

Chapter 5 - Implementation of the Policy by the companies²⁹

One of the significant features of NBS Policy was that MRP of P&K fertilizers would be left open and manufacturers/importers/marketers would fix MRP of these fertilizers at a reasonable level. The word 'reasonable' was, however, neither explained/defined in the Policy nor did DoF issue any implementation guidelines. Audit, therefore, attempted to examine as to how MRP was fixed at reasonable level and what was the monitoring mechanism in DoF to assure themselves of the reasonability of MRPs.

5.1 Issues in MRPs fixed by fertilizer companies

Out of 34 companies (including 26 private companies, 2 co-operative societies and 6 CPSEs) producing/importing decontrolled P&K fertilizers, Audit test checked records of five companies³⁰ relating to import of fertilizer/fertilizer inputs and production by indigenous companies, the supply position of the companies, subsidy claimed and received, the components and inputs loaded while fixing MRPs of their brand and their profitability aspects.

During the course of audit, cost sheets of the fixation of MRPs of various P&K fertilizers subsidised under NBS Policy were called for from DoF and the selected five fertilizer companies. Neither DoF nor the selected five companies provided the cost sheets³¹.

Despite the assurance provided by DoF during the Entry Conference (July 2013), the cost sheets for companies were furnished to Audit in October 2014 i.e. only after issue of the Draft Audit Report to DoF in September 2014. Moreover, above data was not supported by documentary evidence. Audit, thus, could not verify the accuracy of the facts depicted in the cost sheets. Resultantly, Audit was unable to vouchsafe the reasonableness of MRPs of the fertilizers.

DoF had not laid down any guidelines for assessing and enforcing the reasonableness of MRPs so fixed by the fertilizer companies. In the absence of any mandatory requirement for preparation of cost sheet in respect of subsidized fertilizers, DoF did not have any mechanism to assure itself about necessity/reasonability of all the components included in the cost. This was evident from the fact that during the examination of the records of fixation of price of DAP by IFFCO, which were the only cost sheets made available to Audit, instances were found which depicted loading of MRP with some components that were not reasonable. Further, other instances where Audit was unable to conclude that MRPs fixed by the fertilizer companies were, indeed, reasonable, also came to notice. These have been discussed below:

²⁹ In respect of five fertilizer companies selected for Audit.

³⁰ IFFCO, IPL, CFCL, ZIL and FACT.

³¹ Except IFFCO, which too had provided cost sheets only in respect of imported DAP.

5.1.1 Unreasonable loading of cost component on MRP

5.1.1.1 Recovery on loss on sale of bonds

GoI issued fertilizer bonds amounting to ₹8396.11 crore during 2007-08 and 2008-09, towards settlement of subsidy dues to IFFCO. The bonds carried a coupon rate of 6.20 to 8.30 per cent and were maturing during 2022-2026. IFFCO sold them in the market and to RBI under buy back scheme of GoI, and thereby incurred a loss on sale of these bonds. To adjust the loss sustained by the company, IFFCO added ₹142 PMT as 'loss on sale of fertilizer bond' as a component of cost for fixing MRP of DAP (imported) w.e.f. 23 September 2011. Subsequently, it was observed that while revising MRP of DAP in May 2012, the cost component of ₹142 PMT on account of loss on sale of bond was excluded. Thus, recovery of loss on account of sale of bonds amounting to ₹9.89 crore³² (during the period 23 September 2011 to 30 May 2012), due to addition of ₹142 PMT in MRP, was not justified. The cost sheets of other products were not provided to Audit and therefore, the recovery of loss, if any, from other products could not be verified in Audit.

IFFCO in its reply stated (June 2014) that MRP was fixed based on various parameters viz. cost of imported fertilizers, handling and other associated costs and market conditions. Sometimes, however, industry is constrained to fix MRP below the total cost because of competition and market conditions. Sometimes, MRP was fixed even below the total cost. During the year 2011-12, IFFCO has incurred a loss of ₹5193 lakh (₹473 PMT) on imported DAP. IFFCO further added that it had not earned any profit during the period when MRP was fixed at ₹18100 MT (i.e. after considering ₹142 PMT on account of loss on sale of bonds) and MRP fixed was not unreasonable.

DoF in its reply (June 2014) stated that as per approval of Ministry of Finance, the Government had agreed to reimburse 50 per cent losses (i.e. ₹778.93 crore) incurred by fertilizer companies including IFFCO in buy back bonds by RBI. If IFFCO loaded any cost on account of loss in sale of bonds, in fixing MRP, the subsequent reimbursement of losses it received from Government on this account was undue profit to the company and liable for recovery.

5.1.1.2 Recovery for loss on mopping up

DoF notified (5 May 2011) higher NBS rates for 2011-12 for P&K fertilizers in comparison to those of 2010-11. The increased subsidy on opening stock of imported DAP as on 1 April 2011, amounting to ₹4.41 lakh, was recovered by DoF from IFFCO on 17 August 2011. IFFCO in turn added ₹40 PMT w.e.f. 24.09.2011 as 'loss on mopping up of subsidy' as a cost component for fixing MRP of imported DAP. During October 2011 to March 2012, IFFCO sold 646459.42 MT of imported DAP. Recovery made from IFFCO was not a loss and it had

³² Quantity of DAP sold=696317.28 MT

Cost component on account of loss on sale of fertilizer bonds=₹142

Recovery = (Quantity of DAP sold) X (cost component of loss on sale of bonds) = ₹9.89 crore

no relevance to MRP of DAP. Hence, adding expenses relating to mopping up to the cost element of DAP was not justified. This resulted in extra profit of ₹2.59 crore as well as inflated MRP of imported DAP for 2011-12.

IFFCO in its reply stated (June 2014) that since the notification was issued on 11 July 2011, by no stretch of imagination could IFFCO envisage such costs (by way of mopping up) and thereby be able to absorb the same. Hence, IFFCO considered the cost of ₹40 PMT in fixation of MRP effective from 24 September 2011. As no recovery with regard to the opening stock of raw materials was made by GoI subsequently, the above mentioned loss of ₹40 PMT, which was originally envisaged to be recovered in 5 years, was not considered while revising MRP from 1 June 2012.

DoF in its reply stated (June 2014) that during 2011-12, the subsidy rates were revised twice as no imports were possible due to higher international prices. The higher rates of subsidy were not applicable to old stock imported prior to increase in international prices. Hence, mopping up of higher subsidy claimed or allowed on the closing stock as on 31 March 2011 and sold after that date, was done in DoF. The higher subsidy claimed on closing stock imported prior to March 2011 was undue benefit to the company. Hence, the subsidy mopped up on this account should not have been reckoned as a part of the production cost or for fixing MRP of subsequent imported fertilizers by IFFCO.

5.1.2 Benefit of lower procurement cost not factored in MRP of DAP

DoF, while finalizing benchmark price for fixation of subsidy for each nutrient considers prevailing international prices of fertilizers. Audit, however, noticed instances where fertilizer companies made procurement at rates below the benchmark price e.g. CFCL and ZIL imported DAP at rates ranging between US\$ 477.50 cfr PMT to US\$ 500 cfr PMT during the year 2010-2011. Since the purchase cost in these cases was less than the benchmark price of US\$ 500 PMT considered by DoF for fixation of subsidy for DAP for 2010-11, there would have been savings to these companies on account of lower procurement cost. In the absence of any cost sheet of calculation of MRP of DAP for the year 2010-11, Audit could not verify whether these companies had passed on the benefit of such lower cost of purchase to farmers through reduced MRP of DAP in 2010-11.

CFCL stated (June 2014) that DAP consignments were bought on ruling international prices and their contribution was 1 per cent of the average cost of sales of packed goods sold in the year. So there was no scope of MRP revision. Any such revision would have resulted into further lowering of company margin.

ZIL stated (June 2014) that audit team has ignored the actual exchange rate at which the imports were made to arrive at the Indian Rupee cost of import which, in our view, was higher than the exchange rate considered by the Government while fixing NBS rates. It also stated that handling charges actually incurred by the company were also on the higher side.

Replies of CFCL/ZIL could not be verified since the cost sheets of these companies were not furnished to Audit for verification.

5.1.3 Unjustified fixation of MRP

5.1.3.1 Disproportionate increase in MRP in lieu of withdrawal of freight subsidy

Secondary freight was inbuilt in subsidy rates declared under NBS as per notification of DoF dated 16 March 2010. DoF announced on 1 December 2010 that secondary freight for P&K Fertilizers (except SSP) would be paid in line with the 'Uniform Freight', applicable for Urea, w.e.f. 1 January 2011. This partial modification resulted in reduction of the freight subsidy by ₹300 PMT in the case of DAP.

Subsequent to the said notification, it was observed that fertilizer companies had increased their MRPs from the existing ₹9950 PMT to ₹10750 PMT w.e.f. 16 January 2011 (CFCL); 21 January 2011 (IPL) and 1 February 2011 (IFFCO). No cost details regarding the calculation of the revision of MRPs i.e. cost sheets etc. were produced to Audit by these companies. An internal note of CFCL, however, contained following justification for increasing the price of DAP:

“DoF has notified withdrawal of secondary freight of ₹300 PMT on DAP/MOP w.e.f. 1st January 2011. In line with the price increase by other companies, we propose to revise our MRP to ₹10750 PMT with immediate effect.”

It appears from the above that MRP was increased only to compensate reduction of the secondary freight of ₹300 inbuilt in NBS rates. Audit observed that increase in MRP should have, at the most, been equivalent to the reduction in NBS rates i.e. by ₹300 PMT only. By increasing MRP of DAP by ₹800 PMT, the fertilizer companies had overburdened MRP by ₹500 PMT.

CFCL in its reply stated (June 2014) that they had earned a margin of ₹300.42 PMT on sale of 401486.750 MT, which was around 1 per cent of the average cost of sales of packed goods sold in the year. Reduction by ₹500 PMT would have resulted in further lowering of company margin.

5.1.3.2 Disproportionate decrease in MRP

Audit observed that for the period 31 January 2012 to 23 May 2012, procurement cost of CFCL reduced by ₹5398 PMT to ₹5466 PMT whereas reduction made in MRP of DAP by the company was only ₹1100 PMT. This resulted in additional profit of ₹67.37 crore³³ to the company.

CFCL in its reply stated (June 2014) that they had sold imported DAP under NBS Policy during 2010-11, 2011-12 & 2012-13 at various MRPs, which were fixed based on the costs and also to align with the market, from time to time. The company had earned a margin of ₹525.65 PMT on sale of 1335682 MT, which was around 1.55 per cent of the average cost of sales of packed goods sold during the years 2010-11 to 2012-13. As such, the company had not earned any higher realization.

³³ Additional profit worked out as follows: 155517 (Quantity sold) x ₹4332 (difference between average price of November/December 2011 and February/March 2012 as reduced by ₹1100).

Reply submitted by CFCL and supplemented by DoF, pertaining to the observation in para 5.1.3.1 is not acceptable due to the fact that the enhancement in MRP was done by CFCL only to compensate the reduction in NBS rates due to removal of the secondary freight subsidy element of ₹300 PMT, which was evident from the internal note of CFCL. Therefore, the increase in MRP should have been restricted to ₹300 PMT only. Further, neither CFCL nor DoF had furnished any cost sheets regarding fixation of MRPs to Audit.

Replies of CFCL and DoF, pertaining to the observation in para 5.1.3.2, need to be viewed in the light of the fact that one of the prime objectives of NBS Policy was to allow fertilizer companies to fix MRPs of the fertilizers at a reasonable level. The fertilizer companies were expected to take into account the actual procurement rate while fixing MRPs so that the same could be passed on to the farmers. Further, DoF has conceded that there was a need to verify the reasonableness of MRPs fixed for the P&K fertilizers by the companies.

A common thread running in reply of DoF to audit observations on reasonableness of MRP was that under NBS Policy, MRP of P&K fertilizers was left open and fixed by the fertilizer companies at reasonable level. In order to ensure reasonableness, companies had been providing certified cost data as per the requirement and directions given by DoF from time to time. The companies were also reporting MRPs of P&K fertilizers regularly to DoF in FMS. The companies were claiming subsidy as per NBS rate announced by the competent authority as per recommendation of IMC. DoF further replied (October 2014) that it had decided to obtain cost data from P&K fertilizer companies from 2012-13 onwards. As there is no manpower and technical competency to scrutinise the cost data of these companies, the Department has appointed certified Cost Accountants/Firms to undertake the cost data study. Action would be initiated after the receipt of reports from Cost Accountants/Firms. As regards the individual cases reported in the report, the Department would examine the issues separately.

Recommendation 9: As NBS Policy left MRPs open for being fixed by fertilizer companies at a reasonable level, DoF may critically review adequacy of measures to assure itself that prices are actually fixed by companies at a reasonable level. For this, cost accounting firms already appointed by DoF may be instructed to submit their reports in a timely manner, so that action could be taken by DoF against fertilizer companies loading their cost with irrelevant components. Further, DoF may also consider extending verification of cost data of fertilizer companies from April 2010 onwards i.e. with effect from date of introduction of NBS Policy instead of getting cost data examined only from 2012-13.