

### 3 Audit Approach, Previous Audit Findings and Organisation of Current Audit Findings

#### 3.1 Audit Approach

##### 3.1.1 Audit Objectives

The main objectives of the performance audit were to ascertain whether:

- Policies and procedures for subsidy/ concession on fertilizers were designed to ensure adequate and timely availability and equitable distribution of fertilizers, minimise the budgetary impact of fertilizer subsidy, incentivise efficiency gains, and minimise leakage of subsidised fertilizer beyond the targeted beneficiary group;
- Subsidy/ concession was paid in accordance with the stipulated policies and procedures;
- Procedures for monitoring the production and distribution of fertilizers were adequate and effective;
- There were adequate and effective procedures for actually verifying the timely receipt of fertilizers, and its equitable distribution at the stipulated prices at the grassroot level; and
- Procedures for ensuring the quality of fertilizer at all levels were adequate and effective.

##### 3.1.2 Audit Criteria

The main sources of audit criteria were:

- Instructions/ circulars/ orders issued by DoF/FICC governing the grant of subsidy/ concession;
- Supply plans and ECA allocations issued by DoF; and
- Sanctions for payment of subsidy/ concession.

##### 3.1.3 Audit Scope and Coverage

The performance audit covered the fertilizer subsidy payments for the period from 2006-07 to 2008-09 (3 years) involving scrutiny of 979 claims amounting to Rs.54,358 crore, as well as imports at one port (Kandla). Further, verification of the distribution of fertilizers covered the period from May 2008 to December 2008 was conducted in 24 States, covering 94 districts, 188 blocks. In addition, records of 44 fertilizer quality control laboratories were scrutinised, and surveys of 5498 farmers and 1092 dealers in 24 States were conducted.

Sample selection was done using the “Simple Random Sampling without Replacement (SRSWOR)” method. Details of the audit sample are indicated in **Annexe-3.1**.

### 3.1.4 Audit Methodology

The performance audit commenced with a presentation at an entry conference held with the Department of Fertilizers in April 2009, wherein the audit methodology, scope, objectives and criteria were explained. Field audit, including scrutiny of records and surveys was conducted between June 2009 and March 2010. In addition, a meeting with the Fertilizer Association of India was also held in January 2010.

The Draft Audit Report of Performance Audit on Fertilizer Subsidy was issued to the Department of Fertilizer on 1.12.2010. Despite issue of a reminder, no reply was received, nor could an exit conference being scheduled with the DoF to discuss the audit findings. However, exit conferences were held with 21 out of the 24 State Governments (except Bihar, Maharashtra and Tripura) in respect of the State specific audit findings.

Audit gratefully acknowledges the cooperation and assistance extended by the DoF, the State Governments and their officials at various stages of conduct of the Performance Audit.

### 3.2 Previous Audit Findings

A review on “Implementation of Retention Price Subsidy Scheme on sale of controlled fertilizers” had appeared in the CAG’s Audit Report No. 2 of 2000 (Civil). The main audit findings of this review were as follows:

- Fertilizer Industry Coordination Committee (FICC) paid fertilizer subsidy on urea of Rs. 25,155 crore during 1992-98 on the basis of cost data furnished by the fertilizer units without independent verification and scrutiny of basic records maintained by them.

DoF in their Action Taken Note stated (August 2001) that Office of the FICC had been advised to identify suitable Cost and Chartered Accountants from the Institute of Chartered Accountants of India to verify the cost data.

- Delay in revision and adjustment of subsidy on reduction in corporation tax of all fertilizer units during 1994-95, 1996-97 and 1997-98 resulted in advance excess payment of subsidy of Rs. 408 crore.

DoF stated that the delay in revision and adjustment of subsidy was attributable to :

- a) delay in approval of the parameters of 6<sup>th</sup> pricing period,
  - b) paucity of staff and its frequent transfers,
  - c) FICC being involved in a number of committees constituted during that period
- Sample checks disclosed that FICC allowed Rs.2731 crore to 20 fertilizer units during 1991-97 on account of corporation tax<sup>10</sup> without ascertaining the actual amount of corporation tax paid by these units. Also, provisions made for payment of corporation tax aggregating Rs. 1849 crore for 1993-98 were transferred to general reserve and, in

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<sup>10</sup> One of the elements of costs reckoned by FICC for calculating the retention price.

turn, treated as part of net worth for computation of Retention Price Scheme, which resulted in extra outgo of subsidy of Rs. 460 crore.

DoF, in reply, merely enclosed a copy of the DoF's note dated 16.8.1994 considered and approved by CCEA in its meeting held on 26.8.1994, saying that rate of return on net worth might be allowed @12%, grossed up at the prevailing rate of corporate tax, and the Group Retention Price might not be applied for the present.

- FICC adopted higher rate of depreciation of 6.33 per cent against the prescribed rate of 5.28 per cent. This resulted in excess provision of depreciation of Rs. 592 crore during 1993-98, which led to payment of excess subsidy.

DoF, in their action taken note, stated that they were in the process of formulation of a new pricing policy for urea units keeping in view the recommendations of the Expenditure Reforms Commission.

- Recovery of subsidy was not made on sale of sub-standard fertilizer, where subsidy was paid on the basis of standard fertilizers.
- Subsidy of Rs. 43 crore paid during 1986-95 were pending recovery from various units due to closure of some units referred to BIFR.

DoF stated that the issue of recovery would be taken up after the receipt of the decision of BIFR.

- Delay in finalization/revision of retention price in respect of nine fertilizer units had resulted in non-recovery of Rs. 678 crore of excess subsidy paid to them.

DoF stated that out of nine units, notifications effecting changes in the retention prices in respect of 6 units had already been issued. In respect of one unit, recovery was being made. In other two cases, the units were different than the one mentioned by audit.

An IT audit review of the Concession Scheme Information System (CSIS) also appeared in Chapter 3 of the CAG's Audit Report No.3 of 2005 (Civil). The main audit findings are summarized below:

- Deficient planning, design and implementation of the computerized Concession Scheme Information System (CSIS) for regulating the concession to the manufacturers and importers on the sale of decontrolled fertilizers entailed the risk of unauthorized working practices and depressed the reliability and usefulness of the System.
- Absence of formal security policy and procedures in the IT system rendered the system insecure.
- The programme lacks many important features that are essential for risk free management of the Concession Scheme and does not contain appropriate validation checks or master data tables for minimizing erroneous data entry and consequential incorrect payments of concession.

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This system has since been replaced by the Fertilizer Monitoring System (FMS) with effect from 22<sup>nd</sup> January 2007.

### 3.3 Organisation of Current Audit findings

*The findings from the current Performance Audit have been categorized into two sections.*

- *Overall Audit Findings – In this section, different areas of interest have been analysed from a nation-wide perspective, and only brief, summary information on findings in different States has been provided.*
- *State specific findings – In this section, detailed findings, amplifying the overall audit findings, have been presented state-wise.*