

CHAPTER IV

Performance Audit relating to Public Sector Undertakings (other than Power Sector)

Management of non-subsidised commodities in The Kerala State Civil Supplies Corporation Limited

Executive Summary

Introduction

The Kerala State Civil Supplies Corporation Limited was setup with the main objective to purchase, store, process, transport, distribute and sell food grains and any other essential commodities for distribution at subsidised rates. The Company is also empowered to deal in non-subsidised commodities in order to enhance profitability. During 2013-14 to 2017-18, the Company procured FMCG, Sabari (Company's own brand) products and medicines for ₹4,698.11 crore.

Assessment of requirement

Absence of integrated software at outlets, depots and Head Office has resulted in improper assessment of requirement, accumulation of stock in outlets and issuance of multiple purchase orders in each month for same commodities at different rates resulting in extra expenditure of ₹7.94 crore.

Procurement in violation of the Stores Purchase Manual

All the 15 depots resorted to limited tenders for procurement above ₹5 lakh instead of e-tender. The procurement cost of rice and pulses through limited tender in 10 out of 15 depots were higher by ₹3.83 crore than the centralised e-tender procurement cost of same items for subsidised sale.

Procurement through negotiation

Negotiations were conducted with all the bidders in 2,749 out of 8,172 cases (33.60 per cent) instead of lowest bidder and purchase orders were issued to bidders other than the original lowest bidder in 1,108 cases.

Short supply of commodities by the suppliers

Short supply of commodities and delay in transferring commodities from the depots to the outlets resulted in potential loss of margin of ₹22.98 crore and loss of interest of ₹2.43 crore respectively.

Wrong fixation of selling price

The pricing policy of the Company was not reviewed periodically (last two revisions were in July 2008 and April 2015). The selling price for branded

rice was fixed wrongly, resulting in loss of revenue of ₹11.26 crore. Incorrect implementation of the pricing circulars resulted in loss of ₹39.53 crore.

Fixation of higher selling price

Discounts (minimum five per cent) were not provided to the customers in line with the policy of the Company. There were instances of selling price offered by the Company being higher than the open market price.

Extension of unauthorised credit facility

Unauthorised credit facility of ₹5.74 crore was extended to customers, despite the non-clearance of previous bills in 39 out of 100 outlets resulting in loss of interest of ₹0.40 crore.

Irregular collection of quantity discounts from suppliers

There was no proper system for collecting discounts and incentives from suppliers resulting in loss of ₹4.02 crore.

Multiple GST registrations resulting in blocking up of input tax credit

Instead of taking only one GSTIN, the Company took 62 GSTINs for its depots, Regional Offices and Head Office. So, the input tax credit accumulated in the GSTINs of 56 depots and five Regional Offices amounting to ₹7.55 crore could not be utilised due to accounting of all sales in the Head Office GSTIN.

Violation of the Food Safety and Standards Act, 2006

Out of the 4,412 samples sent for testing, 383 were found unfit for human consumption. In 369 samples, there were delays in removal of these commodities.

Procurement of medicines for Supplyco Medical Stores

Neither monthly report in order to monitor the purchase, sales and stock holding of medical stores nor medicine-wise details were prepared. In the absence of this information, it was not possible to assess the efficiency of inventory management.

Performance of Supplyco Medical Stores

Performance of Medical Stores with turnover below the break-even sales (16 out of 106) were not periodically monitored.

Introduction

4.1 The Kerala State Civil Supplies Corporation Limited (Company) was setup (June 1974) as a fully owned State Government Company with the main objective to purchase, store, process, transport, distribute and sell food grains, food stuffs and any other commodities considered essential by Government of Kerala (GoK). Besides dealing in subsidised commodities, the Company is empowered to deal in non-subsidised commodities, the price of which is fixed with a profit motive. Non-subsidised commodities include Fast Moving Consumer Goods (FMCG), Sabari products (own brand of the Company), medicines and petroleum products. As of March 2018, the Company dealt in 42,405 FMCG commodities, 28 Sabari products and 12,370 medicines and 5 petroleum products. Percentage of turnover of non-subsidised commodities to the total turnover of the Company ranged between 32.16 and 35.26 during 2013-14 to 2017-18.

Organisational set up

4.2 The Company with its Registered Office at Kochi, Kerala is managed by the Board of Directors (BoD) with the Chairman and Managing Director (CMD) as the Chief Executive. As of April 2018, the overall administration of the Company is vested with the CMD who is assisted by one General Manager, two Additional General Managers, three Managers, five Regional Managers and a Company Secretary. The Company has 1,560 retail outlets as on 1 April 2018 under the control of 56 depots operating in five Regional Offices. A list of the supply chain is given in *Appendix 8*.

Scope of audit

4.3 The Performance Audit covered the performance of the non-subsidised segment comprising FMCG, Sabari products and medicines during 2013-14 to 2017-18. The Performance Audit covered various aspects such as assessment of the requirement, economical procurement, pricing, sales and marketing of the commodities.

Out of 56 depots in the Company, 15 depots were selected on the basis of stratified⁵⁶ random sampling for detailed audit along with 119 outlets out of 478 outlets in the selected 15 depots. During 2013-14 to 2017-18, the Company procured FMCG, Sabari products and medicines for ₹4,698.11 crore. Out of this, Audit examined procurement amounting to ₹1,913.79 crore (40.74 per cent) in 15 depots.

⁵⁶ Based on three strata of purchase value (more than ₹100 crore – 5 depots, between ₹50 crore to ₹100 crore – 8 depots and below ₹50 crore – 2 depots) and also on rural urban classification with at least two depots from each region as shown in *Appendix 8*.

Audit objective

4.4 The objective of the Performance Audit was to assess whether the profitability of the company increased because of sale of non-subsidised commodities.

Audit criteria

- 4.5** Audit criteria were derived from the following sources:
- Pricing Manual of the Company;
 - Purchase Manual of the Company;
 - Stores Purchase Manual of GoK;
 - Guidelines issued by the Central Vigilance Commission;
 - Minutes of Depot Management Committees;
 - Annual accounts of the Company;
 - Food Safety and Standards Act, 2006; and
 - Central Goods and Services Tax Act, 2017.

Audit methodology

4.6 The methodology adopted consisted of review of records/files and documents maintained by the Company and analysis of data extracted from Depot Management System (DMS) of 15 depots.

Audit objectives, audit criteria and scope of Performance Audit were discussed with the Management and the Government in an Entry Conference held on 17 May 2018. Audit was conducted during May to September 2018.

The audit findings were discussed in an Exit Conference held on 25 February 2019 with the Government and the Management. Replies were received from the Government and the Management. The views expressed by them have been duly considered while finalising the Report.

Acknowledgement

4.7 Audit acknowledges the co-operation and assistance extended by the Management and staff of the Company and the Department of Food and Civil Supplies, GoK in the conduct of this Performance Audit.

Audit findings

4.8 The Company ventured into trading in non-subsidised commodities to enhance maximum possible returns. In the absence of segment-wise profitability analysis, Audit worked out the profitability⁵⁷ of the non-subsidised segment as in **Table 4.1**:

⁵⁷ After apportioning the overhead expensed on the basis of turnover.

Table 4.1: Details of profitability of non-subsidised commodities**(₹ in crore)**

Year	Net profit from subsidy segment	Profit from non-subsidised commodities					Net Profit of the Company
		FMCG	Sabari	Medicine	Petroleum	Total	
2013-14	-98.27	17.37	11.34	-8.63	-10.92	9.16	-89.11
2014-15	-106.68	10.91	8.36	-10.40	-9.62	-0.75	-107.43
2015-16	-125.77	86.55	30.88	-11.17	-7.18	99.08	-26.69
2016-17	-150.08	34.97	14.35	-14.96	-10.09	24.28	-125.80
2017-18	-164.67	39.49	16.88	-15.22	-11.54	29.61	-135.06

(Source: Annual accounts of the Company. Figures for 2015-16 to 2017-18 were taken from provisional accounts.)

As could be seen from the above table, the profit from the non-subsidised commodities decreased from ₹99.08 crore in 2015-16 to ₹29.61 crore in 2017-18. This was mainly due to lack of economy in procurement of commodities, improper fixation of selling price and ineffective marketing as discussed below.

Procurement of non-subsidised commodities

4.9 The Company procures branded FMCG products from the suppliers registered under the centrally consolidated indenting system (CCIS)⁵⁸ and centrally listed companies (CLC)⁵⁹. FMCG products and other products are also procured from the suppliers registered with the Depot Management Committees (DMC). The Head Office of the Company procures commodities from the CCIS registered suppliers while the depots procure commodities from the suppliers listed under CLC and DMC.

The Sabari products are procured by the Head Office of the Company through competitive tendering. Medicines are procured by the five Medical Wholesale Divisions (MWD) from the pharmaceutical companies registered with the MWD. During 2013-14 to 2017-18, the Company procured FMCG products, Sabari products and medicines valuing ₹3,962.01 crore, ₹441 crore and ₹295.10 crore respectively.

Assessment of requirement

4.9.1 Assessment of requirement is the first step in procurement. As per Rule 6.1 of the Stores Purchase Manual (SPM) issued by GoK, purchase of commodities for public service should be based on the assessment of requirements for the year so far as they can be foreseen. As per the guidelines issued by the Company, the requirement of commodities in an outlet shall be limited to 1.50 times the previous three months' average sales.

⁵⁸ Vendors having monthly sales above ₹0.25 crore in 25 depots of the Company or monthly sales above ₹0.30 crore in 15 depots excluding the sale of rice and edible oil or annual turnover of ₹10 crore and above in Kerala market.

⁵⁹ Vendors with sales in 20 or more depots of the Company and sales turnover of ₹2 crore or sales in 10 or more depots of the Company and sales turnover of ₹5 crore including the Company or sales turnover of ₹8 crore in Kerala market.

Audit observed that the procurement of non-subsidised commodities in the Company was managed by four independent software, namely, FMCG Indenting System, Sabari Indenting System, Depot Management System (DMS) and Outlet Management System (OMS). In the absence of an integrated software, the centralised assessment of requirement based on sales and stock data available in the OMS was not possible. The indents for FMCG commodities were instead prepared arbitrarily by the outlets. Out of 100 sample selected outlets⁶⁰ examined, it was noticed that in 30 outlets, fresh lot of the same commodities was purchased during 2017-18 and 2018-19 when sufficient stock was available at the outlets.

The Company replied (February 2019) that the new integrated software planned to be rolled out in April 2019 would enable the Company to ascertain the receipt and issue of commodities against the indents and sale of commodities to the ultimate customers.

However, the Company did not roll out any integrated software so far (July 2019).

Procurement of commodities by the Head Office

4.9.2 Audit observations on procurement of FMCG commodities and Sabari products are discussed below:

Registration of suppliers

4.9.2.1 According to Rule 1.2 of the SPM, public procurement activities should be conducted in a transparent manner ensuring competition, fairness and elimination of arbitrariness in the system. As per the provisions of the Kerala Financial Code and the SPM, all efforts should be taken to ensure that the procurement price of the commodities is at the minimum.

Audit observed that one of the conditions for the registration of suppliers under CCIS and CLC was the declaration by the suppliers that the margin offered to the Company was the highest in Kerala market. However, many commodities were sold by competitors at a price lower than that of Supplyco. The Company did not have a system to gather market intelligence to ensure that the suppliers complied with the declaration and that the commodities offered by the suppliers were at the lowest cost. Such a system was important since the selling prices were determined based on the margin obtained from the suppliers.

The Company replied (February 2019) that the market intelligence system would be strengthened.

Short procurement of Sabari products

4.9.2.2 Under the Sabari brand, the Company sells non-subsidised commodities like tea, coffee, coconut oil, curry powders, rice products, salt,

⁶⁰ Excluding 19 Supplyco Medical Stores.

notebooks etc. The Sabari products are available only in the Supplyco outlets and are in high demand. The substitutes for all the Sabari products are also available in the outlets. The Sabari products fetch higher margin to Supplyco than that of substitute products.

On an examination of procurement of 15 Sabari products⁶¹ in five depots⁶² during 2014-15 to 2017-18, it was noticed that against the actual requirement of 47,45,263 units, only 35,99,450 units (76 per cent) were received from the suppliers. This was due to short placement of orders by the Head Office and short supply by the suppliers. As a result, there was stock out of Sabari products in 33 out of 151 outlets under the five depots for periods ranging from 3 days to 313 days leading to loss of margin of ₹0.10 crore.

The Company replied (February 2019) that the short placement was on account of various reasons including financial, subsidy element etc.

The reply of the Company was not acceptable as there was no subsidy element in the sale of Sabari products excluding coconut oil and, in fact, the Company earned margin on the sale of such commodities during 2013-14 to 2017-18.

Procurement of commodities by Depot Management Committee

4.9.3 As per the procurement practice of the Company, the DMC formed at each of the 56 depots was given authority to purchase commodities of suppliers listed in CLC and DMC based on indents received from the outlets. FMCG commodities registered under CLC and DMC are procured considering the agreed margin on the purchase price. Other commodities viz., ordinary rice, jaggery, raw turmeric and pulses are procured on the basis of limited tenders received from the vendors registered with DMC.

During 2013-14 to 2017-18, the value of procurement of FMCG and other commodities was ₹3,962.01 crore. Out of this, value of purchase by DMCs through CLC and DMC amounted to ₹1,588.13 crore (40.08 per cent). Though the depot level purchases constituted 40.08 per cent of the total purchase of non-subsidised commodities, the Company did not have a transparent procurement procedure as discussed below:

Procurement of commodities in violation of the Stores Purchase Manual

4.9.3.1 The GoK directed (May 2015) that all Government Departments/Boards/ Public Sector Undertakings shall follow e-procurement for all the tenders above ₹5 lakh.

Audit observed that:

- The 15 depots examined in audit issued 41,096 purchase orders (POs)

⁶¹Free flow salt 1 kg, Black pepper, Chilly powder 100 gram (gm), Chilly powder 500 gm, Coriander powder 100 gm, Turmeric powder 100 gm, Asafoetida powder 50 gm, Asafoetida cake 50 gm, Asafoetida powder 100 gm, Asafoetida cake 100 gm, Meat masala, Chicken masala, Fish masala, Rasam powder, Sambar powder.

⁶²Kanhangad, Kottayam, Nedumangad, Thalasserry and Kanjirappally (The subject matter was not examined in the other 10 sample-selected depots due to non-availability of data in required format).

to procure commodities worth ₹767.78 crore during 2014-18. Out of this, 1,140 POs were to be e-procured as the value exceeded ₹5 lakh. Instead of e-procurement, the commodities valuing ₹150 crore were procured from the vendors registered with DMCs.

- The Head Office of the Company procured rice and pulses for subsidised sale through e-tenders during 2013-14 to 2017-18. On comparison of the e-tender rate with the procurement rate in 15 selected depots, it was noticed that the procurement rate of rice in ten depots was higher than the e-tender rate resulting in extra expenditure of ₹3.83 crore.

Thus, due to procurement of commodities through DMC, the Company lost the benefit of economies of large-scale centralised procurement.

The Company replied (February 2019) that the SPM was primarily intended for the purchase of stores. The procedures specified in the SPM were modified through the Purchase Manual of the Company approved by GoK to suit the purchase of its trading goods.

The reply of the Company was not acceptable as the GoK modified the SPM in June 2013 and made it applicable to all PSUs. Hence, the modified SPM prevailed over the Purchase Manual of the Company approved by GoK in May 2006.

Procurement through negotiation

4.9.3.2 As per Rule 1.2 (x) of the SPM, negotiations with the tenderers must be severely discouraged. The Central Vigilance Commission also clarified (January 2010) that there should normally be no post tender negotiations and if at all negotiations are warranted under exceptional circumstances, then they can be with the lowest tenderer only.

Audit observed that in 15 depots test checked, in 2,749 out of 8,172 cases, the DMC held negotiations with all the bidders. At the time of negotiation, the bidders quoted fresh lower rates and in 1,108 cases, the purchase orders were issued to the bidders other than the original lowest bidder. Though there was a marginal decrease in the cost of procurement, the negotiation process was against the guidelines issued by the GoK and the CVC.

The Company replied (February 2019) that directions were given to comply with the CVC guidelines on negotiation.

Procurement of commodities through issue of multiple POs

4.9.4 As per Rule 6.1 of the Stores Purchase Manual issued by GoK, purchase of commodities for the public service should be based on the assessment of requirement for the year so far as they can be foreseen. For the procurement of commodities listed under DMC, the DMC was to approve the rate and quantity of procurement.

All the 15 depots examined in audit issued multiple POs in a month for DMC listed commodities during the years 2013-14 to 2017-18 due to faulty indenting system. The procurement rate as per the POs issued to the same supplier in respect of the same commodity was different, resulting in extra expenditure of ₹7.94 crore.

Short supply of commodities by the suppliers

4.9.5 In order to ensure due performance of the contracts, Rule 8.19 of SPM specified collection of security deposit equivalent to five *per cent* of the total value of the contract. Further, as per Rule 8.30 of SPM, the security deposit shall be forfeited in the event of breach of contract.

Audit observed that the Company did not collect any security deposit due to non-inclusion of such provisions in the POs. In all the 15 depots examined in audit, out of the total order value of ₹1,618.69 crore for FMCG, commodities valuing ₹187.61 crore were not supplied during 2013-14 to 2017-18. Thus, the non-supply of commodities by the suppliers may have led to potential loss of margin of ₹22.98 crore to the Company in addition to the dissatisfaction among the customers.

The Company replied (February 2019) that the suppliers would come to know about the ordered quantity only at the time of receipt of the POs and hence, may not be in a position to supply the entire quantity. As the Company released payment only against the quantity supplied, the Company did not incur any loss due to the non-supply of commodities.

The reply of the Company was not acceptable as the suppliers accepted POs with the condition to supply the entire quantity within the prescribed time. Delay/ non-supply of ordered quantities may result in stock out position and consequent potential loss of margin.

Delay in transfer of commodities to outlets

4.9.6 As per the procedure in vogue, the suppliers deliver the commodities to the depots/outlets. The commodities received at the depots are transferred to the indented outlets. The depots need not hold the stock of these commodities beyond three days, a reasonable time for dispatching the commodities to outlets.

Audit observed that there were delays ranging up to 340 days in transferring FMCG and Sabari commodities to the outlets during 2013-14 to 2017-18 resulting in blocking up of funds of ₹455.94 crore and consequent loss of interest of ₹2.43 crore. Inefficient logistic management by the Company was the reason for delayed transfer of non-subsidised commodities to outlets.

The Company replied (February 2019) that while transporting items to outlets, importance would be given to subsidised commodities. As the transfer of the commodities to the outlets would depend on the number of outlets, distance to outlets and availability of storage space at outlets, the Company started promoting outlet delivery.

The reply of the Company was not acceptable as the delay in transfer of commodities to the outlets resulted in blocking up of funds and consequent loss of interest. The Company should have arranged the necessary logistic support to deliver the commodities which are margin earning to the outlets immediately on their arrival.

Fixation of selling price for commodities

4.10 As the sale of non-subsidised commodities is not intended to regulate prices in the market, the Company is free to fix suitable price for such commodities. During 2013-14 to 2017-18, pricing of the commodities in the Company was regulated by two circulars issued in July 2008 and April 2015 as shown in *Appendix 9*.

Audit examined the impact of both the circulars in maximising profit of the Company and observed the following:

Wrong fixation of selling price

4.10.1 The pricing circular issued in July 2008 and in force till March 2015 aimed at sufficient profit for the Company from the sale of FMCG as well as lesser selling price than the open market price. The price was to be fixed as mentioned in the circular. In respect of Sabari products, selling price was arrived at by adding five *per cent* of the material cost as administration overhead and three *per cent* of the selling price as sales overhead.

Audit observed that:

- The pricing method in the July 2008 circular was adopted for FMCG on the assumption that direct and administrative cost was around 6.90 *per cent* of the sales price. The Company continued the pricing policy till March 2015 during which, the overall direct and administrative costs increased from 9.32 *per cent* in 2013-14 to 9.89 *per cent* in 2014-15. The failure of the management to review the pricing policy periodically based on the increase in direct and administrative costs resulted in lesser recovery of margin than envisaged at the time of price fixation.
- In the case of Sabari products, the actual overheads during 2013-14 to 2017-18 increased from 9.49 to 11.03 *per cent*. The increase in the overhead rate was not considered while fixing the selling price. This resulted in lesser recovery of margin of ₹20.50 crore in respect of Sabari products.
- As per the July 2008 circular, considering the importance of rice, the Company fixed the selling price of non-branded rice at a margin of five *per cent* on purchase price while the selling rate of branded rice was fixed at a margin of 10 *per cent* on the purchase price. Other varieties of branded rice such as Broken rice, Ghee rice, Biryani rice, Basmathi rice, Jeeraka sala rice *etc.* were priced by adding margin up to 22.50 *per cent* on purchase price. According to the April 2015 circular, the Company

re-fixed the selling price of all the varieties of rice including branded rice at purchase price plus four *per cent* (six *per cent* in case of depot delivery) instead of pricing at higher rate based on Maximum Retail Price (MRP). Fixation of selling price of branded rice by adding lesser margin resulted in loss of revenue of ₹11.26 crore during 2015-16 to 2017-18 in all the 15 depots examined in audit.

The Company replied (February 2019) that the fixation of selling price based on MRP for branded rice would result in higher selling price in the outlets of the Company. However, considering the observations of Audit, the Company revised the selling rate to purchase price plus nine *per cent* margin.

The reply of the Company was not acceptable as selling price of all commodities with MRP, except branded rice, was fixed with reference to the MRP.

- The two price circulars (July 2008 and April 2015) stipulated methods for fixing selling price of various commodities by adding certain margin to the purchase price. Due to the error in the implementation of the price circulars, there was short fixation of selling price in all the 15 depots examined, resulting in loss of ₹19.03 crore during 2013-14 to 2017-18.

Fixation of higher selling price

4.10.2 Besides ensuring assured margins to the Company, the pricing circular of April 2015 aimed at ensuring competitiveness of the selling price of the non-subsidised commodities for attracting more customers. The revision of selling price was also necessitated by the complaints received from public regarding the higher rate of some popular branded products compared to the rate of other retail chains. As per the pricing circular of April 2015, the consumers were to be offered a minimum discount of five *per cent* on MRP.

Audit observed that:

- In all the 15 depots, the Company fixed higher selling rates in respect of some commodities than the rate stipulated by the circular resulting in excess realisation of ₹1.94 crore during 2015-16 to 2017-18.
- Similarly, in all the 15 depots examined, products valuing ₹93.33 crore were sold to customers without offering the stipulated minimum discount of five *per cent* on MRP as envisaged by the price circular.

The Company replied (February 2019) that on implementation of the integrated software, all the anomalies in the present system would be rectified.

Audit also observed that the Company did not have a mechanism to compare the selling price fixed by the Company *vis-à-vis* the price charged by the competitors on the same commodity. The competitor's pricing for similar products was not considered for the pricing decisions of the Company. A price

comparison (September 2017) between the open market and the Company was as detailed in **Table 4.2:**

Table 4.2: Comparison of selling price of the Company and open market price

Sl. No.	Item	MRP (₹)	Selling price of the Company (₹)	Open market price (₹)
1	Total wash 1 kg	74.00	70.30	65.38
2	Every Day 400 gm	169.00	160.55	156.61
3	Colgate Strong Teeth 100 gm	52.00	48.50	44.18
4	Texma 1 ltr	39.00	37.05	34.89
5	Harpic Ordinary 500 ML	78.00	74.10	73.89
6	Sunlight Washing powder 500 gm	39.00	38.28	37.16
7	Kabani XL Washing soap	62.00	58.90	58.00
8	Dr.Wash 200 + 10 gm	25.00	23.75	23.35
9	Gold Bar 916 - 850 gm	67.50	64.12	63.76

(Source: Report of the Vigilance Officer of the Company)

Since the Company was competing with large supermarket chains, the competitive edge in respect of pricing was essential to sustain in the Kerala retail market. Therefore, the incidence of higher price being charged by the Company vis-à-vis the competitors would result in low sales volume in the Company.

The Company replied (February 2019) that the local super market chains would reduce their selling rates in certain areas where competition was more. The Company with around 1,600 outlets in the State adopted a uniform pricing policy and therefore, could not deviate from the selling rate based on local rates.

The reply of the Company was not acceptable as the present pricing policy of the Company was not realistic and dynamic because there was no periodical revision of the pricing method. Between 2008 and 2018, there was only one revision of the pricing method in April 2015.

Credit and incentive policy

Loss of interest due to unauthorised credit facility

4.11 In order to streamline the credit sales, the Company issued (December 2008) directions for credit sales to various Government departments and Public Sector Undertakings (PSUs). According to these directions, credit sales can be effected for a maximum period of 30 days subject to there being no pending bill against the customer.

Audit observed that:

- On an analysis of credit sales of 100 outlets⁶³, in 39 outlets there were 214 customers with ₹0.94 crore outstanding against previous credit sales of commodities. In spite of non-clearance of the previous bills, subsequent credit sales of ₹5.74 crore were extended to 178 customers

⁶³ Total sample 119 outlets out of which 19 are medical stores.

in violation of the credit policy. Due to this, an amount of ₹6.68 crore remained to be realised from 214 customers in these 39 outlets as of March 2018. Non-realisation of the amount from the customers resulted in loss of interest of ₹0.40 crore.

- The Company did not collect any security deposit against the credit sales of non-subsidised commodities as the credit policy/supply orders did not contain any provision for the collection of security deposit. As a result, though the credit period was offered for 30 days, dues could not be collected even after periods ranging up to 786 days.

The Company replied (February 2019) that curtailing further distribution of commodities to such organisations on the ground of delayed credits would attract queries from the Government and complaints from the public, adverse newspaper reports *etc.* Depot Managers were, however, asked to be prompt in liaising with the departments concerned to collect the arrears.

The fact, however, remained that despite liaising with the Government, an amount of ₹71.48 crore remained to be recovered from the Government departments and Public Sector Undertakings as of March 2018.

Irregular collection of quantity discounts from suppliers

4.11.1 Manufacturers of FMCG offer incentives to bulk consumers for placing annual POs above the pre-determined value. The Company procures commodities in bulk under FMCG category from manufacturers and is the largest dealer for many of the FMCG commodities in the Kerala retail market. Hence, the Company obtained volume/quantity incentive or discount from the suppliers based on the purchase turnover.

Audit examined the incentive scheme and observed that:

- The Company did not have complete and accurate data for claiming incentive and depended on the data given by the suppliers. The officers responsible for collecting the incentives were unaware of any official document for substantiating the incentive received from the suppliers. Hence, there was no standard policy for assessment and collection of the volume/quantity incentive.
- As per the existing practice, the Company collected quantity discounts at the rates ranging from 0.50 *per cent* to 4 *per cent* of the value of procurement from 20 out of 49 suppliers under CCIS list. There was no proposal from any level of management for collecting incentive from 29 suppliers registered under CCIS list. In the case of 17 out of 20 suppliers, there were omissions and errors in calculation of incentive resulting in loss of incentive of ₹4.02 crore.

Though the value of depot level purchases through CLC and DMC was 40.08 *per cent* of the total purchase, the Management did not, however, collect any incentive from these suppliers.

The Company replied (February 2019) that the payment to a supplier during a financial year was considered as a single payment for calculation of incentive by Audit whereas each PO was distinct.

The reply of the Company was not acceptable as there was no agreement with the supplier in respect of the computation pattern of incentive. Further, computation based on each PO may absolve the supplier from the payment of incentive.

Multiple GST registration resulting in blocking up of input tax credit

4.12 According to Section 25 (2) of the Central Goods and Service Tax (GST) Act, 2017 (Act), a person seeking registration under the Act shall be granted a single registration in a State or Union territory. Provided that, a person having multiple business verticals in a State or Union territory may be granted a separate registration for each business vertical. Section 25 (4) of the Act states that a person who has obtained or is required to obtain more than one registration, whether in one State or Union territory or more than one State or Union territory shall, in respect of each such registration, be treated as distinct persons for the purposes of this Act. Section 2 (62) of the Act states that “input tax” in relation to a registered person, means the central tax, State tax, integrated tax or Union territory tax charged on any supply of goods or services or both made to him.

Audit observed that the Company obtained (May 2017) 62 separate GST registrations for the Head Office, five regional offices and 56 depots, though it had only one business vertical and operations only in Kerala. This was done on the ground that separate registrations would make depots accountable for proper entry of purchases. However, the Company decided in August 2017 to retain the GSTIN of Head Office and surrender all the other GSTINs. The applications for cancelling the GSTINs were, however, made only during November 2018 to March 2019 and 60 GSTINs were cancelled (November 2018 to September 2019).

Meanwhile, the suppliers billed the supplies against GSTINs of the depots for the purchases made by them. The Company, however, accounted the sales of the depots under the GSTIN of the Head Office. As of October 2018, the cancelled GSTINs had accumulated input tax credit amounting to ₹7.55 crore. Since each GSTIN is treated as a distinct person as per the Act, the input tax credit in the GSTINs of regional offices/ depots could not be set off against the tax obligation under the GSTIN of the Head Office.

The Company replied (February 2019) that GST Return 3B was filed claiming the entire input tax credit on inward supply including those accumulated in depot GSTINs.

The reply was not acceptable as the Act does not permit setting off the input tax credit of a registered person against the tax obligation of another registered person.

Performance of Supplyco Medical Stores

4.13 As of March 2018, the Company operated 106 Supplyco Medical Stores (SMSs) under five Medical Wholesale Divisions (MWDs). For these 106 SMSs, the medicines are procured either through five MWDs or locally by the SMS when the required medicines are not made available by the MWDs.

Audit examined the performance of the SMSs and observed that:

- According to the Circular No.18/2008 dated 11 July 2008, if the monthly sales in a SMS are less than the stipulated break-even sales, the Regional Manager should make recommendation to close the SMS so that commercial/social loss could be avoided. Out of 106 SMSs, 16 SMSs did not attain the break-even sales in any of the five years. Despite non-achievement of break-even sales, the Regional Managers did not assess the feasibility of continuation or relocation or closure of these 16 SMSs.

The Company replied (February 2019) that steps like, shifting/ closure of SMSs having sales less than the break-even sales, appointment of pharmacists as officers in charge of SMSs *etc.*, were taken to improve the performance of SMSs.

- As per the circular issued (November 2008) by the Company for ensuring higher margin, all MWDs should ensure that local purchases should be limited to 20 *per cent* of the value of medicines sold through medical stores to get the advantage of additional margin associated with bulk procurement.

Audit observed that the local purchase of medicines by the SMSs exceeded the 20 *per cent* limitation prescribed by the Company. The local purchase during 2013-14 to 2017-18 was ₹108.08 crore against the permissible value of ₹78.82 crore. The reasons for the excess local purchase was non-procurement of medicines from listed pharma companies in MWD as well as non-listing of those pharma companies whose medicines were being indented by outlets. Thus, due to excess local procurement of medicines during 2013-14 to 2017-18, the Company sustained loss of margin to the extent of ₹2.63 crore.

- Due to non-achievement of break-even sales by the SMSs, the fixed cost of ₹78.64 crore involved in the operation of SMSs during 2013-14 to 2017-18 was recovered to the extent of ₹18.27 crore only.
- The Company issued (December 2008/ March 2011) circular stipulating analysis of performance of medical stores on a monthly basis in order to monitor the purchase, sales and stock holding of medical stores. However, no such report was prepared on a monthly basis. Besides, medicine-wise stock details were also not prepared. Further, the software applications used in the Medical Wholesale Division and in the Medical Stores were neither similar nor integrated, because of which the

Division's software was unable to fetch the inventory requirement of Stores. In the absence of this information, it was not possible to assess the efficiency of inventory management.

Thus, due to uneconomical procurement of medicines and non-achievement of break-even sales, the operation of SMSs became unviable.

Violation of the Food Safety and Standards Act, 2006

4.14 As per Section 31 of the Food Safety and Standards Act, 2006, any person carrying on any food business shall obtain a licence from the Designated Officer. As per Section 28 of the Food Safety and Standards Act 2006, the products unsuitable for human consumption should immediately be withdrawn from the market.

Audit observed that:

- As indicative cases, the depots at Kollam, Alathur, Palakkad and Chengannur and its outlets examined by Audit did not obtain licenses for all the food products dealt by them.
- Out of 4,412 samples sent for testing to Food Quality Monitoring Laboratory at Council for Food Research and Development during 2013-14 to 2017-18, 383 samples tested unsuitable for human consumption as the samples contained 'Salmonella', 'E. coli' or 'Moulds'. However, in respect of 369 samples, there was delay up to 17 days in giving direction to the outlets for removing the products.

The audit observation was accepted (February 2019) by the Company while stating that instructions were issued to comply with the legal requirements.

Restriction on MIO claims affecting profitability

4.15 As per the directions of the GoK, the Company sells essential commodities to the public at prices fixed by the GoK as a part of the Market Intervention Operation (MIO). The reimbursement of the MIO loss by GoK was limited to actual loss as per the audited accounts.

Audit observed that the actual loss as per the annual accounts is the aggregate of the MIO loss and the profit from non-subsidised commodities. Hence, the profit of ₹1,222.25 crore generated from the non-subsidised segment was totally subsumed in the MIO loss and hence, was not available for its sustainability.

The Company admitted (February 2019) that limiting the reimbursement of MIO loss to the actual loss of the Company affected its profitability.

The Government of Kerala endorsed (June 2019) the reply furnished by the Company to all the audit observations.

Conclusion

Though the Company ventured into the trading in non-subsidised commodities to enhance the maximum possible returns, the profitability of the non-subsidised segment decreased from ₹99.09 crore in 2015-16 to ₹29.61 crore in 2017-18. Incorrect assessment of requirement of commodities, uneconomical procurement, ineffective inventory management, violation of provisions of the Stores Purchase Manual and wrong fixation of selling price *etc.* led to extra expenditure/ loss of revenue to the tune of ₹91.10 crore. Taking multiple GST registrations instead of a single GST registration led to non-utilisation of the input tax credit of ₹7.55 crore. Similarly, irregular collection of quantity discount from suppliers resulted in short collection of ₹4.02 crore towards trade incentive.

Recommendations

- The Company should adopt realistic assessment of requirement based on proper indenting. Procurement of commodities should be made economical by following proper tendering procedure.
- Inventory should be managed effectively for ensuring optimum stock holding.
- Fixation of selling price should be made more realistic and mechanism should be put in place to ensure that prices fixed are adopted strictly.
- Credit policy should be strictly adhered to while offering credit sales. The procedure for collection of incentive needs to be streamlined in order to bring in transparency in the present system.
- Monitoring mechanism of Supplyco Medical Stores should be adhered effectively for evaluating performance and course corrections.
- Ensure effective compliance to the provisions of Food Safety and Standards Act, 2006.
- As the operation of schemes at the behest of the State Government affects profitability, the Company must approach State Government for providing adequate funds to compensate losses.
- Audit observation is based on our analysis on sample cases only. There is a possibility of more such cases occurring in the Company. The Company may identify such cases and take suitable action.