CHAPTER VI: MINISTRY OF CONSUMER AFFAIRS, FOOD AND PUBLIC DISTRIBUTION

Central Warehousing Corporation

6.1 Non-realisation of storage charges on time-barred bonded goods

Central Warehousing Corporation did not dispose off time barred bonded goods leading to non-realisation of storage charges of ₹ 167.29 crore

According to Section 61 of the Custom Act, 1962 warehoused goods may be left in the warehouse in which they are deposited for a period of one year or such extended period as permitted by the custom authorities. The procedure for unclaimed/uncleared cargo is prescribed under Section 48 of the Customs Act, 1962. For expeditious disposal of the backlog of accumulated unclaimed/uncleared and confiscated cargo and to ensure that no delays in disposal took place in future, a permanent mechanism was put in place by the Central Board of Excise & Customs (CBEC) in circular dated 1 December 2005 and the instructions were reiterated on 22 July 2010. As per procedure, unclaimed/uncleared cargo lying with the custodians, landed at least one year prior to the date of custom clearance, was to be disposed off and the responsibility for disposal and fixation of reserve price was on the custodian.

Audit observed that CWC had 53 Public Bonded Warehouses with total capacity of 3.80 lakh MT (244530 square meters) as on 31 March 2011 out of which capacity utilised was 2.26 lakh MT (i.e. 145431 sq.mtrs.). Bonds of 2725 depositors who had hired the storage space were lying from two to twenty six years and had become time-barred. These had occupied storage capacity of 61670 square meters (i.e. 42.40 *per cent* of the total utilised capacity). The accrued income in respect of these time-barred bonds to the extent of ₹ 167.29 crore upto 31 March 2011 was not accounted for by CWC due to uncertainty of its recovery. Since the time-barred goods were lying in the warehouses for long periods, CWC as a custodian should have disposed off these goods. Non-disposal of time-barred bonded goods (December 2010) resulted in non-realisation of huge outstanding storage charges amounting to ₹ 167.29 crore.

The Management stated (July 2011) that the cargo stored in the bonded warehouse was to be disposed off within the stipulated time by the Customs Department and that CWC could not take any arbitrary decision in the matter. The Management further stated (December 2011) that the CWC had hardly any role in the matter, as without the explicit approval of the Customs, no time barred bonded goods could be disposed by the CWC. The reply stated that the Customs conduct auction of time barred goods as per the Custom Act, 1962 and that the issue of disposal was regularly discussed with the Commissioner of Customs by the concerned Regional Managers and CWC could not do much in this regard except putting in a request for early disposal.

The reply is not acceptable since as per the prescribed procedure, the responsibility for disposal of time-barred bonded goods was on the custodian i.e. CWC. Despite Government of India laying down a permanent mechanism for expeditious and timely

disposal of unclaimed cargo, CWC had not taken any definite action as per above procedure.

The matter was reported to the Ministry in October 2011; reply was awaited (May 2012).

Food Corporation of India

6.2 Avoidable expenditure on procurement of levy rice

Reimbursement of mandi labour charges against the paddy procured at farm gate/mill point resulted in excess payment to private rice millers ₹ 107.95.

Government of India's (GOI) cost sheet for procurement of levy rice includes Minimum Support Price (MSP), Statutory/non statutory charges (such as mandi labour charges, milling charges, market fee, etc.), and other charges. The element of mandi labour charges was included in the cost sheet to compensate the cost incurred for handling of paddy at mandi yards by private Rice Millers for paddy procured at mandis only.

A test check of records in six District Offices (DO) of Food Corporation of India (FCI) at Srikakulam, Visakhapatnam, Kakinada, Tadepalligudem, Guntur and Nellore in Andhra Pradesh region revealed that the paddy was procured by rice millers directly at farm gate/rice mill point and not at mandi yard during KMS 2007-08 to KMS 2009-10 (October 2007 to March 2010). In other four districts at Nizamabad, Kammam, Mahaboobnagar and Sanathanagar, Audit observed that the purchases made by private rice millers at farm gate/rice mill point ranged from 54 *per cent* to 94 *per cent* of the total paddy procured during KMS 2007-08 to KMS 2009-10 whereas the balance quantity of paddy was procured at mandis.

Though the purchases were made at farm gate/mill point, FCI reimbursed mandi labour charges to the private rice millers without verifying whether paddy was procured at mandi yard or not. This resulted in excess payment of ₹ 107.95 crore as reimbursement to private rice millers during KMS 2007-08 to KMS 2009-10.

The Management stated (December 2011) that while there was some merit in the contention of Audit that the rice millers were likely to incur lesser expenditure when paddy was procured by them in their mill premises/gate instead of mandi, the payments were made based on the MSP certificate issued by the district administration and as per the costing sheet issued by GOI.

The reply is not acceptable as the mandi labour charge is not part of the MSP but is a separate element forming part of procurement incidentals included in the cost sheet to be paid against performance of the handling work at mandi yards. Since the procurement was directly made at farm gate/mill point, handling work such as cleaning, weighing, filling of bags, stitching, etc., was not done by the mandi labour. Hence, payment made towards mandi labour charges was not admissible.

Thus, due to irregular payment of mandi labour charges against the procurement of paddy at the farm gate/mill point, the FCI made excess payment as reimbursement to the private rice millers in Andhra Pradesh region amounting to ₹ 107.95 crore on procurement of levy rice during KMS 2007-08 to KMS 2009-10.

The matter was reported to the Ministry in September 2011; reply was awaited (May 2012).

6.3 Loss due to Interest Rate Swap transactions

FCI suffered a loss of ₹ 33.61 crore on account of interest rate swap transactions

Food Corporation of India (FCI) raised ₹ 8605 crore through Government of India (GOI) Guaranteed Bonds in 2005 bearing, on an average, a fixed coupon rate of 7.31 *per cent* per annum and a maturity period of five to ten years. FCI on the advice of an external consultant (Advisor-Cum-Treasury Manager), decided (July 2005) to go in for Interest Rate Swap (IRS)[♣] to lower the interest cost against its fixed interest bearing bonds. Before entering into the transactions, FCI sought further opinion from M/s. Darashaw & Co and M/s. Citi Bank in November 2005 and December 2005 respectively. While M/s. Darashaw & Company was in favour of the IRS with due adoption of risk mitigation measures, Citi Bank clearly informed FCI that fixed to floating rate IRS at that point of time did not make economic sense given the upward pressure on interest rates.

FCI entered into two complex IRS agreements based on floating rate with UTI bank (now Axis Bank) and Barclay Bank having a composite Indian rupee and USD benchmarks from January 2006 with maturity date as 28 February 2010. FCI undertook IRS for a total notional principal amount of ₹ 700 crore (₹ 350 crore with each bank) from fixed coupon rate of 7.10 *per cent* to a floating rate.

The floating rate was above the fixed rate right from the first settlement date i.e., 28 February 2006 and continued to rise during the period upto December 2008. Consequently, FCI had to pay a total of ₹ 20.81 crore on the prescribed settlement dates (₹ 1.61 crore to Barclays and ₹ 19.20 crore to Axis bank). In addition, FCI incurred ₹ 12.80 crore as winding up cost to exit from the IRS deals with Barclays bank (January 2008) and Axis bank (December 2008). Thus, FCI suffered a total loss of ₹ 33.61 crore on account of IRS transactions.

In order to have a clear picture on the IRS transaction entered into by FCI, Audit sought expert advice from M/s. Basix Forex and Financial Solutions Private Limited, (March 2011) which found the two Interest Rate Swap (IRS) transactions not advisable on the following grounds:

- Interest rate swap transactions were not executed based on the prevailing market trend which did not give any indication of interest rate cut or any downward trend from January 2005 till the deal was finalised in January 2006. As such entering into transaction from fixed interest rate to floating interest rate was not advisable.
- The IRSs were complex structured deals which included currency exchange rate and USD interest rates. Hence, FCI was exposed not only to the upward movement of the interest rates but also to the exchange rates and US$ LIBOR movements.
- The IRS transactions involved RBI regulatory compliance according to which domestic rupee benchmark should only be used for interest rate derivatives. The

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♣ ***Interest Rate Swap (hedging) is a contract between two counter parties to exchange interest obligations on specified dates based on the notional principal. An IRS can be either from 'fixed' to 'floating' or from 'floating' to 'fixed'. In case of fixed to floating the risk is generally not further mitigated. This is because an IRS holder does not know the exact cash flows he is bound to pay on various maturities. Such swaps are only entered when there is a very strong view that the interest rates will be in a downward trend for atleast a couple of years from the start date of swap.***

same was not complied with in the IRS transactions with the two banks though the regulatory aspect was pointed out to FCI by M/s. Darashaw & Company Private Limited in November 2005 i.e., before finalisation of the deal in January 2006.

Audit further observed that FCI did not obtain approval of the administrative ministry prior to entering into IRS agreement which was a risky venture, as FCI gets budgetary support from the Government of India and bonds were backed by Government guarantee.

The Ministry stated (August 2009) that though formally it was apprised of the position on 06 January 2006, the representative of the administrative ministry was present throughout the process of entering into the IRS swap transaction as a member of the Advisory Committee.

In response to the observations of M/s Basix Forex and Financial Solutions Private Limited the Management stated (July 2011) that the Corporation did study the historical behaviour of the bench mark rates and had followed expert advice before undertaking the transactions. So far as RBI regulations were concerned, FCI stated that both the banks clarified in December 2005 that the interest rate swap proposed by them was permitted under RBI regulations; that the FCI had no reason to disagree with the clarifications given by the banks who were accountable to comply with all regulatory guidelines.

The replies of the Ministry/Management are not acceptable as the IRS agreements were not in compliance with the RBI regulations which allowed using only domestic rupee benchmarks for interest rates derivatives. **FCI entered into complex deals against the opinion sought for and obtained from M/s. Citibank which contained the analysis of the grounds on which interest rates were expected to rise and in violation of the extant RBI regulations leading to loss of ₹ 33.61 crore. The transactions did not lead to lowering of interest cost but only in increasing the GOI food subsidy to the extent stated above.**