CHAPTER II

2. REVIEWS RELATING TO GOVERNMENT COMPANIES

2.1 PROCUREMENT AND DISTRIBUTION OF COMMODITIES BY THE KERALA STATE CIVIL SUPPLIES CORPORATION LIMITED

Highlights

The Kerala State Civil Supplies Corporation Limited incorporated with the objective of making available food grains and other essential commodities to the public at reasonable prices failed in fulfilling the objective as the prices of commodities supplied were far higher than market prices. Audit scrutiny revealed that :

- **the grant obtained from Government to subsidise the selling price of essential commodities to the public was passed on to a few local traders in the form of exorbitant prices.**
- **the quality parameters were generally relaxed and infested commodities were accepted.**
- **the selling prices, being higher or equal to open market prices, made the Company's products unattractive leading to losses.**

(Paragraphs 2.1.1, 2.1.10, 2.1.11, 2.1.20 to 2.1.23)

The Company purchased pulses and spices at rates higher than open market rates resulting in extra expenditure of Rs.42.04 crore.

(Paragraph 2.1.10)

Sugar was purchased far in excess of requirements/sold at lower rates resulting in loss of Rs. 5.75 crore.

(Paragraph 2.1.14)

Transportation of commodities to primary depots and subsequent retransfer to secondary depots resulted in avoidable expenditure of Rs. 2.97 crore .

(Paragraph 2.1.15)

The Company fixed Maveli Sale prices far below the open market retail price which resulted in loss of Rs. 42.73 crore.

(Paragraph 2.1.20)

Introduction

2.1.1 The Company was incorporated in June 1974 with the objective of procurement and distribution of food grains and other essential commodities so as to ensure their easy availability to the public at reasonable prices. The activities of the Company were confined mainly to:

- purchase and sale of 16 items* of food grains and other essential commodities under the subsidised sales scheme, petroleum products, tea, medicine, sugar, etc.,
- act as the authorised agent of the State Government for lifting, transporting and distribution of rice, levy sugar and wheat under Public Distribution System (PDS);
- blending of tea and conversion of wheat to atta;
- distribution of rice and pulses to schools under the Mid-day Meal Scheme (MDMS);
- procurement and distribution of vegetables during festival seasons like Onam, Christmas and Ramzan in order to control the price of such commodities.

The day to day affairs of the Company were being managed by the Chairman-cum-Managing Director who was assisted by one General Manager, six Additional General Managers (in charge of Purchase, Tea & Business Promotion, Commerce, Marketing, Personnel & Administration and Finance), two Managers (in charge of Management Information System and Internal Audit) and a Company Secretary.

As on 31 March 2005, the Company had five Regional offices, 56 Depots, 1067 Maveli stores (including 43 Maveli Medical Stores), 10 Super markets, 10 Petrol Bunks, four LPG outlets, one Kerosene depot and 10 Sub-depots (for PDS).

The procurement and distribution of essential commodities covering the period from 1987-88 to 1992-93 was reviewed and included in the Audit Report (Commercial) for the year 1992-93. The Audit Report has not been discussed by the COPU so far (August 2005).

Scope of audit

2.1.2 The present review conducted during the period from December 2004 to May 2005 covers the procurement and distribution of commodities during the five years ending 31 March 2004.

Audit objectives

2.1.3 The performance audit of Procurement and Distribution of Commodities was conducted with a view to ascertaining whether :

* Rice, Green gram, Green gram dhal, Black gram (Washed), Black gram (Split), Bengal gram (Bold), Bengal gram (Small), Toor Dhal, Peas Dhal, Lobia, Green Peas, Chilly, Coriander, Methi, Cumin seed and Mustard.

- the Company could achieve its main objective of ensuring availability of essential commodities at reasonable prices to the public;
- the Company had deviated from the policy and directions of the Government;
- the procurement system was economical, efficient and effective so that the Government subsidy was not mis-utilised;
- the commodities procured and distributed were of acceptable quality and standard; and
- the intervention of the Company in the distribution system acted as a control mechanism in stabilising the market prices.

Audit criteria

2.1.4 The criteria used for assessment were to evaluate whether:

- procurement prices were lower than the open market whole sale prices or comparable with the cost of procurement from the sources of production of commodities;
- the Company had ensured that the commodities were supplied strictly as per the terms of purchase orders and suppliers were not favoured with undue benefits;
- the selling price fixed was competitive and not resulting in trading loss to the Company; and
- quality control measures were apt, and adequate, and were properly implemented/executed.

Audit methodology

2.1.5 The performance audit of the working of the purchase and distribution system with reference to the objectives of the Company and Government guidelines was conducted by a general review of the tender files, payment vouchers, sales price statements, Management Information System data and Annual Accounts. The audit team reviewed mainly the records of the Company's Head Office as procurement of essential commodities were arranged centrally and also visited one out of five Regional Offices, and collected sample data that were being transmitted to Head Office for MIS purposes.

Audit findings

2.1.6 Audit findings as a result of test check were reported to the Company/Government in July 2005 and discussed in the meeting of the Audit Review Committee on Public Sector Enterprises (ARCPSE) held on 29 July 2005, which was attended by the Joint Secretary, Civil Supplies Department, Government of Kerala and Chairman-cum-Managing Director of the Company. The views expressed by the members have been taken into consideration while finalising the review.

Audit findings are discussed in the succeeding paragraphs.

Procurement of commodities

2.1.7 The procurement activities of the Company, previously confined to essential commodities only viz. rice, pulses and spices, etc., expanded over the years to various other items like sugar, tea, medicines and petroleum products. **Annexure 9** gives the details of purchases made by the Company during the five years ending 31 March 2004.

It would be seen from the Annexure that the purchase of essential commodities (pulses and spices), levy sugar and rice had declined in terms of quantity and value, during the five years up to 2003-04. This was due to poor sales performance despite subsidised sale of commodities to the public. The decline in sale of levy sugar and rice was due to the restriction of sale of levy sugar only to the people below poverty line and availability of the materials at lower prices in the open market.

Essential Commodities

Purchase Policy and Procedure

2.1.8 A systematic procedure for the purchase of commodities by the Company was laid down by the State Government in August 1994 which envisaged a centralised system of purchase and invitation of tenders after assessing the requirement on the basis of indents received from the Depots and Sub-depots. It was to be ensured that the purchases of the commodities were effected during the crop season and that too directly from the production/procurement centres. While the purchases were to be effected at the lowest prices, it should not, in any case, be above the prevailing local market rates.

The Company had also to follow the general principles laid down in the Government's Stores Purchases Manual (SPM) since February 1995. The manual *inter-alia* mentioned that :

- requirements should be assessed correctly before inviting tenders ;
- the purchases should be effected in harvest season and indents should be for the full year;
- Public Sector Undertakings and Small Scale Industrial units should be given price preference, exemption from Earnest Money Deposit (EMD)/Security Deposit (SD), etc.

The Company followed the system of centralised purchasing, for the procurement of essential commodities such as pulses and spices. The commodities were procured on the basis of monthly tenders and the quantum of purchases was decided with reference to the sales for corresponding three months in the previous year, sales for the immediately preceding three months, stock in transit, stock in hand, and requirement communicated by the Regional Offices.

It was noticed during audit that the system followed by the Company was in deviation from the Government's instructions and provisions of SPM, as discussed in paragraph 2.1.9 *infra*. The Company had sought (June 2000) Government approval for the system followed by it, but the approval, had not been received so far (August 2005).

2.1.9 The deficiencies noticed in the purchase procedure, with reference to Government's instructions and the SPM are discussed below:

- As per the instructions issued (August 1994) by the Government, the procurement of commodities was to be effected in the crop season and that too directly from the production/procurement centres. Instead, procurement was made on the basis of monthly tenders giving wide publicity. A comparison of the rates, paid by the Company for various commodities during 2003-04, with prices prevailing in the important producing/procuring centres revealed that excess prices (six to 260 *per cent*) were paid. Audit analysis further revealed that the purchase of pulses and spices were being made mainly from nine local traders at exorbitant rates.
- Clause 24 b (ii) of the SPM, clearly provided that after inviting tenders the quantity should not be varied materially. Audit scrutiny revealed that the Company invited tenders for fixed quantities each month, but that the actual procurement there against was very low, and ranged only between 20.95 and 65.12 *per cent* of the tendered quantities during the three years ended 31 March 2004. By procuring lower quantities against tenders for huge quantities, the Company was deprived of the benefit of competitive rates that could be offered by small tenderers.
- As per Clause 24 (d) of SPM, specifications of commodities should be carefully drawn up so as to avoid ambiguity in type, size, packing, etc. The Company, however, was not specifying the variety/quality/grade of each commodity in the tender invited. Due to this, the Company could not ensure that the commodities offered conformed to the required specification. At the same time the Company used to reject tenders on grounds of deviation from specifications like discoloured pods, moisture content, etc., rather than variety, thereby reducing competitiveness in tenders.
- In deviation from Clauses 25 and 52 of SPM, fixing one *per cent* and five *per cent* respectively for EMD and SD, the Company had been accepting EMD of only Rs.100/MT up to November 2002 and Rs.150/MT thereafter and an SD of one *per cent* only. For the month of March 2004 alone the short collection on this account amounted to Rs.1.29 crore. The purchases were, therefore, not adequately secured notwithstanding the interest loss on the short collected amount.
- During the five years ended 31 March 2004, the tenderers failed to supply commodities on 37 occasions and there was short supply in 63 cases. In five cases the Company resorted to alternate purchases resulting in aggregate loss of Rs.40.98 lakh, which could not be recovered in the absence of adequate security.
- In violation of the directions of the Central Vigilance Commission to hold negotiation with the lowest tenderer only, the Company used to negotiate with all the tenderers. As a result, all the tenderers could amend the quoted rates through negotiation. A test check of 115 tenders relating to 10 items revealed that in 86 cases orders were not given to the lowest tenderers.

Audit analysis revealed that the Company incurred wasteful/extra expenditure due to the deficiencies in the purchase procedure, which are discussed in paragraphs 2.1.10 and 2.1.11 *infra.*

Purchase of pulses at prices above market rates

Procurement of nine items of pulses and spices at rates higher than the open market rates resulted in extra expenditure of Rs.42.04 crore

2.1.10 The instructions issued (August 1994) by the State Government required that the purchases should be effected at the lowest price prevailing in the local market. It was noticed during audit that there was no system of comparing the purchase rates quoted with the prevailing open market rates, taking into account the quality/variety of the item offered/ordered for supply. A comparison of the purchase prices of the Company with the whole sale market prices at Kochi revealed that, in most of the purchases, the price paid by the Company was higher than the average prevailing market prices. In nine items of pulses, involving a quantity of 1,80,944 MT relating to 507 purchases made during the five years ended 31 March 2004, 316 purchases for a quantity of 1,17,115 MT were made at rates above the market prices, involving extra expenditure of Rs.42.04 crore.

Further analysis of these purchases revealed that;

- In 236 purchases, the prices paid exceeded the maximum market rates, up to 70.09 *per cent* and the value of such excess was Rs. 26.44 crore.
- A comparison of the prices paid for pulses and spices with the then prevailing local market rates as reported by the Regional Managers of the Company revealed that the rates paid by the Company were higher. In respect of 10 items involving a quantity of 1,86,515 quintals, supplied at regional headquarters during 2003-04, the extra expenditure incurred amounted to Rs.6.39 crore.
- The Company was procuring commodities even at prices higher than the average open market retail prices (AVOPMR). The extra expenditure on the purchase of 45,146 MT of pulses/spices during the three years 2001-04 amounted to Rs.8.71 crore.

Benefit to private traders at Government cost

2.1.11 State Government prescribed (February 1994) that the prices of commodities in the Maveli Stores* were to be fixed at 10 *per cent* below the retail market price. This loss was to be subsidised by Government by way of grant. The Company received Government grant of Rs.206.77 crore for the five years ended 31 March 2004; out of this only Rs.72.38 crore was utilised for market intervention and the balance Rs.134.39 crore was passed on to private traders by way of procurement at rates higher than the open market prices. Thus, the Company not only failed in its role of market intervention to hold the level of prices but also acted as an intermediary for passing on Government grant of Rs.134.39 crore to private traders.

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* Maveli Stores function as the retail outlet of the Company for distribution of essential commodities at subsidised rates.

Quality Control

2.1.12 In order to procure only quality materials the Company has prescribed several parameters in the tender itself. The Quality Control Wing under the control of Manager - Quality Control (Q.C) was primarily responsible for ensuring that the commodity received conformed to the tender conditions and the variety as per the samples accepted.

It was, however, noticed during audit that the Company was frequently accepting goods by relaxing quality parameters, which resulted in acceptance of inferior quality goods from suppliers, as discussed below:

The Company accepted 23,870.440 MT of infested commodities after collecting fumigation charges

- As per Grade Specifications in the tender, the commodities should be wholesome, free from moulds and insects. The Company was, however, regularly accepting infested commodities after collecting fumigation charges. The Company had accepted 4,79,664 bags (23,870.440 MT) of infested commodities during the five years 1999-2004. The acceptance of such commodities was against the tender conditions and resulted in sale of infested commodities to the public.

18027.1 quintals of pulses and spices having variety other than sample variety was accepted without assessing the price difference.

- Tender samples were being rejected on account of inferior variety, small variety, mixed variety, etc. The Company, however, used to accept commodities even if it differed from the variety of the sample submitted at the time of tender by charging a penalty as decided by the Managing Director. Accordingly the Company accepted 18,027.1 quintals of lower variety pulses/spices during the five years 1999-04, imposing variety cut of 2.5 *per cent* of the value. The Company, however, had not assessed the price difference that existed between the tender sample variety and the actual variety supplied. This practice enabled suppliers to submit samples of better variety and make the bulk supply with a lower quality and to reap the benefit in price.
- During the five years up to 2003-04 the Company accepted 4,704.62 MT of defective commodities valued at Rs.11.93 crore with quality cuts. There was also no mechanism for counter checking the quality of goods accepted by the Depots.
- The quality parameters of different commodities stipulated in Schedule I and II of the tender prescribed that the Bengal Gram (Bold) and Bengal Gram (Small) shall not be sulphur treated. While chemical treatment of commodities is harmful to health, the quality control wing of the Company did not have any facility to check such chemical contamination.
- The Company had not been assessing the excess moisture content in respect of spices such as methi, cumin seed and mustard after fixing the minimum level. In the case of cumin seed, Company's depots did not assess the actual moisture content but accepted 14,562 quintals during the five years up to 2003-04 after visual inspection.
- The tender specified rates of quality cut for spices like coriander, methi, cumin seed and chilly for any deviation from parameters like discolouration, presence of other edible seeds, etc. It was, however, noticed that the percentage of quality cut applied in respect of four items during the period 1999-2004 was only at the rate of 50 *per cent* of

specified rates resulting in excess payment of Rs.40.56 lakh to the suppliers.

Other commodities

Purchase of sugar at higher rates

Purchase of sugar at rates higher than open market retail prices resulted in extra expenditure of Rs.97.97 lakh.

2.1.13 The Company had not been following the practice of comparing the landed cost of sugar with the local market rates to assess the economy of purchases. As a result the cost incurred by the Company was often higher than the open market retail rates. Audit scrutiny revealed that in 27 out of 60 months during the five years up to 2003-04, landed cost of sugar was higher than the average open market retail prices, resulting in extra expenditure of Rs.97.97 lakh. Sugar being an item not classified as essential commodity, purchase of sugar at higher cost lacked justification.

Accumulation of Stock of free sale sugar

2.1.14 As per the State Government instructions (August 1994), the Company was to hold stock of two months' requirement of sugar as reserve stock. The details of purchases, sales and stock of free sale sugar during the three years up to 2002-03 are given in **Annexure 10**

Details in the **Annexure** indicate that the actual stock held during the three years ranged between 4.2 months' and 14.9 months' sales resulting in blocking of borrowed working capital, ranging between Rs 2.76 crore and Rs. 8.52 crore during the three years up to 2002-03. The loss of interest there on amounted to Rs.1.78 crore at the rate of 12 *per cent* per annum.

Sugar purchased far in excess of requirements resulted in loss of Rs. 5.75 crore

The Management stated (August 2005) that on certain occasions when the open market rates were less, sale was poor resulting in accumulation of stock. The reply is not acceptable as it was noticed in audit that the Company was continuing the purchases irrespective of the stock accumulation and sold accumulated stock (48,249 MT) of sugar at prices less than open market prices and sustained a loss of Rs.3.97 crore.

Storage and handling operations

The deficiencies noticed in the storage and handling of commodities are discussed in succeeding paragraphs.

Extra expenditure on transportation and storage of commodities

2.1.15 As on 31 March 2004, the Company had 28 primary depots and 28 secondary depots. The suppliers had agreed to deliver the commodities at various depots in the State without any extra charge for transportation. Audit scrutiny revealed that as per the terms of the purchase orders, the commodities were being delivered by suppliers first at the primary depots and were then being transferred to secondary depots by the Company itself. The distribution to the retail outlets was being done from all the depots under their distribution network.

Receipt of commodities at primary depots and retransfer to secondary depots resulted in avoidable expenditure of Rs.2.97 crore.

The Company could have avoided the handling and transportation charges from the primary to secondary depots by issuing direction for delivery of the commodities at the secondary depots itself. Failure to manage the transportation of goods efficiently resulted in avoidable expenditure of Rs.2.97 crore during the two years up to 2003-04.

2.1.16 It was further noticed in audit that the Company operated 17 hired godowns at two to four locations in seven towns* and the number of buildings in a godown ranged from three to eight. The monthly utilisation was, however very low ranging from 15 to 51 *per cent*; 13 godowns in the above seven towns having an aggregate capacity of 2645 MT, where no stock was being kept, could have been surrendered. Failure to surrender the excess storage facility resulted in avoidable expenditure of Rs. 29.70 lakh towards payment of rent during the five year period 1999-2004.

The Management stated (August 2005) that the surrendering/de-hiring was usually blocked by the head load workers on the plea that they lose jobs and efforts were on to increase the sales performance so as to increase the utilisation of godowns. The reply is not tenable since the excess capacity mentioned pertained to separate building where no stock was being kept. As such the question of resistance by labour did not arise.

Distribution

As at the end of March 2004, there were 968 Maveli Stores, 10 Super markets, 38 Maveli Medical Stores, 10 Petrol Bunks, four LPG outlets, one Kerosene Depot and 10 Sub-depots (for Public distribution). The Company acted as wholesale dealer of the State Government to Authorised Ration Dealers (ARDs) for levy sugar, rice, and wheat besides direct sale of rice and pulses. Government under the MDMS also entrusted the Company with distribution of commodities to schools.

Sales Performance

2.1.17 Commodity-wise details of sales made by the Company during the five years ending 2003-04 were as given in **Annexure 11.** Details in the Annexure indicate that:

- total sales decreased by 39 *per cent* during the span of four years ending 2002-03;
- sale of rice, pulses and spices, levy sugar, atta, sub-depot rice and wheat which constituted 76.20 *per cent* of the total sales during 1999-2000 decreased to 40.79 *per cent* during 2002-03;

Audit analysis revealed that the decline in sales was due to fixation of higher selling prices in the Company's outlets compared to the open market prices, frequent and prolonged stock out situations; availability of free sale sugar/rice at lower prices in open markets; inefficient management and structural weakness of the Company.

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* Neyyattinkara, Nedumkandam, Cherthala, North Parur, Wadakkancherry, Ottappalam, Manjeri.

Performance of Maveli Stores

2.1.18 The functioning of Maveli Stores, Supermarkets and other retail outlets were reviewed and included in the Report of the Comptroller and Auditor General of India for the year 1996-97. The Report was not discussed by COPU (August 2005).

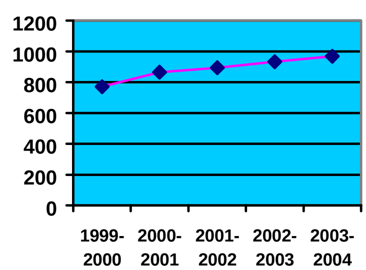
2.1.19 The Company had 968 Maveli Stores (MS) including Labham Stores (LS) as at the end of 2003-04; out of this 273 MS were opened during the five years ending 2003-04, at the instance of the State Government, without assessing the viability and necessity of these stores. Audit analysis of the working results of these MS revealed the following deficiencies:

As per the Government instructions (1994) the MS should be working on 'no profit no loss basis'. It was observed that 76 *per cent* of Maveli Stores were working below the Break Even Point. The percentage of MS with daily turnover of less than Rs.5,000* varied from 31 to 54.40. Large number of MS, ranging from 739 to 831 with very low sales volume during the period 1999-2004, indicated that the MS were not opened and operated based on necessity. The Company had not (May 2005) chalked out a comprehensive programme to achieve daily minimum sales of Rs.5,000 in respect of these MS.

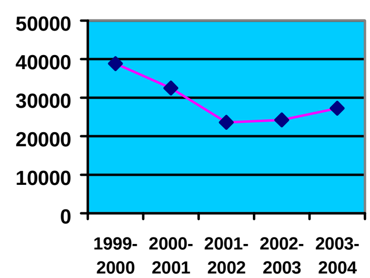
The total volume of sales through MS drastically declined from 38,790 tonnes in 1999-2000 to 27,243 tonnes in 2003-04. While the number of outlets increased from 778 (1999-2000) to 968 (2003-04) the volume of sales declined to 70 *per cent* in five years.

Graphic presentation of sales performance of MS is given below.

No. of Maveli Stores



Sales Quantity (MT)



The Management attributed the decline in sales to:

- unattractive prices of commodities with reference to quality
- inefficient management and structural weaknesses in the company
- frequent stock out of commodities
- increased competition from Margin Free Markets, Triveni, Neethi Stores, etc.

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* Fixed by the Company as minimum sales to meet operating expenses such as salary, rent, electricity and other incidentals.

Audit noticed cases of extra/wasteful expenditure by the Company due to deficiencies in the system of distribution of commodities which are discussed below:

Fixation of Maveli prices of pulses and spices

Increased number of cases of excess pricing over open market retail prices made the MS unattractive to the public

2.1.20 The standing instructions from the State Government, on fixation of Maveli price required that the prices of pulses and spices were to be fixed 10 *per cent* below the market price. Government had also directed that fixing the sale price at very low levels as compared to the open market prices was against the spirit of the Government Orders and encouraged black marketing, diversion, etc., of the essential commodities. Audit analysis of sale prices during the five years ended 31 March 2004 revealed that Maveli prices fixed were higher than or equal to open market retail prices in 133 out of 468 cases since June 2001. The Company, while fixing the Maveli price, failed to take into consideration the open market prices. The excess pricing had its negative impact in the sales performance of Maveli Stores, as more people opted out of Maveli Stores, leading to sharp decline in Maveli sales over the years. This negated the objective of the Company to provide essential items at reasonable prices to the public.

Fixing of MS price far below the open market price resulted in loss of Rs. 42.73 crore

Audit further noticed that in 444 out of 792 cases, sale prices were fixed far below the 10 *per cent* prescription of Government with reference to market prices. During the five year period of 1999-2004, the percentage of subsidy effected in the sale prices of certain commodities ranged up to 55.56 *per cent*. The loss incurred by the Company consequent on the fixation of sale price below the prescribed 10 *per cent* amounted to Rs.42.73 crore. The loss could have been minimised by following the norms fixed by Government.

Short realisation of sale value of pulses/spices

2.1.21 The Company had been selling pulses/spices through MS at prices fixed and published every month. The selling price so fixed for each item was being communicated to all the outlets.

A review of the monthly statements of sales prepared by the Regional Offices of the Company for the five years up to 2003-04 revealed that the price adopted by Maveli Stores was lower than the price fixed by the Head office, resulting in short realisation of sale value. The amount short realised in 40 cases during the period 2000-2004 amounted to Rs.28.44 lakh.

Performance of Supermarkets

2.1.22 The Company operated 10 Supermarkets (SM) as on 31 March 2004 with the objective of reducing the trade deficit in the MS. The selling price of supermarket items was generally fixed at a profit margin of 8 *per cent.*

The Super Markets which were functioning on margin basis incurred an aggregate loss of Rs 64.74 lakh

A review of the performance of existing ten super markets, indicated that four∗ SMs were incurring heavy losses continuously over the past three years (2001-2004) aggregating Rs.64.74 lakh. The reasons for loss were insufficient

∗ Thiruvananthapuram, Ernakulam, Thrissur and Kozhikode.

contribution and heavy overhead expenditure. In order to improve sales, the Company during 2002-03 and 2003-04 converted six MS as Labham Stores. The Company, however, did not convert the above major loss making SMs as Labham Stores.

Sale of pulses and spices through Supermarkets at lower prices

Pulses and spices were sold through SMs at prices less than purchase price resulting in loss of Rs.47.01 lakh

2.1.23 As per Government directions, sale of pulses and spices through supermarkets should be made on profit. The Company could earn profit in the sale of pulses and spices up to 2001-02 as the sale prices as well as open market retail prices were higher than the purchase prices. The purchase prices overtook sale prices gradually due to inefficient purchase and 27.6 *per cent* of the total sales in 2002-03 and 64.5 *per cent* of the total sales during 2003-04 were effected at a loss. As retail market prices were lower than the Company's purchase prices, the Company could not raise the selling prices. Out of 5117.07 MT of pulses /spices sold during the period 2000-2004, 1309.78 MT (25.6 *per cent*) was sold below the purchase price involving loss of Rs.47.01 lakh.

Payment of additional retail commission to Authorised Retail Dealers (ARDs)

2.1.24 The Company was acting as the authorised agency of the State Government for the purchase, transportation and wholesale distribution of levy sugar allotted to the State. The purchases were effected from sugar mills in Kerala and neighbouring States based on the orders issued by the Government of India and stored at taluk depots for sale to ARDs. While Government of India fixed the selling price of levy sugar to consumers, the Company, as Authorised Wholesale Distributor (AWD) was entitled for wholesale margin, which was also fixed by Government of India.

The MRP of levy sugar, as fixed by Government of India was Rs.1,325 per quintal with effect from March 2001 and the corresponding sale price to ARDs was Rs.1,319.50 per quintal. Deviating from the directive of Government of India, ARDs were allowed by the State Government to collect Rs.1,335 per quintal as MRP at an extra margin of Rs.10 per quintal.

The Government of India further raised (March 2002) the MRP of levy sugar to Rs.1,350 per quintal and the price of ARD was fixed at Rs.1,344.50 per quintal. Since the Government of India did not allow deviation from the ARD price to consumers, the Company had to bear the extra burden of Rs.10 per quintal allowed by State Government as additional margin.

The Company sold 24,623.06 MT of levy sugar during the period from March 2002 to March 2004 and had to bear the additional retail commission (at the rate of Rs.10 per quintal) of Rs.24.62 lakh allowed to ARDs by the State Governments. Thus, the Company acting as an intermediary for distribution of levy sugar had to bear avoidable additional expenditure of Rs.24.62 lakh at the instance of the State Government.

Mid Day Meal Scheme

2.1.25 The Government of India (GOI) introduced (August 1985) a scheme of National Programme for Nutritional Support to Primary Education (NP- NSPE) under which rice would be allotted by Government of India through Food Corporation of India (FCI) to the State Government free of cost for issue to school children. The Civil Supplies Department of the State Government had entrusted (July 1997) the Company the work of lifting of rice from the godowns of FCI and supply to schools under the Mid Day Meal Scheme (MDMS) of GOI and was paid handling and transportation charges by the Director of Public Instructions (DPI). The schools/beneficiaries were identified by the DPI. Audit noticed cases of excess payments during the implementation of the scheme as discussed below:

Purchase of rice

2.1.26 The GOI allotted rice to the State Government under Above Poverty Line (APL) and Below Poverty Line (BPL) quota. The price fixed for APL rice was Rs.738.40 per quintal which was raised (July 2002) to Rs.839.55 per quintal. The BPL rice was priced at Rs.571.50 per quintal and substantial quantity of this rice remained unlifted. The State Government, however, directed (July 2002) the Company to lift 3,200 MT of rice from the APL quota at higher rates for the supply of additional quantity of rice to the School Children during festival season. The Company lifted (August 2002) 2,550 MT at an aggregate cost of Rs.2.14 crore.

On realising the accumulation of stock under BPL quota at the lower rate of Rs.571.50 per quintal, the State Government directed (August 2002) the Company to lift the rice (earlier directed to be lifted from APL) from BPL quota. Since the Company had already lifted 2,550 MT at higher rate, it could lift only the balance quantity at the lower rate under BPL. Though the Company lifted the rice at higher rates as directed by the Government involving extra expenditure of Rs.68.35 lakh, the Company did not follow up the matter with the Director of Public Instruction to obtain refund.

Excess procurement of MDMS rice

Procurement of rice under MDMS (Special) in excess of requirement resulted in loss of Rs.79.24 lakh

2.1.27 The Company took delivery of a total quantity of 1,95,700 quintals of rice from FCI at the rate of Rs.959.50 to Rs.1141.30 per quintal for distribution to school children during festival season of 2000-01. Out of this quantity, the total issue was 1,49,807.67 quintals leaving a balance of 45,892.33 quintals. The purchase price of rice was decreased to Rs.838.80 per quintal during 2001-02. Out of the balance quantity of 45,892.33 quintals of rice lifted from FCI during 2000-01 at the rate of Rs.1141.30 per quintal, 26,153.24 quintals of rice was issued during 2001-02 including 6,200 quintals of rice lifted from FCI during the year at the rate of Rs. 838.30 per quintal. The Company’s claim for the excess cost of Rs.303 per quintal paid on 26,153.24 quintals was not allowed by the Director of Public Instructions while settling (July 2003) the claims. The excess procurement of rice at higher rate during the year 2000-01, resulted in a loss of Rs.79.24 lakh.

Supply of pulses for MDMS at prices in excess of market prices.

2.1.28 The Company supplied (1999-2004) pulses (Greengram, Bengalgram, Lobia, etc.) to schools under MDMS as directed by the State Government. The Company fixed the sale price of pulses issued to MDMS taking into account purchase price of pulses including sales tax, loading and unloading charges, internal transporting charges, storage cost, interest on investment, etc. On a review of the selling prices of MDMS items, it was noticed in audit that the prices fixed were often much higher than even the open market retail prices. The details of total quantity of pulses and spices supplied, quantities supplied at prices higher than the retail prices, and the extra expenditure during the five years ended 2003-04 were as given in **Annexure 12**.

Pulses/spices were procured at rates higher than market prices and supplied under MDMS resulting in extra expenditure of Rs. 10.43 crore to Government

Details in the Annexure indicate that the Company could supply 19,241 MT of pulses during 1999-2001 at economic rates whereas about 80 to 99 *per cent* (26,274.3 MT) of the supplies made during 2001-2004 were at prices higher than the retail market prices. This was due to the high procurement cost of the Company especially since August 2002. Thus, due to the high procurement cost incurred by the Company, the Government had to incur extra expenditure of Rs.10.43 crore in administering a social security scheme. The traders were ultimately benefited by the higher procurement rates.

Operation of Sub-depots under Public Distribution System

2.1.29 The State Government directed (December 1996) the Company to take over the seven Sub-depots previously operated by FCI as wholesale dealer. Subsequently (1996-97) three more Sub-depots were taken over at the instance of the State Government.

While entrusting the Sub-depot operations to the Company, the Government agreed (November 1996 and March 1997) to reimburse the loss. The loss in the operation of nine Sub-depots during the four years ending 2000-01 amounted to Rs.3.00 crore. There was no system of assessing periodically the working results of the Sub-depots. In the absence thereof, the Company could not claim from the State Government the loss in the operation of ten Sub-depots up to March 2005.

Internal control system

2.1.30 Audit noticed the following major deficiencies in the internal control system of the Company:

- The company was not having manuals regulating/systemising the major areas of its functions in Internal Audit, purchases, sales, pricing, quality control, etc.
- The Company was not following the system of depositing with the Bank the EMD received in the form of demand drafts as provided in the Accounting Manual. As the Company had been utilising borrowed funds for its working capital requirements, non-remittance resulted in loss of interest amounting to Rs.24.34 lakh during the period from December 2002 to October 2004.

- Samples of commodities were accepted and purchase orders placed by the head office. The details of samples and purchase orders, were not being intimated to the Depot Managers and they were not involved in quality assurance, though the stocks were actually accepted in the Depots.
- Though the goods were received at Depots and payments for supplies made at head office, the system of reconciling the quantity received as per the Head Office records with the quantity received as per Depot records was not in vogue. The Company was not ensuring that payments were made for quantities actually received by Depots. Audit scrutiny revealed short accounting of receipt of 638.705 quintals of pulses and spices valued at Rs.25.03 lakh at the depots for the five years 1999-2004.
- The Company did not have an adequate system of identifying, replacing and disposing of inferior/defective goods.
- Timely detection of the shortages and recovery of the loss was not being done promptly.
- A system of cross checking the data generated by different departments of the organisation was not in vogue and accuracy remained unascertained.
- There was absence of reconciliation of credit sales in the case of petroleum products and dues were not ascertained and got confirmed promptly.
- There did not exist an adequate system for ascertaining the liabilities from the staff for shortages or for its prompt recovery.
- None of the head office transactions was subjected to internal audit, though all major purchases, transportation etc., were made by the head office. The internal audit was conducted only at the Regional office, Depot/Outlet level.
- There were heavy arrears (two years) in internal audit due to which prompt and timely action was not being taken against system deficiencies.

Government stated (August 2005) that the management has taken/ proposes to take remedial measures to set right the deficiencies pointed out by Audit.

Conclusion

The Company set up in June 1974 with the objective of making available food grains and other essential commodities to the public at reasonable prices failed to fulfill the objective as the prices of the commodities supplied were far higher than market prices. Procurement was being made regularly from nine Kerala traders, at prices far higher than the maximum market rates. The Company's specific quality parameters were often relaxed for accepting inferior/defective goods. Selling prices which were higher than or equal to the open market rates rendered the Company's products unattractive to the public and the Company's sales drastically came down over the period due to inefficient management and structural weaknesses in the Company. The Government grant meant to subsidise the selling price of essential commodities to the public, was being passed on to a few traders by way of high procurement cost.

Internal control system was deficient in many areas viz. purchase, sales and inventory control.

Recommendations

- ***The company should formulate suitable procurement policy/procedure in line with the Government's instructions and the provisions of the Stores Purchase Manual and ensure compliance thereof.***
- ***The procurement should be made directly from the producing/ procurement centres, avoiding intermediaries.***
- ***The Company should ensure that the rates paid are not only less than the prevailing market rates but also reasonable taking into account the quality/variety of the item offered/ordered for supply.***
- ***Scientific quality parameters should be evolved and enforced for ensuring the quality of commodities procured.***
- ***The Company should improve the sales at outlets and periodically verify the prices to ensure that it was not above the prevailing market rates.***
- ***Management and State Government should analyse the reasons for the inefficiency/ structural weaknesses in the organisation and take remedial measures.***
- ***Internal audit and the internal control system in the Company requires revamping and strengthening.***

The above recommendations were agreed to by the Management and the Government during the ARCPSE meeting held on 29 July 2005.