS for last five years from 2012-13 to 2016-17 have been given in **Table 3.2.5** below:

**Table 3.2.5**  
**Financial position of SBS for the years from 2012-13 to 2016-17**

(₹ in crore)

Particulars	As at 31 <sup>st</sup> March				
	2013	2014	2015	2016	2017*
<b>Capital &amp; Liabilities</b>					
Paid-up Share Capital	0.53	0.53	0.53	0.53	0.53
Reserve & Surplus	4.77	6.90	8.15	24.83	30.56
Deposits	1566.28	1904.15	1955.57	1960.09	2074.69
Borrowings	54.94	40.39	24.31	30.94	178.25
Other Liabilities & Provisions	99.61	104.70	114.39	103.30	112.47
<b>Total</b>	<b>1726.13</b>	<b>2056.67</b>	<b>2102.95</b>	<b>2119.69</b>	<b>2396.50</b>
<b>Assets</b>					
Cash & Balance with RBI	64.91	37.47	66.21	46.08	15.52
Balances with Other Banks	1216.86	1361.03	1187.99	1155.66	1054.58
Investments	6.00	7.16	14.40	36.23	334.48
Advances	311.00	532.77	730.93	805.41	871.21
Fixed Assets	2.79	3.14	3.67	5.00	5.66
Other Assets	114.71	108.87	97.11	71.31	115.05
Profit & Loss Account (Debit Balance)	9.86	6.23	2.64	0.00	0.00
<b>Total</b>	<b>1726.13</b>	<b>2056.67</b>	<b>2102.95</b>	<b>2119.69</b>	<b>2396.50</b>

\* Provisional unaudited figures

As per Good Banking practices adopted by other nationalised banks, SBS was required to formulate a well-thought investment policy for investment of its surplus funds in a manner so as to maximise the returns without compromising the safety, security and reasonable liquidity of the funds invested. Examination of records of SBS revealed that the SBS had not devised any Investment Policy even after almost five decades of its existence. In the absence of a well-defined investment policy, there was no precise system in SBS for selection of appropriate avenues best suitable for investment of the surplus funds.

As can be seen from **Table 3.2.5**, SBS had been holding huge 'Deposits' from its customers ranging from ₹ 1,566.28 crore (2012-13) to ₹ 2,074.69 crore (2016-17) during 2012-17. The rate of interest on the 'Deposits' was fixed by a committee<sup>34</sup> constituted for this purpose. Audit observed that the 'Deposits' of the customers of SBS had not been protected through any bank deposits insurance scheme.<sup>35</sup>

<sup>34</sup>Managing Director (Chairman of committee), Chief General Manager, All General Managers, Sr. Manager (Operation) (Member Secretary of Committee), Sr. Manager (Inter Branch Reconciliation), Asst. Manager (Inter Branch Reconciliation),

<sup>35</sup> Deposit Insurance is a measure to protect bank depositors from losses caused by a bank's inability to pay its debts when due.

SBS stated (November 2017) that the insurance cover for the ‘Deposits’ was not available for SBS, as it was not licensed by RBI.

The reply was not acceptable as the SBS should have obtained the necessary license for carrying out the banking operations from the RBI as per the requirements of the Banking Regulations Act, 1949, which was made applicable to SBS long back in December 1987.

### 3.2.8.3 Credit appraisal and sanction

The biggest risk faced by the banking sector was the credit risk, which was associated with the uncertainty of default by the borrowers in repayment of the loan amount. Accordingly, as per good practices in the banking sector, banks generally adopt an effective credit appraisal mechanism before sanctioning the loans. This involved critical evaluation of borrowers’ current and future ability to fulfil obligations of the repayment of interest and principal. This exercise consisted of various processes starting from the documentation, sanctioning and disbursement of loan, grading of loan assets. The credit appraisal mechanism is generally documented as a Lending or Credit policy

SBS provided various credit facilities, such as Cash Credits/Overdrafts (CC/OD), Employees Personal Loan, Construction Loan and various other loans to its customers. CC/OD are short-term credit facilities provided against security. Employees Personal Loan are credit facilities provided to the employees of the GoS and State PSUs based on their net emoluments. Construction Loans are loans provided for construction purposes against the mortgage of land/building, etc. The summarised details of ‘Loans and Advances’ disbursed by SBS during the years from 2012-13 to 2016-17 have been depicted in **Table 3.2.6** below:

**Table 3.2.6**  
**Disbursement of Loans and Advances**

Type of Credit	2012-13	2013-14	2014-15	2015-16	2016-17*
Cash Credit /OD	54.51	110.09	69.59	77.70	127.45
Employees Personal Loan (EPL)	6.89	27.92	29.92	37.10	22.72
Construction Loan	16.80	18.19	20.96	27.29	12.16
Other Loans	19.02	92.43	83.29	61.52	37.47
<b>Total</b>	<b>97.22</b>	<b>248.63</b>	<b>203.76</b>	<b>203.61</b>	<b>199.80</b>

\* Provisional unaudited figures

From the Table above, it is evident that during 2012-17, SBS advanced loans aggregating ₹ 953.02 crore at an average of ₹ 190.60 crore per year. SBS however, had not framed any General or Specific Lending Policy or Credit Policy to regulate and safeguard the credits extended by it. SBS also did not have any Fair Lending Practices Code. The procedure followed by SBS for credit appraisal and sanction of credit facilities was as follows:

- Applications for availing credit facilities were received and summarised in Loans section.

- The summary of the proposals was put up to the Loan Appraisal Committee<sup>36</sup> (LAC) till February 2014, when the LAC was disbanded. From March 2014 onwards, the summary of loan proposals were submitted to the Managing Director (MD).
- The loan proposals valuing upto ₹ 10 lakh were sanctioned by MD and those beyond ₹ 10 lakh were put up to the Board of Directors for sanction.
- After sanction of the loan proposals by the MD/Board, the sanction was communicated to the borrower and the process of documentation was taken up. This included obtaining of the required security against the loan amount.
- The disbursement of loan/advance was made after execution of documents.

As on 31 March 2017, the SBS had total receivables of ₹ 1,026.54 crore against 16,301 loan cases<sup>37</sup>; of which audit selected 261 cases<sup>38</sup> (1.6 per cent) involving ₹ 534.90 crore (52.11 per cent) for detailed scrutiny. In the absence of a documented Lending policy and detailed Credit Appraisal Mechanism, the sanction of credit facilities were not based on the laid down objective criteria of the loan schemes. The valuation of securities pledged, site plan in case of construction loan, permission from the local authorities were only considered before sanctioning a loan. The deficiencies noticed in the sanction of all the 261 loan cases test checked are detailed below:

- performance of loan applicants for previous years (3 to 5 years) in terms of their working results and financial position was not reviewed;
- details of credit facilities already availed by the applicant/borrower from SBS or other institutions were not ascertained;
- grading of loans/advances based on the credentials of the loan applicants was not done and no analytical tools were used for credit appraisal;
- credit worthiness of the applicants were not documented before sanction of loan;
- there was no system in existence to ascertain whether the applicant/borrower featured in the list of wilful defaulters (261 cases);
- LAC/MD recommended the loan proposals for sanction by the Board of Directors without the credit appraisal report of the loan applicants with regard to their past financials, past cash-flows, credit rating, financial ratio analysis, projected financials, business model and debt-servicing ability. The Board also approved the loan proposals without calling for the detailed credit appraisal reports for each proposal;
- in the absence of a lending policy, there was no prescribed time period for sanction/rejection of loans.

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<sup>36</sup>, Chief General Manager, General Managers(Admn), General Manager (Loan & Recovery), Manager(Loan), Asst.Manager(Overdraft/Cash-credit)

<sup>37</sup>1935 nos. of construction loans amounting to ₹ 209.68 crore, 598 nos. of CC amounting to ₹ 367.76 crore and 13768 nos. of other loans amounting to ₹ 449.10 crore.

<sup>38</sup>111 nos. of construction loans amounting to ₹ 131.45 crore, 109 nos. of CC amounting to ₹ 286.43 crore and 41 nos. of other loans amounting to ₹ 117.02 crore.

The SBS accepted the facts and assured (November 2017) to formulate an appropriate Lending Policy and Fair Lending Practice Code, incorporating the System of evaluating the borrower's credit worthiness, grading tools for loans and time period for sanction/rejection.

#### 3.2.8.4 Post Sanction activities

As per good practices in banking sector, a well-documented system for effective monitoring and follow-up of loans and advances is essential. It was, however, noticed that SBS did not have any established comprehensive procedure for post sanction monitoring of credit facilities. The follow-up of loans and advances was *ad-hoc* in nature on case to case basis. The following important deficiencies were noticed in the monitoring and follow-up action of SBS in respect of all the 261 loan cases scrutinised in audit:

- the quarterly progress reports (physical or financial) on the activities/progress of works of the borrowers pertaining to construction and business loans were not obtained and reviewed;
- statements showing the operational results/balance sheets of the borrowers were not scrutinised on periodic basis;
- there was nothing on the records of SBS to establish that:
  - regular inspection of borrowers' assets mortgaged with SBS as security was carried out and the monitoring of guarantors and value of collateral security was done;
  - regular inspections were carried out to ensure that the borrowed funds were deployed for purposes/activities or creation of assets for which the loan was sanctioned;
  - periodical visits were made to the borrower and the project location where the assets were being created with loan amount;
- the periodical stock/assets statements were not obtained. There was no system of periodical audit of stock/assets of the borrowers to ensure correctness and adequacy of securities against loan amount;
- follow-up and persuasion with the loan defaulters at initial stage of default in repayment of loan installments was missing; and
- regular follow-up and negotiation with loan defaulters to secure the financial interests of SBS was missing.

The SBS stated (November 2017) that during the last five years, it had tried to improve the inspection and monitoring aspects with periodical inspection of properties and projects. It further stated that a system of calculating drawing power on the basis of statement of stocks and bills receivables in cash credit accounts has been introduced (2017) and SBS was consciously trying to bring more improvement in post sanction activities.

The reply was not acceptable considering the fact that there was still wide scope for improvement in the asset quality as compared to other Public Sector Banks (PSBs) of the country. This was evident in the comparative analysis of the Gross NPAs of SBS and that of the PSBs brought out under **paragraph 3.2.8.5** *infra*. SBS thus, needed to streamline its post sanction activities by putting in place a comprehensive procedure for post sanction monitoring and follow up of credit facilities.

#### **3.2.8.4.1 Recovery Policy of SBS**

The Recovery Policy of SBS approved (September 2014) by the Board of Directors provided the basic guidelines mainly on the matters relating to compromise settlement. The Recovery Policy, however, did not address several important aspects like Code for collection for unpaid dues, seizure of securities of the defaulting borrowers, valuation and sale of the property seized, etc. Audit observed that in 21 cases test checked in audit out of a total of 254 cases of ‘construction loans’ disbursed during 2012-17, there was total outstanding balance of ₹ 2.54 crore as on 31 July 2017. It was observed that the borrowers had not paid a single installment against these loans so far (August 2017). SBS, however, failed to initiate any legal proceedings against these defaulting borrowers for recovery of unpaid dues. During 2012-17, a total of 35 cases of ‘compromise settlement’ were approved and SBS sacrificed the interest income aggregating ₹ 4.04 crore (notional interest i.e. the interest which accrued on these loans at the rate of 9 *per cent* simple interest from the date of declaration of NPA to the date of settlement) through waiver, which included interest of ₹ 3.72 crore receivable against CC/OD. Poor credit appraisal, inadequate documentation and lack of proper monitoring and follow up of loans and advances led to these loans and advances becoming bad debts and ultimately resulting in a loss of ₹ 4.04 crore to SBS.

The SBS stated (November 2017) that Recovery Policy of SBS is a comprehensive documentation of bank’s intention to reduce the burden of unproductive assets and deals mostly on recovery of NPA accounts. As regards the interest waiver, SBS stated that the amount of sacrifice was only the notional interest portion which were written off.

The reply was not acceptable as the Recovery Policy of SBS needed appropriate revisions/modifications addressing several significant issues like seizure of securities available against loan assets and their disposal for speedy recovery of outstanding loans defaulted by borrowers. Further, failure of SBS to take the available legal course of action against the defaulters for recovery of unpaid interest amount was also not justified.

#### **3.2.8.5 Asset Classification and Provisioning**

With a view to reflect a true picture of the financial health of banks in their balance sheet, RBI had prescribed (1992) the prudential norms for income recognition, asset classification and provisioning for the advances portfolio of the banks. Accordingly, all the Public Sector Banks had adopted the said norms in a phased manner (1992 onwards).

The SBS had not adopted the said prudential norms prescribed by RBI so far (November 2017). The SBS, however, prepared and adopted (April 2011) its own guidelines namely, ‘Asset Classification and Provisioning Guidelines’ (Guidelines), which mainly addressed

issues relating to the classification and provisioning against the loan assets of SBS, and were broadly in line with the RBI norms prescribed on the subject.

As per these Guidelines, if interest or installment of principal remained overdue for more than 90 days, loans were to be classified as Non-Performing Assets (NPAs). NPAs were further classified into Substandard, Doubtful and Loss Assets. The Substandard Assets included those assets which remained NPA for a period of less than or equal to 12 months. Doubtful Assets included those which remained Substandard Assets for a period of 12 months. Loss Assets were those assets where loss had been identified by SBS or by the internal or external auditor but the amount had not been written-off completely.

As per the Guidelines, SBS was required to create the provisions against its loan assets as per the details given below:

**Table 3.2.7**  
**Details of provisions against loan assets**

Asset category	Provision required
Loss Assets	100 <i>per cent</i> provision
Doubtful Assets:	
For unsecured portion of loan assets	100 <i>per cent</i> provision
For the secured portion of assets	<ul style="list-style-type: none"> <li>• 25 <i>per cent</i> provision of secured portion of assets if assets remained doubtful upto 1 year;</li> <li>• 40 <i>per cent</i> provision of secured portion of assets if assets remained doubtful for 1 to 3 years; and</li> <li>• 100 <i>per cent</i> provision of secured portion of assets if assets remained doubtful for more than 3 years</li> </ul>
Substandard Assets	15 <i>per cent</i> provision on total outstanding
Standard Assets	0.40 <i>per cent</i> provision on total outstanding

The **Table 3.2.8** below depicts the summarised details of classification of the loan assets by SBS as at 31 March during last five financial years (2012-13 to 2016-17):

**Table 3.2.8**  
**Asset Classification**

Classification as on	Standard Assets		Substandard Assets		Doubtful Assets		Loss Assets		Gross NPAs	
	(₹ in crore)	<i>per cent</i>	(₹ in crore)	<i>per cent</i>	(₹ in crore)	<i>per cent</i>	(₹ in crore)	<i>per cent</i>	(₹ in crore)	<i>per cent</i>
31 March 2013	147.42	34.63	175.40	41.20	98.13	23.05	4.80	1.13	278.33	65.37
31 March 2014	292.58	43.32	368.26	54.52	8.87	1.31	5.70	0.84	382.83	56.68
31 March 2015	477.18	52.85	397.58	44.04	21.19	2.35	6.90	0.76	425.67	47.15
31 March 2016	520.29	53.61	438.27	45.16	4.38	0.45	7.64	0.79	450.29	46.39
31 March 2017*	556.90	54.25	467.68	45.56	0.08	0.01	1.88	0.18	469.64	45.75

\* Provisional unaudited figures

From the Table above it can be noticed that during 2012-17, the loan assets of SBS consisted of a significantly high proportion of Substandard Assets. It ranged from 41.20 *per cent* (2012-13) to 54.52 *per cent* (2013-14) of total loan assets. High proportion of Sub-standard assets had contributed towards high level of Gross NPAs in SBS during the five years ranging from 45.75 *per cent* (2016-17) to 65.37 *per cent* (2012-13) of loan assets. This indicated that there was scope for improvement in the quality of the loan assets.

The Net NPAs of SBS are arrived at after deducting the ‘bad debts’ and provisions made there against from the Gross NPAs. The interest receivable against these ‘bad debts’ was also transferred to ‘interest suspense account’. Examination of the records of SBS, however, revealed that SBS did not create provisions against various categories of loan assets as prescribed under the Asset Classification and Provisioning Guidelines. On the contrary, SBS only created general provision for Bad and outstanding Doubtful debts to the extent of 7.5 per cent of the net profits for the respective year as discussed under **paragraph 3.2.8.2 supra**.

The SBS stated (November 2017) that although the Asset Classification and Provisioning Guidelines had been adopted in full, implementation was being done in a phased manner. SBS further assured to fully comply with the Guidelines in future.

The reply was not acceptable as the Guidelines were adopted by SBS with the aim of providing true picture of the financial health of SBS in its financial statements. Non-provisioning against loan assets as per the percentage prescribed under the Guidelines had completely distorted the working results/profitability of the SBS as presented in its financial statements for the last five years (2012-13 to 2016-17).

The summarised position of Gross and Net NPA ratio as a percentage of total loan assets of SBS as at the end of last five financial years (2012-13 to 2016-17) has been depicted in **Table 3.2.9** below:

**Table 3.2.9**  
**Percentage of Gross and Net NPAs to total outstanding loans and advances of SBS**

<b>Position as on</b>	<b>Gross NPA percentage</b>	<b>Net NPA percentage</b>
31 March 2013	65.37	52.60
31 March 2014	56.68	45.08
31 March 2015	47.15	34.72
31 March 2016	46.39	35.40
31 March 2017*	45.75	36.08

\* Provisional unaudited figures

As can be noticed from the Table above, despite a declining trend in the Gross NPAs during the five years under reference, the level of Gross NPAs of SBS as on 31 March 2017 remained significantly high. The high level of Gross NPAs had correspondingly reduced the availability of funds for carrying out the credit and lending activities of SBS to that extent. This had correspondingly destabilised the chain of recycling of fund thereby disrupting the entire economic cycle of SBS.

The comparative position of various categories of the loan assets of SBS and that of the Public Sector Banks (PSBs) of India as on 31 March 2016<sup>39</sup> has been depicted in the **Table-3.2.10**:

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<sup>39</sup>Position as on 31 March 2017 for PSBs not available

**Table 3.2.10**  
**Asset classification of SBS vis-à-vis PSBs as a percentage of their total loan assets as on 31 March 2016**

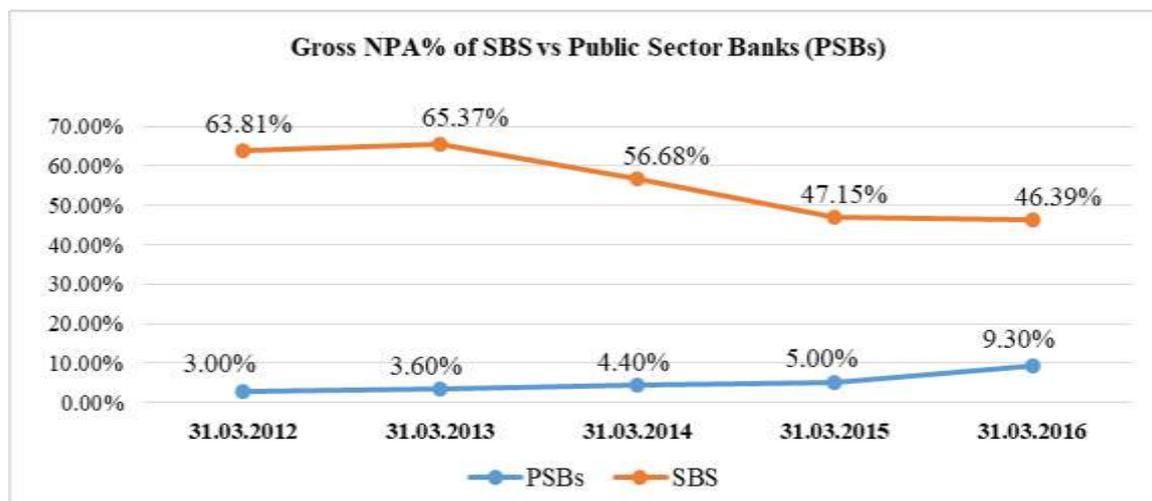
Particulars	<i>(in percentage)</i>				
	Standard Advances	Substandard Advances	Doubtful Advances	Loss Advances	Gross NPAs
Public Sector Banks (PSBs) <sup>40</sup>	90.70	3.40	5.50	0.30	9.30
State Bank of Sikkim (SBS)	53.61	45.16	0.45	0.79	46.39

Source: RBI's website <https://dbie.rbi.org.in> and Data collected from SBS

As evident from the Table above, the Standard assets of SBS as on 31 March 2016 were 53.61 *per cent* of the total loan assets. This was far below the Standard assets of PSBs (90.70 *per cent*) indicating that the quality of loan assets of SBS was very poor. Further, the Substandard assets of PSBs as on 31 March 2016 were merely 3.40 *per cent* whereas the Substandard assets of SBS were as high as 45.16 *per cent* of the loan assets. From the above, it is evident that the asset quality of SBS was highly weakened as compared to that of the PSBs of India.

The comparative position of Gross NPAs of SBS and PSBs as a percentage of their respective loan assets as at the end of last five years from 2011-12 to 2015-16 has been depicted in **Chart 3.2.1**.

**Chart 3.2.1**



Source: RBI's website <https://dbie.rbi.org.in> and Data collected from SBS

As can be noticed from the Chart above, the assets quality of SBS was highly deteriorated in comparison to that of the PSBs. Although the percentage of Gross NPA of SBS showed a declining trend during 2011-16, it was significantly higher at 46.39 *per cent* at the end of 2015-16 in comparison to that of PSBs (9.30 *per cent*). The poor position of Gross NPA was attributable to failure of SBS to control its asset quality through effective credit appraisal before sanction of loans and effective monitoring of loans and advances after disbursement.

<sup>40</sup> Average of all public sector banks in India as on 31 March 2016

The SBS while accepting that the proportion of NPA was high, stated (November 2017) that there was reduction of NPA in terms of percentage.

The reply was not acceptable since the Gross NPA of SBS, despite showing decreasing trend during last five years, was still very high in comparison to that of PSBs during the years under reference.

### **3.2.8.6 Functioning of Branches**

The services provided by the branches of SBS to the account holders included facilities of creating fixed deposits, utilising the Automated Teller Machines (ATMs) for 24x7 cash withdrawal, preparing of Demand Drafts (DDs)/Pay Orders, etc. These facilities were in addition to the routine services of depositing cash to and withdrawals from the account maintained with the bank. SBS, however, did not offer telephone and online banking services to its customers. As of 31 March 2017, SBS had a total of 39 branches located throughout the State of Sikkim, which included the Main Branch at head office of SBS in Gangtok. During the course of PA, 10 branches of SBS were selected for detailed examination. The summarised details of the branches and ATMs of SBS located in each district of Sikkim vis-à-vis the population in the respective district have been depicted in **Table 3.2.11** below:

**Table 3.2.11**  
**District-wise population of State vis-à-vis the number of Branches and ATMs of SBS**

Name of District	Population (as per census 2011)	As on 31 March 2017 (in Nos.)	
		SBS Branches	SBS ATMs
North District, Sikkim	43,709	4	1
West District, Sikkim	1,36,435	10	1
South District, Sikkim	1,46,850	7	2
East District, Sikkim	2,83,583	18	4
<b>Total</b>	<b>6,10,577</b>	<b>39</b>	<b>8</b>

As can be noticed from the Table above, SBS had a total of 39 branches as on 31 March 2017 against the total State population of 6.11 lakh with average availability of one branch for a population of 15,655 persons. This was reasonably adequate against the All India average availability of one branch for 15 thousand<sup>41</sup> persons.

Further, the State had a total of 193 ATMs as of 31 March 2017, which included the ATMs of Public Sector Banks (132), private sector banks (53) and SBS (8). Thus, the contribution of SBS in the ATMs available in the State was a meagre 4 *per cent* of total ATMs in Sikkim. As evident from the above, SBS could provide only one ATM against the average population of 76,322 persons in the State as a whole. As such, there was scope for further expansion in the number of ATMs to serve the needs of the State population.

On 8 November 2016, the GoI announced demonetisation of old currency notes of denomination of ₹ 1000 and ₹ 500. Audit noticed that all eight ATMs of SBS were non-functional since the announcement of demonetisation by GoI (8 November 2016) and the same could be made operational only in November 2017, after a period of one year. The

<sup>41</sup>Source: Reserve Bank of India

reasons for all eight ATMs lying defunct for such a long period was attributable to delay in recalibration of the cash cassettes of the ATMs in accordance with the size of new currency notes of ₹ 2000 and ₹ 500 denomination. It was also attributable to pending migration of SBS to new software (Core Banking Solution) since April 2017, which required fresh integration. Non-functioning of SBS ATMs for such a long period had caused hardship to the customers.

#### **3.2.8.6.1: Record-keeping at Branches**

The general and subsidiary ledgers (including various registers maintained to record miscellaneous information/data) were the main source of SBS's financial data/information. Therefore, SBS needed to maintain these records in the prescribed format duly completed and updated on periodical basis so as to provide authentic and correct picture of the financial and operational activities of SBS. Examination of records, however, revealed that the Stock and Issue registers maintained by the branches of SBS had not been updated on regular basis. This defeated the intended purpose of these records. It was further observed that SBS had not been maintaining several important registers/records as detailed below:

- Registers to record particulars of lost instruments (drafts, cheques, etc.) based on details received from the head office;
- Registers to record particulars of outstanding inter-branch entries, received from the inter-branch reconciliation department of the SBS, which were to be responded by the branches concerned.

Audit also noticed the following deficiencies at all the 10<sup>42</sup> test checked branches:

- Account opening forms for all types of accounts (including Savings, Current & Deposit accounts) did not record the assurance regarding completion of 'Customer Due Diligence' process. The process of verification of the identity of the customer, as such, remained incomplete.
- Physical verification reports of fixed assets of branches were not available on record.
- Bank reconciliation statements relating to the bank accounts maintained by SBS with other banks were not prepared on time.
- Details of nominees of the account holders of SBS were not registered by the branches concerned.
- No written manual of instructions was found at any of the SBS branches describing the detailed procedures for executing various types of transactions at branches and delegation of powers in respect of various operations of the branches.
- Branches of SBS did not have a Grievance Redressal Policy and a code of commitment to customers.

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<sup>42</sup>Out of 39 branches of SBS

The SBS stated (November 2017) that the bank was planning to formulate a General Rule and Code of Ethics (GRACE) for the benefit of its customers and also assured to regularly maintain all the required records/registers.

### 3.2.8.7 Internal Control and Compliance

An Internal Control Mechanism can be defined as a combination of the processes designed, implemented and maintained to provide reasonable assurance with regard to reliability of financial reporting, effectiveness and efficiency of operations, safeguarding of assets and compliance with applicable laws and regulations by an entity. Thus, an effective Internal Control Mechanism has a significant role to play in the efficient functioning of an organisation. The deficiencies noticed in the 'Internal Control Mechanism' of SBS have been discussed in the following paragraphs:

#### 3.2.8.7.1 Reconciliation of Inter-branch transactions.

As per Good Practices in Banking Sector, inter-branch transactions should be reconciled on a daily basis. In SBS, the reconciliation of inter-branch transactions was done manually due to lack of inter-connectivity in the application software between the branches and Head Office (HO) and between branches themselves. Accordingly, the inter-branch accounts were reconciled at HO and unreconciled entries were sent to branches for their response. It was observed that due to lack of connectivity, poor record keeping and non-response by 22 branches (out of 36 branches having unreconciled entries), the inter-branch reconciliation in SBS could not be done on a daily basis. Examination of records revealed that as on 31 March 2017, huge balances of inter-branch transactions were lying unreconciled as per the details given in **Table 3.2.12** below:

**Table 3.2.12**  
**Unreconciled Inter Branch Transactions**

(₹ in crore)

Account Name	Balance as per the records of HO	Balance as per the records of the Branches	Difference	Unreconciled Since
Head Office (Old)	545.41(Dr <sup>43</sup> )	379.64(Cr)	165.77	01 April 2011
Head Office (Central Account)	922.67(Dr)	794.64(Cr)	128.03	01 April 2011
ATM Transactions	4.08(Dr)	5.08(Cr)	1.00	01 November 2011
Any Branch Banking <sup>44</sup> (ABB) Transactions	51.73(Cr)	11.71(Cr)	63.44	01 April 2016
Draft Account	944.54(Dr)	920.91(Cr)	23.62	01 December 2015
Suspense Account	0.37(Dr)	0.15(Dr)	0.52	
Interest Suspense	108.26	0.00	108.26	-N.A.-
Clearing Suspense	0.04	0.00	0.04	
		<b>Total</b>	<b>490.68</b>	

As can be noticed from the Table above, there were huge balances of inter-branch transactions aggregating ₹ 490.68 crore lying unreconciled as on 31 March 2017. Further, a significant portion of these balances (₹ 294.80 crore) was lying unreconciled for more than six years since April/November 2011. It was further observed that an old un-

<sup>43</sup> Dr=Receivable; Cr=Payable

<sup>44</sup> it is a system where a customer can deposit and withdraw money from any of the online branches of the bank on a payment of minimal charge

reconciled block difference of ₹ 3.41 crore was written off (March 2017) by SBS due to non-availability of proper records. Lack of periodic and regular reconciliation causes inter-branch account susceptible to frauds. Recognising this, SBS needs to take immediate measures for expeditious reconciliation of these transactions.

### 3.2.8.7.2 Reconciliation of accounts maintained with other banks

Audit observed that Bank reconciliation statements for accounts maintained by Head Office of SBS with State Bank of India (SBI) and Central Bank of India (CBI) were pending for more than six years. The differences amounting to ₹ 202.17 crore as on 31 March 2017 between the balances as per the records of SBS and that of the two banks were lying unreconciled as shown below:

**Table 3.2.13**  
**Unreconciled Bank Accounts**

<i>(₹ in crore)</i>	
<b>In account with State Bank of India (SBI) as on 31 March 2017</b>	
Balance as per SBS (Debit balance)	45.48
Balance as per SBI (Credit balance)	4.77
<b>Difference</b>	<b>40.71</b>
<i>(₹ in crore)</i>	
<b>In account with Central Bank of India (CBI) as on 31 March 2017</b>	
Balance as per SBS (Credit balance)	138.84
Balance as per CBI (Credit balance)	22.62
<b>Difference</b>	<b>161.46</b>

It was observed that during August 2017, the SBS had entrusted the work of reconciliation of balances to an outside agency and the same was in progress (November 2017). It was further noticed that SBS had not framed any Accounting and Operations Manual to provide necessary guidance to the Branches for proper accounting of inter-bank/inter-branch transactions. Considering the huge unreconciled amounts in inter-branch/bank transactions, SBS should frame and adopt an Accounting and Operations Manual. The Manual should set out Comprehensive General Ledger controls and Standard Accounting & Operating procedures for strengthening the banking procedures, reconciliation, reporting and monitoring processes in the branches of SBS.

While accepting the observations, SBS stated (November 2017) that the work of reconciliation of inter-branch/inter-bank balances was under process and the same was expected to be completed within a reasonable time. SBS also assured to formulate the Accounting and Operational Manual for better operations of SBS.

### 3.2.8.8 Delay in finalisation of financial statements

As per section 33 of the State Bank of Sikkim Proclamation, 1968 the audited financial statements of the SBS along-with the auditors' report thereon should be furnished to the designated authority within three months after the end of the relevant accounting period. As such, the SBS was required to finalise its annual financial statements for each financial year and get the same audited latest by 30 September of the next financial year. Annual financial statements of SBS for the last five years (2012-17) were, however, finalised after considerable delays. The delays ranged from 3 to 21 months from the due date as reflected in **Table 3.2.14** below:

**Table 3.2.14**  
**Finalisation of Annual Financial Statements**

Year	Due Date	Actual date of approval/adoption of the Financial Statements by the Board of SBS	Delay (in Months)
2012-13	30 June 2013	31 March 2015	21
2013-14	30 June 2014	14 October 2015	15½
2014-15	30 June 2015	26 September 2016	15
2015-16	30 June 2016	26 September 2016	03
2016-17	30 June 2017	16 October 2017	3 ½

\*Position as on 30 November 2017

Delays in finalisation of the financial statements were mainly attributable to excessive time consumed in compilation of the financial figures. The avoidable delays had correspondingly caused delay in payment of Advance Taxes as well as delays (ranging from 11 to 17 months) in filing of income tax returns for the financial years 2012-13 to 2014-15. Examination of the records further revealed that due to failure of SBS to pay the advance tax on time and failure to file the income tax returns within the due dates, it had to bear avoidable loss of ₹ 3.71 crore on account of the interest liability. The details of such losses under section 234 A, 234 B & 234 C of the Income Tax Act, 1961 (IT Act, 1961) are given in **Table 3.2.15** below:

**Table 3.2.15**  
**Interest paid u/s 234A, 234B and 234C of the IT Act, 1961**

(₹ in crore)

Financial Year	Delay in filing of the Income Tax Returns			Delay in payment of advance tax	
	Due date	Actual date	Interest u/s 234A	Interest u/s 234B	Interest u/s 234C
2012-13	30.09.2013; 31.10.2013 (extended)	31.03.2015	0.63	1.05	0.14
2013-14	30.09.2014; 30.11.2014 (extended)	21.03.2016	0.75	0.70	0.21
2014-15	30.09.2015; 30.10.2015 (extended)	07.10.2016	-	-	0.20
2015-16	30.09.2016; 17.10.2016 (extended)	07.10.2016	-	0.02	0.01
2016-17	30.09.2017; 31.10.2017 (extended)	Pending*	-	-	-
<b>Column Total</b>			<b>1.38 (A)</b>	<b>1.77 (B)</b>	<b>0.56 (C)</b>
<b>Total (A+B+C)</b>			<b>3.71</b>		

\*Position as on 31 August 2017

The SBS stated (November 2017) that delay in finalisation of accounts was caused due to confusion on the applicability of IT Act, 1961 to the SBS.

The reply was not acceptable as the IT Act, 1961 was made applicable to the State of Sikkim long back with effect from 1<sup>st</sup> April 1990<sup>45</sup> and the income tax liability, being a statutory obligation, should have been taken cognizance of by SBS.

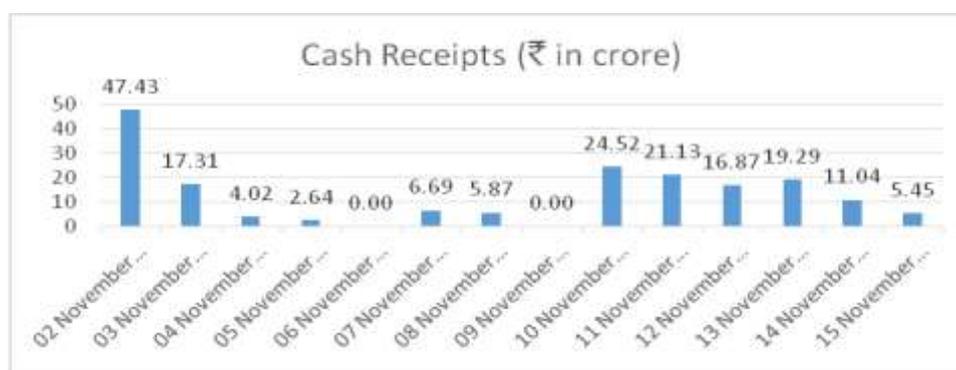
<sup>45</sup> As per Finance Act, 1989

### 3.2.8.9 Demonetisation

As discussed under **paragraph 3.2.8.6** *supra*, Government of India (GoI) announced (8 November 2016) demonetisation of old currency notes of denomination of ₹ 1000 and ₹ 500 (referred to as Specified Bank Notes or SBNs). The citizens of the Country were accordingly, advised to exchange or deposit the old currency notes of SBNs under their possession to the banks between 9 November and 30 December 2016, by providing the necessary details of the cash holdings so deposited/exchanged. GoI, however, restricted (8 November 2016) the cash withdrawal from a bank account over the counter to ₹ 10,000 per day subject to an overall weekly limit of ₹ 20,000. The weekly limits of cash withdrawal were subsequently revised from time to time (upto ₹ 50,000) subject to certain conditions.

The **Chart 3.2.2** below provides the graphical presentation of daily cash receipts of SBS during the period from 2 November 2016 to 15 November 2016:

**Chart 3.2.2**  
Cash receipts of SBS



As can be noticed from the above Chart, there were no abnormally high cash receipts on the day of demonetisation, i.e., 8 November 2016. Scrutiny of the records of SBS, however, revealed that during the period from 9 November 2016 to 30 December 2016, a sum aggregating ₹ 84.90 crore of the SBNs was deposited in SBS.

Test check of records further revealed that during the period from 9-13 November 2016 and 14-20 November 2016, there were 40 instances of cash withdrawal from SBS beyond the prescribed weekly limits of ₹ 20,000 and ₹ 24,000 respectively. The withdrawals by the individual account holders during the said periods (9-20 November 2016) ranged between ₹ 25,000 and ₹ 1,48,000.

The SBS stated (November 2017) that cases of excess withdrawal in 40 cases had happened due to ignorance of its employees and accordingly the said employees have been show caused/cautioned by SBS.

The reply was not tenable as irregularity in withdrawal of cash by SBS employees beyond the prescribed limits was indicative of non-existence of an effective internal control mechanism necessitating immediate steps to strengthen the internal controls in SBS.

### 3.2.8.10 Frauds and Misappropriation

The **Table 3.2.16** below provides the details of two frauds which were committed at two branches of SBS during the period of five years (2012-17) covered under the audit:

**Table 3.2.16**  
Amount involved in fraud and recovery thereof

Branch		Month/ Year of fraud detection	Amount involved	Recovery effected	Balance
Kanchenjunga Complex	Shopping	May 2015	0.01*	0.01*	0.01*
Singtam		June 2014	0.27	0.27	Nil
<b>Total</b>			<b>0.28</b>	<b>0.28</b>	<b>0.01*</b>

(₹ in crore)

\* Represents ₹ 70,000.00 only

Examination of records of SBS revealed that the fraud at one of the two branches {viz. Kanchenjunga Shopping Complex (KSC) Branch} was committed (May 2015) by an employee of the Branch. It was done by way of fraudulent withdrawal of cash from the account of a customer by forging the withdrawal forms. On detection of the fraudulent withdrawal, however, the employee concerned was suspended (May 2015) by the SBS.

The KSC branch of SBS was visited (11 August 2017) by the Audit team to observe the procedure prevailing in the branch for cash withdrawal after occurrence of the above mentioned fraud. The following procedural lapses were noticed in the process of cash withdrawal through withdrawal form:

- As per the standard practice, a customer (i.e., account-holder) intending to withdraw from his account by utilising withdrawal forms was required to present his Pass-Book personally.

It was, however, observed that at no stage of cash withdrawal through withdrawal form, the Pass-Book of the customer (i.e., account-holder) was sought for to verify the genuineness of the customer. The entire process was, thus completed without verification of the Pass-Book of the account-holder in contravention to the established practice in the banking sector. It exposed the bank against the risks of fraud/forgery. This was indicative of absence of an effective internal control system in the KSC branch of SBS.

When the above lapses were brought to the notice of the Branch Manager of the branch, the branch Manager assured that all the deficiencies would be taken care of in future and henceforth, no withdrawal forms would be accepted by the Branch without the Pass-Book of the account-holder.

As detailed under **Table 3.2.16** above, the misappropriation of funds at Singtam branch was committed by the Branch Manager in collusion with another staff member of the branch. The misappropriation was caused mainly on account of the system flaws prevailing in the branch as indicated below:

- closing down of small balance accounts without the written consent/communication to the account-holder and not crediting the proceeds to General Charges Receipt Accounts;

- showing fictitious credits without Voucher;
- showing fictitious withdrawals in 'Day Cash Book' without posting the withdrawal slip;
- manipulation of interest payable account on Savings Bank Accounts;
- passing of fictitious entries in various accounts (like, Staff welfare fund account, Branch Manager's account, etc.) and making withdrawals at subsequent dates.

During examination of the records of Singtam branch of SBS, Audit noticed that the following internal control deficiencies had been persisting in the branch. These deficiencies facilitated occurrence of the misappropriation of funds by the staff members.

- non-maintenance of proper Day Books and Cash Books;
- absence of a system to cross-check the entries made in the Days Books/Cash Book with General Ledger figures on daily basis;
- non-existence of any system of Internal Audit of the branches;
- lack of regular inspections by Head Office to monitor the activities of branch.

Besides the two cases of fraud detailed under **Table 3.2.16** above, there were seven other cases of fraud, which occurred prior to 2012-13, which were in the notice of Management. These seven cases of fraud involved ₹ 3.13 crore, out of which ₹ 2.79 crore was pending recovery (November 2017). All these cases of frauds could have been avoided or noticed at the first instance if an institutionalised internal control system was put in place by SBS. However, despite occurrence of repeated cases of frauds, SBS did not carry out a comprehensive exercise to identify processes and procedures that were vulnerable to fraud and take appropriate steps to avoid such incidents. SBS had also not introduced a system for regular internal audit of its branches.

The SBS, while accepting the observations stated (November 2017) that it recognises the importance of bringing in a proper control system in place and would also be coming out with an Anti-Fraud Policy of its own in order to minimise the instances of frauds.

#### **3.2.8.11 Regulatory framework, Governance and Monitoring in SBS**

The regulatory framework of SBS mainly consisted of the State Bank of Sikkim Proclamation, 1968 (the Proclamation), which being an old law of Sikkim had been protected under Article 371F(k) of the Constitution of India. Thus, the Proclamation would continue to be in force in the State of Sikkim until amended or repealed by Competent Law/Authority.

As discussed under paragraph 3.2.1 *supra*, the Banking Regulation Act, 1949 (Banking Regulations) was extended (15 January 1976) to the State of Sikkim and the GoI appointed the 15<sup>th</sup> day of December 1987 as the date on which Regulations were to come into force in the State of Sikkim. The notification of GoI to this effect was also republished (23 January 1989) by GoS in its Gazette notification confirming the stipulations of GoI notification on the applicability of the Banking Regulations in the State of Sikkim.

With the extension of the Banking Regulations to the State of Sikkim with effect from 15 December 1987 onwards, a peculiar situation had arisen making it mandatory for SBS to comply with the requirements of both the statute, viz. the State Bank of Sikkim Proclamation, 1968 as well as the Banking Regulation Act, 1949. As, however, observed during the course of audit, SBS did not comply with the provisions of the Banking Regulation Act, 1949 so far (November 2017).

Examination of the records of SBS further revealed that the SBS also did not comply with certain important provisions of the Proclamation as detailed below:

- As per Section 4 (1) of the State Bank of Sikkim Proclamation, 1968, not less than twenty *per cent* of authorised share capital at any time shall be held by the United Commercial Bank Limited (now UCO Bank). As discussed under paragraph 3.2.2 *supra*, UCO bank had surrendered (June 2006) its shareholdings in SBS (10,000 shares with face value of ₹ 100 each). The paid up amount (₹ 5.00 lakh) against these shares was also refunded (June 2006) by SBS to UCO bank. Thus, UCO Bank did not hold any share capital at any time during the last five financial years (2012-13 to 2016-17) in contravention to the provisions of the Proclamation.
- During 2012-17 the Board did not have any director nominated by the UCO Bank as required under Section 9(c) of the Proclamation. This was due to the fact that the UCO bank ceased to be a shareholder of SBS after the surrender (June 2006) of its equity stake in SBS.
- No quarterly returns on the position of the assets and liabilities of SBS were being submitted by SBS to the GoS/designated authority as per the requirements of Sections 27A (2) and 28 (1) of the Proclamation.
- As per Section 34 (2) of the Proclamation, the rate of dividend to be declared by SBS was to be determined by the Board with the approval of GoS. Section 34(3) of the Proclamation further stipulated that before declaration of the dividend, a Reserve Fund shall be created by SBS. A minimum sum equivalent to 20 *per cent* of the 'profits of the SBS for the year concerned shall be transferred to the said Reserve Fund. During the period of five years covered under audit (2012-17), however, SBS declared dividend aggregating ₹ 5.60 crore with the approval of GoS but did not transfer any amount to the Reserve Fund in violation of Section 34 (3) of the Proclamation.
- The SBS had never held the annual general meeting of the bank though it was mandatory as per section 35 of the Proclamation.

The SBS stated (November 2017) that the issue of applicability of the Banking Regulations in the State of Sikkim/SBS and the issue pertaining to protected Proclamation were the subject matter of constitutional experts and required to be dealt with by the highest authorities. Commenting on such issue at this point would be pre-matured. SBS also stated that it did not submit returns on assets and liabilities of SBS to GoS in the absence of necessary clarification/specific guidelines in the matter from GoS. GoS

assured to henceforth hold the Annual General Meetings of SBS shareholders as per the requirements of the Proclamation.

The reply was not acceptable as the Banking Regulations had already been made applicable by GoI to the State of Sikkim and SBS in December 1987 and GoS had also confirmed the said decision by republishing (January 1989) the GoI's notification on the issue. Hence, it is imperative that SBS should start complying with the requirements of the said Regulations with immediate effect. Further, SBS should earnestly comply with the requirements of the State Statute (viz. the Proclamations) so as to improve the functioning of the bank.

### 3.2.8.12 Capital Adequacy Requirements

Capital Adequacy Ratio (CAR)<sup>46</sup> indicates the strength and potential of a bank to absorb the probable losses, which may occur in its day-to-day functioning. Regulatory framework for CAR for banks is globally framed by the Basel Committee on Banking Supervision (BCBS). BCBS is a committee of bank supervisors consisting of members from representative<sup>47</sup> countries.

Till date, three sets<sup>48</sup> of Basel norms have been issued. Global standards on the regulatory capital requirements for banks were issued (1988) by BCBS, which was known as Basel I Accord. The Basel I Accord was imposed on the banking sector globally through a minimum CAR. The CAR is expressed as the ratio of 'Regulatory Capital Funds'<sup>49</sup> to 'Risk-Weighted Assets'<sup>50</sup> (RWA), which internationally active banks would be required to maintain.

The RBI norms, however, had been more stringent than the Basel norms. As against the Basel norms of minimum CAR of 8 per cent, RBI prescribed a CAR of 9 per cent for Indian banks. At present, the minimum CAR as prescribed (July 2015) by RBI was at 9 per cent. During 2012-17, the entire paid-up capital of ₹ 0.53 crore of SBS was held by GoS. GoS, however, had not framed any regulatory Capital Adequacy Norms for SBS so far (November 2017). SBS, however, had voluntarily disclosed the CAR as per Basel I Capital Accord for the last three financial years as follows:

Table 3.2.17

Financial Year	2014-15	2015-16	2016-17
Capital Adequacy Ratio – (Basel I)	0.84%	3.22%	3.78%

It was evident from the above that the present CAR (Basel I) of SBS was far below the minimum CAR norms as prescribed by RBI (9 per cent) and Basel I Accord (8 per cent).

<sup>46</sup>CAR = Regulatory Capital Funds/ Risk-Weighted Assets (RWA)

<sup>47</sup>Representative – the number of countries represented in BCBS had changed over time. During the formulation of Basel I and II, RBI was not part of BCBS. However, RBI was represented in BCBS during the design of Basel III as part of the G-20 countries. <https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=9011&Mode=0>

<sup>48</sup>Basel I norms in 1988, Basel II norms in 2004 and Basel III norms in 2010

<sup>49</sup>Regulatory capital funds include Tier I (core) capital and Tier II (supplementary) capital. Tier I capital consists mainly of share capital and disclosed reserves (minus goodwill, if any).

<sup>50</sup>Bank assets carry a degree of risk with them. Based on the riskiness of the asset, a specific risk weight is assigned to it and the asset value is adjusted as per the risk weight; more risky the asset, higher the risk weightage and lower its asset value. In India, RBI prescribes risk weights for different assets. The notional amount of the asset is multiplied by the risk weight assigned to the asset to arrive at the risk-weighted asset.

This indicated that the strength of SBS to absorb the probable losses remained significantly lower than the prescribed level.

The SBS stated (November 2017) that it was not bound to follow the Basel norms/RBI prescribed CAR norms. However, as a best practice, SBS had been planning to improve its capital base by introducing Tier-II capital under revaluation of its capital assets in 2017-18 to improve its CAR.

The fact, however, remained that SBS cannot ignore internationally accepted best practices which is necessary for strengthening its potential to absorb the probable losses in its banking operations also.

### **3.2.8.13 Monitoring of SBS by GoS**

The Proclamation did not prescribe any mechanism for monitoring of the functioning of SBS. The entire management of SBS was vested with the Board of Directors (Board) which included only the representatives of GoS, who are generalists and not banking professionals. It was informed (14 September 2017) by FRED that there was no regulatory body appointed for regulating or monitoring the activities of SBS. The Audit, however, observed that FRED was the administrative department for SBS and was responsible for monitoring the activities of the SBS and to provide necessary guidance on the issues of significance in its operations so as to develop and establish a strong and resilient ‘control and oversight system’ in SBS.

Examination of the records of SBS, however, revealed that during the period of five years (2012-17) covered under audit, FRED did not carry out any inspection/evaluation of the functioning of SBS. As such, there was no effective mechanism in place for GoS to control and monitor the activities of SBS. This was evident from the fact that during the five years (2012-17) covered under audit, huge differences had been existing in the ‘cash balances of GoS’ as per the records of FRED/Treasury Pay and Accounts Office (TPAO) and that as per the records of SBS, which remained unreconciled over the years. The year-wise details of unreconciled differences that existed during the last five years (2012-17) in the ‘cash balances of GoS’ as per two sets of records (viz. records of GoS/TPAO and SBS) has been summarised in **Table 3.2.18** below:

**Table 3.2.18**  
**Differences in the cash balance of GoS**

*(₹ in crore)*

<b>Year</b>	<b>2012-13</b>	<b>2013-14</b>	<b>2014-15</b>	<b>2015-16</b>	<b>2016-17</b>
‘Cash Balance of GoS with SBS’ as per the records of FRED/TPAO	51.40	259.51	171.35	210.80	59.34
‘Cash Balance of GoS’ as per the records of SBS	19.65	207.07	125.63	135.71	39.91
<b>Difference</b>	<b>31.75</b>	<b>52.44</b>	<b>45.72</b>	<b>75.09</b>	<b>19.43</b>

As can be noticed from the Table above, significant differences were existing during all the five years in the ‘cash balances of GoS’ as per the records of FRED/TPAO and that of the SBS. There was a significant reduction in unreconciled balances during the period from 2015-16 (₹ 75.09 crore) to 2016-17 (₹ 19.43 crore). The GoS and SBS, however,

had not taken any effective steps to identify the reasons for the differences and settle/resolve the discrepancies in the 'Cash balance of GoS' in a time bound manner.

During the exit conference, FRED stated (October 2017) that due to ambiguity about the administrative department, it did not carry out any inspection of SBS till date. GoS is likely to issue a notification to bring SBS under the control of FRED thereby establishing a formal regulatory/monitoring process for SBS. SBS stated (October 2017) that the differences in the 'cash balance of GoS with SBS' would be reduced substantially after implementation of Core Banking Solution (CBS). Regarding the significant reduction in unreconciled balances during the financial year from 2015-16 to 2016-17, PAO(HQ) stated (December 2017) that to identify the specific reason for significant reduction in unreconciled balances for the financial year 2015-16 and 2016-17, a detailed investigation and some additional time would be required.

The fact, however, remained that there was no mechanism in existence for monitoring of the activities of SBS by GoS despite the fact that SBS was a State owned Public Sector Bank and the GoS was fully responsible for its activities and impact thereof.

### 3.2.9 Conclusion

*There was scope for improvement in the functioning of the State Bank of Sikkim (SBS) with regards to planning, operations and internal control mechanism. SBS did not prepare any strategic plan. In the absence of a lending policy and detailed credit appraisal mechanism, the sanction of credit facilities was not based on objective criteria. SBS did not have any comprehensive procedure for post sanction/disbursement monitoring and follow-up of loan assets leading to high level of Gross NPAs, to the extent of 45.75 per cent of total loans assets of SBS as on 31 March 2017.*

*There was also scope for further expansion in the number of Automated Teller Machines (ATMs) as there were only eight ATMs of SBS in the State. The internal control mechanism of SBS was weak as was evident from the fact that there was no system in place to prepare Bank Reconciliation Statements for inter branch/inter-bank transactions on regular basis. There was no system of internal audit in SBS nor was there any formal arrangement for regulating the activities of SBS through oversight functions or through administrative supervision by GoS indicating ineffective internal control mechanisms in SBS. Instances of non-compliance with the provisions of the State Bank of Sikkim Proclamation, 1968, Banking Regulation Act, 1949 and RBI guidelines were also observed.*

### 3.2.9 Recommendations

The GoS and SBS may consider:

- Preparing a strategic plan for setting and achieving long term goals.
- Framing a dependable comprehensive framework for 'credit risk management' including lending policy, risk rating framework/loan grading system and

comprehensive recovery policy to ensure complete and timely recovery of all outstanding loans and advances.

- Putting in place an effective internal control mechanism through framing of the Accounting and Operations Manual and establishing a system of internal audit of branches for a systematic evaluation and continuous improvement of the effectiveness of risk management and governance processes in SBS.