CHAPTER II

2. Performance reviews relating to Government Companies

Kerala State Cashew Development Corporation Limited

2.1 Performance Review on the Working of Kerala State Cashew Development Corporation Limited

Highlights

Failure of the Company in streamlining the system of procurement of raw cashew nuts and regulating its cost of procurement as per All India procurement cost resulted in a loss of Rs. 19.45 crore.

(Paragraph 2.1.11)

The impact of excess price paid in 11 out of 24 consignments (50,247 MT) imported during the five years up to March 2008 worked out to Rs.7.51 crore.

(Paragraph 2.1.13)

Loss on account of low recovery of export wholes amounted to Rs. 24.27 crore.

(Paragraph 2.1.19)

Failure to obtain the State average price for kernels during the three years up to 2007-08 resulted in revenue loss of Rs. 14.71 crore.

(Paragraph 2.1.23)

As against 275 days, the Company could provide employment to cashew workers for 17 to 138 days only during 2003-08.

(Paragraph 2.1.25)

Arrears pending payment to staff amounted to Rs. 38.89 crore.

(Paragraph 2.1.25)

Introduction

2.1.1 The Kerala State Cashew Development Corporation Limited was incorporated in July 1969 under the Companies Act, 1956 with the objective of purchase of raw cashew nuts from within and outside the country; establish, maintain and operate factories in the State for processing cashew nuts and sell the processed cashew nuts (kernels) and other by-products of cashew within and outside India thereby providing fair number of employment days to cashew workers in the State. As on 31 March 2008, the Company was operating 30 cashew-processing factories (including 20 hired factories).

The Management of the Company is vested in a Board of Directors consisting of the Chairman, Managing Director and nine directors. As on 31 March 2008 there were eight directors excluding Chairman and Managing Director. The Managing Director is the Chief Executive of the Company who is assisted by General Manager (Personnel), Commercial Manager, Production Manager, Materials Manager, Finance Manager and the Company Secretary.

The activities of the Company were last reviewed in the Report of the Comptroller and Auditor General of India for the year 1996-97 (Commercial). The review was discussed by the Committee on Public Undertakings (COPU) and their recommendations as presented (July 2003) to the Legislature were as follows:

- The Company should adopt well defined sales and marketing policy in consultation with an expert agency.
- The Internal audit wing should be strengthened and the Internal Audit Cell should inspect all the major transactions like import, export, sales of cashew nuts, etc.

Both the recommendations had not received adequate attention and the deficiencies still persist as discussed in the audit findings *infra*.

Scope of Audit

2.1.2 The present performance review, conducted during the period November 2007 to April 2008, covers the activities of the Company during 2003-2008. The audit findings are based on a test check of records at the Corporate office and eight* out of 30 factories (five own and three hired) of the Company selected on the basis of ownership (50 *per cent* of own factories and 15 *per cent* of hired factories) as well as quantity processed (33.5 *per cent*).

Audit Objective

2.1.3 The audit objectives of the review were to ascertain whether:

- The funds available and received from the State Government/ other agencies were efficiently utilised;
- There existed purchase policy and procedure and the procurement was efficient and economical;
- Processing was done efficiently and capacity available in the factories was utilised to the optimum level;
- There existed sales policy and procedures, pricing policy and marketing strategy to earn maximum revenue;
- The Company fulfilled its objective of providing maximum days' employment to cashew workers in a cost effective manner;
- There was effective manpower management and corporate governance; and
- Internal control and internal audit were adequate and efficient.

* Ayathil, Kottiyam, Chittumala, Talassery, Pullur, Kayamkulam, Nooranadu and Chengamanadu.

Audit criteria

2.1.4 The following criteria were adopted for analysis:

- Government orders and policies prescribing the manner of utilisation of funds provided;
- Procedures fixed for procurement and processing of raw materials and marketing;
- Workability statements prepared by the Company at the time of raw material purchase;
- Processing norms fixed by the Company;
- Terms and conditions in the contracts and agreements in connection with procurement and sales; and
- Targets fixed by the Company for employment days.

Audit Methodology

2.1.5 The performance audit was conducted using the following methodology:

- Review of State Government budget and policy declarations relating to the industry;
- Scrutiny of contracts for procurement of raw nuts, sale of kernels, production statements and workability statements;
- Review of study reports of various committees and detailed system study in the Company;
- Review of internal audit reports and internal control system; and
- Interaction and discussion with the Management.

Audit Findings

2.1.6 Audit findings as a result of performance review were reported (May 2008) to the Management/Government and discussed in the meeting (30 July 2008) of the Audit Review Committee for State Public Sector Enterprises (ARCPSE), which was attended by the Principal Secretary to Government of Kerala, Industries Department and Managing Director of the Company. The views expressed by the Management/Government have been taken into consideration while finalising the review.

Audit findings are discussed in succeeding paragraphs.

Finance and Resources

Capital Structure

2.1.7 The authorised share capital of the Company as on 31 March 2008 was Rs. 120 crore against which the paid up capital was Rs. 116.79 crore held by the State Government. In addition, the State Government released share capital advance of Rs. 83.85 crore which was pending allotment since 1999.

Financial position and working results

2.1.8 The Company had finalised its accounts up to 2004-05. The financial position and working results (including provisional) of the Company for the five years up to 31 March 2008 are given in ***Annexures 10*** and ***11***. It would be seen from ***Annexure 10*** that:

- The borrowings of the Company as on 31 March 2008 were Rs. 287.11 crore comprising of secured loans of Rs. 104.08 crore, State Government loans of Rs. 173.25 crore and loan from Kerala Minerals and Metals Limited (KMML) of Rs. 9.78 crore. In view of heavy cash losses, the Company had not made any repayment of principal or interest on borrowed funds. Interest accrued and due on these borrowings as on 31 March 2008 was Rs. 79.46 crore.

The accumulated loss of Rs. 579.98 crore as on 31 March 2008 had wiped off the paid up capital of Rs. 116.79 crore.

- The accumulated loss of Rs. 579.98 crore of the Company as on 31 March 2008 had wiped out the equity capital of Rs. 116.79 crore. The reasons as analysed in audit were exorbitant cost of procurement, low sales realisation and low productivity of workers as discussed in succeeding paragraphs.
- The current ratio during the five years ranged between 1:1 and 1:3.77 (acceptable ratio of 2:1) indicating that the current liabilities were not adequately represented by current assets. The ratio was as high as 1: 3.77 during the year ended 31 March 2006 mainly due to non-payment of employee benefits and amounts due to State Government.
- The quick ratio during the five years ranged between 1:1.33 and 1:5.91 (acceptable ratio of 1:1) indicating precarious liquidity position.

Audit further noticed that in all the years the Company had cash flow deficit. This was supplemented by long term loans from Government, non-payment of principal and interest on loans, fresh working capital arrangements through other sources, non-payment of gratuity to employees, etc. Against the total loss of Rs. 166.06 crore for the period 2003-2008, the cash loss was Rs. 124.38 crore. The total loss did not include provision for interest on Government loans and liability towards gratuity to workers for the years 2006-07 and 2007-08.

Details in ***Annexure 11*** indicate that during the five years up to 2007-08 the Company's working resulted in losses ranging between Rs. 9.10 crore and Rs. 69.49 crore indicating that by processing cashew nuts and selling kernels, the Company could contribute to increased losses only. In the years 2006-07 and 2007-08 the loss declined to Rs. 12.44 crore and Rs. 9.10 crore respectively due to non-provision of interest on loans/ gratuity.

Funds Management

2.1.9 The business operations of the Company were regulated on the basis of availability of funds from the Government and banks. Due to inadequate stock to cover the credit, the working capital facility was suspended (August 2001) and hence there was no processing operation in the Company till December 2004 (except 17 days in 2003). During the five years ending 2007-08, the

Company availed working capital loan of Rs. 60 crore[*] from consortium of banks, Rs. 27 crore from the State Government and usance LC[µ] facility of Rs. 18.62 crore from State Trading Corporation (STC). Since adequate stock security was not provided and the credit account was overdrawn (31 March 2007) to the extent of Rs. 59.44 crore, the Company could not avail of further working capital facility.

Audit observed that the Company did not:

- have a business plan or a system for mobilisation of resources.
- prepare periodical financial budgets including cash and fund flow statements.

Audit further observed that due to lack of adequate financial discipline in the management of working capital, the Company incurred financial losses as discussed below:

Failure to remit the sales proceeds against LC account resulted in payment of excess interest of Rs. 1.01 crore.

- The Company paid excess interest[¥] of Rs. 1.01 crore on defaulted LC payment of Rs. 18.46 crore during 2005-06 for import of 9,029 MT of raw nuts.

Delay in taking delivery of raw-nuts despite availability of funds resulted in avoidable payment of demurrage, etc., amounting to Rs. 11.90 lakh.

- While there were sufficient funds in short term deposits earmarked for business operations as sanctioned (March 2002) by the Government, the Company failed to arrange funds for clearance of 1,660 MT of GB origin and 762.45 MT of Ivory Coast origin raw nuts arrived (September 2003) at Cochin Port. The delivery was taken after a delay of two to three months (October to December 2003) involving avoidable payment of Rs. 11.90 lakh.
- To save interest payment on cash credit, the Company had to realise the export sale proceeds immediately after opening of Letters of Credit by the buyers. Out of 156 cases of exports during the four years up to 2007-08, in 112 cases there was substantial delay ranging between 21 days and 96 days in shipment of kernels after opening of LC. The delay resulted in loss of interest of Rs. 12.54 lakh on deferred realisation of sale proceeds even after allowing 10 days as the normal time for shipment.

Interest loss due to delay in realisation of export bills amounted to Rs. 16.57 lakh.

- The Company discounted bills for export of kernels and the Banks collected interest initially for a period of 25 days. On realisation of the sale amount, the excess interest collected would be refunded to the Company. Audit noticed that the earliest period within which the bank could collect the amount was 5 days. Out of 276 cases of exports during 2003-08, in 271 cases the delay in excess of five days (the earliest period within which payment was credited by the bank) varied between five days and 49 days. This resulted in interest loss of Rs. 16.57 lakh due to delay in collection by banks. The Company, however, failed to take up the matter with the banks for early collection of bills so as to avoid the loss of interest.

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[*] Rs.50 crore as overdraft facility and Rs. 10 crore as bills discounting facility.

[µ] A letter of credit payable at a determined future date after presentation of conforming documents.

[¥] At the rate of 2.75 *per cent* to 11.75 *per cent* over the applicable rate of 7.50 *per cent.*

Procurement

2.1.10 The Company purchases raw cashew nuts from within and outside the country for processing. In emergent cases, the imported raw nuts are also purchased from the local agents. The Company invites tenders for supply of imported raw nuts by advertisements. Tenders are submitted by local agents of international suppliers. The bids are opened by the BoDs and compared with the workability rates (in the case of imports only) on which purchase decisions are made by the Company. These workability rates are arrived at after deducting procurement and processing cost from the expected sales value of kernels. The rates in the tenders opened are, however, considered as the market rates. The rate quoted by tenderer depends upon the outturn in pounds (one lb = 0.454 kg.) per bag (80 kg) and count in numbers per kg. Thereafter negotiations are made with all valid tenderers (agent/ representative of supplier). In the case of local raw nuts, no workability statement is prepared. After negotiations with all the tenderers, the lowest negotiated rate is selected. If the rates are considered high, the Company resorts to re-tendering.

Absence of Procurement policy

2.1.11 The COPU, while discussing the review in its 42nd meeting held in July 2003 had insisted that:

- The system of procurement of raw cashew nuts required to be streamlined so that the required quantity of quality nuts are procured during the season; and
- The cost of procurement/import of the raw nuts should be regulated in such a way that the same does not exceed the All India procurement cost.

In spite of the COPU recommendations, the Company had neither streamlined the system of procurement of raw cashew nuts nor regulated its cost of procurement as per All India procurement cost which resulted in a loss of Rs. 19.45 crore (Rs. 7.51 crore in the case of import and Rs. 11.94 crore in the case of local purchase) as discussed in paragraph 2.1.14 *infra*. The Company, however, had not formulated any procurement policy so far.

Audit noticed the following deficiencies in the procurement procedure:

- The purchases were made by the Board of directors on the basis of ad hoc decisions.
- There was no system for assessment of requirement of raw nuts with reference to sale of kernels at the time of taking purchase decisions.
- In the absence of any data base on prevailing market rates, the Company could not ascertain the economy in rates accepted.
- The purchases were made irrespective of cost so as to provide maximum days' of employment to the cashew workers.

- The workability statements were not evaluated properly to arrive at economic procurement decision.
- The Company could not take advantage of competitive rates at National/ Global level, since advertisements were issued mainly in local dailies only for import of raw nuts. This is evident from the fact that out of 12 local agents who represented 16 international suppliers in the tenders during the period 2003-04 to 2007-08, the purchases were made only through five agents of eight suppliers. During the five years ended 2007-08 the Company placed orders valued Rs. 54.80 crore through one agent on nine out of 21 cases, which constituted 29 *per cent* of total quantity procured. Out of the total imports of 50,247 MT, the Company placed orders for 36,622 MT (73 *per cent*) through two agents[€] during the period from 2003-04 to 2007-08 indicating the inadequate competition in the procurement of raw nuts.
- The practice of holding negotiations with various tenderers is not considered as the best practice to be followed for any commercial contracts. Negotiation may lead to indirect entry of ineligible tenderers and provide scope for corruption.

Details of procurement

2.1.12 The details of purchases made by the Company, processing capacity and shortfall in procurement during the five years up to 2007-08 were as given below:

Year	Raw nuts purchased MT		Total	Processing capacity[•] available MT	Shortfall in procurement MT	Percentage of shortfall
	Import	Local				
2003-04	2426	410	2836	57750	54914	95.09
2004-05	9279	3791	13070	57750	44680	77.38
2005-06	11374	4295	15669	57750	42081	72.87
2006-07	15613	1040	16653	57750	41097	71.16
2007-08	11555	3989	15544	57750	42206	73.08
Total	**50247**	**13525**	**63772**	**288750**	**224978**	**77.91**

It would be seen from the above that the shortfall in procurement during the five years up to 2007-08 ranged between 41,097 MT and 54,914 MT mainly due to non–availability/ paucity of working capital funds arising from continuous losses during previous years.

Irregularities in import

2.1.13 The Company procured 50,247 MT of raw cashew nuts valuing Rs. 198.10 crore during the five years ending 31 March 2008. Audit observed that the average purchase price of raw nuts per MT incurred by the Company in respect of 11 out of 24[♣] consignments imported during the last five years up

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[€] Laiju; 14,428 MT and Satheeswaran; 22,194 MT.

[•] at the rate of 210 MT per day for 275 days in a year.

[♣] includes three consignments of already imported raw nuts purchased locally.

Impact of excess price paid in 11 out of 24 imports of raw nuts compared to import rates to Kerala was Rs. 7.51 crore.

to March 2008 was higher than the price of import of raw nuts to Kerala for the corresponding month as per data maintained by Cashew Export Promotion Council. The additional price paid per MT varied between Rs. 763 and Rs. 7,064. The impact of excess price paid by the Company for the five years worked out to Rs. 7.51 crore on 50,247 MT of raw nuts imported.

Audit further noticed that out of 21 consignments of import of raw nuts during the period 2003-04 to 2007-08, the Company resorted to procurement even after knowing the fact that the variable cost could not be recovered in 16 consignments as the purchase price per MT of raw nuts was higher than the workable rate indicating that the decisions taken ignoring workability statement were detrimental to the interests of the Company. Due to this, sales realisation could cover only material cost, direct expenses and insignificant portion of direct wages and there was negative contribution.

Irregularities in the local purchase of raw nuts

2.1.14 Audit observed irregularities in local purchase of raw-nuts as detailed below:

- The Company purchased 13,525 MT during the last five years upto 2007-08. Audit observed that the annual average purchase price of the Company for the five years up to 2007-08 was higher than the average wholesale price published by the Cashew and Cocoa Directorate (DCC) for the corresponding period. The excess price paid ranged between Rs. 1,600 and Rs. 13,790 per MT and the additional expenditure worked out to Rs. 11.94 crore.

  The Government stated (July 2008) that the price for local raw nuts was fixed by adding 15 *per cent* to the maximum price published by DCC. The reply is not acceptable as the percentage of yield obtained by the Company for local nuts processed was in the range of 25.46 *per cent* to 26.16 *per cent* as against the standard kernel weight of 26.57 to 31.58 *per cent* for local raw nuts as published by DCC.

- The Company invited (April 2007) tenders for purchase of imported/ local raw nuts. Orders were placed (April 2007) on JMJ and ATC for supply of dried raw nuts at the lowest negotiated price Rs. 35 per kg and undried nuts at Rs. 32.50 per kg respectively. JMJ and ATC supplied (May 2007) 3,338 MT and 314 MT of undried raw nuts respectively. The Company also received (April 2007) bids for imported raw nuts and the lowest tenderers Sayeed Muhammed and Olam International offered 2,000 MT and 5,000 MT of IC origin raw nuts at the negotiated price of USD 665 per MT and USD 675 per MT respectively. These offers were not accepted since the Company considered that it was above the workable rate of USD 648 per MT.

Audit observed that the Company did not follow the practice of evaluating the comparative economy in rates between local raw nuts and imported raw nuts based on price and outturn. Even after providing the maximum allowance for difference in outturn, the purchase of imported raw nuts instead of local raw nuts would have entailed a savings of USD 150 per MT (Rs. 6,250 to Rs. 6,667). The aggregate savings in expenditure forgone due to failure in analysing and availing of the economy in rates worked out to Rs. 2.28 crore (Rs. 6,250 × 3,652 MT).

Production

Production process

2.1.15 Imported and local raw nuts procured are allotted to 30 factories for providing equal number of working days to workers in these factories. The allocated nuts are drum-roasted/ steam-roasted to produce roasted cashew nuts which are subjected to shelling for removing the shells. The shelled nuts are peeled to remove testa (the outer skin of kernels) and graded into different varieties.

Production planning

2.1.16 In the absence of a procurement plan and continued availability of raw nuts the Company had not been preparing any production plan during the five years up to 2007-08. The raw nuts are procured depending on availability of working capital funds and allocated to factories and processed.

Production performance

2.1.17 The Company had 10 owned factories and 20 leased factories and had a license to employ 9,750 and 22,000 employees respectively to process an aggregate quantity of 57,750 MT of raw cashew nuts per annum. The details of capacity available, actual capacity utilised and percentage of utilisation for the five years up to 2007-08 were as given below:

Year	Aggregate capacity available (MT)	Actual quantity processed (MT)	Utilisation of capacity (*per cent*)
2003-04	57,750	2,835	4.91
2004-05	57,750	9,707	16.80
2005-06	57,750	18,729	32.43
2006-07	57,750	14,451	25.02
2007-08	57,750	16,462	28.51

Unnecessary retention of 20 leased factories resulted in additional fixed expenditure of Rs. 1.05 crore per annum.

It would be seen from the above that the percentage of capacity utilisation was between 4.91 and 32.43 only. This was due to failure of the Company to procure sufficient quantity of raw cashew nuts to utilise the capacity to the maximum. Audit observed that the Company had not prepared any viability statement for each unit and in the absence of which the overall performance of each unit in terms of profitability, production efficiency, etc., could not be ascertained. While Company's own factories (10) itself had an available production capacity[*] of 19,360 MT per annum and had the facility to process additional 12,116.70 MT, there was no need for retaining the 20 leased factories involving a fixed expenditure of Rs. 1.05 crore per annum (provisional). Audit further noticed shortages due to driage as detailed below:

[*] fixed by the Company.

- The Company purchased 46,121 MT of raw nuts (African) during the period 2003-04 to 2007-08 (up to December 2007) and processed 45,979 MT of raw-nuts, involving a shortage of 142 MT (0.31 *per cent*) valuing Rs. 28.76 lakh due to driage.

- In the case of local raw-nuts, the purchased and processed quantity during 2002-07 was 13,674 MT and 13,337 MT respectively. There was shortage of 337 MT which included 122 MT (1.22 *per cent*) of dried nuts valued at Rs. 42.70 lakh.

The shortage due to driage was not justifiable since the purchase price had been fixed taking into account the maximum admissible driage. No responsibility had been fixed for such shortages.

Yield

2.1.18 The COPU in its 42nd report had observed that reason for the low yield was not connected with quality of raw nuts alone. Audit noticed that the Company had not fixed any norm for recovery of quality cashew kernels which would fetch higher prices.

Low yield of export grade kernels

2.1.19 The Company had not fixed any norm for recovery of exportable quality of cashew kernels to earn the optimum revenue. The quantity of export whole nuts in the kernels obtained would fetch higher price in the export market and hence the profitability depended on the recovery of export wholes. Considering the yearly average of 15.24 kg export whole nuts per bag achieved in earlier years as norm, the actual yield obtained during the five year period upto 2007-08 is as detailed below:

Particulars	2003-04	2004-05	2005-06	2006-07	2007-08
Raw nuts processed					
Quantity in MT (A)	2835.02	9706.84	18728.38	14451.84	16462.09
Quantity in Bags (80 kgs per Bag)	35438	121336	234105	180648	205776
Kernels obtained in MT					
Export Wholes	499.76	1706.02	3328.17	2395.08	2658.40
Export Brokens	172.92	533.80	1095.18	904.93	999.84
Indian Grade	52.10	105.26	330.32	248.96	308.43
Rejection	33.82	87.36	252.04	198.01	197.39
Total (B)	758.60	2432.44	5005.71	3746.98	4164.06
Percentage of B to A	26.76	25.06	26.73	25.93	25.29
Kernels in Kg. per bag (80 Kg.)					
Export Wholes	14.10	14.06	14.22	13.26	12.92
Export Brokens	4.88	4.40	4.68	5.01	4.86
Indian Grade	1.47	0.87	1.41	1.38	1.50
Rejection	0.95	0.72	1.08	1.10	0.96
Total	**21.40**	**20.05**	**21.39**	**20.75**	**20.24**

Audit scrutiny of records revealed that during the period October 2003 to March 2008 the monthly average yield varied between 15.39 kg of 'whole nuts' per bag (April 2005) to 9.44 kg per bag (January 2006) indicating that with better labour productivity and workmanship, the earlier year's optimum level (15.24 kg) could have been achieved as the quality of raw nuts imported during the review period was of the same quality as in previous years. The loss on account of low recovery of 'export wholes' during the five years up to 2007-2008 worked out to Rs. 24.27 crore. While the total quantity of raw nuts processed showed an increase of 93 *per cent* from 9,706.84 MT in 2004-05 to 18,728.38 MT in 2005-06, the yield of Indian/ Rejection grade kernels fetching lower sales realisation, showed an increase of 202 *per cent* from 192.62 MT to 582.36 MT.

2.1.20 Audit further noticed that the Company had not only failed to achieve the optimum level of yield as stated above but also did not even attain the assured yield as per the cutting test norms after processing of the raw nuts. At least 88 *per cent* of cutting test outturn of export quality kernels had to be obtained after allowing 12 *per cent* for shortages fixed by the Company. During the period 2003-08 the Company attained a yield ranging between 35.39 lbs and 45.59 lbs per bag (80 kg) of raw nuts roasted as against the cutting test out turn of 47 to 51 lbs per bag assured at the time of procurement of raw nuts. The Company failed to attain the assured yield in all except two instances. The loss due to this worked out to Rs. 6.34 crore.

The Government stated (July 2008) that 88 *per cent* after allowing for shortages cannot be export quality kernels since it would include rejections and Indian grades. The reply is not acceptable since the assured yield as per the cutting test norms was after considering these rejections.

The output percentage varied for different lots of raw nuts of same quality and for different factories. The realisation of export grade kernels varied from factory to factory ranging between 69 and 88 *percent*.

Marketing

2.1.21 The cashew kernels of 39 grades produced by the Company were exported (18 grades) as well as sold within India. The Company exported kernels directly as well as through Indian firms to 15 countries during the five years up to 2007-08 and sold them in the international/ domestic market at prices fixed by the Managing Director on ad hoc basis (except in the case of retail sales to Co-operative agencies and franchisees).

Audit observed that:

- The Company had not formulated any marketing policy;
- The Company did not prepare sales budgets periodically;
- The Company did not have a market intelligence system or any data base on prices to facilitate formulation of appropriate pricing strategy;
- The basis of price fixation was not on record; and
- The price data on kernels as per National Commodity & Derivatives Exchange Limited (NCDEX) were not used as a reckoner. Hence the Company failed to avail of the advantage of the best prices in the

market leading to substantial loss of revenue as discussed in paragraph *2.1.23 infra.*

Sales performance

2.1.22 The year-wise details of total sales, export and domestic sales of kernels for the five years up to 2007-08 were as indicated in **Annexure 12.** It would be seen from the annexure that total sales of kernels increased from 763.75 MT (Rs. 11.69 crore) in 2003-04 to 5,611.36 MT (Rs. 92.23 crore) in 2005-06 but declined to 3,907.82 MT (Rs. 59.15 crore) in 2007-08 due to inadequate procurement, procurement of poor quality raw nuts coupled with ineffective sales strategy.

Export sales

2.1.23 The Company's direct export realisation increased from Rs. 6.77 crore in 2003-04 to Rs. 44.95 crore in 2005-06 and declined to Rs. 13.38 crore in 2007-08. The exports through other agencies recorded substantial increase from Rs. 1.37 crore in 2003-04 to Rs. 41.57 crore in 2006-07. Audit noticed that:

- The prices obtained for exports were lesser when compared to price data published by NCDEX. Out of 166 instances of export of kernels made by the Company during the period April 2005 to March 2008 in 153 instances the prices fetched by the Company were lesser than the NCDEX rates. On 8,816.33 MT of kernels exported the loss of revenue due to reduced rates worked out to Rs. 3.27 crore (net of packing and filling cost for export).
- The Company's overall average export realisation per MT increased from Rs. 1.70 lakh in 2003-04 to Rs. 2.30 lakh in 2004-05 and declined to Rs. 1.80 lakh in 2007-08. Audit noticed that Company could not achieve the average realisation rate for overall Kerala exports since 2005-06 indicating absence of proper strategy in attaining better export prices for kernels. Considering the fact that the company's exports included higher grades of kernels as against the general exports from the State (which included Lower grades also) the decline in export realisation as compared to State exports lacked justification. The Company had not analysed the reasons for decline or worked out strategy to improve its sales realisation.

  The failure to obtain the State average export price for kernels during three years up to 2007-08 resulted in a potential revenue loss of Rs. 14.71 crore on 8,816.33 MT exported during the period.

Failure to obtain the State average price for kernels during the three years up to 2007-08 resulted in revenue loss of Rs. 14.71 crore.

Retail Sales

2.1.24 Audit noticed a wide difference ranging from Rs. 0.67 lakh to Rs. 1.46 lakh per MT between retail prices and export rates of the Company. Though the BoDs decided (June 2000) to enhance the retail sales by appointing distributors all over the state, no effective steps were taken till 2007-08.

Employment to cashew workers and Employees' welfare

2.1.25 As stated in Paragraph 2.1.1 *supra* the Company had to provide fair number of employment days (275 days in a year) to cashew workers in the State. Audit, however, noticed that:

As against 275 days the Company could provide employment to cashew workers for 17 to 138 days only.

- As against 275 days of work that could be provided in each year, the actual number of days' work provided during the five years up to 2007-08 ranged between 17 and 138 only. The annual average days of employment was 91 indicating that the Company had not achieved its social objective of providing maximum days of employment to cashew workers.
- The operational performance of the Company for the five years was as detailed below:

(Rs. in crore)

Particulars	2003-04	2004-05	2005-06	2006-07	2007-08	Total
Operating income	12.23	33.47	93.20	63.59	61.18	**263.67**
Operating expenditure♣	24.39	49.24	136.90	77.49	70.70	**358.72**
Operating loss	**12.16**	**15.77**	**43.70**	**13.90**	**9.52**	**95.05**
Wages and other work related benefits	4.43	12.58	20.79	19.21*	16.81*	**73.82**

* **Provisional**

It would be seen from the table that the Company suffered a total operating loss of Rs. 95.05 crore and incurred an aggregate amount of Rs. 73.82 crore on wages and other benefits to the workers for the five years up to 2007-08.

- As of March 2008 the contribution of the Company towards providing employment to the cashew workers in the State was only six *per cent.*

Arrears pending payment to staff amounted to Rs. 38.89 crore as on 31 March 2008.

- Audit further noticed that the Company had reduced the operating loss during 2006-07 and 2007-08. However, the operating loss would have been higher had the Company discharged the worker related liabilities[∇] amounting to Rs. 38.89 crore.
- The State Government, in the Tenth Plan period (2002-07), had formulated a Social Safety Net Programme for restructuring the State Level Public Enterprises and manpower rationalisation. The Company, however, did not implement the programme on the ground that there was no under utilisation of manpower.

♣ excluding interest on long term loan 2003-04 Rs.22.50 crore, 2004-05 Rs.25.65 crore, 2005-06 Rs.28.37 crore, 2006-07 Rs27.29 crore and 2007-08 Rs.27.28 crore.

∇ including gratuity liability towards staff and workers of hired factories returned.

- The Company subscribed to an Employees' Group Gratuity cum Life Assurance Scheme with Life Insurance Corporation of India (LIC) with effect from 1 January 1975. Under this scheme LIC undertook payment to the employee in the event of normal retirement, resignation or death. The Company had to pay on the commencement of the scheme in lump sum or in five annual equal installments annual premium to LIC on each renewable date.

  The Company, however, could not make payment of the premiums regularly and the scheme had not materialised. The Company had deposited an amount of Rs. 11.06 crore for disbursement of gratuity liability up to 1998 to the employees of the Company against which LIC had appropriated Rs. 65.50 lakh as life assurance premium. As the payment of premium was in arrears no life insurance benefit accrued to the employees of the Company and gratuity valuing Rs. 33 crore could not be disbursed to the retired employees so far (March 2008).

Corporate Governance

2.1.26 Corporate governance is the system by which companies are directed and controlled by the management in the best interest of the shareholders to ensure greater transparency, better and timely financial reporting. The Board of Directors is responsible for governance in State Government Companies. As on 31 March 2008 there were ten members in the board including the Chairman and the Managing Director. During the 60 months from April 2003 to March 2008 the Company held 78 Board meetings and the matters considered comprised of purchase of raw nuts, arranging of finance from outside agencies, employee related matters and post facto ratification of selling prices finalised by the Managing Director. No policy matters were discussed.

There were no technical directors like Director (Marketing), Director (Finance), Director (HR) in the Board.

- The Company had not yet constituted the Audit Committee to ensure better transparency in working and to protect the interests of Government.
- The Board had not formed any sub committee such as the Finance committee, HR committee, etc. Periodical progress report on the operations of the Company were not being presented and discussed at the Board meetings.

Internal Control and Internal Audit

Internal Control

2.1.27 Internal control are the procedures and safe guards that are put in place by the management of an organisation to ensure that the activities are conducted as planned and objectives are achieved in an economic and efficient manner. The internal control system in the Company had the following deficiencies:

- Monthly/ quarterly targets and working results were not prepared and considered by the Board.
- Periodical Production targets and actual performance were also not reported to the Board.
- During the period 2003-2008 the Company had not prepared the periodical financial budgets.
- Standards were not fixed for different stages of production, yield from different origin of raw nuts.
- No Management Information System (MIS) was in existence in respect of material movement and weighment of kernels.

Internal audit

2.1.28 The Internal Audit wing of the Company was headed by an Internal Audit Officer. COPU in its meeting held on July 30, 2003 had recommended that the Internal Audit Wing should be strengthened and should inspect all the major transactions like import, export, sale of cashew nuts, etc. Audit noticed the following deficiencies in the system of Internal audit obtaining with the Company:

- The scope and functions of internal audit had not been defined.
- No internal audit manual had been prepared and adopted.
- The Pre-audit conducted by the internal audit was confined only to checking the arithmetical accuracy of payment.
- Internal audit report was not prepared and presented to Managing Director/ Board during 2003-08 indicating its ineffectiveness.

Government stated (July 2008) that they would take necessary action to improve, strengthen and widen the scope of internal audit system as well as the total financial control mechanism in the organisation.

Acknowledgement

Audit acknowledges the co-operation and assistance extended by the staff and the Management of the Company at various stages of conducting the performance audit.

Conclusion

The Company though in existence for over 39 years had not formulated a policy for procurement and marketing. The imports were made through local agents of foreign suppliers after negotiation with all the tenderers. The purchases were made at exorbitant prices ignoring workability on the ground of providing employment to cashew workers. There was no system of budgeting and sourcing of funds on a continuous basis due to which procurement and processing of raw-nuts was undertaken only on the basis of availability of funds and hence the Company's processing capacity was underutilised. The yield of cashew kernels showed a declining trend and low recovery of 'whole kernels' led to substantial

revenue loss. The cutting test outturn envisaged at the time of procurement was also not achieved on actual processing. The Company's average export rates realisation per MT had been declining over the years. Despite better quality, the Company's kernels were sold at prices below the state's average export prices and even below rates published by NCDEX. While the Company's continued existence despite operating losses was justified on the ground of providing employment to cashew workers, it could not provide any employment during the year 2002-03 and the annual average employment provided during the review period was for 91 days against 275 days envisaged. The Company's internal audit did not have adequate coverage and there was no effective internal control system in the organisation.

Recommendations

The Company needs to:

- **Formulate a well defined procurement policy and procedure in line with the well established and accepted procedures in the industry to reduce the cost of procurement.**

- **Dispense with the practice of negotiation with all the tenderers and introduce suitable system to obtain best prices through auction by fixing a floor price.**

- **Evolve suitable standards at various stages of processing to ensure adequate control over the output and improve labour productivity.**

- **Evolve a proper market intelligence system and formulate pricing policy to obtain best prices for sale of kernels.**

- **Strengthen internal audit and internal control to make it more effective.**

Kerala State Civil Supplies Corporation Limited

2.2 Performance Review on the Funds Management

Highlights

The Company did not receive Rs. 8.44 crore as subsidy from GoI for three completed Kharif Marketing Seasons due to non-preparation of season-wise accounts and non-submission of information and failed to claim additional cost of Rs. 19.81 crore incurred at the instance of State Government.

(Paragraph 2.2.14)

Failure of the Company to produce relevant documents led to non-realisation of SPEF claim of Rs. 15.44 crore from FCI.

(Paragraphs 2.2.16)

The Company incurred avoidable interest payment of Rs. 2.64 crore on overdrafts/ loans due to delay in preferring claims and interest loss of Rs. 1.88 crore due to non-realisation of legitimate claim of Rs. 4.10 crore.

(Paragraphs 2.2.18 and 2.2.19)

Input tax credit of Rs. 26.79 crore is liable to be rejected due to non-production of adequate proof.

(Paragraph 2.2.20)

The Company incurred interest loss of Rs. 22.18 crore due to abnormal delay in realisation of funds.

(Paragraph 2.2.21)

Decision of the Company to convert wheat to fortified atta at 95 *per cent* yield and decentralisation of purchase of medicine without valid grounds deprived the Company of additional income/ eligible discount of Rs. 8.38 crore.

(Paragraphs 2.2.23 and 2.2.24)

The Company could not realise Rs. 3.39 crore relating to 10 suits for which decrees had been obtained as the whereabouts of the suppliers were not known.

(Paragraph 2.2.25)

The Company generated extra income of Rs. 3.59 crore due to distribution of fortified atta at inflated selling price in violation of GoI direction and by collecting tax on an exempted commodity from consumers.

(Paragraphs 2.2.37 and 2.2.38)

Due to inefficiency in implementation of computerised MIS, the investment of Rs. 7.93 crore was only partly fruitful.

(Paragraph 2.2.39)

Introduction

2.2.1 The Kerala State Civil Supplies Corporation Limited was incorporated in June 1974 with the objective of procurement and distribution of food grains and other essential commodities to ensure their availability to the public at reasonable price. The Company expanded its activity by including other items like petroleum products, tea, medicine, sugar, curry powder, groceries and fast moving consumer goods. Besides this, the Company has been acting as the authorised agent of Government of Kerala (State Government) for lifting, transporting and distribution of rice, levy sugar and wheat under Public Distribution System (PDS) and distribution of rice and pulses to schools under the Mid Day Meal Scheme (MDMS). The Company started procurement of paddy from farmers and distribution of Custom Milled Rice (CMR) through PDS with effect from June 2005 as per the directions of the Government of India (GoI).

The overall administration of the Company is vested with the Chairman and Managing Director (CMD) who is assisted by one General Manager, six Additional General Managers (AGM), two Managers, a Company Secretary and five Regional Managers. Finance wing of the Company during the period of review was headed by an Assistant Manager instead of AGM.

As on 31 March 2008, the Company had 56 depots under the direct control of five Regional Offices for managing 1224 outlets (873 maveli stores, 253 labham markets, 72 medical maveli stores, nine super markets, three people’s bazaar, 11 petrol pumps, three LPG outlets) and 10 sub depots.

Scope of Audit

2.2.2 The present performance audit covers management of funds in the Company for the five years ending 31 March 2008. The Performance review conducted during November 2007 to April 2008 covers the activities of 26 out of 56 depots, nine out of 10 sub depots and Head Office of the Company involving 60 *per cent* of the turnover.

Audit Objective

2.2.3 The audit objective was to ascertain whether the overall management of funds in the Company was efficient and effective by analysing whether:

- The requirement of funds was estimated realistically;
- The mobilisation of funds, both from internal and external sources, was made in an economic manner;
- The funds were utilised efficiently; and
- Priority in funds allocation was given to implement Government’s policy of improving Public Distribution System.

Audit Criteria

2.2.4 Audit criteria adopted for evaluation of funds management activity were:

- Government guidelines on financial policy;
- Systems and procedures adopted for proper estimation of funds;
- Annual budgets;
- Systems and procedures in existence for optimum mobilisation of funds at minimum cost; and
- Policy and guidelines prescribed for efficient utilisation of funds.

Audit Methodology

2.2.5 The methodology adopted for attaining the objectives was examination of :

- Financial policy and guidelines;
- Budget, cash flow/ fund flow statements;
- Fund raising activities;
- Revenue earning activities together with the efficiency in collection and banking;
- Agenda and minutes of Board meetings, management committee minutes and financial reports;
- Records maintained in respect of planning, mobilisation, utilisation and deployment of surplus funds; and
- Internal audit reports, statutory audit reports and issue of audit enquiries & interaction with management.

Audit findings

2.2.6 The Audit findings emerging from the Performance Review were reported to the Management/ Government in June 2008. The review was discussed in the meeting of the Audit Review Committee on Public Sector Enterprises (ARCPSE) held on 7 August 2008, which was attended by the Secretary to Government, Food, Civil Supplies and Consumer Affairs Department and the Chairman and Managing Director of the Company. The views expressed in the meeting have been taken into consideration while finalising the performance review.

The audit findings are discussed in the succeeding paragraphs:

Financial position and working results

2.2.7 The Company had finalised its accounts up to 2004-05. The financial position and working results of the Company for the five years up to 31 March 2007* are given in **Annexures 13** and **14**.

Audit scrutiny revealed the following:

- The Company had been incurring heavy losses every year and the accumulated loss which stood at Rs. 384.43 crore in 2002-03 increased to Rs. 711.90 crore in 2006-07 and eroded its paid up capital of Rs. 8.56 crore by 83 times.
- Trade dues and other liabilities increased from Rs. 443.10 crore in 2002-03 to Rs. 738.33 crore in 2006-07 due to non-payment of interest accrued and due of Rs. 681.39 crore on loan of Rs. 133.46 crore from State Government.
- Though the Company improved its sales performance from Rs. 382.56 crore in 2002-03 to Rs. 957.02 crore in 2006-07, it continued to incur heavy loss due to various deficiencies noticed as discussed in succeeding paragraphs.

Financial Ratios

2.2.8 Financial stability of any organisation is assessed by analysing various financial ratios. Some important ratios are:

- Current Ratio which is used to assess the ability of the organisation to cover its current liabilities with its current assets.
- Quick Ratio which is used to assess the ability of organisation to cover its current liabilities with current assets excluding the value of inventory.
- Debt Equity Ratio which is used for measuring the relative proportion of external funds and shareholders' funds invested and indicates the soundness of long term financial stability of the entity.

As per the Asian Development Bank (ADB) covenant, the standard for current ratio is two and that of debt equity ratio is one.

All the three ratios were below the standard and had been deteriorating steadily over the period 2002-07 as shown below:

Particulars	2002-03	2003-04	2004-05	2005-06	2006-07
Current ratio	1:2.3	1:2.8	1:3	1:3.6	1:3.9
Quick Ratio	1:2.9	1:3.6	1:4.1	1:5.3	1:5.7
Debt Equity Ratio	15.7:1	15.7:1	17:1	18.5:1	19:1

Note: Figures for 2005-06 and 2006-07 are provisional.

* The Company has not compiled the provisional accounts for 2007-08.

Arrears in finalisation of accounts

2.2.9 The Company had finalised the accounts upto 2004-05. The State Government had issued instructions to complete annual accounts and annual reports within the stipulated time. Audit noticed that the delay in finalisation of annual accounts from 2005-06 was due to abrupt discontinuation of manual accounting at outlets/ depots before ensuring the completeness and availability of information in the computerised system as detailed in paragraph 2.2.39 *infra*. There was no progress in finalisation of accounts and concrete steps required to be taken to liquidate the arrears.

Estimation of funds requirement

2.2.10 To assess the funds requirements, the Company prepares annual financial budgets during the month of April every year by taking into account the projection regarding purchases, sales and capital expenditure made by various depots and head office. The budget estimates vis-à-vis actuals for the five years ended 2006-07 are as given in **Annexure 15.**

Audit scrutiny revealed that:

- The Company did not have a system of periodical analysis of budgets with actuals to arrest negative variances by suitably adopting remedial measures.
- The budgeted operational surplus for the five years up to 2006-07 was Rs. 109 crore whereas the actual operational result was a deficit of Rs. 51 crore indicating that the budgets were not prepared in a realistic manner. The quantum of sales realisation was less than the budgeted sales. Besides, there was excess out flow of Rs. 49.16 crore in 24 out of 48 items of purchase as compared to the targeted achievement, on account of sale of commodities under Market Intervention Scheme (MIS) at prices much below the purchase price. As per MIS approved by the Board (June 2005) the selling price should not be lower than purchase price of any items in the preceding tender or purchase order of the related month. There were no reasons on record for not following the policy formulated by the Board. Thus, the Company did not utilise the budgetary control as an effective management tool for effective utilisation of funds and increase in performance efficiency.

Utilisation of working capital

2.2.11 The details of working capital of the Company during 2002-07 were as given below:

(Rs. in crore)

Particulars	2002-03	2003-04	2004-05	2005-06 (provisional)	2006-07 (provisional)
Current Assets					
Inventory	40.88	37.18	48.60	57.77	59.35
Sundry debtors	97.70	95.83	85.02	74.37	71.45
Cash and bank balances	9.57	27.32	29.31	24.83	19.96
Loans & advances	44.15	19.08	31.07	25.49	37.81
Total A	**192.30**	**179.41**	**194.00**	**182.46**	**188.57**
Current Liabilities					
Sundry Creditors	19.10	18.29	29.88	31.54	37.99
Other current liabilities	30.24	28.99	27.56	24.59	18.79
Provisions	0.13	0.13	0.16	0.16	0.16
Interest accrued and due on loans	393.64	461.33	532.38	606.19	681.39
Total B	**443.11**	**508.74**	**589.98**	**662.48**	**738.33**
Working Capital	**(-) 250.81**	**(-) 329.33**	**(-) 395.98**	**(-) 480.02**	**(-) 549.76**

Note: The Company has not compiled provisional accounts for 2007-08

The details in the table indicate that:

- The aggregate increase in deficit of Rs. 298.95 crore during 2002-07 was due to increase in current liabilities and decrease in current assets. This had the effect of increase in working capital shortage from Rs. 250.81 crore (2002-03) to Rs. 549.76 crore (2006-07).

The main reasons for working capital deficit were poor operational performance, poor performance in recovery of dues, locking up of funds in inventory, capital expenditure without adequate return as discussed in succeeding paragraphs.

Sources of funds

2.2.12 The Company's main sources of funds were realisation from sale of food grains and other essential commodities (Internal Sources), subsidy from GoI/ State Government, loans from State Government, cash credit from banks (External Sources: Rs. 174.00 crore). During the period from 2002-03 to 2006-07, the Company generated Rs. 3,147.45 crore from internal sources.

Management of Receivables

2.2.13 The sales to the public through its outlets were on cash basis. The other sources of receipts were income from activities as an authorised agent of the Government for procurement and distribution of Levy Sugar, Paddy, Custom Milled Rice and distribution of rice and pulses to schools under MDMS. The value of various shortages recoverable from the employees was also shown as amount receivables. The total revenue during the five years upto 2006-07 ranged between Rs. 422.18 crore and Rs. 996.67 crore. The table below indicates the activity-wise sales and receivables for the five years up to 2006-07.

Activity		2002-03	2003-04	2004-05	2005-06	2006-07
Sales through Outlets	Rs. in crore	282.41	362.49	435.08	443.78	632.20
	Per cent to total income	66.89	72.53	70.46	61.28	63.43
Sales of Petroleum Products	Rs. in crore	75.77	82.39	88.67	89.91	98.87
	Per cent to total income	17.95	16.49	14.36	12.42	9.92
Revenue from Government Sponsored schemes	Rs. in crore	64.00	54.89	93.70	190.49	265.60
	Per cent to total income	15.16	10.98	15.18	26.30	26.65
Total Income	Rs. in crore	422.18	499.77	617.45	724.18	996.67
Outstanding dues	Rs. in crore	97.69	95.83	85.02	74.36	71.45

The outstanding dues as a percentage of total income decreased from 23.14 in 2002-03 to 7.17 in 2006-07. However, audit scrutiny of the management of receivables revealed the various deficiencies as detailed below:

- Failure to raise claims due to non-compilation of required data;
- Failure to substantiate claims with proper supporting documents;
- Delay in preferring claim;
- Failure to evolve a system to raise claims on regular basis;
- Inadequate follow up action and delay in realisation of the dues;
- Failure to execute court decrees;
- Improper decision resulting in short realisation; and
- Non-restriction of sales against advance in the case of petroleum products.

Cases involving deficiencies in management of receivables are discussed in following paragraphs:

Failure to raise subsidy claims

2.2.14 The State Government entrusted (June 2005) the operation of paddy procurement, milling and marketing scheme of GoI to the Company. GoI notified the Minimum Support Price (MSP) of paddy for every Kharif Marketing Season (KMS), cost of conversion, other incidentals, etc., from time to time. The economic cost of Custom Milled Rice (CMR) arrived at on the above basis would be provisional. The difference between the provisional economic cost and the final central issue price (CIP) would be released by GoI to the Company as subsidy (95 *per cent* as advance and the balance five *per cent* on determination of final economic cost). As per the terms of MoU, the implementing agency was required to submit audited accounts to GoI not later than six months after the close of relevant KMS. The State Government refixes the MSP fixed by GoI and reimburses the additional cost to the Company.

Audit noticed that:

Due to non-consolidation of information and non-preparation of season wise accounts, the Company did not receive subsidy of Rs. 8.44 crore from GoI.

- Though the procurement and milling of paddy for three KMS from 2004-05 to 2006-07 were completed and data as to MSP, processing and transportation charges were also available, the Company did not prepare KMS-wise accounts and submit it to GoI for claiming balance five *per cent* subsidy within the time stipulated. This had resulted in non-receipt of subsidy of Rs. 8.44 crore towards balance five *per cent* subsidy for the three KMS.

Failure to claim the additional cost incurred at the instance of Government deprived the Company of the benefit of Rs. 19.81 crore.

- As against the actual increase in cost due to revision of MSP by the State Government during KMS 2004-05 to 2007-08 which worked out to Rs. 119.06 crore, the Company claimed Rs. 99.25 crore only as reimbursement. The Company failed to claim the additional cost of Rs. 19.81 crore from the State Government due to which there was a further loss of Rs. 1.43 crore as the activity was financed by cash credit at the rate of nine *per cent*.

Non-receipt of subsidy under Market Intervention Scheme

2.2.15 Under Market Intervention Scheme (MIS), the State Government identified 12 items[∝] as essential commodities and agreed to compensate the loss suffered by the Company in its sale to the public (Market Intervention Operation- MIO) and provided budget allocation of Rs. 50 crore every year against which utilisation was to be accounted for. The State Government also agreed (July 2005) to compensate the loss suffered by the Company due to opening of new maveli stores in panchayats where no stores existed. However, Audit observed the following:

- The Government assistance on account of grant for the years 2003-04 to 2005-06 was not received in full and an amount of Rs. 60 crore was yet to be received. The Company failed to convince the Government for release of the balance amount as it had not submitted the details of loss incurred.
- Audit noticed (March 2008) that 235 maveli stores were opened by the Company during 2000-01 to 2005-06 in panchayats where no store existed. The Company, however, incurred loss of Rs. 16.23 crore in its operations up to March 2007. The Company had not claimed reimbursement of the above loss incurred as a result of the Government directive.

The Management while admitting the above facts stated (April 2008) that corrective steps were initiated for the improvement of performance.

Delay in Settlement of Levy sugar account

2.2.16 The Company procures Levy sugar at prices fixed by GoI from mills on the basis of monthly quota sanctioned, after making advance payment. The levy sugar was to be distributed to the consumers through Authorised Ration

[∝] green gram, black gram whole, black gram split, bengal gram bold, lobia, toor dhal, mutter dhal, chillies, coriander, mustard, cumin seed and maithi.

Dealers (ARDs) at the price fixed by GoI. Based on the claims submitted every month by the Company, FCI reimburses the wholesale margin and transportation charges under Sugar Price Equalisation Fund (SPEF).

Audit noticed that:

Inordinate delay in submission of claims and failure to produce relevant documents led to non-realisation of Rs. 15.44 crore and loss of interest of Rs. 2.40 crore.

- The claims were submitted on yearly basis instead of monthly basis with a delay ranging from 18 to 50 months for the period from April 1999 to March 2007. The claims submitted were incomplete due to non-production of purchase invoices from sugar mills and certificates from the State Government confirming the veracity of accounts with reference to documents. The inordinate delay in submission of claims and failure to produce relevant documents led to non-realisation of SPEF claim of Rs. 15.44 crore (including Rs. 3.08 crore towards balance claims prior to April 1999) from FCI (March 2008).
- The substantial reduction in inflow of funds on account of this had adversely affected the working capital position of the Company. Loss of interest on the locked up funds up to March 2008 at the average rate of nine *per cent* per annum for working capital funds amounted to Rs. 2.40 crore.
- Due to non-availability of transportation facility through railways the Company had to transport substantial portion of sugar by road incurring additional expenditure. The transportation charges for the period from 1997-98 have not yet been revised by the GoI for want of expenditure statement of accounts duly approved by State Government. As the Company transported major portion of levy sugar by road and failed to obtain revised rates from GoI, it could not obtain reimbursement for the cash loss of Rs. 8.27 crore for the period from 2002-03 to 2007-08.
- The Company submitted its proposal for the revision of wholesale margin for the period from 1998-99 to 2001-02 only in April 2005 and for 2002-03 to 2006-07 in May 2007. These were returned in June 2005 and July 2007 respectively by GoI with a direction to furnish revised proposal in conformity with the guidelines along with necessary supporting documents. The Company submitted (April 2008) revised proposal for period upto 2004-05 and revised proposals for the subsequent periods were not submitted as the audited expenditure details were not finalised by the Company.

Non- receipt of reimbursement of price difference

2.2.17 The State Government decided (February 2006) to distribute 25 Kgs of rice to all BPL cardholders at Rs. 3.00 per Kg. As per the scheme the wholesale price of rice per MT was Rs. 2,506.50 as against the Central supply price of Rs. 5,706.50 by FCI. The State Government directed (February 2006) the Company to distribute CMR to Authorised Wholesale Dealers (AWD) at Rs. 2,506.50 per MT and agreed to reimburse the difference of Rs. 3,200 per MT under the scheme.

Audit noticed that:

- The Company issued 85,504.50 MTs of CMR during February 2006 to March 2008 and submitted monthly claims aggregating Rs. 27.36 crore against which State Government released only Rs. 27.15 crore. In the absence of certificate from the DSOs the Company did not receive Rs. 20.56 lakh towards the price difference of 642.66 MT of CMR distributed to BPL card holders at Rs. 3.00 per Kg during October 2006 to March 2007. The Company failed to pursue the claim for reimbursement of the balance amount due to non-reconciliation of the difference in quantity supplied and number of BPL card holders.

Non-realisation of loss in the operation of sub-depots

2.2.18 The State Government entrusted (March 1997) the operation of nine sub-depots for distribution of food grains consequent on the stoppage of operation by FCI. Under the system, sub-depots purchase food grains at Central Issue Price (CIP) from FCI as per the allotment from Directorate of Civil Supplies (DCS) by making advance payment. The Company is eligible for variable rates of commission on distribution of Annapurna and Antyodaya Anna Yojana (AAY) rice.

The State Government agreed (November 1996 to March 1997) to reimburse the estimated annual loss of Rs. 1.77 crore or actual loss whichever was less. To prefer the claim in time, the sub depots were to prepare monthly accounts and forward the same to head office for preparing consolidated profit and loss account and submitting the same to DCS.

- Based on the provisional data available, the Company had suffered an aggregate loss of Rs. 7.56 crore in the operation of the sub-depots for the period 1996-97 to 2007-08. While claims for Rs. 3.69 crore were preferred (May 2006) for the period up to 2004-05 only, the balance of Rs. 3.87 crore was yet to be claimed.
- The Company had neither consolidated the claim for commission submitted by the sub-depots nor initiated steps for speedy recovery of dues from the Government. An amount of Rs. 76.00 lakh was outstanding from DCS on this account for the period April 2005 to March 2008.
- By not preferring the claims in time, the Company suffered interest loss to the extent of Rs. 2.64 crore on overdrafts/loans.

There was avoidable interest payment of Rs. 2.64 crore on overdrafts/ loans due to delay in preferring claims.

Non- receipt of subsidy on matta rice

2.2.19 The Company was entitled to a margin of rupee one per kg as marketing subsidy from State Government in the procurement of matta rice from co-operative societies and its sale to consumers. The Government Order requires submission of periodical progress report in time and production of evidence for verification of the claim towards reimbursement of margin allowed.

Audit observed that:

Interest loss of Rs. 1.88 crore was incurred due to non-realisation of legitimate claim of Rs. 4.10 crore.

The Company made (May 2006) a consolidated claim of Rs. 4.10 crore (including Rs. 25 lakh towards margin) for the entire quantity (38,505.90 MT) of matta rice procured during the period 1997-98 to 2004-05 without fulfilling the conditions stipulated for claiming the subsidy. As such, the claim of Rs. 4.10 crore had been pending with State Government from 1998-99 to 2007-08 with resultant interest loss of Rs. 1.88 crore.

The Management stated (April 2008) that it maintained necessary records in support of the purchases made and was frequently following up the matter. The reply is not acceptable as the Company was yet to receive the arrears which indicated that the claims were not pursued properly.

Non-receipt of input tax credit

Input tax credit of Rs. 26.79 crore is liable to be rejected due to non-production of adequate proof.

2.2.20 To claim input tax credit under KVAT, the Company was required to furnish monthly return along with purchase invoice in support of VAT paid by it on purchase of goods. The Company filed returns for the years 2005-06 and 2006-07 (up to October 2006[♣]) paying Rs. 2.04 crore after adjusting aggregate input tax credit of Rs. 26.79 crore which were rejected (April/ November 2006) by the Sales Tax Authorities for want of supporting documents. The Company had not yet produced the relevant documents (July 2008). Thus, in the absence of adequate proof for the claim of input tax credit of Rs. 26.79 crore, the amount of VAT payable is liable for revision.

Delay in preferring claims

2.2.21 The State Government entrusted (October 1995) the implementation of the Mid Day Meal Scheme (MDMS) within the State to the Company. Based on the monthly indent prepared by schools/ education offices, the Company lifted required quantity of rice free of cost from FCI and supplied to schools along with the pulses procured separately. Monthly bills for transportation/ handling/ other incidentals (Rs. 140 per quintal as fixed by State Government during August 1995), cost of pulses at actuals and cost of special rice were to be prepared by the Company based on the information received from depots concerned and submitted to Directorate of Public Instruction (DPI) for verification and payment by 15th of the succeeding month. A review of system of preferring claims for the five years up to 2007-08 revealed that:

- There was delay of 90 to 120 days in consolidating and preferring monthly claims to DPI due to non-receipt of supporting data from depots.
- There was overall delay ranging up to 16 months in sanction/ settlement of monthly claims by DPI during the five year period 2003-08 mainly due to non-furnishing of details in respect of item-wise quantity distributed.
- Against the total dues of Rs. 291.81 crore, the Company received Rs. 287.76 crore during the five years ending 2007-08 leaving a balance of Rs. 4.05 crore as on 31 March 2008.

[♣] The Company started filing separate depot-wise accounts since November 2006.

Company incurred avoidable interest payment of Rs. 22.18 crore due to abnormal delay in realisation of funds.

- Due to abnormal delay in realisation of funds of Rs. 287.76 crore from DPI during the period from 2003-04 to 2007-08, the Company incurred avoidable interest payment of Rs. 22.18 crore at the rate of borrowings on cash credit at 9 to 13 *per cent* per annum on the blocked funds.

Non- realisation of dues due to inadequate follow up action

2.2.22 Mention was made in the Report of the Comptroller & Auditor General of India for the year ended 31 March 2005 about the avoidable expenditure incurred by the Company due to payment of additional margin on levy sugar payable to wholesalers at the instance of the State Government. Audit noticed that the Company was incurring a loss of Rs. 10 per quintal on the quantity of levy sugar distributed to the Authorised Ration Dealers (ARD) since March 2002. The loss suffered by the Company on 1,85,884 MT of levy sugar issued at the instance of State Government, during the period from March 2002 to March 2008 worked out to Rs. 1.86 crore. The Company was yet to lodge a claim with Government (July 2008).

Loss due to conversion of wheat into fortified atta at lower ratio

2.2.23 As per the conditions stipulated (August 2006) by Government of India for conversion of wheat into fortified atta, the conversion ratio would be in the range of 95-98 *per cent*. The Company entered into an agreement with miller for conversion of wheat to atta at 95 *per cent* yield. The Company decided (October 2006) for conversion of atta at 95 *per cent* yield without conducting either a market survey or tests on cooking quality of fortified atta obtained at 98 *per cent* yield before the approval of the conversion rate by the Board. The fortified atta at 98 *per cent* conversion had more nutrition content and fetched additional quantity of three MT of fortified atta from every 100 MT of whole wheat, when compared to 95 *per cent* conversion.

Audit noticed that:

Decision on conversion of wheat to fortified atta at 95 *per cent* yield deprived the Company of additional income of Rs. 1.16 crore.

- By adopting 98 *per cent* conversion rate on the total quantity of Atta (37,612 MT) distributed during the period from January 2007 to March 2008, the Company could have recovered and distributed additional quantity of 1,188 MT of fortified atta to the ration cardholders at no extra cost. The loss at Rs. 9.75 per kg (excluding ARD's margin of Re. 0.75 and VAT Re. 0.40) incurred due to short recovery on the above quantity worked out to Rs. 1.16 crore.

The Management stated (April 2008) that if the conversion ratio had been fixed at 98 *per cent*, it might have resulted in atta having contents of bran and impurities exceeding the standards specified by Prevention of Food Adulteration Act (PFA). The reply is contrary to the fact that the millers had accepted the quality specification while quoting the rates for the conversion ratio at 98 *per cent*. During 2005-06 the GoI had approved 98 *per cent* conversion rate in Andhra Pradesh, Meghalaya, Tripura and Himachal Pradesh.

Loss of discount due to decentralised purchase of medicine

2.2.24 Up to October 2004, the Company procured medicine by placing order with pharmaceutical companies and the supply was made through their stockists/ distributors to Medical stores of the Company. The Company was eligible for a maximum discount of 20 *per cent* on purchases and after allowing 10 to 12.5 *per cent* to consumers, it retained 7.5 *per cent*. The Company decided (October 2004) to procure medicine directly from Companies through its regional medical divisions and distribute it through its retail outlets.

Decentralisation of purchase of medicine without valid grounds deprived the Company of eligible discount of Rs. 7.22 crore.

- After a delay of three years, the Company implemented (January 2008) its decision and obtained a minimum margin of 20.5 *per cent*. The delay in implementing the Board decision to procure the medicine through its wholesale division has deprived the Company of getting additional benefit of Rs. 7.22 crore (November 2004 to December 2007).

Non-realisation of dues from suppliers

2.2.25 The Company did not have a system of periodical monitoring of dues and recovery. The Company had not maintained information regarding address, details of assets, etc, of defaulting suppliers.

Audit noticed that:

The Company could not realise Rs.3.39 crore relating to 10 suits for which decrees have been obtained as the whereabouts of the suppliers were not known.

- The Company received (1998-2001) favorable decree from Court for Rs. 3.39 crore in 10 suits filed for recovery of loss sustained by it, on account of purchase at higher rates on short supply by the suppliers, invoking risk and cost clause in the contract. The Company, however, could not realise the amount so far even after a lapse of 7 to 10 years on account of non-availability of information regarding proprietor’s whereabouts leading to non-recovery of Rs. 3.39 crore.
- Further 23 suits filed for recovery of Rs. 64.67 crore invoking risk and cost clause in the supply contract were pending in court since 1994-95 and the Company had not assessed the status of recoverability of the claim.

Recovery pending against employee

2.2.26 The Company did not conduct periodical physical verification of stock or internal audit which resulted in delay in quantifying the value of shortages/ misappropriation of stock as recoverable from its employees. The Company failed to fix the responsibility against the delinquent employees within the time limit of three years since their retirement or death, as required by law. The periodical monitoring of dues and suits filed for recovery of dues was absent. The action contemplated under Revenue Recovery Act was not satisfactory.

Audit observed that:

- An amount of Rs. 1.25 crore was outstanding (March 2008) in 527 cases against 430 employees on account of shortages/ misappropriation of stock. In 107 cases involving Rs. 59.06 lakh, the delay in fixing liability ranged between five and 18 years.

- In respect of 19 out of 430 employees from whom Rs. 73.46 lakh was pending, Audit noticed that all the concerned employees had retired. In three cases involving Rs. 11.04 lakh the Company could not recover the dues from their death cum retirement gratuity as the liability was fixed after three years of their retirement/ death.
- Out of 527 cases (223 cases of Rs. 72.38 lakh prior to 1998 and 304 cases for Rs. 52.66 lakh there after) where liability was fixed, Revenue Recovery (RR) proceedings were in progress in respect of only 17 cases (Rs. 45.19 lakh). The rate of recovery through RR Act was also poor (30 *per cent* in 2005-06 and 13 *per cent* in 2006-07). In all the remaining cases, recovery action had not been initiated.

Non- restriction of sales against advance in case of petroleum products

2.2.27 In the case of sale of petroleum products to the Government Departments the Company is collecting Rs. 10,000 or one month's fuel charges as advance. Audit observed that as the sales of Petroleum Products to Government departments were not limited to the advance available, the dues increased from Rs. 1.49 crore (2002-03) to Rs. 2.59 crore (2006-07) which was against the sales policy of the Company. Due to non-availability of department- wise/ age-wise analysis, the genuineness/ recoverability could not be assessed in audit.

Utilisation of funds

2.2.28 Audit observations on various extra/ avoidable expenditure and other irregularities in the areas of "Procurement and Distribution of Commodities" in the Company which involves utilisation of funds were included in the Report of Comptroller and Auditor General of India for the year ended 31 March 2005. The Committee on Public Undertakings discussed the report during January 2008 and recommendations were awaited (July 2008).

Audit observation on utilisation of funds are discussed in succeeding paragraphs:

Excess procurement of wheat without assessing the requirement of atta

2.2.29 For monitoring the conversion of wheat into fortified atta the Company was required to collect ARD-wise requirement of atta from Taluk Supply Offices during the preceding month to avoid unnecessary accumulation of funds in wheat.

- Audit, however, noticed (February 2008) that the requirement of atta by ARDs was being obtained by the Depot Managers and communicated to the Head Office of the Company only during first week of the succeeding month. Due to this, the Company procured wheat from FCI without assessing the actual requirement leading to blocking of funds during the period December 2006 to March 2008 ranging between Rs. 11.10 lakh and Rs. 1.88 crore leading to loss of interest to the extent of Rs. 13.46 lakh[*].

[*] Calculated at the borrowing rate of interest @ 8.75 to 10.25 *per cent* per annum.

The Management accepted (April 2008) that accumulation of wheat was mainly due to non-receipt of sufficient indent from the TSOs and non-lifting of atta by ARDs. Hence the Company had to ensure a stock of 5,000 MT of wheat so as to avoid complaints of non-availability of atta. The fact remains that the Company's Depot Managers failed to obtain indents from TSOs in time to avoid the blocking of funds in procurement of wheat.

Excess holding of inventory

2.2.30 The Company procures various items of food grains and pulses every month. However it held stock in excess of one month's requirement (up to 73 days in case of rice) and incurred interest loss of Rs. 1.04 crore for the period 2004-05[∅] on items which were having meagre contribution margin.

Working capital management

2.2.31 Consequent to the failure to realise its legitimate dues in time as narrated in various paragraphs, the Company had to avail cash credit from banks for its working capital requirements. The Company had been availing cash credit facility from a consortium of five banks for meeting its working capital requirements since 1988. During the period April 2002 to November 2005 an aggregate cash credit limit of Rs. 15 crore was made available to the Company. The Company entered into an agreement (June 2005) with Federal Bank for cash credit facility of Rs. 15 crore and discontinued (November 2005) the facility from the consortium but continued to maintain separate current account with SBI, SBT and Federal Bank. The limit of cash credit from Federal bank was increased (June 2007) to Rs. 40 crore.

Audit observed that the Company did not:

- Have a system of preparation of periodical cash flow and funds flow statements to assess the availability and requirement of funds in advance.
- Effectively monitor the collection and transfer of funds on periodical basis from various units' bank accounts to central collection account.
- Exercise proper control over timely deposit/cancellation of demand draft to avoid loss of interest.
- Effectively manage the operation of cash credit/current account to reduce financing cost.
- Have a system to verify the correctness of interest charged by the bankers due to delay in preparation of bank reconciliation statements.
- Raise claims for working capital purpose observing prudent business principles.

The irregularities and losses arising out of the above system/procedural deficiencies are discussed below:

[∅] period upto 2003-04 covered in AR 2004-05 & detailed item-wise inventory is not available thereafter.

Idling of funds in operating and collection accounts

2.2.32 The revenue generated at outlets were to be remitted to collection accounts on the next working day and the funds were to be transferred by the bank once in a week to the operating accounts at depot level and subsequently to Head office.

Audit noticed that:

- In respect of 26 operating accounts scrutinised in audit, there was avoidable loss of interest of Rs. 54.73 lakh at the cash credit rate for the period April 2006 to March 2008 on account of failure to transfer Rs. 3.21 crore on daily average basis.
- Transfer of excess fund in collection account of outlets to operating account of depots was not carried out in time. Audit test checked (April 2008) 25 (covering 237 outlets) out of 301 collection accounts relating to the period April 2006 to March 2008 and found that there was interest loss of Rs. 3.78 lakh due to non-transfer of funds.

Delay in depositing demand draft

2.2.33 The payments towards purchase cost of levy sugar were made through Demand Drafts (DD) from banks without assessing the availability of materials at the factory. The Company also kept the DDs for Earnest Money Deposit received from tenders with it and deposited only the DD of successful tenders in the bank on finalisation of tenderer. Audit noticed that there was delay in collection and remittance of DD to the Banks. The Company lost the element of float and it could have reduced the borrowings to that extent as detailed below:

- There were 21 instances of delay ranging from 3 to 14 days in collection and deposit of DDs valuing Rs. 15 lakh to Rs. 30 crore under MDMS from DPI. This resulted in loss of interest of Rs. 12.66 lakh[*] for the period from January 2002 to April 2008.
- During the period from November 2004 to October 2007, the Company received deposits from successful bidders valued at Rs. 5.69 crore and there was delay of 4 to 45 days in depositing the DD with the bank resulting in loss of interest of Rs. 3.06 lakh.
- 18 DDs for Rs. 6.98 crore were cancelled after a period ranging between one to 61 days, as the Company did not ascertain the availability of stock of levy sugar at mills before drawing the DD during the period 2002-03 to 2005-06. This resulted in loss of interest on idle funds and bank charges to the extent of Rs. 3.25 lakh.

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[*] Calculated with reference to prevailing rate of interest on cash credit.

Simultaneous maintenance of cash credit and current accounts

2.2.34 Funds available with accounts of depots were to be transferred periodically to Head office bank accounts to avoid excess drawal of cash credit and resultant payment of interest. While there were sufficient balances in current account with one or more banks within the consortium, the Company used to draw funds from Cash Credit accounts. The Company failed to monitor the balances in current account and reduce drawals from cash credit for the period from April 2002 to November 2007 and failed to take advantage of non-interest bearing current accounts. This resulted in avoidable interest payment of Rs. 32.04 lakh.

Audit test checked and found that:

- In respect of Central Bank of India funds ranging up to Rs. 1.12 crore (11 September 2003) remained for a period up to 368 days (December 2002 to December 2003) in current account without earning interest.
- The Company maintained a separate current account (from July 2005 to May 2006) for paddy transaction. At the same time it operated (October 2005) cash credit account with the same bank for the same purpose. Funds ranging up to Rs. 22.72 crore (10 April 2006) remained in current account for a period of 294 days without earning interest.

This indicated the lack of financial prudence, inefficient management of cash credit and poor monitoring by the Company.

Payment of excess interest on Cash Credit availed

2.2.35 The accuracy of interest charged by the bank on cash credit was not verified as there was delay in preparation of bank reconciliation statement of various banks maintained by the Company. The Company lacked financial prudence in accepting cash credit at higher rate of interest. The persistent system deficiency of non-detection of excess interest charged and acceptance of higher interest rate had resulted in loss of Rs. 42.25 lakh. As per the agreement (June 2005) for availing cash credit facility with Federal Bank, the interest was to be computed at the end of each month on the daily balance of the amount due. Audit noticed (April 2008) that:

- During the period October 2005 to March 2008 the bank charged extra amount of Rs. 36.52 lakh towards interest on cash credit availed. The Company failed to take action to obtain refund (July 2008) from the bank.
- The interest rate offered by Federal Bank was cheaper when compared to rate charged by SBI and SBT (3.25 to 4.75 *per cent*) during the period 2003-04 to 2005-06. The Company, however, failed to avail cash credit to the maximum limit from Federal Bank. This resulted in avoidable interest loss of Rs. 5.73 lakh.

Overburdening of consumers for working capital requirements

2.2.36 While the Company was not taking adequate measures for producing documents for collecting huge over dues from the Government, Audit noticed that the Company had been fleecing consumers by overburdening them to the extent of Rs. 4.52 crore and utilising the funds for working capital as discussed below:

Generation of extra income in violation of Government order

2.2.37 As per GoI direction (August 2006), the Company was to obtain sanction from State Government before fixing the price of fortified atta. Further the State Government agencies were not to make any profit out of the scheme of conversion of wheat into fortified atta for distribution through PDS. The Company in fixing the retail selling price of fortified atta included advertisement charges in excess of actuals resulting in earning of ineligible margin in violation of GoI direction.

Company generated extra income of Rs. 1.35 crore from distribution of fortified atta at inflated price in violation of GoI direction.

- The Head Office Management Committee of the Company fixed (December 2006) the retail-selling price at Rs. 11.00 per Kg for eleven districts even without sending the proposal to State Government for its approval. For the remaining districts of Idukki, Wayanad and Kasargode, price was fixed (June 2007) with the approval of State Government (July 2007) at Rs. 11.50 per kg on the ground of higher processing charges and overhead expenses. Audit noticed (February 2008) that the Company included advertisement charges in the selling price, which were not actually incurred by it, due to which the prices were inflated. The distribution of fortified atta at inflated price resulted in generation of extra income of Rs. 1.35 crore during the period from January 2007 to March 2008 in violation of GoI direction.

The Management stated (April 2008) that the Company incurred expenditure on advertisement for inviting tenders thrice; cover design of packing and on a portion of monthly price bulletin expenses. The fact remained that the non-recurring expenses made on such advertisement were meagre and the price bulletin expenses were already claimed from the State Government through subsidy on MIS.

Inclusion of exempted tax in issue price

2.2.38 The Company had been procuring rice from Food Corporation of India (FCI) and procuring paddy from farmers for conversion into custom milled rice at prices fixed by the GoI for distributing the rice to Authorised Ration Dealers (ARD) under Public Distribution System. As per Kerala Value Added Tax Act, 2003 (KVAT) effective from 1 April 2005, rice issued by Central/ State Government depots for sale by ARDs was exempted from payment of KVAT. The Civil Supplies Department of the State included the element of this exempted VAT @ one *per cent*, to arrive at wholesale/ retail prices.

Audit noticed that:

- The Company did not take up with State Government the issue of inclusion of exempted tax in the issue price. Instead, it paid VAT aggregating Rs. 74.64 lakh on 1,18,348 MT of rice to FCI and in turn collected the same from the cardholders of Above Poverty Line (APL), Below Poverty Line (BPL) categories of PDS during the period April 2005 to March 2008. There was a time gap of one month between procurement from FCI and obtaining funds from ARDs after distribution of rice. Since the exempted VAT was paid to FCI, the working capital funds of the Company were unnecessarily blocked up to that extent.

- During the period of April 2005 to March 2008 it paid VAT aggregating Rs. 18.38 lakh on 61,251 MT of rice to FCI under AAY scheme. The Company issued the rice under AAY at Rs. 300/ MT to ARDs as against Rs. 303/ MT spent by it on procurement and claimed the element of VAT of Rs. 18.38 lakh from State Government. There was no Government direction for reimbursement of the above and the amount still remained to be settled.

Company derived undue benefit of Rs. 2.24 crore by collecting tax on an exempted category of commodity.

- The Company started (July 2005) Public Distribution of CMR and during the period from July 2005 to March 2008 distributed 3,27,000 MT of CMR to APL and BPL categories through AWDs and collected Rs. 2.24 crore by way of VAT from them. Audit noticed (March 2008) that the Company did not remit the amount of VAT collected and excluded the amount in the tax returns filed stating that Custom Milled Rice distributed under PDS was fully exempted from VAT. Thus, the Company had suppressed material facts from tax authorities and derived undue benefit of Rs. 2.24 crore through collection of tax which was exempted for this category of commodity.

Management Information System

2.2.39 The Board decided (October 2004) to strengthen the Management Information System (MIS) by replacing the manual system of flow of information with computerised MIS. The broad requirement to be met by the implementation of computerised MIS which included *inter alia* generation of periodical reports on sales / purchases / net profit at outlets, disciplinary action/ court cases, variation in budgeted and actual expenditure, etc., for timely flow of information to the management for planning business strategies. The Company implemented Depot Management Software (DMS) by June 2005 in 56 depots at a total cost of Rs. 32.98 lakh and Outlet Management Software (OMS) by December 2006 investing Rs. 7.60 crore.

Audit observed the following deficiencies in its implementation

- While implementing DMS as well as OMS, the Company did not formulate documented policies on password, version control, data backup, data security and for timely entering and transfer of data with due assignment of risk and responsibility, in the absence of which integrity of data may be affected. The effectiveness of DMS/ OMS in rendering the benefit defined in user requirement were also not tested and documented before implementation.

- There was inefficiency in areas of implementation as detailed below:

Area of implementation	Audit observations
Sales management	Daily-consolidated data from outlets was not fed in.
Cash/bank management	Value of daily pending bills at depots was not captured in leading to holding of fund in excess of requirement.
Consolidation of daily stock & sales from outlets	Item-wise details of quantity and value of daily sales and closing stock were not fed in the system.
Data transfer to head office MSSR	The details of Monthly Sales & Stock Report (MSSR) from depots upto March 2007 were available, the data was, however, not consolidated.
Timely availability of error free information	The activity of consolidation of MSSR, which was carried out with a time lag of one month in manual system, was not carried out after computerisation.
Data transfer facility (OMS)	MIS division of the Company did not have documented status of connectivity of outlets to facilitate data transfer, the details of outlets which have transferred data to HO.

Investment of Rs. 7.93 crore in Management Imformation System did not yield the intended benefit.

Thus the Company could not fulfill the objective of effective implementation of computerised MIS, rendering the investment of Rs. 7.93 crore partly unfruitful and the intended benefit was also not derived. The Management also lost track of the information from 2005-06 as manual system was discontinued without checking the effectiveness in implementation of computerised MIS. Consequently, the annual accounts from 2005-06 were in arrears (July 2008) even after a lapse of 22 months.

Internal Control and Internal Audit

Internal control

2.2.40 Internal controls are the procedures and safeguards that are put in place by the Management of an organisation to ensure that its activities are proceeding as planned and objectives are achieved in an economic, effective and efficient manner. The following major deficiencies were noticed in the internal control system of the Company:

- Transfer of funds from depots to head office accounts and vice-versa was not reconciled periodically. Transfer of funds to/from operating accounts in respect of all the 56 depots were pending reconciliation since 2005-06.
- Delay in reconciliation resulted in corresponding delay in detection of discrepancies and their rectification. In respect of three years' transactions checked in audit, there were 192 instances involving delay ranging between seven days and 44 months from the date of transfer in providing credit by respective banks during the period July 2000 to

April 2006. Due to this, the Company suffered interest loss of Rs. 2.64 lakh.

- Non-accounting of transfer of an aggregate amount of Rs. 8.59 lakh from one branch of SBT and four branches of SBI during 2002-03. This had not been rectified (May 2008).
- There is no system of carrying out surprise inspection of physical stock.
- Bank reconciliation was pending from 2006-07 in six depots[∇].
- Information in respect of daily collection, remittance into bank, transfer of funds and monthly sales and stock report from outlets were not consolidated in time at depots and transferred to HO.
- The Company had Rs. 2.18 crore outstanding dues on 31 March 2007, which pertained to the period prior to March 2002 for which the party-wise breakup was not available. The Management had not taken any effective steps to identify/ recover the dues.
- Competent staff for commercial accounting and financial management was not available in depots though the average turnover in depots was more than Rs. 10 crore per annum.
- The Company failed to take separate registration for Thrippunithura depot under KVAT, 2003. Due to this, the Commercial Tax Officer served notices (February 2008) imposing penal interest of Rs. 54.03 lakh. The matter was still pending (July 2008).

Internal Audit

2.2.41 Internal Audit Wing (IAW) of the Company consisted of 10 teams each headed by an Assistant Manager and reporting to Vigilance Officer. Since 2007-08, the internal audit was entrusted to a firm of Chartered Accountants.

Audit scrutiny of the functioning of IAW revealed the following:

- The Company did not prepare internal audit manual prescribing scope and coverage of work.
- There was no audit plan indicating the numbers of units to be covered, criteria for selection of units, duration of audit, etc.
- The coverage of five *per cent* units (depots and outlets) up to 2006-07 was not commensurate with the size and nature of business of the Company.
- The Internal Audit entrusted from 2007-08 to Chartered Accountant firms covered only depots. The outlets from where sales revenue was generated were not included in its scope.

Internal audit reports of depots/outlets not submitted to Board of Directors/Audit Committee.

- Internal audit reports of depots/ outlets were not submitted to the Board of Directors/ Audit Committee.

[∇] Ottappalam, Thrissur, Changanassery, Kottayam, Alappuzha and Thrippunithura depots

- In the absence of reliable data regarding number of units actually audited, the arrears in internal audit could not be ascertained.
- Transactions at head office pertaining to centralised purchases, schemes, finance, personnel and computerisation were not subjected to internal audit.
- On detection of shortages/ misappropriation on annual stock verification, the Company conducts detailed audit through IAW for fixing liability. No system, however, was in place to watch the quantification of liability, its recovery and disciplinary action to be taken.

The above matters were reported to Government/ Company in June 2008; their replies were awaited (August 2008).

Acknowledgement

Audit acknowledges the co-operation and assistance extended by the staff and the Management of the Company at various stages of conducting the performance audit.

Conclusion

The Company incorporated in 1974 had been incurring losses and its accumulated loss as on 31 March 2007 was eighty three times the paid up capital. The loss was mainly due to improper management of receivables and exorbitant financing cost arising from over dependence on cash credit. The Company could not use budget as an effective management tool. Huge funds were blocked up due to failure in raising claims with State Government/GoI, substantiating claims with documentary evidence and lapse in taking adequate follow up action. The expenditure incurred in Public Distribution System as well as losses on sub-depots opened at the instance of State Government were not yet subsidised. There was short realisation of revenue under the scheme for distribution of fortified atta and medicines on account of management decisions. There was no system of preparation of periodical cash flow statement to assess the availability as well as requirement of funds. The Working capital management lacked in many respects leading to avoidable finance charges in the operation of cash credit account. The Management Information System did not serve the desired objective due to numerous deficiencies in implementation. The internal control and internal audit system were not effective.

Recommendations

The Company needs to:

- **Implement an effective system for preparation of more realistic budgets so as to serve the purpose of better management.**
- **Evolve a scientific system for efficient management of receivables to avoid undue delays in receipt of overdue amounts from State Government/GoI by preferring the claims in time with required documents and undertaking efficient follow up action.**

- **Devise a more professional and transparent system of cash and fund flow analysis to improve funds management**.
- **Remedy the deficiencies in Management Information System.**
- **Strengthen the internal control and internal audit system.**

2.3 Information Technology Audit of Enterprise Resource Planning System installed at Malabar Cements Limited

Highlights

Malabar Cements Limited (Company) is a cement producing company incorporated by Government of Kerala in 1978. The Company had been using stand alone software with limited integration facilities based on Fox pro till 2006. In December 2006, the Company decided to implement SAP-ERP system to integrate all the departments at an initial cost of Rs. 1.20 crore. Major audit findings are as follows:

Absence of user requirement specification, non-mapping of business rules and business process re-engineering led to deficiencies in implementation.

(Paragraph 2.3.13)

Defects in programming logic clubbed with non-performance of acceptance testing led to a number of end user problems relating to erroneous output reports, non-availability of required data for decision making, functionalities not being used by users, etc.

(Paragraph 2.3.14)

Non-implementation of Customer Relationship Management, Employees Self Service, Environmental Health & Safety modules despite procurement of licences and plan for implementation

(Paragraph 2.3.40)

User manuals were not circulated to the end users. Training provided to end users and IT team was highly inadequate.

(Paragraph 2.3.44)

Introduction

2.3.1 Malabar Cements Limited (Company) is a cement producing company incorporated by Government of Kerala in 1978 and started production of cement in 1984. The management of the Company is vested with a Board of Directors nominated by the State Government. Managing Director is the Chief Executive. The Company had been using stand alone software with limited integration facilities based on FoxPro till 2006. In December 2006, the Company decided to implement SAP-ERP system to integrate all the departments at an initial cost of Rs. 1.20 crore.

Computerisation

2.3.2 The Company started computerisation of its activities in 1994 with the development of software operating in Local Area Network (LAN) environment to manage the activities of pay roll preparation, stores purchase, sales invoicing and financial management. This was developed in-house in FoxPro and Clipper on Novell Netware Server platform. There was limited integration amongst different modules.

In order to integrate all the activities of various departments of the Company and to take care of the automation needs of all the activities including net enabled transfer of data from remote locations, a SAP-ERP system named as SATVA (Solution for Achieving Transparency and Value Addition) was introduced with effect from 2 August 2007. The system was got developed using SAP-ERP version 6.0 with Oracle version 10.2.0.2.0 as the relational database and Windows 2003 Enterprise Edition as the operating system for server. The system was accessible from 138 computer nodes in a LAN environment.

SATVA is tuned to support transactions over internet for 100 named users of the Company (SAP Application Professional – 20, SAP Application Limited Professional-9, SAP Application Employee Self Service-70 and SAP Application Developer-1)

The six modules of the SATVA system in use were:-

FICO - Finance and Costing	MM - Material Management
SD - Sales and Distribution	HR - Human Resources
PP - Production Planning	PM - Plant Maintenance

The Project objective

2.3.3 The objective of the project is evident from the name itself i.e. 'SATVA' (**S**olution for **A**chieving **T**ransparency and **V**alue **A**ddition) and from the mission statement i.e. 'Towards a transparent, efficient and model enterprise through business process re-engineering'.

Project Cost

2.3.4 The total project expenditure (up to July 2008) was Rs. 115.46 lakh (Hardware Rs. 20 lakh, SAP Software Rs. 44.90 lakh, System Development fee Rs. 50.56 lakh inclusive of taxes) as against an estimated cost of Rs. 120 lakh. Expenditure incurred since August 2007 on Annual Maintenance Contract (AMC) for the software was to the tune of Rs. 15.27 lakh.

Status of the Project Implementation

2.3.5 Keltron, Thiruvananthapuram who conducted (December 2006) a system study in the Company recommended SAP-ERP as a suitable platform for implementation of the system. While the Company directly procured (January 2007) the utility software from SAP India Pvt. Ltd, the implementation of the system was entrusted (January 2007) to Keltron, Thiruvananthapuram. As per the work order (January 2007), the project period was 30 weeks from the kick off date (2 February 2007) and was scheduled to be completed by 1 August 2007. Though the Work Order was silent on sub-contracting, Keltron entrusted the work to Saptha Business Solutions, Bangalore (Saptha) for implementation. The system was rolled out (go live status) on 2 August, 2007.

The work order accepted by Keltron provided for only one month's support after 'go live status' of the system. Though the system was rolled out by the stipulated dated, the system was having a number of bugs/defects on account of improper project management. Keltron could not complete the project and the Company could not depend on the system fully resulting in manual operations and usage of old software in the different divisions of the Company. Since, annual accounts of the Company could not be generated through the system, the Company awarded a separate work order (May 2008) to QuestAm, Chennai for solving the problems related to server maintenance and FICO module. Presently, the Company is in the process of issuing further work order(s) to QuestAm, Chennai for solving the pending issues in other modules. Moreover, Company had withheld the payment of Rs.5 lakh to Keltron and discontinued the contract while stating that company is not claiming for the financial and other damages caused on account of Keltron.

Scope of Audit

2.3.6 The scope of audit includes evaluation of System Development Life Cycle (SDLC) and substantive testing of data to evaluate data integrity and to assess the performance of the system. The audit was conducted during March-April and August 2008.

Audit Objectives

2.3.7 The primary audit objective was to review SATVA system to seek assurance that input, processing and output controls were in place which ensures reliability and integrity of data and to evaluate the system processes meant for bringing transparency and efficiency in the functioning of various divisions.

Audit methodology

2.3.8 IT review of various Modules in SATVA was conducted by adopting the following methodologies:

- Discussion, interview, correspondence and feed-back received from the Company in respect of questionnaire issued by Audit.
- Scrutiny of Business blueprint and Configuration documents supplied by the Agency.

Audit Constraints

2.3.9 The essential documents viz., business process procedure documents for FICO, MM and PM Modules indicating process configuration for SATVA were not received from Keltron and therefore, was not available for examination and analysis to identify the sources of defects. Similarly functional specifications which were the basis of customisation were not available with the Company.

Audit Findings

2.3.10 While appreciating the decision of the Company to implement SAP-ERP system, with a view to bring in transparency and efficiency in its operations, the audit review brought out the following deficiencies in the implementation of the SAP system.

Absence of long term IT Plan

2.3.11 The Company while deciding to go for an ERP system did not have any documented long term IT Plan. Though the Company decided to switch on to the globally renowned SAP-ERP system, it did not have any defined long term and short term strategies for IT infrastructure with the result that IT system acquired was largely remaining unutilised.

The Management stated (October 2008) that, the modules implemented were part of a large ERP package having a number of software programs and all the required modules would be implemented before any other PSU in the State. The reply is not tenable since, it is yet to formulate any strategy for utilisation of certain software licenses still remaining idle, identify interfaces for exchange of information between different units/modules and additional hardware required for full automation. No time frame has been indicated for achieving the objectives in full.

Selection of Implementing Agency without assessing technical competence

2.3.12 The Company appointed Keltron as Implementation Agency for the SAP–ERP systems, which conducted a system study in the company earlier. It was based on a single commercial proposal and without inviting tenders. The work order was issued (January 2007) for a lump sum amount of Rs. 50 lakh. Keltron did neither have any previous experience in implementation of SAP systems nor did they have required expertise. Thus, they sub-contracted the work to Saptha. The factors that weighed high in awarding the work to Keltron was not available in records produced to audit.

The Management stated (October 2008) that Keltron was selected since it had 25 years of experience in the field of building up electronic infrastructure in the State and the Government had also directed to consider implementation of IT action plans through government organisations. However audit holds that the criteria for selection should have been expertise and experience in implementation of the specific ERP package which were found lacking in both the contracted agency and the sub contractor.

The deliverables included the following:

- Business Blue Print Document
- Business Procedure Document
- Functional Specification
- Technical Specification
- Source Code

Business blueprint and business procedure documents were delivered only in September 2008 in respect of three Modules, viz., FICO, MM and PM even after go-live status of the project. Such documents in respect of other three modules were also delivered belatedly in May 2008 after go-live status. Other deliverables viz., functional specification, technical specification and source code were given only in June 2008 in respect of all modules.

The following deficiencies in the contracting process led to difficulties in implementation of SATVA:

- Keltron which lacked experience in implementation of SAP entrusted the implementation job to Saptha although there was no sub-contracting clause in the work order. Saptha could not fully meet the customisation requirements of the Company as discussed in succeeding paragraphs.
- The functional heads who were named as Business Process Owners (BPOs) gave certificate of 'successful status' for the system both for 'go-live' and 'post go-live' scenario without user's testing of the modules. This enabled Keltron to declare the system with 'go live status' on 2 August 2007 and receive payment up to 90 *per cent* of the total amount despite remaining bugs in programming and fulfillment of all the functional requirements. The system was found to be having bugs/defects in respect of all six modules which hampered the functioning of all the divisions.
- Since no penal clause was incorporated in the work order, the Company could not levy any penalties on the implementing agency (Saptha) for ensuring proper implementation. The work order provided for support by Keltron was only for one month after go-live which was not sufficient for an ERP system to stabilise.
- Till May 2008, the Company did not have any support service/consultants to carry out modification in programs to correct the deficiencies in the system or to customise further to take care of change in requirements. The Company continued to depend on manual system and the legacy software.
- The Company hired (May 2008) another agency (QuestAm, Chennai) to solve pending issues in server maintenance and FICO module primarily to finalise the annual accounts without canceling the work order signed by the Company and Keltron.

Absence of User Requirement Specifications documents

2.3.13 Saptha entrusted the work of preparation of the User Requirement Specifications to the BPOs. As the BPOs were not having commensurate skills in preparing the requirements' specification after business process re-engineering and did not shown adequate interest in the development, Saptha proceeded with implementation without the requirement study document which resulted in deficiencies that affected both implementation and performance. The Management also stated (October 2008) that the implementing agency did not possess the required experience to carry out the requirements in full.

Deficiencies in configuration and programming

Material Management Module (MM)

2.3.14 The various purchase requisitions are not being issued online through the 'Customer Relationship Management software (CRM Express) as CRM Express could not be implemented although envisaged as per the work order. Such requisitions are issued manually in hard copies after taking printouts using the ERP system. The hard copies of the requisitions do not fully mention the item description as only the first few characters are being printed. This is posing a lot of problems to both the vendors as well as requisitioning departments as it is difficult to identify the materials requisitioned in absence of full description especially in respect of similarly grouped items with minor variations in the description of items.

2.3.15 While receiving a material which requires quality checks to be exercised, it needs to be held as 'Restricted Stock' till its quality is ascertained. As there is no provision in the customised solution to enter such materials as 'restricted stock' before quality checks are exercised, such receipts were being recorded in the system under 'Un-restricted Stock' (105 movement type) requiring no quality checks. Because of this process deficiency, certain raw materials (e.g., dry fly ash) were consumed at times without ascertaining the quality parameters. System needs to be modified to cater to materials requiring quality checks.

2.3.16 In the price comparison list reports, previous order prices and sources of procurement of such items etc., are not appearing. Resultantly, decision making is hampered on account of cumbersome user interface and non-availability of required data in the price comparison list reports.

2.3.17 Since the configuration for UOM (Unit of Material) is limited to 2 decimal places, 'the per unit rate' of materials is shown as zero in some cases after rounding off. For example in service purchase order, if the rate is, say, Rs. 38 per 10,000 numbers, the unit price shown would be Re. 0.00 instead of Re.0.0038. This will have some financial impact in the Material paid account and resultant reconciliation problems.

2.3.18 Analysis of data relating to purchase of materials revealed that same material codes were used for different materials of a similar group. This indicated improper maintenance of master data for materials by way of assigning same code for a group of materials.

2.3.19 While processing a requisition for purchase of a material, the 'approved vendor list' is not displayed in the screen even though the vendor master exists. In the absence of this list, it becomes difficult to identify the vendors for a particular material; which makes the process cumbersome.

2.3.20 The Purchase Orders for raw materials procured from the suppliers contained provisions for quality assessment based on certain parameters. Since the modules in SATVA did not provide for it, the user could not define the grade of the raw material. Accordingly the cost reduction is not done through the system and is done manually at the time of making payments to the suppliers based on a manual report received from the Quality Department.

2.3.21 The Business Rule requires resorting to Emergency Purchases in exceptional circumstances bypassing the normal system of purchasing through competitive bids. This Business Rule for effecting 'Emergency purchases' was not mapped in the ERP system. Absence of such provisions in the module resulted in a situation where there is no distinction between normal and emergency purchases in the database. It was observed that in respect of five purchase documents released on 15 February 2008 for the purchase of Dry Fly Ash, the per unit rates were ranging from Rs. 80 to Rs. 150 and on a purchase document released on 16 February 2008, per unit rate of Dry Fly Ash was Rs. 340. It was not possible to identify the emergency and routine purchases out of these transactions. Non-inclusion of this important requirement provides scope for irregularities in procurement of raw materials.

2.3.22 As per the business rules, purchase requisition authorisation is limited by release strategies based on value of items by the officers and their delegated powers. However, these business rules were not mapped in the system, with the result that the release strategies were controlled manually through hard copies of indent signed by persons delegated which includes the functional heads (BPOs).

Human Resource Module (HR)

2.3.23 HR module has provision for capturing various data relating to Personnel Management of the Company. It is observed that the data entries for preparing various HR functions are being done in Microsoft-Excel and then exported to SAP system for processing. Because of this, the input controls of the SAP system are being bypassed by the users of the HR Department.

2.3.24 Time punches for attendance of employees are captured in SAP system, based on the shift timings. If an employee changes his shift duty with another one mutually, the attendance would show absence in the assigned shift of employee who worked. Because of this the attendance is not correctly calculated by SAP. Therefore a manual attendance register and manual uploading of attendance to the system is necessitated which exposes the system to human errors.

2.3.25 Same position numbers were given erroneously to more than one employee in the ERP system because the positions in the program were limited to the then actual strength instead of the sanctioned strength of various divisions. It was noticed that on promotion of an employee to another position, the system promoted all employees having same position number. The defect in the programming logic requires correction.

2.3.26 It was observed that when one employee was transferred from one department to another, conveyance allowance & HRA (House Rent Allowance) get doubled but variable DA (Dearness Allowance) was halved. This is due to error in program resulting in drawal of full HRA and conveyance allowances both at the old department and new department due to creation of more than one record for an employee during the month in which the employee was transferred. Salary bill was being prepared outside the system by using manual calculation because of such instances.

2.3.27 Leave management utilities are not properly working. The extra work done and compensatory off availed needed to be accounted for total extra days worked. The leave balance reports are also not showing correct balances.

2.3.28 The HR module is not generating 'Section-wise employee list in each department' which is an important Management Information System (MIS) report.

2.3.29 In HR Module while generating pay roll, deductions towards canteen coupon and co-operative society loan recoveries are being keyed in manually every month since these transactions are kept outside the system. As these requirements are part of Company's routine functions in HR, these items should also be processed through the system by providing the required hardware and connectivity to the concerned wing so that the manual intervention could be minimised/avoided.

Finance and Costing Module (FICO)

2.3.30 The Company switched over to SAP system in the middle of the financial year. Because of this, part of the accounts' transactional data was lying in the legacy system and the Company was not able to finalise last year's financial accounts (2007-08) till August 2008. This was because the data from legacy system up to July 2007 could not be properly interfaced to the SAP system.

2.3.31 The pay results indicating various elements of pay/wage and allowances due for a month to various categories of employees like *Mazdoors*, contingent, daily wages, etc are being worked out in Microsoft-Excel and posted to Financial Accounting through export option in SAP. The ERP system was not being used to automatically calculate allowances like Dearness Allowance for different categories of employees on account of program defects.

Production Planning Module (PP)

2.3.32 As per the business requirement in the production module, the system has to arrive at the output rate, stoppage hours and specific power consumption for evaluation purpose on daily basis. This requirement was not included at the time of customisation.

2.3.33 As per the Business Rules the value of various quality parameters of the raw material on an hourly basis need to be assessed for controlling the operation of raw mill kiln and cement mill where proper mixing of different raw materials takes place. In the current scenario, individual page is required to be opened for each material on an hourly basis and the quality of the output assessed. Hence, features for monitoring the data in single view is needed to be done.

2.3.34 The existing program captures the quantitative and qualitative details of the materials like laterite, limestone and sweetener for production of raw-meal. But there is no facility to capture details of other (new) raw material (eg., clay instead of laterite for production of different variety cement, using the same facilities) in weigh feeder output in raw mill and cement mill. Therefore, the program needs to be modified.

Sales and Distribution Module (SD)

2.3.35 Empty bags are supplied free of cost to the consignees to refill loose cement spilled in the wagon due to breakage of bags. The empty bags should not be given to others on any other ground. So while preparing invoice for empty bags, invoice number of the original consignment has also to be included to prevent misuse for which there is no provision in the software.

2.3.36 While attempting to generate sales invoice report, at the time of release of cement bags from the plant, only the quantity (number of cement bags) released so far to a particular customer would appear on the screen, but the value of the stock released would not get displayed. Thus the user would not be able to assess the quantity to be released to the customer based on his balance of advance payment received.

2.3.37 As per the business rules, the Consignee Receipt Certificates (CRC) require to be accounted for invoice-wise so as to regulate payments to the transporter and evaluate the transport efficiency (i.e., to locate delay, if any). The system could not generate an Exception List for CRC not received. Because of this the Despatch Invoices and Consignee Receipt Certificates are not linked before making payments to transporters. This is done manually at present. Therefore system needs modification in the program to ensure that CRC Numbers appear in the invoices too and exception reports are generated automatically for the user.

Plant Maintenance Module (PM)

2.3.38 In Plant Maintenance Module, to estimate the operating cost per hour and for periodic preventive maintenance, the details of equipment running / working hours need to be captured. There was no provision for entering equipment running/ working hours in SATVA, thus resulting in dependence on Manual System.

The Management stated (October 2008) that the problems have been identified and the issue taken up with Keltron. Since Keltron failed to resolve the deficiencies the rectification works were entrusted to QuestAm, Chennai and the rectifications were in progress.

Non-adherence to best practices in inventory control

2.3.39 SAP provides for generation of automatic inventory control level such as minimum quantity, reorder level and maximum level in respect of each material. Though this had been included in the business blueprint, the system does not provide for these control facilities since the management did not fix the desired quantity levels. This important facility available in the system for material control has remained unutilised. Though SAP is designed to make ABC analysis of inventories for ensuring better control over high value stocks, the Management did not intimate the requirement to the implementing agency and as a result customisation for the same was not done. The management stated (October 2008) that ABC analysis has since been introduced but control levels and automatic indenting was yet to be introduced.

Non-Utilisation of System facilities/module licences purchased.

Customer Relationship Management software (CRM Express)

2.3.40 This software intends to build up good customer relations by helping the customers to interact with the Company through the system 'online'. This software was procured as a part of SAP package which is not implemented by Keltron and still remains unutilised.

Employees Self Service (ESS)

2.3.41 This enables the employees to interact with the HR Module and they can claim re-imbursements, view and maintain personal data. This module also was not implemented even though its implementation was included in the work order given to Keltron. Seventy licences for this module available in the Company are yet to be used.

Environmental Health & Safety software

2.3.42 The SAP-Environment, Health & Safety (SAP EH&S) application supports environment, health, and safety processes, as well as management of industrial hygiene, safety, and occupational health processes. SAP EH&S would help to ensure compliance with regulations for product safety, hazardous substances, dangerous goods, and waste management. Even though the Company is an ISO certified one and it could utilise the existing application software licences to meet its requirements, the Management did not even deliberate on the viability of implementing this module.

The Management stated (October 2008) that these utilities would be implemented in the second phase.

Absence of Security and Password Policies

2.3.43 There is no defined and documented security policy to ensure system security and data security. Password is required for ensuring security of the system and integrity of data in a computerised system. An ideal password policy shall specify:

- Periodicity of changing passwords
- Situations in which the password should necessarily be changed, and
- The procedure prescribed for locking/unlocking of user after certain invalid attempt by user.

The Company did not have any defined and documented policy on password and the users were not made aware and communicated the importance of password protection. An analysis of password logs generated by the SAP system confirmed the audit contention.

The Management stated (October 2008) that directions were given for changing passwords more frequently.

Deficiencies in Training

2.3.44 As per the project proposal submitted before the Board during December 2006, Keltron was to provide training to key users e.g., advanced training to IT team of the Company, basic training to end users, etc. However, on scrutiny of records it was revealed that:

- Only an introductory training for one week (3 hours per day) was given to 26 officers in middle management level during June 2007.
- No advanced training was given to the core team with a view to familiarise them with the configuration techniques and trouble shooting solutions.

- The trained BPOs (functional heads) were expected to give the required training to the end users. However, records relating to such training were not made available for audit scrutiny. Inadequate training affected the successful implementation of SATVA and led to continuance of manual system.
- The Management insisted for User Manuals only after 9 months of 'go live'. Even after its receipt, these were not circulated to the end users so far.
- Even though the HoDs are likely to change, a well trained group of officers in IT have not been posted to key posts where IT skills are required.

The Management stated (October 2008) that additional trainings wherever required would be imparted.

Conclusion

The Management could not fully derive the benefits of ERP system to achieve transparency and efficiency in the functioning of various divisions primarily because of the lack of participation from the functional heads (BPOs) of the Departments. This was evident from the fact that the user requirement specifications were not prepared properly before customisation of SAP system by Keltron through Saptha. As a result, the Company could not introduce automation in all areas as expected and continued the manual system in parallel. The objective of improved efficiency by re-deploying the staff to essential areas had not been achieved despite spending more than Rs. 1.30 crore for implementation of this project.

Recommendations

The Company may:

- **Customise all modules of SATVA with a view to remove the existing bugs and inclusion of all functional areas which has not been encompassed so far in the ERP system.**
- **Carry out necessary modifications in the programs according to the business rules and utilise all the modules and licences.**
- **Complete full automation and discontinue all manual processing.**
- **Arrange sufficient training to all the users.**