

## CHAPTER V: MINISTRY OF COMMERCE AND INDUSTRY

### MMTC Limited

#### *5.1 Non-recovery of dues due to lapses in bullion transactions and camouflaged accounting*

**Failure to adhere to the instructions on bullion trading, camouflaged accounting and ineffective internal control in MMTC Limited resulted in non-realization of dues amounting to ₹ 295.99 crore from customers and avoidable loss of ₹ 53.27 crore (till December 2012) towards interest.**

MMTC Limited (Company) imports and supplies gold, platinum and silver to exporters under various schemes as per Foreign Trade Policy of Government of India. MMTC also imports Gold and Silver for sale in domestic market under OGL Scheme. Bullion is imported either on consignment basis or against letter of credit/Standby Letter of Credit (SBLC). Trading of bullion is regulated in accordance with the instructions/guidelines contained in the Precious Metals Procedural Drill (bullion drill) and internal circulars issued by the Company from time to time.

When the transaction is under the Buyers Credit system, the Company obtains Buyers Credit in foreign currency usually for 90 days against funds deposited by the customer covering the value of gold plus incidentals. The amount received from the customer is converted into a Fixed Deposit (FD) by the Company. On expiry of the BC period, the same is liquidated by encashing the FD along with additional funds towards expenses or by availing of Loan Against Deposit (LAD). The interest and related costs of availing such LAD is to be borne by the customer. The bullion drill stipulates maturity period of FDs to be equivalent to the due date of the BC, which has been reiterated by instructions issued by MMTC from time to time.

Under the SBLC scheme, credit is extended by the supplier of gold to MMTC on the basis of 180 day SBLC opened in his favour. The SBLC arranged by MMTC in favour of the foreign supplier is secured with the funds (FD in the name of the Company) placed by the customer with MMTC or a SBLC established in favour of MMTC by the customer.

Under the Domestic Gold Loan scheme, the loan (credit) is provided by the supplier to the Company and the customer is required to furnish security in the form of Bank Guarantee (BG) in lieu of cost of gold delivered on loan. Loan could be advanced for a maximum period of 90 days. A ceiling of 200 KG per customer has been fixed under the scheme. The BG is required to be encashed by Company on default of payment of value of gold by the customer.

The bullion drill mandates obtaining of Foreign Exchange Rate Cover (FERC) to hedge against exchange rate fluctuations. The cost of such FERC is to be borne by the customer. Instructions issued in March and September 2008 mandated compulsory FERC for hedging all BCs in case of gold transactions. Further, instructions issued on 18 December 2006 required each transaction to be treated as separate and squared off on completion, so

as to avoid carry forward of balances. In other words, bunching of transactions was prohibited.

Audit test checked the transactions of Regional Offices (ROs) at Chennai and Hyderabad and observed as under:

**Regional Office, Chennai**

It was noticed in Audit that the Chennai Regional Office of the Company failed to adhere to the bullion drill, instructions issued by the Company from time to time and the internal control measures in day to day operations which resulted in huge loss to the Company as discussed in succeeding paragraphs:

- The Chennai Regional Office of the Company entered into gold trading under the Buyers Credit system with M/s Shiv Sahai and Sons (M/s SSS) from 2007-08 onwards. However, it was observed that foreign exchange exposure was not hedged as the forward cover was kept open. As per para 7(i) of the Agenda item No. 2 given in the 'Note for consideration of Audit Committee of Directors' for 67<sup>th</sup> meeting of the Committee held on 10 February 2012, the differential exchange rate and the buyers' credit expenditure to the tune of ₹ 36.36 crore was not debited to the account of M/s SSS during financial year 2008-09.

Further, as per instructions of bullion drill the total value received including the margin money deposited by the customer should have been utilised to obtain a fixed deposit in Company's name with maturity equivalent to the due date for payment under the buyer's credit. In contravention of these instructions, FDs pertaining to the above transactions with M/s SSS were placed with banks for periods longer (for one year and more) than the duration of the Buyers Credit for 90 days. The Company took loans against deposits to liquidate BCs on the due date. Further, while M/s SSS was duly given credit for the interest earned on FDs, the interest paid by the Company on LADs was not debited to the account of M/s SSS.

It was only during September 2011 to March 2012 the Company raised Debit Notes for ₹ 81.61 crore on M/s SSS. M/s SSS disputed the Debit Notes raised by the Company and filed caveats in Madras High Court.

- Similarly, during the period from 2007-08 to 2008-09, the Company traded with M/s Surana Corporation Limited (M/s SCL) under SBLC scheme where the rate of gold was to be fixed at the time of settlement of the loan. In these transactions the Company issued invoices on provisional basis at the time of delivery to facilitate M/s SCL to avail VAT credit. When the price was finally fixed, the Company raised Debit Notes for differential cost. M/s SCL, however, took the provisional invoice as finally issued and did not consider the differential cost and other costs, accompanying SBLC transactions such as LIBOR charges, withholding tax, L/C charges etc. After a lot of correspondence exchanged between the Company and M/s SCL the Company sent a final demand of ₹ 18.21 crore pertaining to 2007-08 to 2008-09 in June 2012 which has been disputed by M/s SCL.

As mentioned in para 7(iv) of the Agenda item No. 2 given in the 'Note for consideration of Audit Committee of Directors' for 67<sup>th</sup> meeting of the Committee

held on 10-02-2012, in both of the cases mentioned at (a) and (b) above, most of the accounting transactions had been routed through Suspense Account and that Suspense Account was nullified by passing consolidated entries to other vendor accounts. Since vendor accounts have huge credit balances, the above debits against the customers remained concealed.

Lack of Internal Control in the Company also resulted in an erroneous Debit balance of ₹ 116.69 crore in Creditor Account (i.e. Vendor-M/s Natexis Commodity Markets- NCM) which included the erroneous/ camouflaged entries mentioned above.

- Another instance of collapse of internal controls was noticed in failure of the Management to reconcile bank accounts. As a result, un-reconciled FDs amounting to ₹ 17.99 Crore deposited in 2009-10 were transferred to Vendor Suspense Account in the same year. These FDs were later (2011-12) identified and encashed after remaining out of books of MMTC for about two financial years.

Thus due to non-adherence to the stipulated guidelines, undue benefits were extended to the customers in the form of non realization of dues amounting to ₹ 99.82 crore. The Company also suffered avoidable loss of ₹ 38.56\* crore (upto December 2012) towards interest on the above mentioned amount. The resultant losses/recoverables from the customers were concealed by way of creative accounting practices. These serious lapses were not noticed by the Corporate Office of MMTC till the end of 2011.

The Management while admitting the Audit observations regarding non debiting the interest on LADs to the customer's accounts and non posting the debit entries towards differential cost in the accounts of M/s SCL, replied (March & November, 2012) that:

- (i) As M/s Shiv Sahai & Sons expected that Rupee will appreciate, the forward cover was kept open.
- (ii) Volume of bullion transactions at RO, Chennai were on a large scale and hence it was not possible to settle on transaction to transaction basis.
- (iii) Bullion Trading System (BTS) has been upgraded to incorporate Buyer's Credit and SBLC with effect from 04 July 2012.
- (iv) In the Bullion Trade, there have been the cases of pending recoveries from the customers on account of lack of commercial prudence and delay in booking of accounting transactions, delay in reconciliation of bank account, non maintenance of proper record of financial securities (Fixed Deposits etc.), failure to seek periodical timely confirmation of balances from the customers, non accounting of interest and other expenses recoverable from the customers, recovery of TDS from the customers, wrong refunds to the customers, misuse of suspense accounts to manipulate vendor accounts which could not be pointed out by professional Internal Auditors (CA) and Statutory Auditors.

Reply of the Management was not acceptable in view of the following:

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\* Interest @ 10 per cent

- (i) Keeping FERC open was in violation of the specific instructions mandating compulsory FERC requirement issued on 10 March 2008.
- (ii) The contention of the Management that it was not possible to settle on transaction to transaction basis was not acceptable as it is contrary to company's own specific instructions dated 18 December 2006 which required that each transaction be treated as separate and carry forward of balances be avoided. It further stipulated that any release of bullion to any of the customers was to be made only when the party account was fully reconciled and should be upto date.
- (iii) The changes effected in Bullion Trading System will be assessed in future only. The fact, however, remains that Company sustained losses due to poor internal controls.
- (iv) The reply was silent on the reasons due to which Corporate Office failed to monitor and implement the norms/principles of accounting. The primary responsibility of ensuring adherence to bullion drill and internal orders and preparation of true and fair financial statements was that of the Management/Corporate Office of the Company. The company also did not provide any reason for transferring unclassified/ unlinked entries from suspense account to vendors account.

Thus failure in adherence by RO, Chennai to the instructions on bullion trading, camouflaged accounting and ineffective internal control resulted in non-realization of dues of ₹ 99.82 crore and avoidable loss of ₹ 38.56 crore (till December 2012) towards interest to the Company.

#### **Regional Office, Hyderabad**

Audit test checked the transactions of Regional Office (RO), Hyderabad, in March 2012 covering the period from 2010-2011 and 2011-12 (upto November 2011) and it was revealed that in case of one of the customers viz. M/s MBS, the Company kept forward cover open without taking additional security, in contravention of provisions of Bullion Drill and instructions mentioned above. Audit further noticed that shortfall in the amount of security given by M/s MBS increased from ₹ 19.04 crore in 2010-11 to ₹ 72 crore in November 2011. Despite bringing out the above position by Audit to the notice of the Management of RO, Hyderabad in March 2012 and the Corporate Office in April 2012, the Company did not take any effective steps to makeup the deficient security from the customer and continued bullion trading with M/s MBS.

Audit further observed that during January 2012 the Corporate Office (CO) procured from its supplier viz. Standard Chartered Bank (SCB) 500 kg gold valued at USD 2,55,35,400 (in two tranches of 250 kg each on 11<sup>th</sup> and 13<sup>th</sup> January 2012) on loan for 90 days repayable on 10 and 11 April, 2012. This bullion was issued by RO, Hyderabad to M/s MBS group for a value of ₹ 142.10 crore in contravention to the provisions of Bullion Drill and circulars issued from time to time on trading of bullion; the bullion was delivered without adequate security from M/s MBS, no FERC was taken to hedge against foreign currency rate fluctuations and quantity restriction of 200 kg per customer was flouted.

While the said quantity of 500 KG Gold was handed over to M/s MBS in January 2012, the payment for the same was not received on due dates i.e. 10 and 11 April, 2012. To

meet the obligation for repayment of loan to SCB on due dates, the RO requested CO to transfer funds amounting to ₹ 140 crore. Though the said amount was transferred from CO to RO, Hyderabad on the due date of remittance of loan in April 2012, yet RO Hyderabad repaid the loan by utilizing receipts from cash sales made to various other parties mainly M/s Chanda Anjaiah Parmeshwar and fresh Buyer's Credit (BC) was taken against those cash sales. Till March 2013, an amount of ₹196.17 crore approximately remained unrealised from M/s MBS towards loss on forward cover kept open, interest and bank/miscellaneous charges not booked to MBS and outstanding exposure shown as on 31 March 2012. The status of recovery of ₹ 196.17 crore from M/s MBS Group was not made available to Audit.

The Management while reiterating the facts of the case stated (March 2013) that as per request (April 2012) of the RO, Hyderabad seeking fund of ₹ 40 crore for making remittance to the foreign supplier and Buyers Credit liabilities due on 11 and 18 April 2012 the matter was examined at CO. As per details given by RO, Hyderabad, against the total liability of ₹ 210 crore, financial security of ₹ 167 crore was available with an exposure of ₹ 43 crore in respect of M/s MBS Group. Under the circumstances, CO had no option but to transfer the required funds to effect the remittance as not doing so would have irreparably damaged the credibility of the Company, as there had never been any instance of delay or default in payment to the foreign bullion suppliers. It was further stated that matter was under Audit by M/s KPMG and the Final Report was awaited.

Management's reply tantamounts to acceptance of non adherence to the instructions on bullion trading, camouflaged accounting and ineffective internal control in the Company which resulted in non-realization of dues of ₹ 196.17 crore from M/s MBS and avoidable loss of ₹ 14.71crore<sup>1</sup> (till December 2012), towards interest thereon to MMTC Ltd.

The above cases points to the utter failure of the Corporate Office and higher Management of MMTC to monitor and control the actions of its Regional Offices. The fact that such improprieties were allowed to flourish for years together, in spite of warning signs such as un reconciled bank accounts, is a telling comment on the quality of Corporate Governance in the Company. The Ministry of Commerce needs to take serious note of the transactions and prevent failure of the control mechanism in the Company.

The matter in case of RO Chennai and RO Hyderabad was reported to Ministry in October 2012 and March 2013, respectively; their reply was awaited (March 2013).

## ***5.2 Imprudent investment in Joint Venture with M/s Indiabulls Financial Services***

**Guidelines of Forward Market Commission<sup>2</sup> issued in May 2008 (ahead of incorporation of the JV) had negated the main premise on which investment by the Company in the JV was considered viable. The Company did not revisit its decision of equity participation in the JV. Resultantly funds of ₹ 26 crore were blocked in the loss making venture.**

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<sup>1</sup> Interest @10 per cent for nine months from April 2012 to December 2012.

<sup>2</sup> A Regulatory Authority set up in 1953 under the Forward Contracts (Regulation) Act, 1952.

M/s India Bulls Financial Services Limited (IBFSL)\* approached (June 2007) MMTC Limited (the Company) with a proposal to become strategic partner in an International Commodity Exchange proposed to be set up for Spot and Future markets that would target commodities such as agro products, industrial metals & minerals, bullion and precious metals and energy (gas and crude). The proposal envisaged incorporation of a Joint Venture with an equity capital of ₹ 100 crore to which IBFSL and MMTC were to contribute ₹ 74 crore and ₹ 26 crore, respectively.

The Company in response requested (June 2007) IBFSL to get the Detailed Project Report (DPR) and Feasibility Study prepared by reputed consultant like Price Waterhouse Coopers (PWC), SBI Capital etc. The IBFSL engaged M/s PWC accordingly. The Board of Directors of the Company considered the feasibility report prepared by PWC in its 350<sup>th</sup> meeting held on 07 September 2007. The Board approved the proposal to invest ₹ 26 crore, subject to approval by the Government of India, for acquiring equity shares of Special Purpose Vehicle being created by IBFSL.

The advantages enumerated by the Company while seeking (September 2007) approval of the Ministry of Commerce and Industry (MoCI), to the above proposal, *interalia*, included:

- MMTC would be able to trade in existing products such as gold, silver and agricultural commodities in the exchange and a turnover of minimum of ₹ 500 crore per year was expected. The Company could also trade in commodities of its interest such as iron ore and coal.
- The Company would be given 'most favoured customer' rates and treatment in the exchange and would be made a member without payment, which in turn would bring down its costs of hedging/commodity trading considerably.
- Selected warehouses of the Company would be declared designated warehouses.
- Tie up with quality assurance services would help the Company to procure commodities of the requisite standards / specifications.

MoCI approved (October 2007) the proposal for equity participation by the Company.

Accordingly, on 18 August 2008 a JV in the name of International Multi Commodity Exchange Limited (IMCEL) was incorporated. A 'Shareholders Agreement' (SHA) was entered into on 12 February 2009 amongst the Company, IBFSL and IMCEL. The Company invested ₹ 26 crore (in March and May 2009). IBFSL had 40 *per cent* stake in the JV while KRIBHCO, IDFC and Indian Potash and others held the balance 34 *per cent* of equity capital. The name of the JV was subsequently changed in July 2009 to Indian Commodity Exchange Limited (ICEX). The Department of Consumer Affairs, Ministry of Consumer Affairs, Food & Public Distribution (MoCA F&PD) granted recognition to ICEX on 9 October 2009 and ICEX started its operations on 27 November 2009. The ICEX did not show profit since its creation and it had accumulated losses of ₹ 63.50 crore as of 31 March 2012.

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\* *A retail financial services company in the business of consumer loans, commercial vehicle loans, home loans, brokerage and depositary services, for equities and commodities, distribution of mutual funds and other third party products.*

In the meantime, the regulatory authority viz. Forward Markets Commission (FMC) issued (May 2008) 'Guidelines for recognition of new National Commodity Exchange'. Para 5.2 of the said guidelines stipulated that "the proposed exchange shall have a demutualised structure i.e. the share holders of the Exchange shall not have any trading interest either as a trading member or client at the Exchange."

Audit observed that the above guidelines of FMC were issued much ahead of incorporation of the JV and had negated the main premise on which the investment by the Company in the JV was considered viable. The Management, however, did not revisit its decision of equity participation in the JV in the changed scenario.

It was further observed that as per the SHA and the revised guidelines issued by FMC on 17 June 2010, equity investment in the commodity exchange was subject to a lock in period of three years, which could be relaxed by one year by the FMC in exceptional circumstances. As such the minimum lock in period for an equity investor was two years.

Disregarding the provisions of lock in period, IBFSL on 2 August 2010 proposed to the Company to induct M/s. Reliance Exchangenext (R-NEXT) with 26 *per cent* stake in ICEX as Anchor Investor\* with MMTC Limited and IBFSL each divesting 15 *per cent* and 11 *per cent* of their equity for a total consideration of ₹ 47.35 crore (₹ 9.10 for each share of ₹ 5). On 19 August 2010, IBFSL gave Right of First Refusal to the Company whereby IBFSL offered its 26 *per cent* holding in ICEX to MMTC Limited on the same terms and conditions as offered to R-Next. The Company was to reply within 30 days. After receiving the offer from IBFSL, MMTC Limited engaged M/s IDBI Capital Market Services Limited to value the shares of the exchange and asked IBFSL to grant time till 05 October 2010 for taking a decision. In any case as per the SHA, MMTC had time till 2 November 2010 to respond to the first offer and till 19 November 2010 to the ROFR offer.

Again, in blatant violation of the SHA and FMC guidelines, 15 months before the completion of mandatory lock in period, an application was made by ICEX on 27/31 August 2010 to the FMC to transfer the stake of IBFSL to R-NEXT. The FMC, within 4 working days vide letter dated 6 September 2010, forwarded the application to the Department of Consumer Affairs, MoCA F&PD, for its approval.

The Department of Consumer Affairs, MoCA F&PD, showing unusual alacrity, within a period of 12 working days (including time taken for delivery of correspondence), in turn accorded approval to induct R-next into ICEX and informed FMC of its approval vide letter dated 23 September 2010. This enabled IBFSL to transfer 26 *per cent* equity to R-NEXT on 13 December 2010, i.e., within just 13 months of recognition of the Commodity Exchange.

As the Company could have accepted the offer of IBFSL and partly divested its equity till 2 November 2010, the hasty decision of the Department of Consumer Affairs, MoCA F&PD to relax the lock in period denied the Company the opportunity of taking a decision to partly divest its holding in ICEX.

The Management in its reply (March 2013) reiterated the facts of the case and stated that the revised guidelines of FMC were informed to the Board of Directors in its 358<sup>th</sup> meeting held on 23 July 2008.

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\* *Anchor Investor is an investor who plays the lead role in managing a National Commodity Exchange.*

The above reply was not acceptable because despite being aware of the revised guidelines of FMC, before incorporation of the JV, the Management did not revisit its decision which resulted in blocking of ₹ 26 crore in an unfruitful venture. The hasty decision of the Department of Consumer Affairs, MoCA F&PD also denied the Company an opportunity to dilute its investment in the venture.

The matter was reported to the Ministry in March 2013; their reply was awaited (March 2013).