CHAPTER IX
MAJOR FINDINGS IN TRANSACTION AUDIT

9.1 Locking up of funds and consequential loss of interest due to advance procurement of materials without definite order

Advance procurement of materials without definite order resulted in locking up of funds of Rs 4.74 crore and consequential loss of interest of Rs 1.41 crore.

Purchase Orders were placed for materials required for production of equipment, in anticipation of an order from AHQ

ITI Limited received two enquiries (May and July 2001) from Army Headquarters (AHQ), New Delhi, for supply of 2,320 numbers of ADM MUX 6 Channel equipment. The Company submitted the quotations (May and July 2001) and also started procurement action for purchase of materials required for 500 numbers of equipment, without waiting for the order. Purchase orders for procurement of the materials were placed during the period between July 2001 and February 2002 and the materials were received during the period between September 2001 and March 2002. Simultaneously, production activities were also commenced. The Company procured material valued at Rs 4.74 crore for production of equipment besides incurring Rs 12.63 crore towards labour and overhead which were fixed. As no orders were received from AHQ, work in process containing materials worth Rs 4.74 crore was lying in stock (June 2004), resulting in locking up of funds and consequent loss of Rs 1.41 crore towards interest thereon.

As no order was received, materials worth Rs 4.74 crore were lying in stock resulting in locking up of funds and consequent loss of interest of Rs 1.41 crore

The Management stated (January 2004) that advance procurement action was initiated with a view to supplying the equipment in time, in case of receipt of order and that efforts were on to get the order from AHQ.

The reply of the Management is not tenable as initiating production activities involving huge investment based on mere enquiries was an imprudent decision especially when the product was a proprietary item of the Company. Further, the Company may not get any order as there is no user requirement for the equipment.

Thus, procurement of material and initiation of production activities based on mere enquiries without firm order, resulted in locking up of funds of Rs 4.74 crore and consequential loss of interest of Rs 1.41 crore up to June 2004.

The matter was referred to the Ministry in May 2004; its reply was awaited as of November 2004.

9.2 Extra expenditure on procurement of memory modules

Procurement of memory modules from the collaborator, instead of from world market sources in the absence of any clause in the agreement with the collaborator requiring the Company to purchase these items as proprietary items, resulted in an extra expenditure of Rs 3.50 crore.

Memory modules were world market items

M/s Alcatel (collaborator) categorised these as proprietary items

ITI Limited (Company) requires memory modules[1] for manufacture of OCB[2] 283 exchanges. As per agreement[3] with M/s. Alcatel (collaborator) these memory modules were not proprietary items but were world market items[4]. However, the collaborator categorised these as proprietary items in July 2001. The Company procured 4,200 Integrated Circuit Code-1 at a unit rate of Rs 3,089.40 and 9,000 Integrated Circuit Code-2 at a unit rate of Rs 3,861.75 from the collaborator during February 2002 to December 2002 on the ground that these were proprietary items of the collaborator.

The Company incurred extra expenditure of Rs 3.50 crore by purchasing Integrated Circuit Codes 1 and 2 from the collaborator instead of from world market sources

Meanwhile, in order to meet urgent requirement, the Company procured (October 2002) 1000 Integrated Circuit code-2 at unit rate of Rs 1,144 against the collaborator's unit rate of Rs 3,861.75 from M/s. Brepo Systems India Private Limited, New Delhi. The Company also procured (December 2002) from M/s. Brepo Systems India Private Limited, New Delhi, 1,200 Integrated Circuit code-1 at a unit rate of Rs 1,134 against the collaborator's unit rate of Rs 3,089.40. The Company did not face any quality problems in the above purchases. These purchases clearly established that alternative cheaper sources capable of meeting the specifications of the Company were available and the Company incurred an extra expenditure of Rs 3.50 crore in the purchase of these Integrated Circuits from the collaborator.

The Management stated (February 2004) that purchase of memory modules from M/s. Brepo Systems, New Delhi, was only a commercial risk attempted in view of urgent delivery requirement, which cannot be generalised as availability of an alternate source. It was also stated that this issue was taken up with the collaborator but they turned down the request of the Company to purchase these items from the world market. The Ministry endorsed (July 2004) the views of the Management.

The reply of the Management/Ministry is not tenable as

(i) these items were originally in the world market category, which were subsequently transferred arbitrarily by the collaborator to proprietary category though there was no provision in the collaboration agreement for such transfers;

[1] ***Integrated Circuits Code 1-1AB 073210002 and Integrated Circuits Code-2 IAB 109210001***
[2] ***Organdy Commanded B-Version***
[3] ***Copy of the agreement with the supplier may please be supplied***
[4] ***Items which can be procured by the Company from sources approved by the collaborator***

(ii) the decision of the collaborator to categorise these items as proprietary has not been incorporated in the agreement by way of amendment;

(iii) the Company did not face any quality problems in the memory modules procured from sources other than the collaborator; and

(iv) the collaborator also did not take any action against the Company in the absence of any agreement in this regard.

Thus, procurement of memory modules from the collaborator, instead of from world market sources in the absence of any clause in the agreement with the collaborator requiring the Company to purchase these items as proprietary items, resulted in an extra expenditure of Rs 3.50 crore.

9.3 Loss due to advance payment of excise duty

ITI Limited (Company) did not avail of the benefit of fortnightly payment of excise duty resulting in loss of interest of Rs 69.85 lakh.

As per Rule 173 G of Central Excise Rules 1944 and Rule 8(1) of the Central Excise Rules 2001 the duty on goods removed from the factory or the warehouse during the first fortnight of the month shall be paid by the 20th of that month and the duty on the goods removed during the second fortnight shall be paid by the 5th of the following month. Further, Rule 57A of the Central Excise rules 1944 and Rule 3 of the Cenvat Credit Rules 2002, allow a manufacturer or producer of the final products to avail credit of excise duty paid on any inputs received in the factory and such credit may be utilized for payment of excise duty on any final products cleared.

Mankapur and Naini units deposited excise duty in advance instead of availing of the benefit of fortnightly payments and Cenvat credit as stipulated in the rules

Instead of availing of the benefit of fortnightly payment as allowed in the rules, Mankapur and Naini units of the Company had been depositing the amount of duty in advance under the personal ledger account with the Excise authorities. While making advance payment the company also did not take into account full credit available to it under Rule 57A of the Central Excise Rules and Rule 3 of the Cenvat Rules as above. The units have discontinued this system of advance payment of duty from April 2003 after the failure was pointed out by Audit (August 2002/January 2003). As these units were availing cash credit facility, they could have avoided interest amounting to Rs 69.85 lakh (Rs 18.89 lakh in Mankapur unit and Rs 50.96 lakh in Naini unit) during April 2000 to March 2003 if they had availed the benefit of fortnightly payment and Cenvat credit.

The Ministry stated (July 2004) that Naini unit had definite plan to dispatch equipment worth Rs 55 crore up to March 2002 for which the excise duty of Rs 8 crore was deposited. However, these could not be cleared due to quality assurance problem.

The reply of the Ministry is not tenable because the company should have paid the duty on the consignment after the end of the fortnight in which it was cleared as per rules instead of paying it in advance. The problem of blocked funds would not have arisen in that case even if the consignment could not be cleared due to quality assurance problem.

Non-availment of the above benefits resulted in loss of interest of Rs 69.85 lakh

Thus non-availment of the benefit under the excise rules resulted in loss of interest of Rs 69.85 lakh.