

CHAPTER - II BUSINESS OPERATIONS

Audit Objective: To assess whether the business operations of CSD were managed efficiently and effectively.

2 Business Activities

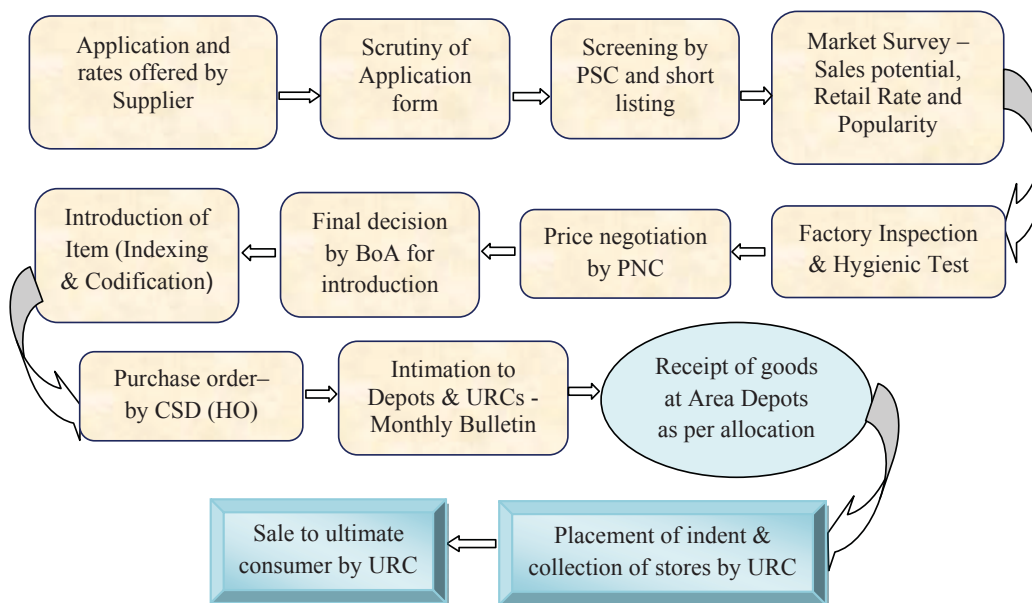
Business operations of CSD including introduction of items, functioning of Base Depot and Area depots are covered in this chapter.

2.1 Introduction of items

CSD has a three-tier system for introduction of a new item. All offers are initially screened by the Preliminary Screening Committee (PSC) of the BoA from the point of view of desirability. If the decision is positive, it is passed on to the Price Negotiation Committee (PNC). After the market survey is carried out, PNC negotiates with the manufacturer for the maximum price advantage and finalization of terms. Thereafter, the case is put up for approval of the BoA. Once an item is introduced, it is indexed and codified for procurement, storage, distribution and sale. Generic code is awarded to similar types of items and items introduced are accordingly placed under that generic code.

The procedure of introduction of items in CSD is summarised in flow Chart 3 below:

Chart 3: Procedure of introduction of item in CSD



As per the prevalent practice new items are considered for introduction only at the request of the suppliers. During the period under review, a total number of 9134 items were offered

by the suppliers, of which 3234 items i.e.35.40 *per cent* were recommended by the PSC for introduction and finally 3035 items i.e.33.23 *per cent* were introduced in CSD. Of these 3035 items, 1733 items i.e. 57.10 *per cent* were introduced during last two years. The items introduced added to the variety of the already available items. Further, there was nothing on record to show whether the user requirement (consumer demand) was being considered and accepted before introducing a new item. Even these new items were not categorized as Vital, Essential and Desirable (VED) as laid down in URC manual.

2.1.1 Introduction of imported items

As per the procurement policy, CSD was to carry out its procurement only from the manufacturer so as to obtain maximum discount thereby eliminating the middle man's profit and also ensure genuineness of the goods. If manufacturer does not undertake marketing itself, all India sole selling agent/distributor appointed by manufacturer can be opted. BoA, in September 2012 brought out that since CSD took a decision in the past to enlist the products from Brand Owners and Importers besides Manufacturers and All India Sole Selling Agents/Distributors, sole importers on all India basis were also considered for supply to CSD for the products found to be popular and competing with the comparable local products.

We observed (December 2015) that a number of regular use items like Chappals⁶, Blankets⁷, Door Mat, Rain Suit⁸, Fabric conditioner⁹, Handbags¹⁰ *etc.* that are locally available were introduced in CSD which were imported from China by the suppliers (Instances given in the footnote). Scrutiny of records revealed that no exercise was carried out by CSD to confirm if the said goods are locally manufactured, popular and competing with comparable products except that market surveys were conducted to verify the rates offered by the supplier/importer. In some of the cases, the percentage of market share of the said products was also not available on record.

For instance, a firm registered with CSD as manufacturer of perfumes was introduced as supplier of imported slippers from China. The tax invoice furnished to support their trade prices indicated excisable goods as fabric perfume. Further, as per the terms of introduction, though it was mandatory to furnish a copy of the agreement between the principal manufacturer and Importer, indicating the terms of trading, validity *etc.* along with the Introduction form, unsigned agreement on stamp paper obtained in February 2015 was accepted though the firm contended that the items were introduced in civil market in May 2011. This indicated lack of proper scrutiny of the documents in respect of imported items by CSD.

Since the Government is encouraging domestic Small Scale Industries, introduction of daily use items imported from China lacked justification and defeats the initiative of the Government.

⁶ 'Evera' brand Chappals imported by M/s Mayuri Kum Kum

⁷ Blankets and door mats imported by M/s Hastimal Textiles

⁸ Rain Suit imported by Eskay Global

⁹ Downy fabric conditioner imported by Universal Corporation

¹⁰ 'Lavie' brand Ladies Handbags imported by M/s Bagzone Life Style Pvt Ltd

Further, independent quality inspection of the imported items introduced by CSD was not carried out to ensure quality standard of the goods *vis-a-vis* comparable products produced in India.

In reply, CSD stated (July 2016) that imported items were introduced as there was no ban on importing items from China and importing items by medium enterprises contribute to economy and providing employment to Indian people.

The reply furnished did not answer audit observation about failure of CSD to ensure itself of the popularity of the items, market share and agreement between the importer and the principal manufacturer as required before introduction of the new items.

Conclusion 1:

CSD items are introduced generally at the request of Supplier. However, there was nothing on record to show whether the needs and the choice of the consumer or the popularity of the product available in civil market was ascertained before introducing the item. Imported items were introduced without conducting market survey and quality checks & without ensuring availability of agreement between the importer and the principal manufacturer.

2.2 Uneconomical functioning of Base Depot, Mumbai

The CSD Base Depot, Mumbai functions as a feeder depot to all CSD Area Depots for all the stores except those which are despatched directly by the suppliers to the Area Depots or local supply items. Stores are received in the Base Depot in bulk and are then transferred to all the Area Depots by road as per the allocation of stores by CSD (HO) Mumbai.

Uneconomical functioning of the Base Depot due to the meagre receipt of rebate amount from the suppliers and blockage of funds towards VAT refund claims for the items routed through Base Depot was commented upon in C&AG Report No.14 of 2010-11. In response to the Audit suggestion, Ministry had stated that they would initiate suitable action as required. PAC in its 48th report had also desired that an amicable solution be arrived at so that neither the entire supply chain management was adversely affected nor the payment of VAT blocked or delayed.

Besides the increasing VAT refund claim from ₹ 66.86 crore in March 2009 to ₹ 485.47 crore in March 2016 (**Annexure D**), we examined the functioning of the Base Depot and found that the business operations of Base Depot continue to be uneconomical as enumerated below:

2.2.1 Extra burden of tax on CSD consumers due to transportation of goods through Base Depot

The items procured from outside State attract Central Sales Tax. Therefore, two *per cent* CST which is levied by suppliers is recovered by the Area Depots from the URCs.

As per Government of Maharashtra, Finance Department, Mumbai letter issued in August 2006, as and when CSD in Maharashtra effects consignments of the tax paid goods to CSD depots located in other states, in such an eventuality, by virtue of Rule 53(3) of Maharashtra VAT Act, the set off in excess of four *per cent* of the taxes paid on purchases shall be

admissible to CSD. Since Base Depot Mumbai, located in the State of Maharashtra transfers the goods to various Area Depots under Transfer Invoices, it can claim the refund of VAT paid over and above four *per cent* from the Maharashtra State Government. Base Depot accordingly indicates applicable tax of four *per cent* in the transfer invoices forwarded to various Area Depots located outside Maharashtra who in turn load the same on the whole sale price while selling the goods to URCs.

Had the items been directly delivered to the concerned Area Depots by the suppliers, the tax loaded on the supplies would have been only two *per cent* CST instead of the four *per cent* now being loaded. Hence, due to the routing of goods through Base Depot, the ultimate consumers have to bear a burden of additional two *per cent* of cost of the goods. Such additional burden passed on to the consumers during the last six years worked out to ₹ 43.89 crore as detailed in Table 2 below:

Table 2: Value of goods received with rate of VAT as 4 *per cent* & above (₹ in crore)

Year	Goods purchased within Maharashtra	Goods transferred to depots in other states	Two <i>per cent</i> additional tax on goods transferred to other depots
2010-11	437.14	387.63	7.75
2011-12	452.31	428.70	8.57
2012-13	486.36	365.95	7.32
2013-14	386.55	266.99	5.34
2014-15	440.63	374.43	7.49
2015-16	397.95	370.99	7.42
Total			43.89

CSD (July 2016) stated that Maharashtra State Government has increased CST element on inter depot transfer from two to four *per cent* only with effect from 1 April 2012, hence the additional burden of two *per cent* exist from 2010-11 as brought out by Audit was not correct. It was also assured that concerted efforts have been initiated to move the majority of companies from Base Depot to direct supply.

The reply is factually incorrect as the Transfer Invoices of Base Depot itself indicate that four *per cent* CST on Maharashtra based supply has been charged since April 2010. Further, the levy of additional two *per cent* on the consumers defeats the very motto of providing items at cheaper price.

2.2.2 Delay in receipt of Form 'F' for Inter Depot Transfer (IDT) resulting in blockage of VAT refund claims

In respect of transfers carried out by Base Depot to other Area Depots, the receiving depots are required to forward Form 'F' to Base Depot in acknowledging the receipt of items, which forms the basis for the Base Depot to claim VAT refund. We, however, observed that Area Depots were not prompt in forwarding the original Form 'F' to Base Depot. The value of such outstanding Form 'F' as on 31 March 2016 was ₹ 983.07 crore which pertained to

the period 2007-08 to 2015-16. The non-receipt of Form 'F' resulted in disallowance of VAT refund claims worth ₹ 64.26 crore for the period 2007-08 to 2010-11, as seen from the records maintained by Base Depot. Assessment for the period 2011-12 onwards was still in progress and therefore the amount of such disallowance of VAT could be even more.

2.2.3 Non-recovery of arrears of freight rebate from the suppliers

According to CSD policy circular of November 2011, annual revision of freight rebate is to be carried out on or before 30 June to be effective from 1 April of the same year. However, we observed that revision of freight rebate applicable with effect from 1st April was carried out only in October-December. Further, though the revision of freight rebate was made applicable with effect from 1 April, the arrears of the freight rebate due from 1 April till date of revision was not recovered from the concerned suppliers from January 2012 to May 2013. The arrears on this account worked out to ₹ 2.11 crore for 2 years.

In reply to the reasons for delay in revision of freight rebate, Army HQ (QMG's Br) stated (July 2016) that under recovery of freight rebate is worked out and being recovered from the respective companies dependent on Base Depot.

Conclusion 2:

PAC had desired that an amicable solution be arrived at so that neither the entire supply chain management was adversely affected nor the payment of VAT blocked or delayed. We observed that the business operations of Base depot continued to be uneconomical. Blockage of VAT refunds of ₹ 485.47 crore and additional burden of ₹ 43.89 crore on ultimate consumers was attributable to increasing reliance on the Base Depot.

2.2.4 Non-utilization of land acquired at ₹ 6.12 crore

Mention was made in C&AG Report No.14 of 2010-11 (AR) regarding delay in shifting of Base Depot at Sewree, Mumbai to a new location despite acquisition of land on lease at a total cost of ₹ 6.12 crore in July 1992. Delay in construction by CSD had resulted in a liability of ₹ 99.53 crore as additional Lease Premium. Besides, an amount of ₹ 52.31 lakh had also been paid as service charges up to March 2005 and a provision of ₹ 4.47 crore has been made in the annual accounts for the year 2014-15 towards further charges payable till March 2015.

It was assured by the Ministry in their Action Taken Note (May 2015) on AR that the construction will be carried out after obtaining waiver of penalty and approval for extension of construction period from CIDCO. We, however, observed that despite the assurance given by the Ministry, CSD failed to construct new accommodation for its Base Depot even after 23 years of acquisition of land. However, in view of uneconomical working of Base Depot pointed out here-in-before and CSD's stated efforts to move majority of companies from Base Depot to direct supply, CSD should review its plan for construction of Base Depot.

2.3 Area Depots unaware of items listed with CSD

Area Depots in their Monthly Information Reports (MIR) indicate the total number of items listed and held with them. The number of items listed in the CSD should be uniform in all

Area Depots. However, comparison of data compiled from the MIR furnished by Depots and CSD (HO) indicated that the number of listed items varied at all depots as detailed in the Table 3 below:

Table 3: Total number of items held against items listed

CSD Depot	Total number of items held against listed as on 31 March											
	2011		2012		2013		2014		2015		2016	
	Listed	Held	Listed	Held	Listed	Held	Listed	Held	Listed	Held	Listed	Held
CSD (HO)	4314	-	4423	-	4413	-	4444	-	4604	-	5548	-
BD Bari	3509	2714	3386	2202	3386	2162	3387	2428	3513	2807	4208	3177
Jabalpur	4230	3629	4651	2308	4173	2944	4242	3129	4314	3255	4858	4521
Bikaner	3811	2253	4152	1711	4252	2001	4211	1894	4347	2125	5184	2775
Hissar	3298	2007	3687	1964	3737	2247	3737	2157	3737	2239	3739	3131
Jalandhar	4567	1926	5011	1904	5087	2147	5106	1830	5469	2512	6083	2965
Bangalore	4215	2151	3715	2040	4123	2441	3678	1901	4374	1956	5316	2626
Khadki	2641	1965	4440	1986	3715	2192	3715	2192	3543	2438	4314	2815
Delhi	3094	1961	4315	2099	4553	2597	4577	2360	4577	2676	5069	4253
Masimpur	2480	2073	2357	2032	2204	1795	2046	1722	2969	2171	3474	2456
Lucknow	4176	2015	4667	1565	4685	2432	4799	2108	4961	2355	4603	2433
Baghdogra	*	*	*	*	*	*	3107	2281	2926	2459	3525	2854

*Data not furnished

It can be seen from the above details that the items reported as listed by the Area Depots were grossly at variance with those listed by CSD (HO). The listing at Depots was either short by an extent up to 54 per cent or even higher by upto 19 per cent. This indicated that the range of items listed with Depots was faulty. Further, the number of items held was also less than items listed as per Depots records resulting in non-availability of items to URCs. Non availability of items compounded with faulty listing resulted in denials to the dependent URCs as highlighted in subsequent paragraph.

We observed that though the information of the items listed by depots were being furnished in the monthly returns to CSD (HO), reasons for the wide variation with reference to the items listed by CSD (HO) were not called for from the depot, indicating lack of proper monitoring at CSD (HO).

CSD stated (July 2016) that Area Depots have been advised to obtain total number of items listed in inventory from EDP Branch of Head office and complete automation will nullify this problem as the database will be uniform throughout. CSD, however, did not provide any time frame for complete automation.

2.3.1 High percentage of Denials

One of the objectives of CSD is to ensure that the satisfaction of consumer demands is maintained at the maximum. The inability of the Area Depot in issuing the item as demanded by the URC is termed as 'Denial'. In view of the large number of denials observed during the previous Audit, PAC had impressed upon the Ministry to strengthen the measures already initiated besides innovating other appropriate measures to effectively address the impediments in the supply of all indented stores to the jawans. Our analysis in the 11 Area Depots for the period 2010-11 to 2015-16 however, indicated that denials ranged from 7.17

to 25.42 per cent and the value of denials amounted to ₹ 3866.34 crore as detailed in the Table 4 below:

Table 4: Average percentage of denials

Sl. No.	CSD Area Depot	Average percentage of denials						Total value of denial (₹ in crore)
		2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	
1	Baghdogra	DNF	DNF	DNF	11.83	10.90	7.82	73.15
2	Lucknow	11.06	14.48	14.82	16.42	16.70	14.86	544.32
3	Delhi	9.35	10.67	14.99	11.75	9.24	13.13	575.27
4	Masimpur	7.92	8.25	9.17	8.50	8.00	7.17	343.77
5	BD Bari	14.21	16.50	23.93	19.21	16.11	13.25	258.25
6	Jabalpur	15.06	10.16	15.37	13.25	10.40	9.49	266.67
7	Bikaner	15.60	14.67	18.06	16.59	16.11	15.41	155.12
8	Hissar	8.51	15.13	9.48	10.66	11.64	14.90	107.18
9	Jalandhar	24.83	23.08	25.42	20.00	19.50	9.79	567.79
10	Bangalore	14.17	14.67	13.42	11.63	14.38	12.35	464.45
11	Khadki	DNF	11.58	11.25	10.00	7.83	16.04	510.37
Total value of denials during last six years								3866.34

DNF = Data not furnished

The highest number of denials was noticed at Jalandhar & Bikaner and the percentage of denials was increasing at Area Depots Lucknow and Hissar indicating that adequate measures were not taken by CSD to reduce the denials.

One of the reasons for high percentage of denial was non-holding of all the items by the depots which is evident from the fact that 11 selected depots were holding items ranging between 33.53 per cent and 93.06 per cent against listed, during 2010-11 to 2015-16. This denial was further compounded by the fact that depots' listing was itself incomplete and inaccurate as brought out in Table 3 above.

CSD stated (July 2016) that the denials occurred due to warehousing constraints, non-supply/short supply of items by firms, delayed delivery of items etc. Measures such as reduction in lead time for delivery and improvement in warehouse spaces to overcome shortage of spaces have been taken to avoid the denials.

Reply is not acceptable as against denial of stores commented during last performance audit of CSD, PAC had impressed upon the Ministry to strengthen the measures already initiated to effectively address the impediments in the supply of all indented stores to the jawans. However, denials upto 25 per cent still continued affecting the consumer satisfaction.

Conclusion 3:

Listing of items at Depots was at variance with those listed by CSD (HO). There were denials of items to URC ranging from 7.17 to 25.42 per cent thereby affecting the consumer satisfaction.

2.4 Inordinate delay in completion of Integrated Canteen Stores Department System (ICS DS)

A mention was made in AR on 'Time and Cost overrun in implementation of Inventory Management System' of CSD on turnkey basis. Appraising the Public Accounts Committee of the action taken in this regard, the Ministry stated that system was being implemented at the earliest. However, we observed that CSD is yet (March 2016) to fully implement the system. Details of the case are discussed below:

Computerisation of CSD in two phases at a total investment of ₹ 7.11 crore was sanctioned by Ministry in April 1993. Phase-I was completed by M/s Tata Infotech Ltd, New Delhi at a cost of ₹ 2.12 crore in June 2001. Phase-II was contracted to M/s Wipro Limited, Bangalore for ₹ 7.00 crore in August 2006 against a sanctioned amount of ₹ 4.99 crore with period of completion as 52 weeks from the date of commencement of the contract. M/s Wipro could not complete the work as per the schedule (September 2007) and handed over the system to CSD in July/September 2009. Although CSD had gone 'live' with the project in October 2009, during its application users continued to report various issues/bugs on regular basis along with serious connectivity issue at almost all locations. It was also observed that due to non-implementation of Phase-II, the continued dependence on the existing Fox-pro programme also affected the working of Finance & Account (F&A) Branch leading to generation of inaccurate data and erroneous reports to audit.

While intimating the progress made in implementation of the project, CSD stated (July 2016) that ICS DS Phase II is running in seven depots (July 2016) and all sections of Head Office. It was also brought out that as the hardware have become outdated, the same needs upgradation and once the sanction for upgradation is accorded by Ministry, the project will be completed by October 2016.

The reply is only partially correct as F&A Branch at CSD (HO) is continuing to use the existing FoxPro system for its day to day activities. Thus, even after 22 years of initial sanction by the Ministry and incurring an expenditure of ₹ 2.12 crore (Phase-I) and committing an expenditure of ₹ 7.00 crore (Phase-II) against which no expenditure has been incurred, the project was yet to be completed (March 2016) and made fully operational.

Conclusion 4:

There was abnormal delay in getting completed the ICS DS Phase II affecting the inventory management and financial reporting system in CSD.

RECOMMENDATIONS:

1. *Since CSD is holding an inventory of 5548 items, which includes 3035 items introduced in last six years, there is an urgent need for a comprehensive policy for introduction of new items, factoring in the consumer requirement and the popularity of the product.*

2. *Utility of having a centralized Base Depot needs to be reviewed due to its uneconomical functioning and in the light of advancements in logistics as well as in communication and information technology.*
3. *To enhance consumer satisfaction there is a need to analyse the denials and identify the URC/area wise items whose availability needs to be augmented. Slow-moving and non-moving items, if any, should also be identified and their procurement be scaled down.*
4. *Ministry and CSD should expedite the implementation of ICSDS Phase II for better management of the inventory, accounts and finances.*