Chapter-I
Introduction

Procurement of food grains is one of the important elements for implementation of Food Management Policy of the Government of India (GoI) and for catering to the need of public consumption of food grains in the country. For procurement, movement and storage of food grains such as paddy/rice and wheat in the country at large scale, the GoI incorporated Food Corporation of India (FCI) in 1964. FCI, in coordination with the Ministry of Consumer Affairs, Food & Public Distribution, Department of Food & Public Distribution at Central level and State Governments and State Government Agencies (SGAs) at State level carries out the procurement operations of paddy/ rice as an integral part of the food grains management operations.

1.1 Food Grains Procurement Policy

The Food Grains Procurement Policy of the GoI has the following objectives:-

a) To meet the requirement of Targeted Public Distribution System (TPDS) and Other Welfare Schemes (OWS) of the Government, so that the subsidized food grains are supplied to the poor and needy;

b) To ensure that farmers get remunerative prices for their produce; and

c) To build up buffer stock of food grains to ensure food security.

To meet these objectives, the Government of India procures wheat and paddy/rice every year through Food Corporation of India (FCI) and State Governments/SGAs at Minimum Support Price (MSP). Apart from procuring paddy directly from the farmers and getting it milled to convert it into rice, a substantial quantity is procured through rice millers in the form of levy, whereby rice millers procure paddy directly from the farmers, convert it into rice and deliver the same to FCI and State Governments/SGAs.

1.2 Food Corporation of India (FCI)

FCI works under the administrative supervision and control of the Ministry of Consumer Affairs, Food & Public Distribution, Department of Food & Public Distribution (hereafter referred to as the Ministry) which is responsible for implementation of the national food security system.

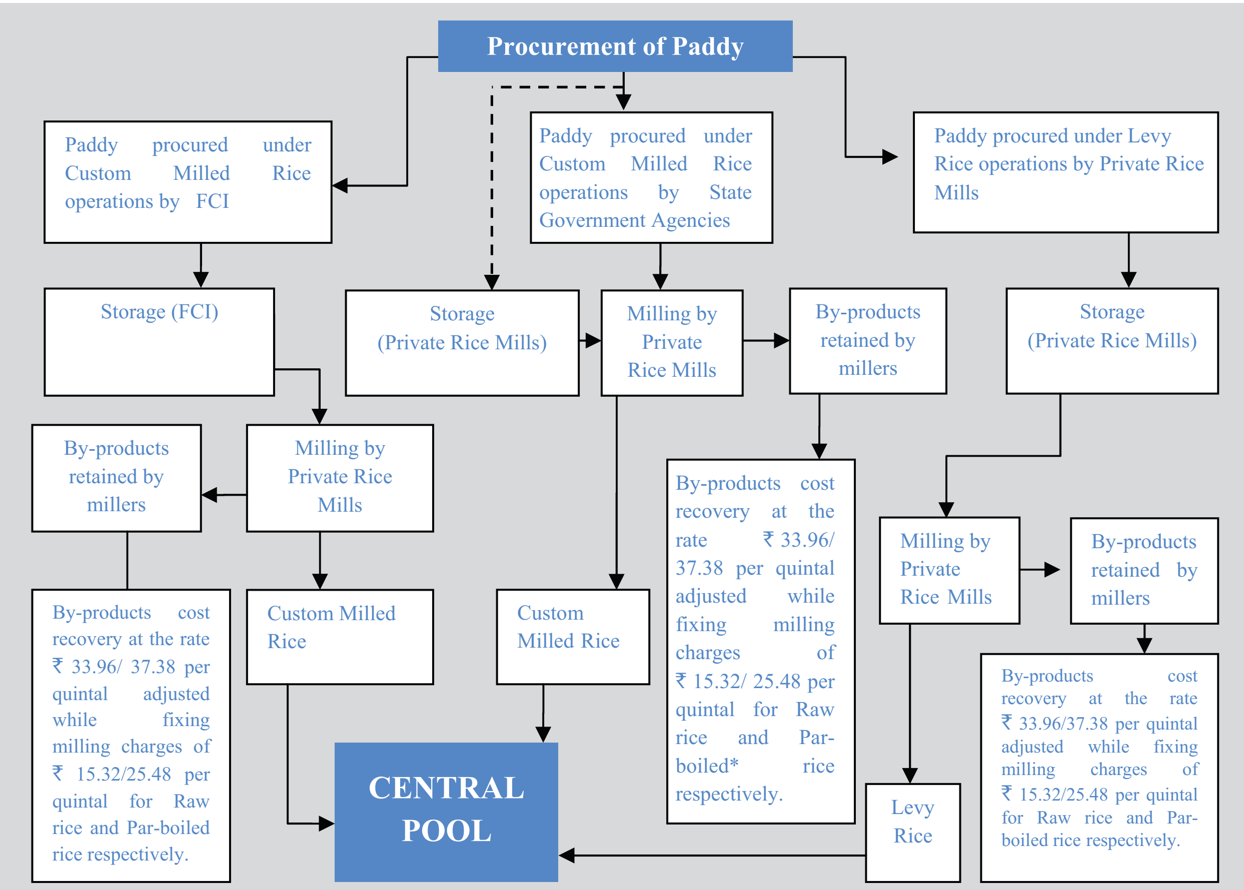
The affairs of FCI are managed by a Board of Directors headed by Chairman & Managing Director along with two Directors representing the Ministry of Consumer Affairs, Food and Public Distribution, one Director from the Ministry of Agriculture & Co-operation, one *ex-officio* Director (Managing Director of Central Warehousing Corporation) and non official

Directors. Its functions are managed through country-wide network of offices with headquarters at New Delhi with five Zonal offices, 24 Regional offices, 168 District offices and one Port office at Adipur (Kutch), Gujarat. The main operations of FCI comprises of Procurement of food grains, Storage of food grains, Movement of food grains and Distribution and sale of food grains.

1.3 Operational framework for procurement of paddy and delivery of rice

The Government has built up an elaborate administrative mechanism for implementation of the Food Management Policy. The Ministry of Agriculture and the Ministry of Consumer Affairs, Food and Public Distribution formulates and implements the Food Management Policy of the Government of India. The Ministry of Agriculture is responsible for formulation of national policies and programmes relating to prices of agricultural products. The formulation and implementation of national policies relating to procurement, management, storage and distribution of food grains, TPDS, maintaining of buffer stock, export and import, quality control and specifications of food grains, administration of subsidies on food grains etc. are handled by the Ministry.

A flow chart depicting various stages from procurement of paddy to delivery of rice to FCI/State Government/SGAs is shown below:



* *Paddy soaked in water and steamed in mild steel cylindrical parboiling tank and dried in dryer before milling*

The main components of the Food Management Policy are explained below:

Minimum Support Price (MSP)

Based on the recommendations of the Commission of Agricultural Costs and Prices (CACP)[2], views of the State Governments and various Central Ministries, the GoI fixes MSP for different food grains every year to protect interest of the farmers.

Economic cost of food grains

It is the aggregate of acquisition cost of food grains including procurement incidentals, administrative overheads, handlings and shortages etc.

Procurement Incidentals

Expenses incurred by FCI from procurement to the stage of receipt in the first storage point are classified as the procurement incidental charges. These expenses are incidentals on direct procurement of paddy and rice procurement from millers and SGAs and comprise of statutory expenses like *mandi*[3] charges, Purchase tax/Value Added Tax (VAT) and non-statutory charges like *Mandi* Labour Charges (MLC), Custody and Maintenance (C&M) charges etc.

Targeted Public Distribution System (TPDS)

Under this system, the States are required to formulate and implement foolproof arrangements for identification of poor, for delivery of food grains to Fair Price Shops (FPS) and for their distribution in a transparent and accountable manner at the FPS level.

Central Issue Price (CIP)

Wheat and rice are issued from the Central Pool to the State Governments/Union Territories administrations at the CIP for distribution. The CIP is fixed below their economic cost.

After streamlining and restructuring of the Public Distribution System (PDS) with focus on the poor (the Targeted PDS), two different CIPs are fixed, one for the families Below Poverty Line (BPL) and the other for Above Poverty Line (APL). The Central Government bears the subsidy burden on this account, especially for making available food grains at subsidised rates to the BPL category.

Buffer Stock Policy

Food stocks are maintained by the GoI: i). to meet the prescribed minimum Buffer Stock norms for food security; ii). for monthly releases of food grains for supply through the PDS/TPDS/Welfare schemes; iii). to meet emergent situations arising out of unexpected crop failure, natural disasters etc.; and iv). for market interventions to augment supply so as to help moderate the open market prices.

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[2] *CACP submits its recommendations to the Government in the form of Price Policy Reports every year, separately for five groups of commodities namely Kharif crops, Rabi crops, Sugarcane, Raw Jute and Copra.*

[3] *The market place notified by the State Government/FCI where food grains are brought by farmers for sale.*

The Central Pool stock is maintained by FCI, the State Governments and SGAs. Wheat, paddy and coarse grain are procured at the purchase centres opened in the surplus States by FCI/SGAs. The stock procured by the State Governments/SGAs is taken over by FCI on payment of MSP and incidental charges. A certain percentage of paddy milled by millers and resultant rice[4] produced has to be handed over to FCI under the Levy Orders issued by the State Governments under the Essential Commodities Act, 1955. The percentage of rice to be delivered under Levy orders varies from State to State.

1.4 Procurement of paddy for the Central Pool

Under the existing Procurement Policy of the GoI, paddy for the Central Pool is procured by various agencies such as FCI, SGAs and private rice millers. Procurement for the Central Pool is carried out on open ended[5] basis at MSP fixed by the GoI. Paddy procured by the State Governments falling under Decentralised Procurement (DCP) scheme is also part of the Central Pool. Under this scheme, the DCP States/UT[6] procure, store and directly distribute food grains, including Levy Rice, towards TPDS and OWS. Any surplus stock over their requirements is taken over by FCI for the Central Pool. In case of any shortfall in procurement against allocation made by the GoI for distribution to TPDS, FCI meets the deficit out of the Central Pool.

Custom milling of procured paddy

The paddy procured for the Central Pool by FCI, State Governments and SGAs and private rice millers, based on MSP, is milled in rice mills. This activity is called custom milling of paddy[7]. Custom milling of paddy by Government/private rice millers results in conversion of paddy into rice (called resultant rice) and delivery of this rice to FCI on payment of specified milling charges. Milling of paddy under the present arrangement is for paddy procured for the Central Pool through CMR and Levy route.

- **Custom Milled Rice (CMR) -** During Rabi/Kharif Marketing Seasons (RMS/KMS[8]) every year, FCI along with SGAs, Co-operative Societies etc. procures paddy directly from the *mandis*/procurement centres which is got converted into rice through rice millers and the resultant rice (which is known as CMR) is delivered to FCI. The paddy procured by FCI is first transported to its godowns from where the same is issued to millers for conversion of the same into rice. In this arrangement, rice is to be received by FCI in advance from the miller before giving paddy to rice millers for milling. In the case of

[4] *Rice obtained from milling of paddy.*

[5] *There is no upper ceiling on procurement; whatever is brought to the mandis by the farmers is to be procured by FCI/SGAs.*

[6] *Andaman & Nicobar Islands, Chhattisgarh, Karnataka, Kerala, Madhya Pradesh, Odisha, Tamil Nadu, Uttrakhand, and West Bengal.*

[7] *Removal of husk and the bran layers, and production of edible, white rice kernel that is sufficiently milled and free of impurities.*

[8] *Rabi crops are sown in winter from October to December and harvested in summer from April to June. Kharif crops are grown with the onset of monsoon in different parts of the country and these are harvested in September-October. In most of the southern States paddy is sown in both the seasons as against the northern states (Punjab, Haryana etc.) where wheat is a major crop in the Rabi season.*

paddy procured by SGAs, the same is generally moved directly from *mandis* to the millers' premises for milling and the resultant rice is delivered directly to FCI. In a few cases, paddy procured by the SGAs is first stored in their own godowns and from there the paddy is issued for milling to private rice millers.

- **Levy Rice –** Paddy procured directly from the farmers and milled by rice millers under Levy orders and the resultant specified percentage of rice delivered to FCI is called Levy Rice. This is carried out under the statutory levy system wherein the State Governments, in exercise of powers conferred by the Essential Commodities Act, 1955, issue levy orders in consultation with the GoI, directing the private rice millers/dealers to deliver a specified percentage of the resultant rice (from paddy procured by them directly from the farmers) to FCI for the Central Pool.

The production, *mandi* arrival and procurement of paddy during 2009-10 to 2013-14 were as under:

Table 1.1
Production, *mandi* arrival and procurement of paddy (in terms of rice)*

(Lakh Metric Tonne - LMT)

Year	Production of paddy in India	*Mandi* arrival of paddy	Procurement*			
			FCI	SGAs	Total	Levy Rice (Included in Total)
2009-10	890.90	346.39	101.73	218.61	320.34	112.64
2010-11	959.80	363.81	119.70	222.09	341.79	116.05
2011-12	1043.20	375.20	91.10	259.31	350.41	97.85
2012-13	1030.00	403.34	70.33	270.11	340.44	80.44
2013-14	1061.90	399.32	60.30	261.30	321.60	80.07

**Paddy is converted into rice at the out-turn ratio of 67 per cent; accordingly, the figures for paddy are based on this conversion ratio.*

Source: Annual Report of the Ministry of Agriculture, Annual Report of the Ministry and FCI Procurement Division

As can be seen from Table 1.1, procurement by FCI is showing a decreasing trend over the years. Under the current procurement framework, rice obtained through the direct purchase of paddy by FCI costs less because of comparatively lower incidentals as against rice received by it through SGAs under CMR operations. Thus, decreasing procurement by FCI translates into additional expenditure on overall rice procurement and supply resulting in higher subsidy burden on the GoI.

1.5 Food Subsidy

Food subsidy is provided in the budget of the Ministry to meet the difference between economic cost of food grains and their sales realization at Central Issue Prices (CIPs) for

TPDS and OWS. In addition, the Central Government also procures food grains for meeting the requirements of buffer stock for which carrying cost[9] is also reimbursed by the GoI as part of subsidy.

The Government notified the National Food Security Act, 2013 on 10 September 2013 with the objective of providing food and nutritional security by ensuring access to adequate quantity of quality food at affordable prices to people to live with dignity. The Act provides for coverage of up to 75 *per cent* of the rural population and up to 50 *per cent* of the urban population for receiving subsidized food grains under TPDS, thus covering about two-thirds of the population.

Reimbursement of Subsidy

The Central Government undertakes to reimburse the entire expenditure incurred by the State Governments/SGAs on the procurement operations undertaken on behalf of it, as per the approved costing Principles[10].

The subsidy is provided to FCI, which is the main instrument of the GoI for procurement and distribution of wheat and rice under TPDS and other welfare schemes and for maintaining the buffer stock of food grains as a measure of food security. The GoI determines State specific economic cost under DCP scheme and the difference between the economic cost so fixed and the CIP is passed on to the respective State as food subsidy.

Under the existing system of release of food subsidy to the State Governments, the Ministry issues provisional cost sheets indicating various incidentals to be paid to the SGAs (Millers in case of Levy Rice) before each marketing season, after receiving proposals from all the States in respect of CMR and Levy Rice.

The State Governments/SGAs procure food grains for Central Pool, which is either delivered to FCI or used for their own PDS requirements under the DCP scheme. Therefore, separate cost sheets are worked out for the food grains to be delivered to FCI, and retained by the State Governments for distribution under DCP scheme.

The State Governments/SGAs prefer their claims to FCI on the basis of provisional cost sheets in respect of delivery/off take for Central Pool operations. For DCP operations, the SGAs submit their quarterly claims to the Ministry. Since the cost sheets are provisional and subject to finalization based on the audited accounts and there is always a time-lag in finalization of accounts in the States, quarterly subsidy is released on provisional basis after deducting five *per cent* on the amount claimed. In addition to the provisional subsidy after the end of the quarter, 90 *per cent* of the estimated subsidy for the next quarter is also paid in advance as ‘advance subsidy’. The advance subsidy is adjusted from the claim of the States made during the subsequent quarter. After finalization and submission of the accounts by SGAs, the cost sheets are finalised by the GoI and provisional subsidy, already released to the

[9] *Includes storage cost, maintenance, insurance etc., less opportunity costs and losses.*

[10] *Issued by the GoI in 2003 for finalization of cost of procurement incidentals.*

State Governments is adjusted from the final claims of the State and the differences are to be paid/recovered appropriately. Under the system, therefore, all the actual costs incurred by the States on the operations carried out on behalf of FCI are reimbursed by the GoI.

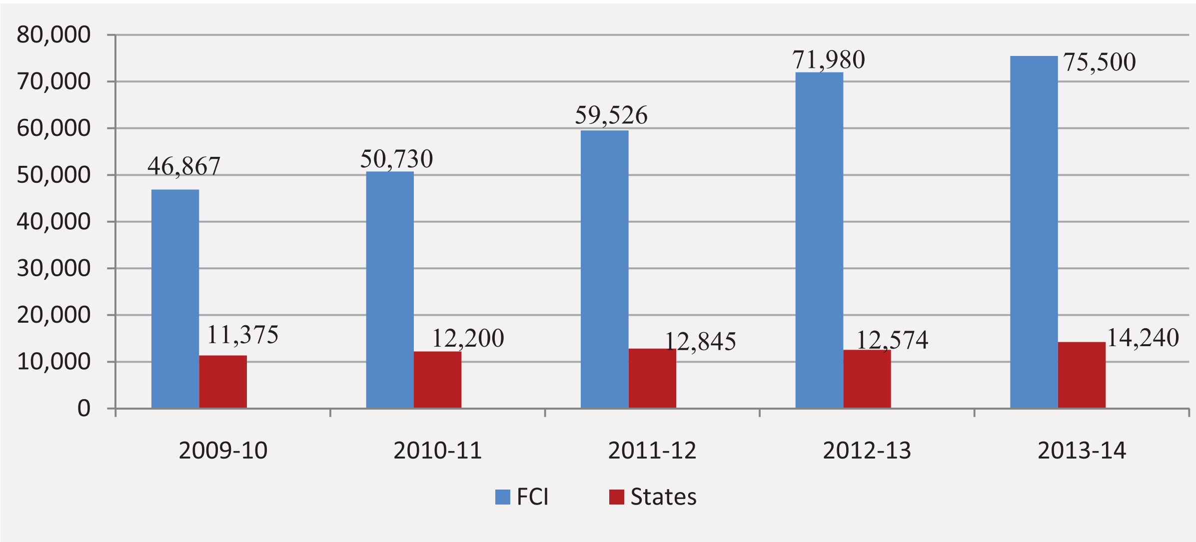
Similar system for payment of subsidy is applicable for FCI wherein it prefers quarterly claims in respect of consumer subsidy i.e. the difference between the economic cost and sales value of the food grains meant for distribution under PDS. In addition, subsidy is also paid in respect of the cost incurred in carrying the Buffer Stock as per the existing guidelines. The provisional claims are finalised based on the audited accounts of FCI.

It was observed in audit that procurement incidentals of Andhra Pradesh and Telangana, Chhattisgarh, Haryana, Odisha, Punjab and Uttar Pradesh had been finalised only till 2008-09 (Andhra Pradesh and Telangana), 2007-08, 2011-12, 2004-05, 2008-09 and 2006-07 respectively. Moreover, the accounts of Bihar are awaited since 2000.

The year-wise break-up of subsidy released for distribution of subsidized food grains (Wheat, Rice and Coarse grains) and maintenance of buffer stocks during the last five years to FCI and the States operating the DCP scheme is as under:

Chart 1.1
Food subsidy released by the GoI to FCI/SGAs

(₹ in crore)



Source: Annual Report of the Ministry

As is evident from the above chart, the food subsidy outgo has shown a continuous rise over the last five years and it stood at ₹ 89,740 crore as on 31 March 2014.

1.6 Rationale of Audit

The GoI spends huge amount of money for supply of rice under TPDS. As indicated in chart 1.1, the food subsidy burden stood at ₹ 89,740 crore as of 31 March 2014. The milling charges were fixed by the GoI long back in 2005, on the basis of recommendations of the Tariff Commission of India and since then the milling charges have not been revised. However the rice millers are still carrying out the milling operations at milling charges fixed in 2005, without any demand for increase in the milling charges even though the cost of milling has increased significantly. The selling price of the by-products i.e. rice bran, broken rice and husk generated in the milling process, has increased substantially. There were also concerns regarding payment of Minimum Support Price (MSP) to farmers, revision of milling charges for paddy and non-delivery of rice. Accordingly, this Performance Audit was conducted to examine such issues along with the effectiveness of monitoring and control processes at various stages.

1.7 Audit Objectives

The performance audit was conducted to evaluate whether:

- the rates of various incidentals, including milling charges, in the cost sheet were fixed in a transparent and economical manner;
- the system of selection of millers was sound, linkage of *mandis* with rice mills was economical and allocation of paddy to rice millers was carried out efficiently;
- the system of ensuring quality and quantity of paddy/rice procured for Central Pool was effectively implemented;
- the terms and conditions of Milling Agreements/Levy Orders were duly complied with; and
- the monitoring and review mechanism for procurement of paddy, storage, milling and up to the stage of delivery of rice is adequate and effectively operationalised.

1.8 Scope of Audit

The present performance audit broadly covers the following areas:

- Compliance with instructions of the GoI while procuring paddy/rice, allotment of paddy and linking of rice mills;
- Issue of paddy to rice millers and its storage;
- Custom milling and delivery of rice to FCI/SGAs;
- Accounting of paddy received/stored and rice issued; and
- Compliance with various regulatory requirements by the rice millers.

Storage and movement of food grains operations of FCI were covered in Performance Audit on ‘Storage Management and Movement of Food grains in Food Corporation of India’ printed in Report No. 7 of 2013 of the C&AG of India.

1.9 Audit Criteria

The performance was assessed against the criteria drawn from the following:

- The GoI instructions/guidelines, State Government orders, Operational guidelines of SGAs;
- Custom Milling Agreement entered into by FCI/SGAs with rice millers;
- Levy Orders of the respective States;
- Returns/Stock accounts of paddy procured, milled and rice delivered etc.; and
- Relevant records of FCI, concerned State Public Sector Undertakings (PSUs), Food & Civil Supplies Departments, SGAs, Co-operative Societies, and other concerned Departments (e.g. Land Revenue and Transport) of the States.

1.10 Audit Methodology

After a preliminary study and collection of background information, an Entry Conference (16 May 2014) was held with the Ministry/FCI Management wherein the scope, objective and methodology of audit were discussed and the audit criteria were agreed upon. Field audit was conducted during May 2014 to December 2014 in case of non DCP States[11] and September 2014 to January 2015 in case of DCP States[12].

The performance audit was carried out in the States of Andhra Pradesh, Bihar, Chhattisgarh, Haryana, Odisha, Punjab, Telangana, and Uttar Pradesh (these States accounted for approximately 95 *per cent* of the total procurement of paddy in 2012-13) by selecting a sample of 20 to 25 *per cent* of their districts[13] (in different States) on the basis of procurement of paddy during 2009-10 to 2012-13. As much as 17 to 25 *per cent* of rice mills (in different States) were considered for detailed examination in these selected States. Further, the States of Chhattisgarh and Odisha were selected being Decentralized Procurement States (DCP) for rice, wherein 25 *per cent* of districts and 10 *per cent* of mills were selected for detailed examination. ***(Annexure-I)***

Besides examination of records for the selected States' authorities and FCI offices, the relevant records of the Ministry of Consumer Affairs, Food & Public Distribution, Department of Food & Public Distribution for the five year period from 2009-10 to 2013-14 were also examined.

The Draft Report was issued to the Ministry on 22 June 2015. The Ministry communicated its response vide letters dated 24 June 2015. The Exit Conference with the Ministry/FCI was

[11] *Andhra Pradesh, Bihar, Haryana, Punjab, Telangana and Uttar Pradesh*

[12] *Chhattisgarh and Odisha*

[13] *including respective FCI Regional/Area Offices*

held on 25 June 2015 at Krishi Bhawan, New Delhi, wherein the audit findings and recommendations were discussed.

1.11 Acknowledgement

Audit acknowledges and appreciates the co-operation and assistance extended by the Ministry, State Governments of Andhra Pradesh, Bihar, Chhattisgarh, Haryana, Odisha, Punjab, Telangana, and Uttar Pradesh and the Management of FCI at various stages of the performance audit. Audit also expresses its appreciation for the promptitude displayed by the Ministry in offering its specific replies to the audit observations and responses to the recommendations made by Audit in the Report.