Chapter II : Accounts of co-operative sugar factories

As per Rule 61 of the MCS Rules, 1961, the annual accounts are required to be prepared by the CSFs within 45 days from the end of the financial year. As per Section 81 of the MCS Act, the Commissioner, as Registrar, is responsible for audit of the accounts at least once in each year.

2.1 Accounts of CSFs

Financial statements are the final product of the financial accounting process. The accounts of the CSFs are required to be prepared as per Form N of Rule 62 of the MCS Rules, 1961 and audit of the same is conducted by the statutory auditors. As per Form N, it is mandatory for the CSFs to make the following disclosures:-

Disclosure of material facts, as required under MCS Act and the Generally Acceptable Accounting Principles, was not made in the Financial Statements of the CSFs

- the mode of valuation of the investment;
- the mode of valuation of stock of raw material and finished goods;
- contingent liabilities, which have not been provided for and statutory disputes and amounts involved in them;
- the method of providing depreciation.

None of the 22 working CSFs test-checked had made the above disclosures in their accounts.

Besides, the following material facts, required to be disclosed as per Generally Accepted Accounting Principles, were also not disclosed by the 22 test-checked working CSFs:-

- the fact of acknowledgement of debtors and creditors to avoid over-statement or under-statement along with age-wise analysis;
- retirement benefits, particularly gratuity liabilities as on the balance sheet dates, on the basis of actuarial valuation;
- the dates up to which assessment of income-tax, sales tax and purchase tax had been completed.

Thus, the certificates issued by the Statutory Auditors to the effect that the accounts depicted a true and fair picture of the state of affairs of the CSFs, as envisaged in the MCS Act and the Generally Accepted Accounting Principles, were not proper.

2.1.1 Preparation of Accounts

As per Rule 61 of the MCS Rules and Section 75 of the MCS Act, the annual accounts are required to be prepared by the CSFs within 45 days from the end of the financial year. The accounts so prepared are required to be placed before the annual general meeting (AGM) of the members within three months along with the audit report, to enable the members to know the working of the co-operative factories.

The annual accounts were not prepared within the due dates and the delays ranged from five to 19 months. One important reason cited by the CSFs was that as the Ministers' Committee finalised the cost of the closing stock only between August and October every year, the accounts could be finalised only after that. Due to delays in finalisation of the accounts, there were further delays in conducting statutory audits.

Government had been granting permission to postpone holding of AGMs frequently. During 2001-06, extensions were given in 28 cases for periods ranging from six months to two years, on grounds of non-conducting of audit, prolonged crushing periods and prevailing drought conditions. Government stated (January 2008) that it had granted extensions under Section 157 of the Act by which the State Government could exempt the CSFs from any of the provisions of the Act. The reply was not tenable because the reasons cited by the CSFs did not warrant postponements in holding of AGMs for such long periods. Further as per the Generally Accepted Accounting Principles, the current assets including stock in trade and work in progress are to be valued at cost or market price, whichever is lower.

2.1.2 Provisions for bad and doubtful debts

Provisions for bad and doubtful debts of Rs 44.07 crore were not made by 20 CSFs

The CSFs in operation obtained secured and unsecured loans on Government guarantees from financial institutions against pledges of sugar and molasses at interest rates ranging from 11.50 *per cent* to 14.50 *per cent*. From these loans, temporary advances were paid to contractors, suppliers, harvesting and transport (H&T) contractors, sugar cane suppliers, staff and others. According to the balance sheets for the year ending 31 March 2006, the receivable amounts in respect of the 22 working CSFs test-checked were Rs 322.35 crore (advances: Rs 125.85 crore and other receivables: Rs 196.50 crore). As per instructions issued (March 2005) by the Commissioner, the CSFs were required to make provisions for bad and doubtful debts at 20 *per cent* for dues outstanding for more than one year, at 50 *per cent* for two to three years and at 100 *per cent* for periods above three years.

However, 20 out of the 22 test-checked working CSFs did not make any provision for bad and doubtful debts for amounts totalling Rs 44.07 crore though the advances and other receivables were outstanding for more than one year. This resulted in understatement of losses of these CSFs. These advances were required to be adjusted in the same financial year or immediately after the crushing season. Of the amounts receivable, there were advances (out of loans raised) which were not settled for periods ranging from one to five years.

2.2 Financial position of the CSFs

2.2.1 Outstanding liabilities

In 22 CSFs outstanding dues as on 31 March 2006 were Rs 2658.65 crore

As per the MCS Act, the dues payable or likely to be payable are required to be cleared by the CSFs before closure of the financial year or provisions for the same are required to be made in the annual accounts before calculation of net profits.

The balance sheets for the year 2005-06 showed that all the 22 test-checked working CSFs had outstanding statutory dues aggregating Rs 2658.65 crore. These comprised Government dues (Rs 116.95 crore), Government loans (Rs 213.90 crore), National Co-operative Development Corporation (NCDC) loans (Rs 6.98 crore) members' cane bills (Rs 277.20 crore), other dues (creditors/suppliers) (Rs 497.96 crore), secured/unsecured loans (Rs 1416.40), SDF loans (Rs 62.97 crore) and recoveries effected from cane bills but not passed on to the financial institutions (Rs 66.29 crore). These dues were outstanding for periods ranging from two to five years.

Government stated (January 2008) that during the period 2001-06, the sugar industry was faced with various problems and the CSFs had not earned net surpluses. However, with the tagging of Rs 25 per quintal of sugar sold, for the settlement of Government dues for 2007-08, some part of the dues would be recovered. This was, however, a one time measure valid for one season only. Considering the production of 8.35 crore quintal of sugar during 2006-07, the percentage of Government dues including outstanding guaranteed loans, likely to be recovered by the tagging would be only 7.24 *per cent*[8].

2.2.2 Non-realisation of share capital due from the shareholders

Share capital amounting to Rs 164.41 crore was not realised from shareholders

The CSFs raise capital from sugar cane growers, Government, financial institutions and nominal members. Under Section 23 of the MCS Act, it is obligatory on the part of the CSFs to admit every eligible farmer applicant from their zones or areas of operations, as their members. For becoming members of CSFs, farmer applicants are required to pay Rs 5000[9] per share in a phased manner[10] within a year. In 22 test-checked working CSFs, a total amount of Rs 164.41 crore out of the value of the shares was not recovered from their shareholders. Raising their own share capital could have reduced the dependence of the CSFs on borrowed funds.

Government stated (January 2008) that the Ministers' Committee decided (August 2006) to allow the CSFs to make compulsory deductions from sugar

[8] (Rs 25 x 8.35 crore quintal x 100)/Rs 2883.87 crore (outstanding guarantees)=7.24 *per cent*

[9] Minimum amount of share capital for each farmer was Rs 2000 upto July 1992, Rs 3000 from July 1992 to April 2000 and Rs 5000 from April 2000 onwards.

[10] Rs 1250 is to be paid along with the application, Rs 2500 within one month from the date of intimation of enrolment as member and balance within one year from the date of allotment.

cane price bills to raise their share capital base. Further, under the NABARD package (April 2005) of restructuring of term loans, the CSFs were required to raise the level of their members' share capital. A Committee, at the level of NABARD, had been monitoring the compliance. However, the fact remains that in spite of these initiatives, the CSFs had not raised their own share capital base as discussed in paragraph 3.5.2.

Further, a sum of Rs 72.15 crore had been collected by 19 out of the 22 test-checked working CSFs for enrolling the farmers as shareholders upto March 2006. They were, however, not enrolled as shareholders on the plea that requisite documents had not been furnished by them. The amounts remained as share *'anamat'* (suspense) with the CSFs. The Commissioner did not issue any directions to the CSFs to clear the suspense amounts. As the Profit and Loss accounts of these CSFs showed losses, these amount might have been spent by the CSFs, which was irregular. Government stated (January 2008) that the sugar mills had been instructed to issue share certificates to the members after collecting the full amount of shares.

2.2.3 Provision of Capital Redemption Reserve Funds

Eight CSFs did not create capital redemption funds amounting to Rs 15.35 crore

As per the conditions governing the sanction of share capital by Government, CSFs are required to create capital redemption funds at one fifteenth of their share capital contribution every year and the same are to be invested to ensure repayment of Government dues within the due dates. Fifty *per cent* of Government share capital is to be redeemed within 10 years from the date of release of share capital and the balance within the next five years.

During 2001-02 to 2005-06, eight[11] CSFs did not create the required capital redemption funds, amounting to Rs 15.35 crore. As a result, three[12] CSFs had not redeemed Government share capital of Rs 4.60 crore which was due for redemption by March 2006.

The Government stated (January 2008) that the CSFs were being persuaded to make adequate provisions for their share capital redemption funds.

2.2.4 Reconciliation of cash book and pass book balances

Two CSFs did not reconcile differences between ledger and pass book balances, resulting in frauds amounting to Rs 13.26 crore

Reconciliation of cash book and pass book balances is to be verified by the statutory auditors and points on non-reconciliation, if any, are to be included in the audit reports. Niphad and Kadva CSFs had not carried out the reconciliation of the differences between the cash book and pass book balances. The Commissioner should have ensured reconciliation of the balances or got it done through third parties and recovered the costs from the CSFs as per Section 79 of the Act. This would have prevented occurrence of

[11]Adivasi, Navapur; Bhaurao Chavan, Nanded; Jai Bhavani, Beed; Kukadi, Ahmednagar; Nira Bhima, Pune; Rena, Latur; Samarth, Jalna and Vasant, Yavatmal
[12] Jai Bhavani, Beed; Sant Tukaram, Pune and Vasant, Yavatmal

frauds, or at least, helped in their early detection, as discussed in the following paragraph.

- As per directives (February 1982) of the Commissioner, the CSFs are to sell sugar only on receipt of the full cost of the sugar before its delivery. The Niphad CSF sold (till June 2005) sugar against cheques without confirming the encashment of the cheques from their bank. During November 2004 to April 2005, cheques valued at Rs 10.12 crore received from a sugar trader bounced, but the fact was not known to the CSF as reconciliation of the cash balance with the bank balance was not being done. The fraud was detected by the statutory auditor only in July 2007. Deviation from the prescribed procedure and non-reconciliation of the cash and bank balance resulted in non-detection of the fraud of Rs 10.12 crore in time and also in an avoidable loss of interest (Rs 3 crore) due to non-clearance of the outstanding balance of the pledge loan to be borne by the CSF.
- For purchase of sugar, traders had written (2004-05 and 2005-06) fake amounts on counterfoils of challans (Rs 3.14 crore) as proof of payments to the bank and submitted these counterfoils to the Kadva CSF. Based on these counterfoils, the staff of the sugar sales department of the Kadva CSF had advised the bank to release their pledged sugar[13] to the traders, without verifying the actual receipt of the amounts in their pledge[14] account. The fact of the fraud was detected only in July 2007 by the statutory auditor as reconciliation of cash and pass book balances had not been done by the CSF.

The Commissioner stated (January 2008) that FIRs against the concerned persons of Niphad and Kadva CSFs had been lodged (July 2007).

2.2.5 Maintenance of loan ledgers and Government dues registers

Position of outstanding loans, share capital and guarantee fees could not be ascertained as loan registers were not updated

According to the terms and conditions governing the sanction of Government loans and share capital, the Commissioner is responsible for maintaining loan ledgers, effecting recoveries of the loans and redemption of share capital on due dates and obtaining share certificates of the Government from the CSFs. These duties have been delegated to the RJDs with effect from 10 February 2005.

The loan registers had, however, not been updated after 1996-97 in the five RJD offices test-checked and therefore, the position of outstanding loans, share capital, Government guarantee fees etc could not be ascertained in audit.

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[13] The sugar of the CSF pledged to its lead bank against working capital loan (pledge loan) raised by it. The loan is repaid from the sale proceeds of the sugar.
[14] The account opened in the lead bank by the CSF into which the sale proceeds are credited for clearance of the pledge loan.

The Commissioner stated (December 2007) at the exit conference that the registers would be got updated.

2.3 Conclusion

The financial statements of CSFs did not disclose certain material facts, and as such, did not depict a correct picture of the affairs of the CSFs. Provisions for bad and doubtful debts were not made in the accounts. Preparation of accounts of the CSFs was delayed mainly due to late finalisation of the cost of closing stock by the Ministers' Committee. Statutory dues were outstanding for periods ranging from two to five years. Share capital balances were not recovered and the amounts recovered were kept under suspense. Share capital redemption funds were not created as required. Non-reconciliation of balances in cash books and the bank books resulted in delayed detection of frauds. Loan ledgers had not been updated since 1996-97.

2.4 Recommendations

- Disclosure of the material facts in the Accounts of the CSFs, as envisaged in the MCS Act, should be ensured.
- Ministers’ Committee meetings should be convened in April every year, so as to avoid delays in finalising the accounts.
- Creation of share capital redemption reserves by the CSFs should be ensured.
- Increase in the share capital base of the CSFs should be emphasised.
- System of regular reconciliation of cash book balances and bank balances should be put in place in each CSF.
- The loan registers and the Government dues registers should be made upto-date.