2.2 Working of Uttar Pradesh State Sugar Corporation Limited

Highlights

Uttar Pradesh State Sugar Corporation Limited, incorporated in March 1971 to run the sick sugar mills, acquired 30 mills during 1971 to 1989 under the U.P. Sugar Undertaking (Acquisition) Act, 1971. In September 2002, 18 mills were transferred to the newly formed subsidiary Company. One mill was transferred to the state of Uttaranchal leaving 11 working mills with the Company.

(Paragraph 2.2.1)

The Company incurred loss in every year except during the years 2000-01 and 2003-04. The profit earned during these years was due to write back of interest on Government loan.

(Paragraph 2.2.7)

The performance of subsidiaries was poor, as a result the equity investment of Rs.*75.89 crore remained unproductive.*

(Paragraph 2.2.9)

The sugarcane price arrears increased from Rs.110.48 crore (1999-2000) to Rs.*171.69 crore (2003-04) thereby affecting the steady flow of sugarcane to the mills.*

(Paragraph 2.2.14)

The direct cost of production exceeded the sales realisation during the five years ending 31 March 2004. As a result, the Company incurred cash losses aggregating Rs.541.56 crore.

(Paragraph 2.2.16)

The quota for sale of free sugar valuing Rs.*28.02 crore lapsed affecting ways and means position of the Company.*

(Paragraph 2.2.23)

The inventory holding of finished sugar reached up to the level of Rs.*550.60 crore as at 31 March 2004, which was equivalent to 16.81 months' sale of the Company.*

(Paragraph 2.2.28)

Due to underutilisation of man-hours, expenditure on idle wages amounting Rs.3.56 crore was incurred during the period 1998-99 to 2002-03.

(Paragraph 2.2.29)

Introduction

2.2.1 Uttar Pradesh State Sugar Corporation Limited (Company) was incorporated on 26 March 1971 under the Companies Act 1956 as a wholly owned Government Company to run the sick sugar mills acquired by the State Government under the U.P. Sugar Undertaking (Acquisition) Act, 1971. The Board for Industrial and Financial Reconstruction (BIFR) declared the Company as sick industrial Company from 21 August 1995. The Company was controlling

30 sugar mills (acquired during 1971 to 1989) up to 1997-98; of these, 10 mills were closed (four mills from crushing season 1998-99 and six mills from crushing season 1999-2000) as these units became unviable due to continued losses and one mill[1] was transferred (January 2002) to the State of Uttaranchal. According to conditions of BIFR (July 2001) and the decision taken by the State Government, 18 sugar mills (10 closed mills and 8 working mills) were transferred to the new subsidiary Company viz. U.P. State Sugar and Cane Development Corporation Limited in September 2002. Thus, the Company is left with only 11[2] working sugar mills with installed crushing capacity of 25,200 tonnes per day (TCD[3]) in crushing season 2003-2004 onwards. In July 2003, the Company decided to lease out these 11 sugar mills at the direction of the State Government. The Company/State Government had, however, not transferred these sugar mills on lease because the approval of BIFR was awaited (August 2004).

2.2.2 The sugar production in the State during 2003-04 was 45.51 lakh tonnes in which the share of the Company was 2.98 lakh tonnes i.e. 6.55 *per cent* of the total production in the State. Although the total sugar production in the State varied from 45.56 lakh tonnes in 1999-2000 to 45.51 lakh tonnes in 2003-04, the share of the Company varied during the period from 3.64 lakh tonnes (7.99 *per cent*) to 2.98 lakh tonnes (6.55 *per cent*). The Company could not grow because the sugar mills acquired by the Company were sick at the time of their acquisition itself, having old/obsolete plant and machinery and very low crushing capacity. Consequently, the cost of production of sugar in most of the mills of the Company was higher than its sales realisation.

Objectives

2.2.3 The main objectives of the Company are:

- to carry on the business of sugar mills including dealings in sugar, sugarcane, molasses and by-product thereof.
- to establish sugar mills and carry on business thereof as well as promote any sugar company as its subsidiary.

Organisational set-up

2.2.4 The management of the Company is vested in a Board of Directors consisting of 11 Directors including a full time Chairman and a Managing Director nominated/appointed by the State Government. The Managing Director is the Chief Executive who is assisted by three Joint Managing Directors, Company Secretary, Director (Finance)[4], Director (Technical)[4], Director (Engineering)[4], Chief Cane Development Advisor, three General Managers at the Headquarters and a General Manager in each mill.

The Company as at 31 March 2004 was controlling (by way of holding equity capital), four subsidiary companies namely Nandganj Sihori Sugar Company Limited, Chhata Sugar Company Limited, Ghatampur Sugar Company Limited and U.P. State Sugar and Cane Development Corporation Limited. There were 22 mills under the control of these subsidiaries, out of which 11 mills were working and 11 were non-working.

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[1] Doiwala

[2] 30 – 1 (transferred to Uttaranchal) – 18 (transferred to new subsidiary Company).

[3] Tonnes crushed per day.

[4] These are the administrative/technical posts other than the Board of Directors.

Scope of Audit

2.2.5 The working of the Company was last reviewed by the Comptroller and Auditor General of India in 1976. The review was discussed in the Committee on Public Sector Undertakings (COPU) in 1988-89. The COPU in its 16^{th} Report, *inter alia,* recommended that (i) the Government would take an early action for privatisation of its loss incurring mills; and (ii) despite incurring huge expenditure on rehabilitation and modernisation of old mills, there had not been commensurate increase in production, quality and decrease in cost; hence installation of new plants by way of abandoning unviable old plants/mills would be more profitable.

The Company/ Government was yet (August 2004) to take a decision on the privatisation of its chronically sick and loss incurring units. The Company carried out expansion plan in 10 mills during 1986-87 to 1997-98. In the expansion, old plant and machinery were replaced by new ones.

In the present review which was conducted during December 2003 to April 2004, the records of all the 11 working sugar mills existing as on 31 March 2004, in addition to the records of the Corporate office and sales offices, were test checked for the period of five years ending 31 March 2004.

Audit findings, as a result of review on the working of the Company were reported to the State Government/Company in June 2004 with specific request for attending the meeting of Audit Review Committee for State Public Sector Enterprises (ARCPSE) so that viewpoints of the Government/Management were taken into account. The meeting of ARCPSE was held on 10 August 2004 with the Management of the Company. The meeting was not attended by representatives of the State Government. The views expressed by the members have been taken into consideration during finalisation of the review.

Cane Supply Policy and Sugar Policy

2.2.6 The State Cane Supply Policy (2001-06) envisages to establish a balance among the crushing capacity of the mills, production of cane by farmers and availability of cane for the sugar mills of the State to ensure supply of cane to the mills according to their requirement. For this purpose, the State Government determines requirement of cane for sugar mills and allots quota of cane supply to the mills by the farmers, who shall essentially be a regular member of a cane society.

The Government of India declares Sugar Policy each year. It further provides for the Statutory Minimum Price (SMP) of cane to be paid to cane growers by each mill for each season, under the clause (3) of Sugarcane (Control) Order, 1966 on the basis of past recovery of sugar of each mill (considering 8.5 *per cent* as the basic minimum recovery). The State Government, however, declares a uniform State Advisory Price (SAP) of sugarcane payable by all the mills of the State.

The implementation of the above policies have been discussed in succeeding paragraphs 2.2.11 to 2.2.13, 2.2.21 and 2.2.23.

Financial position and Working results

2.2.7 Accounts of the Company had been finalised up to the year 2000-01 (August 2004). The Company had, however, prepared provisional accounts up to 2003-04. The **Annexures-19 and 20** summarise the financial position and working results of the Company at the end of the last five years ending 31 March

2004. The main financial indicators depicting the financial health of the Company as derived from the **Annexures** are as under:

(Rupees in crore)

Sl. No.	Particulars	1999-2000	2000-01	2001-02 (Prov.)	2002-03 (Prov.)	2003-04 (Prov.)
1.	Paid-up Capital (including share application money)	480.02	594.93	594.93	594.93	943.47
2.	Net Worth	(-) 911.68	(-) 735.37	(-) 845.68	106.47	485.23
3.	Cost of Sales	656.96	633.51	677.13	640.99	532.76
4.	Sales	470.92	422.93	427.22	394.86	420.59
5.	Net Profit / Net Loss (-)	(-) 169.82	92.01	(-) 211.41	(-) 207.77	30.20
6.	Accumulated loss	1391.11	1299.10	1410.13	488.46	458.24
7.	Percentage of Cost of Sales to Sales	139.51	149.79	158.50	162.33	126.67
8.	Investment in subsidiaries	83.01	83.51	83.51	91.95	92.10

The above financial position indicates that:

- The accumulated loss had fully eroded the paid-up share capital of the Company up to the close of the year 2001-02 thereby negating its net worth. The net worth of the Company, however, turned positive at the end of the year 2002-03, which was only due to transfer of accumulated loss of Rs.1,129.45 crore to the newly created (September 2002) subsidiary (Uttar Pradesh State Sugar and Cane Development Corporation Limited).

  The net worth of the Company improved further to Rs.485.23 crore in 2003-04 as against Rs.106.47 crore in 2002-03 due to conversion of loan of Rs.348.54 crore (State Government loan: Rs.330.29 crore and loan by U.P. Sugar Special Fund Committee: Rs.18.25 crore) into equity by the order of the State Government.

The Company incurred loss except during the years 2000-01 and 2003-04. The profit earned during these years was due to write back of interest on Government loan

- In the operational activities, the Company was incurring loss every year as the cost of production of sugar was higher than its sales realisation. The profit during 2000-01 and 2003-04 was due to write back of interest amounting to Rs.269.22 crore in 2000-01 and Rs.96.50 crore in 2003-04 on loans from Government of Uttar Pradesh, Uttar Pradesh Sugar Special Fund Committee and Financial Institutions.

Borrowings

2.2.8 The main source of finance of the Company is borrowings from the State Government. During the last five years ended 31 March 2004, the Company received loans aggregating Rs.624.08 crore from the State Government to manage the affairs of the Company. The loans were mainly obtained for the purpose of making payment for purchase of cane, repayment of dues of financial institution and payment under Voluntary Retirement Scheme (VRS), etc. The Company did not repay any instalment of loan and interest to State Government due to shortage of funds. The Company also availed of Cash Credit arrangements with U.P. Cooperative Bank (Bank) against pledge of sugar stock for payment of purchase price of sugarcane and other recurring expenses of the sugar mills. The repayment is made from the sale of sugar. The year wise

The interest liability of the Company on cash credit increased from Rs.29.78 crore (1999-2000) to Rs.44.37 crore (2003-04) due to increase in cash credit as a consequence of non-liquidation of stock.

position of outstanding balance and interest liabilities on cash credit account is given in the table below:

(Rupees in crore)

Year	Outstanding balance of Cash Credit Account at the end of the year	Interest on Cash Credit Account for the year
1999-2000	289.24	29.78
2000-01	380.36	39.07
2001-0 2	404.41	50.77
2002-03	358.27	48.60
2003-04	378.16	44.37

It would be seen from the above table that interest liability had increased from Rs.29.78 crore in 1999-2000 to Rs.44.37 crore in 2003-04. The reason for increase in interest liability was attributable to non-liquidation of stock of sugar. The stock of sugar in 11 mills increased from Rs.386.94 crore (10.53 months' sale) in 1999-2000 to Rs.550.60 crore (16.81 months' sale) in 2003-04, which adversely affected the financial position of the Company.

The Management stated (August 2004) that sincere efforts at the level of Company and the Government had been made which resulted in release of additional quota of 20.74 lakh quintals of sugar during last five years, and further efforts to get additional quota were going on. The reply is not acceptable as the Management even failed to dispose off the entire quota of sugar released by the Government during the period 1999-2000 to 2001-02 as discussed in paragraph 2.2.23 *infra*.

Poor performance of subsidiaries

Against the investment of Rs.75.89 crore, the subsidiaries of the Company had accumulated loss of Rs.996.80 crore up to 2003-04.

2.2.9 The Company had invested a sum of Rs.75.89[1] crore as on 31 March 2004 in its four subsidiary companies engaged in the similar business activity viz. manufacturing of white crystal sugar. The performance of these subsidiaries, up to 2003-04 remained unsatisfactory as they incurred operating losses since inception as evident from the table given below:

(Rupees in crore)

Particulars	Nandganj Sihori Sugar Company Ltd., Raebareli	Chhata Sugar Company Ltd, Mathura	Ghatampur Sugar Company Ltd, Kanpur Dehat	U.P. State Sugar and Cane Development Corporation Limited
Equity investment by the Company (as on 31 March 2004)	34.43	24.22[2]	8.80[3]	8.44[4]
Profit/loss for the year 2003-04	(-) 13.18	(-) 1.92	(-) 7.98	(-) 425.53
Accumulated loss (as on 31 March 2004)	159.92	57.74	75.23	703.91
Net worth (paid up capital plus free reserves and surplus less accumulated losses, as on 31 March 2004)	(-) 125.49	(-) 21.56	(-) 66.28	(-) 150.88

From above, it would be evident that these subsidiaries had accumulated loss amounting to Rs.996.80 crore against equity investment of Rs.75.89 crore; out of

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1 Excluding equity investment of Rs.16.21 crore in Kichha Sugar Company Limited (a subsidiary) transferred to the state of Uttaranchal in October 2001 without any consideration. This investment is, however, still being shown in the Company's books of accounts.

2 Paid up capital of the Company is Rs.36.18 crore.

3 Paid up capital of the Company is Rs.8.95 crore including Rs.0.15 crore invested by Chhata Sugar Company Limited.

4 Paid up capital including share application money of the Company is Rs.553.03 crore including Rs.544.59 crore of loan converted into equity.

these, Ghatampur Sugar Company and Nandganj Sihori Sugar Company have been ordered to be wound up in pursuance of decisions of BIFR in January and May 2002 respectively. The performance of Chhata Sugar Company has also not been satisfactory with an accumulated loss of Rs.57.74 crore against its paid up capital of Rs.36.18 crore. The investment in these companies thus, remained unfruitful as no return was obtained in all these years besides complete erosion of the investments. The Statutory Auditors in their report for the year 31 March 2001 also stated that investment in these companies had diminished permanently in value and required provision to that extent.

Management while accepting the facts, intimated (August 2004) that the main reason for poor performance of subsidiaries was non-availability of cane for crushing according to requirement of the mills. It was also stated that these mills were established in the backward areas with a view to reduce regional and industrial imbalance.

These mills, however, failed to achieve the intended objective since on account of non-availability of cane and continued losses, these mills got sick and have been ordered to be wound up.

Improper cane management

Inadequate cane development

2.2.10 Based on the period of harvesting, the sugarcane is classified into three varieties viz. early, mid and late. The sugarcane of early variety is considered to be beneficial for the mills for two reasons. First, the sugar content in early variety sugarcane is generally more as compared to mid and late varieties. Secondly, the availability of early variety sugarcane enables the mill to start the crushing season at an early date, and smooth supply of cane is ensured, when combined with mid variety. Considering the importance of the early variety sugarcane, the State Government also provided incentive to the canegrowers by way of declaring State Advisory Price of early variety cane higher than other varieties.

The Company could procure early variety cane only up to 10.13 to 11.56 *per cent* of the total procurement during the year 1999-2004.

During the last five years (1999-2000 to 2003-04), the Company incurred a meagre expenditure of Rs.4.74 crore (0.30 *per cent*) towards cane development in respect of its 11 mills against procurement of 1,745.54 lakh quintal of cane valued at Rs.1,577.53 crore.

Due to insignificant emphasis on cane development, the procurement of early variety cane in respect of 11 mills remained at a low level ranging from 10.13 to 11.56 *per cent* during 1999-04. Had the Company made concerted efforts for development of high yielding varieties of sugarcane, the Company could have improved the sugar production.

Raw material planning

2.2.11 The mills workout their estimated requirement of cane based on their installed capacities for the next crushing season and accordingly submit the proposals to Cane Commissioner for reservation of cane area under Section 15 of U.P. Sugarcane (Regulation of Supply and Purchase) Act, 1953 and Rule 21 of U.P. Sugarcane (Supply and Purchase) Rules, 1954. The Cane Commissioner after considering the proposals for various mills, allots the cane area to the mill. On the allotment, the Cane Growers Cooperative Societies of the reserved area make an offer of the quantity (on the basis of estimated yield from the standing crops) of cane to be supplied to the mill, which is then agreed to by the mill as per its requirement. According to daily requirement of cane in the mill, indents are placed by the Mill Management on the Societies in advance by three days. The cane growers supply the cane at the mill gate/outside procurement centres.

Fixation of cane price

2.2.12 The Statutory Minimum Price (SMP) of sugarcane to be paid to the canegrowers by each mill is fixed by the Government of India for each season under the clause (3) of the Sugarcane (Control) Order, 1966. The State Government, however, declares a uniform State Advisory Price (SAP) of sugarcane payable by all the mills of the State. The SAP declared by the State was higher than the SMP declared by the Government of India. The SAP declared by the State Government ranged from Rs.85 to Rs.100 per quintal during the period 1999-2000 to 2003-04 whereas the SMP declared by the Government of India ranged from Rs.56.10 to Rs.82.35 per quintal during the same period. The Company paid the cane price to the canegrowers as declared by the State Government.

Cane procurement

2.2.13 The table given below indicates the performance of 11 working mills for the five years ending 31 March 2004:

(Figures in lakh quintal)

Crushing season	Actual cane production	Estimated cane requirement of mills	Cane offered by the societies	Cane procured	Short procurement against cane offered by societies (4-5)
(1)	**(2)**	**(3)**	**(4)**	**(5)**	**(6)**
1999-2000	946.66	407.90	413.39	324.99	88.40
2000-01	981.81	407.40	404.08	330.80	73.28
2001-02	1054.46	416.45	418.28	366.43	51.85
2002-03	1121.51	416.85	418.03	404.19	13.84
2003-04	1058.84	387.00	402.11	319.13	82.98
Total	**5163.28**	**2035.60**	**2055.89**	**1745.54**	**310.35**

The Company could not procure and crush 310.35 lakh quintal of sugarcane resulting in shortfall in production of 26.38 lakh quintal of sugar.

The above table indicates that 11 mills collectively could not procure the quantity of cane offered by the Societies. Consequently, the Company could not procure and crush 310.35 lakh quintals of sugarcane in the mills which resulted in shortfall in production of 26.38 lakh quintals of sugar (calculated at minimum recovery of 8.5 *per cent*), besides operation of the mills for lesser number of days from the normal days in a season.

The reasons for short procurement of cane as analysed in Audit were:

- Diversion of cane to private mills, crushers and Khandsari units due to delay in payment of cane price by the mills, as discussed in paragraph 2.2.14 *infra*.
- Delay in starting the operations by the mills as compared to private mills.
- Higher rates offered by private mills/crushers/Khandsari units during the years when overall production of cane was low.
- Prolonged waiting time by the cane growers due to frequent and prolonged mill stoppages during season as discussed in paragraph 2.2.20 *infra*.

Thus, despite the fact that there was adequate cane production in the area, Company could not procure cane as per its requirement.

Management stated (August 2004) that low crushing capacity, late start of the crushing in the mills of the Company and the higher rates offered by private mills were beyond the purview of the cane management and the drawal percentage* of the Company was lower on account of higher crushing capacity of private mills which were drawing more cane in the area.

The reply is not convincing since the Cane Commissioner of the State decides the cane area after considering the requirement of the mills, and mills could have started their operations earlier through proper planning in advance.

Mounting arrears of cane price

The cane price dues against the Company increased from Rs.110.48 crore (1999-2000) to Rs.171.69 crore (2003-04) due to poor liquidation of stock of sugar, higher cost of sales, etc.

2.2.14 The table below indicates the cane price dues outstanding at the start of the financial year, amount due for the year, actual amount paid during the year and dues outstanding at the close of the financial year:

(Rupees in crore)

Year	Opening balance of cane price dues	Purchase of cane during the year	Payment made	Closing balance of cane price dues (2+3-4)
(1)	(2)	(3)	(4)	(5)
1999-2000	105.83	338.54	333.89	110.48
2000-01	110.48	357.95	341.95	126.48
2001-02	126.48	384.35	315.26	195.57
2002-03	195.57	332.11	279.12	248.56
2003-04	248.56	302.55	379.42	171.69

It would be seen from above that cane price dues increased from Rs.110.48 crore in 1999-2000 to Rs.171.69 crore in the year 2003-04. The reasons analysed by Audit for such high level of outstanding arrears of cane dues were:

- poor liquidation of stock of sugar due to which the working capital of the Company was blocked for longer duration.
- cost of sales being higher than the sales in all the five years. As a result, even revenue generated from sales was not sufficient to meet its cost of sales.

While accepting the observations of Audit, the Management stated (August 2004) following further reasons for mounting of arrears:

- the additional amount of cane price liable for payment by the Company as per the SAP declared by the State Government; which is fixed at a higher level than SMP declared by the Government of India.
- non-release of sugar quota for sale in the free market as the same was controlled by the Government of India.
- higher burden of interest on high inventory of sugar.

The Management's reply in respect of release of sugar quota by the Government of India is not convincing as the Company could not even sell the quota of sugar released in their favour, as discussed in paragraph 2.2.23 *infra*.

Production performance

2.2.15 The mills on the basis of lab analysis estimate the content of sugar in the sugarcane procured. The estimated sugar content, actual sugar recovered and the total percentage of loss of sugar for five years up to 2003-04 is given below:

Particulars	1999-2000	2000-01	2001-02	2002-03	2003-04
(1)	(2)	(3)	(4)	(5)	(6)
Sugarcane crushed (lakh tonnes)	32.38	32.97	36.54	40.40	31.89
Sugar Produced (lakh tonnes)	2.87	3.06	3.24	3.59	2.98

* Percentage of cane procured of the total cane production in the area.

(1)	(2)	(3)	(4)	(5)	(6)
Estimated percentage of sugar content in cane	10.21 to 12.03	11.17 to 12.22	10.75 to 11.67	10.55 to 11.80	11.18 to 12.05
Percentage of sugar recovered	8.86	9.28	8.87	8.89	9.34
Percentage of sugar lost	2.21 to 2.83	2.21 to 2.61	2.19 to 2.68	2.15 to 2.79	2.10 to 2.50

The sugarcane crushed varied from 31.89 to 40.40 lakh tonnes in respect of 11 mills during the five years ending 31 March 2004. The quantity of sugarcane crushed (31.89 lakh tonnes) during 2003-04 was abnormally low which was mainly due to lower cane procurement compared to the offered quantity.

In this connection, following deserve mention:

Higher cost of production

2.2.16 The table given below summarises the average direct cost of production (excluding depreciation) and average sales realisation in respect of 11 mills during the period from 1999-2000 to 2003-04:

Sl. No.	Particulars	1999-2000	2000-01	2001-02	2002-03	2003-04
(i)	Sale of sugar (in lakh tonnes)	3.33	2.97	2.81	2.86	2.80
(ii)	Cost of raw material (Rs. per tonne)	10079	10192	11091	10821	10964
(iii)	Direct conversion cost (Rs. per tonne)	7944	7560	5848	4198	3229
(iv)	Direct cost of production (Rs. per tonne) (ii) +(iii)	18023	17752	16939	15019	14193
(v)	Average sales realisation (Rs. per tonne)	13237	13402	13479	11482	12243
(vi)	Cash loss (Rupees per tonne) (iv) – (v)	4786	4350	3460	3537	1950
(vii)	Total cash loss (i) x (vi) (Rs. in crore)	159.37	129.20	97.23	101.16	54.60

The Company incurred cash loss of Rs.541.56 crore on sale of sugar during the last five years up to 2003-04 due to higher direct cost of production.

The above table indicates that during the period 1999-2000 to 2003-04, average sales realisation per tonne never covered the average cost of production. Thus, there was a total cash loss of Rs.541.56 crore on sale of 14.77 lakh tonne of sugar during the period from 1999-2000 to 2003-04 with reference to the total direct cost of production. The factors responsible for higher cost of production compared to average sales realization per tonne have been discussed in the succeeding paragraphs:

Excess loss of sugar

The Company incurred cash loss of Rs.44.70 crore during the years 1999-04 due to excess loss of sugar against the norm.

2.2.17 With a view to improve the working of sugar factories in India, an Expert Technical Committee appointed by the Government of India had prescribed (May 1988) the norm of sugar loss of 2.2 *per cent* (maximum) of cane crushed. The mill-wise quantity of cane crushed, sugar percentage in cane, sugar recovery and sugar loss in *per cent* is given in **Annexure-21**. From the Annexure it would be observed that the actual loss of sugar ranged from 2.10 *per cent* to 2.83 *per cent* of cane crushed against the norm of 2.2 *per cent* of cane crushed. This resulted in excess loss of sugar valued at Rs.44.70 crore.

The Management neither investigated the reasons of excessive loss of sugar nor initiated remedial action.

Management stated (August 2004) that a large number of machines of low capacity and of old technology had been retained in expansion, as a result the efficiency was low.

The reply is not tenable since the norm formulated by the Government of India was applicable in expanded plants and out of 11 mills, four* had achieved this norm in one or more years.

Excess consumption of bagasse

The Company incurred excess expenditure of Rs.37.93 crore during the years 1998-03 due to excess consumption of bagassee.

2.2.18 The mills of the Company use bagasse (the fibrous residue of sugarcane after milling) as fuel in their own captive power plants. The surplus bagasse is sold in the market. According to Sugar Industry Enquiry Commission Report of 1974, the fuel requirement in a well operated and maintained factory, in terms of bagasse should not exceed 28 *per cent* of the cane crushed. The actual consumption of bagasse, however, far exceeded the norm. The main reasons for excess consumption of bagasse were non-installation of steam saving devices, lack of insulation in vessels and existence of low capacity old boilers. It was observed that the mills not only consumed the bagasse produced by them but also had to purchase it from outside to meet out their requirement (except Saharanpur, Bijnor and Khadda mills which did not resort to outside purchases). As a result, the cost of generation of power through turbine increased. This ultimately resulted in increased cost of production of sugar. The excess consumption of bagasse in respect of nine mills, where the information was made available, worked out to Rs.37.93 crore during the period of five years up to 2002-03 based on the sale rate of bagasse sold by the mills **(Annexure-22)**.

Management stated (August 2004) that the steam saving devices could not be installed and adequate insulation of heating vessels could not be done due to poor financial position and shortage of funds, which resulted in increased consumption of bagassse.

The reply is not acceptable in view of the fact that no remedial action either to effect saving in fuel or to make the mills energy efficient to bring about economy had been initiated.

Extra expenditure on transportation of sugarcane

2.2.19 The mills of the Company are required to procure sugarcane at the mill gate/procurement centres opened for the purpose depending upon the supply of sugarcane by the canegrowers. The sugarcane prices fixed by the State Government are for delivery at the mill gate. The State Government, however, allows deduction in prices by a fixed amount irrespective of the distance of procurement centres from the mill gate. The mills arrange transportation of sugarcane from the procurement centres to mill gate. So the expenditure on transportation of sugarcane should be restricted to the fund generated through the deduction in prices of sugarcane.

The Company incurred extra expenditure of Rs.17.52 crore on transportation of sugarcane during 1999-2004 due to failure to contain the expenditure up to allowable deduction from the cane price.

During scrutiny of records of 11 working mills, it was observed that the Management failed to control the expenditure on transportation of sugarcane within the deduction allowed by the State Government in all the five years ending 31 March 2004 except Sakhoti Tanda (2002-03) and Bijnor (2002-03 and 2003-04) mills and had incurred an excess expenditure of Rs.17.52 crore during 1999-2000 to 2003-04. This resulted in increased cost of raw material and ultimately enhanced the cost of production of sugar.

* Saharanpur, Amroha, Chandpur and Bijnore.

Further, there was lack of coordination among the mills over fixation of rates of transportation of sugarcane from procurement centres to respective mill. Resultantly, Amroha mill incurred higher transportation cost as compared to Bijnor mill (located in same geographical region with distance of 50 km). The rates of transportation (per km/quintal) of Amroha mill were much higher than those of awarded by Bijnor mill, which resulted into extra expenditure of Rs.1.32 crore by Amroha mill during the period 1998-99 to 2002-03. The excess expenditure could have been avoided had there been coordination among the mills.

The Management stated (August 2004) that any expenditure over and above the deduction permitted by the State Government was to be borne by the Company, and in order to obtain minimum rates, tender notice was published in several newspapers and the rates so obtained were compared to previous years and those awarded by nearby units.

The reply is not tenable since the Management never represented the case with the Government for compensation of higher transportation cost either directly or through deduction from cane price. Further, the rates obtained in tenders were seldom compared with the neighbouring units as pointed out in case of Amroha unit.

Plant performance

2.2.20 At present the Company has 11 mills with a total crushing capacity of 25,200 TCD. Sugar industry being seasonal in nature, its operation is generally limited to 150 days in the Eastern Zone and 180 days in the Western Zone. An Expert Technical Committee appointed by Government of India opined (1988) that the maximum time for stoppages during crushing should not exceed 10 *per cent* of the available hours. The table below indicates total hours available, hours worked and hours lost in respect of all the 11 mills.

Particulars	1999-2000	2000-01	2001-02	2002-03	2003-04	Total
Total hours available	38129	37672	41913	48038	36199	201951
Hours worked	32173	33015	36473	41664	31901	175226
Hours lost due to						
(i) Non-availability of cane	1427	673	774	889	591	4354
(ii) Mechanical and electrical troubles	2019	1886	2413	2688	1810	10816
(iii) General cleaning	2115	1845	1924	2384	1429	9697
(iv) Miscellaneous	395	253	329	413	468	1858
Total hours lost	5956	4657	5440	6374	4298	26725
Percentage of hours lost to available hours	15.62	12.36	12.98	13.27	11.87	13.23

In this regard Audit observed that:

- the percentage of hours lost varied from 11.87 to 15.62 *per cent* against the norm of 10 *per cent*.
- non-availability of cane represented 16.29 *per cent* of hours lost which indicated lack of proper co-ordination between the various departments viz. procurement, production and maintenance.
- mechanical/electrical troubles represented 40.47 *per cent* of the hours lost and this was inspite of spending Rs.76.16 crore on repairs and maintenance during 1999-2000 to 2003-04.
- the hours lost due to miscellaneous reasons represented 6.95 *per cent* of the total hours lost. The reasons for the same have not been analysed by the Company.

The capacity utilisation of five mills of the Company ranged from 74.83 to 90.07 *per cent* only during 1999-04 due to non-availability of sugarcane, mechanical and electrical troubles.

- capacity utilisation of five* mills, out of 11 mills, was not satisfactory as it ranged from 74.83 to 90.07 *per cent* during all the five years (**Annexure-23).** The reasons for low capacity utilisation were non-availability of sugarcane besides mechanical and electrical troubles.

Management stated (August 2004) that the norm of 10 *per cent* stoppages was applicable for new plants. Further, this norm included the stoppages due to mechanical breakdowns and general cleaning only.

The reply of the Management is not acceptable since the norm set by the Government of India provided for stoppages at 10 *per cent* for new factories as well as factories expanded on the basis of 1973 standard specifications. Further, the norm of 10 *per cent* was set for the maximum down time which in itself included all types of stoppages.

Sales performance

The Company did not have transparent system of sale of free sugar.

2.2.21 Under the dual pricing policy, the Government of India announces from time to time, the percentage of allocations of total sugar produced by the mills for free and levy sale. The free sugar can be sold in the open market while the levy sugar is to be sold, at the rates predetermined by the Government of India, to Government agencies under Public Distribution System. The ratio of free and levy sugar during 1999-2000 was 70:30 and changed from time to time to 90:10 from March 2002. For sale of sugar in the free market, the quantity is decided by the Government of India on month to month basis through its release orders. The quota of levy sugar fixed by the Government of India is released to the State Government through the representative bodies of the State Government.

In respect of free sale of sugar produced at its mills and its subsidiaries, the Company decides the sale rate on daily basis and sale is made through selling agents appointed through out the State and in New Delhi. The sale advices are issued to the selling agents indicating date of sale, last date of lifting, quality, quantity and rate. The selling agent takes delivery of sugar either himself or through his representative after making payment to the mills. In addition to this, free sale of old sugar is done through auction.

It was noticed that free sugar was sold in the market through sale offices at New Delhi and Lucknow under the supervision of General Managers (Sales). The General Managers (Sales) enquired the rates of sugar prevailing in the private mills and mills of the Cooperative Federation and the market rate through its selling agents on telephone. Accordingly, sale rates of sugar were fixed on daily basis to be quoted in the market. These rates were offered to the selling agents. In this process, there remains no written document of offers submitted by agents as well as documentary proof of the efforts made and negotiation done in the fixation of rate. Thus, transparency and benefit of competitive rates was missing in this process.

Management stated (August 2004) that there was transparency in the system of sale of sugar and the sugar was sold after intimating the rates to all selling agents.

The reply is not convincing as the lack of transparency as pointed out by Audit is attributable to non-generation of any written documentary evidence in support of the transaction executed over telephone. This could have been avoided had any

* Bulandshahar, Mohiuddinpur, Amroha, Jarwal Road and Siswabazar.

other mode of communication, which generated written document, such as fax been used.

Unfruitful expenditure on computerisation of sales procedure

The expenditure of Rs.15 lakh on "on-line computerisation system" to ensure transparency in sale of sugar remained unfruitful as the system was operative only for a short period.

2.2.22 With a view to have transparency in the sales procedure, the Company decided (March 2000) to introduce 'on line computerised system' for sale of sugar. After incurring an expenditure of Rs.15 lakh on installation of computers/software, 'on line computerised system' was introduced from 1 August 2000 but it could function only up to 25 August 2000. During this period both systems were working and the total sale was 65,000 bags; of this, only 8,000 bags could be sold through on-line system and the remaining bags were sold through old system of collecting rates on telephone for fixation of sale rate. At present the old system of sale has been prevalent in the Company. Thus, the expenditure of Rs.15 lakh remained unfruitful and transparency in sales mechanism could not be achieved.

Management stated (August 2004) that reasons for failure of on-line system of sale of sugar were (i) lack of computer system with many agents, (ii) agents not being stationary at one place, and (iii) excess time involved in execution of trade followed by post confirmation over telephone.

The reply is not tenable as the Company did not evaluate acceptability of new system by agents prior to its launching.

Lapse of free sale quota

2.2.23 For free sale sugar available at units and at subsidiaries, the Directorate of Sugar releases quota for sale during a month and the quantity remaining unsold at the close of the month gets lapsed. The table below indicates year-wise allotment of quota, quantity sold and lapsed quantity:

Year	Total quota released (in Qtl)	Quantity sold (in Qtl)	Lapsed quantity (in Qtl)	Average sales realisation per quintal during the year (in Rupees)	Value of quantity of sugar lapsed (Rs. in crore)
1999-2000	3214324	3129144	85180	1323.70	11.28
2000-01	2720875	2716880	3995	1340.20	0.54
2001-02	2824774	2704607	120167	1347.90	16.20
2002-03	3010847	3016428	NIL	---	---
2003-04	3276785	3520149	NIL	---	---
Total			**209342**		**28.02**

The above table would reveal that 2,09,342 quintals of free sugar valued at Rs.28.02 crore lapsed during 1999-2000 to 2001-02. The lapsed quantity of sugar for free sale was abnormally high during 2001-02. This resulted in further increase of accumulated stock of sugar and increase in inventory carrying cost. This reflects poor sale efforts by the Management.

Management stated (August 2004) that the quantities lapsed were insignificant and were on account of changes in Government policies, excess sale by private mills, transporters' strikes and natural calamities, etc.

The reply of the Management is not tenable as quantities lapsed in the years 1999-2000 and 2001-02 were substantial amounting to Rs.11.28 crore and Rs.16.20 crore respectively. Further, so far as Government policies, transporters' strikes and natural calamities are concerned, these were common to the sugar industry as a whole. As regards, excess sale by private mills it is worth mentioning that private mills could make excess sale under the circumstances which were common to the Company and private mills.

Lapses in sale of molasses

2.2.24 Molasses, one of the by-products of sugarcane is produced during the process of production of sugar. The molasses is to be stored in steel tanks and covered masonry tanks till the time of its disposal and it has to be disposed off on regular basis due to the following reasons:

- The capacity for storage of molasses in the mills has not been sufficient to hold the production of entire season.
- In case the storage capacity (steel tanks and covered masonry tanks) is exhausted, any subsequent production has to be stored in kuchha pit which is prone to degradation in the quality due to microbial formation and mixing of rain water, etc.
- Risk of auto-combustion of molasses stored in steel tanks/covered masonry tank/kuchha pit and blasting of steel tanks consequent to the overheating during summer.
- To maintain adequate level of cash flow.

Audit observed that:

- The entire quantity of molasses was not disposed off. Quantity of molasses ranging from eight to 66 *per cent* of total stock remained un-liquidated at the time disposal during the period 1999-2000 to 2003-04.
- Management had considered the estimated production of molasses up to the date of tender (for disposal of molasses) only instead of taking into account the estimated production of molasses up to the date of lifting of molasses. Actual lifting took place after 20 to 30 days from the date of tender. Incorrect estimation of stock of molasses for disposal resulted in its avoidable accumulation. The retention of such huge quantity lacked justification.

2.2.25 The mills continuously faced the problem of storing the molasses during the season due to disposal of inadequate quantity of molasses on irregular basis. Instances, noticed in audit, are discussed below:

The molasses earmarked for sale after retaining huge stock. Molasses valuing Rs.28.55 lakh stored in kuchha/damaged pit were degraded.

- In case of Khadda mill during the crushing season 2002-03, the molasses produced after 22 April 2003 had to be stored in kuchha pit (30,906 quintals) and covered masonry pit in a damaged condition (1,367 quintals); of this, 21,958 quintals of molasses valued at Rs.28.55 lakh (at the rate of Rs.130 per quintal) was degraded and was lying undisposed (May 2004).

Management stated (August 2004) that efforts were made to dispose off the molasses stored in kuchha pit at the earliest but it could not do so because the offers received in May/June 2003 were not valid and the rates quoted by the buyers in July 2003 were not attractive. As a result of storage in kuchha pit the quality of molasses deteriorated.

- In case of Bulandshahar mill, during the crushing season 2002-03, 27,823 quintals of molasses, stored in kuchha pit, valued at Rs.39.23 lakh (at Rs.141 per quintal) was damaged due to auto combustion on 2 July 2003. The insurance claim was not accepted (February 2004) by the insurance company.

Management stated (August 2004) that the entire molasses stored in kuchha pit which was damaged due to auto combustion was sold in April 2004 at the rate of Rs.143 per quintal and out of above 5,626.60 quintal was lifted by the buyer. Regarding rejection of insurance claim, Company stated that the matter had been taken up with Insurance Regulatory Development Authority.

Audit has, however, observed that the balance quantity of 22,196.40 quintals valuing Rs. 31.30 lakh of molasses was still not lifted, and was lying undisposed (August 2004). Chances of its lifting are bleak.

Besides, due to the excessive storage as a result of non-continuous disposal of molasses, at times the molasses had to be sold on emergency basis instead of calling tenders, at lesser rates due to insufficient competition as well as demand and supply imbalance. Audit noticed that in case of Khadda, Siswabazar, Baitalpur, Pipraich, Ramkola and Shahganj mills 40,000 quintal of molasses had to be sold on emergency basis in April 2003 at Rs.90 per quintal while the rates decided by tendering process during the same period ranged between Rs.135 to Rs.140 per quintal.

Insufficient storage facility for sugar

The Company had to incur expenditure of Rs.1.35 crore on rent, transportation, security etc. due to insufficient storage.

2.2.26 According to Indian Standard Code of Practice For Construction of Sugar Godowns, the capacity of the sugar godowns for storing sugar bags should be roughly estimated at the rate of 100 kg per bag of sugar with a space volume of 0.150 M^3. Accordingly, the capacity of the sugar godowns are fixed for storage of sugar. It was, however, observed in Audit that the capacity of godowns were not sufficient to meet the demand of mills for storage of sugar. Hence the mill Management had to keep the sugar bags in godowns beyond their capacity and at other places such as workshop, store and drier house against the norms, besides keeping it at its godowns of other closed mills. In addition to above, outside godowns were taken on rent and the expenditure was incurred on rent, security, excise supervision charges and transportation. As on 31 December 2003, the total capacity of the godowns of 10 mills was 24,92,000 bags against which 27,80,269 bags were kept in godowns and other places, and 3,60,554 bags were stored in outside godowns taken on rent. During the last five years ending 31 March 2003, the Company incurred Rs.1.35 crore on rent besides expenditure on transportation and security, etc.

It was further noticed that due to long storage of sugar, the sugar became Below Indian Standard Specification (BISS) in mills and it had to be reprocessed. This resulted in loss of sugar valued at Rs.31.71 lakh.

Management stated (August 2004) that storage problem arose due to non-lifting of levy sugar, and additional storage capacity could not be created on account of paucity of funds. The reply is not convincing as the additional storage capacity could be created by generating fund from sale of free sugar instead of letting the quantities of free sale sugar lapse.

Higher level of inventory

Stores and spare parts

2.2.27 Maintenance of inventory of stores and spares (lime, sulphur, lubricants, gunny bags, bearing, machinery spares, etc.) at optimum level is important for efficient operation of the mills. Inflated inventory leads to blockade of funds and consequent loss of interest. The value of stores and spare parts consumed by the factory during the years and balance at the close of each of the five years up to 31 March 2004 are given below:

Year	Consumption of stores and spares during the year (Rupees in crore)	Closing stock of stores and spares at the close of the year (Rupees in crore)	Closing stock in terms of monthly consumption
1999-2000	32.04	19.85	7.43
2000-01	31.18	20.37	7.84
2001-02	32.29	18.67	6.94
2002-03	24.57	11.84	5.78
2003-04	25.42	12.31	5.81

From above, it would be seen that the inventory of stores and spare parts remained high up to 2001-02 and marginally improved during the years 2002-03 and 2003-04 resulting in blockade of scarce resources. Management had not fixed any norm in this regard. Management had identified old and obsolete inventory but not taken any steps for liquidation to channelise the resources. Apart from this, the store items had not been classified according to ABC analysis. Maximum, minimum and re-ordering levels in respect of various items of stores had also not been fixed.

Management intimated (August 2004) that they have constituted a Committee for disposal of old/obsolete machinery items available in the mills and efforts were being made for its disposal.

Finished sugar

2.2.28 The level of inventory of finished sugar during the period of five years ending 31 March 2004 is given in the table below:

Year	Sale of sugar during the year (Rupees in crore)	Closing stock of sugar at the close of the year (Rupees in crore)	Closing stock in term of months' sale
1999-2000	440.90	386.94	10.53
2000-01	397.99	476.32	14.36
2001-02	394.83	592.46	18.01
2002-03	370.58	509.61	16.50
2003-04	393.13	550.60	16.81

The inventory of sugar increased up to the level of Rs.550.60 crore as on 31 March 2004 due to decrease in sale. The old stock of sugar would fetch Rs.11.03 crore less.

From above, it would be seen that the sales of the Company decreased by 10.83 *per cent* during the period of five years as a result of which the inventory of the sugar increased considerably and reached an alarming level of stock equivalent to 16.81 months' sale during 2003-04 from a level of 10.53 months' sale during 1999-2000 which adversely affected the financial position of the Company. The closing stock of sugar at the end of March 2004 was 43.22 lakh bags which included 22.80 lakh bags of old stock. The Company sells old stock of sugar after reducing at the rate of Rs.35 for each previous year from normal sale rate of current season. The old stock of sugar in the inventory of the sugar would fetch Rs.11.03 crore less to the Company.

Management stated (August 2004) that from time to time, requests had been made to the Government of India for release of additional quota of sugar, and as a result additional quota of 20.74 lakh quintals of sugar were obtained.

The reply is not convincing as the Management failed to even dispose off the quota allotted in full as discussed in paragraph 2.2.23 *supra*.

Manpower

Idle wages

The Company incurred expenditure of Rs.3.56 crore on idle wages during 1998-2003.

2.2.29 During the crushing season, the mills operate in three shifts. It was noticed in respect of 10[*]mills that, out of 1,571.16 lakh available man-hours, 59.73 lakh man-hours[**] representing 3.80 *per cent* of the available man hours remained idle during the period from 1998-99 to 2002-03, mainly due to shortage of cane and machinery breakdowns. This resulted in payment of idle wages to the extent of Rs.3.56 crore as shown in the table below:

Year	Available man hours (in lakh)	Man hours utilised (in lakh)	Idle man hours (in lakh)	Idle wages (Rs. in crore)
1998-99	299.92	252.24	17.69	1.06
1999-2000	290.78	246.10	15.60	0.96
2000-01	304.84	269.75	6.36	0.38
2001-02	318.59	279.77	8.60	0.51
2002-03	357.03	311.09	11.48	0.65
Total	**1571.16**	**1358.95**	**59.73**	**3.56**

Excess manpower

2.2.30 The Company had not fixed any norm for the number of workers according to the crushing capacity of the mills.

- In Rohanakalan mill, although the crushing capacity was least (1300 TCD) among the 11 mills, the deployment of manpower was much more (894 workers: 2002-03) even when compared to the mill of highest capacity (Amroha: 3000 TCD, 891 workers: 2002-03) during all the five years ending March 2003 (**Annexure-24**).

No steps had been taken by the Management to rationalise the manpower in the mills.

Management stated (August 2004) that in Rohanakalan mill, the sugar was produced under carbonation process (being labour intensive) up to 1998-99 and under double sulphitation process from 1999-2000 and onwards. It further stated that the number of workers in few mills (of same capacity) were more as these mills were expanded by retaining old plant and machinery also. Besides this, the number of workers also depend on the number of outside procurement centres, etc.

The reply is not convincing since even after switching over to the double sulphitation process in Rohanakalan mill, the number of workers remained high as compared to other mills. The number of workers in Saharanpur mills (where whole plant of 2500 TCD was newly established) were more against those in Siswabazar mill (marginally expanded by retaining old plant and machinery). Further, inspite of less number of procurement centres in Bijnor as compared to Bulandshahar and Saharanpur mills, the number of workers were more in the mill during 1999-2003.

[*] Bulandshahar, Mohiuddinpur, Rohanakalan, Sakhoti Tanda, Saharanpur, Amroha, Chandpur, Bijnor, Khadda and Siswabazar.

[**] After allowing permissible loss of man-hours at the rate of 10 *per cent* of available man-hours, as per the norm set by the Government of India.

Internal Control and Internal Audit

Internal Control

2.2.31 Internal Control is a process designed to provide reasonable assurance for efficiency of operation, reliability of financial reporting and compliance with applicable laws and statutes. Audit observed that there was no laid down internal control procedure in the Company except for the Accounting Manual and Internal Audit Manual. Audit further observed that:

- the internal control system in sales mechanism remained weak especially in the area of transparency in fixation of sale rate of sugar, as discussed in paragraph 2.2.21 *supra*,
- the Statutory Auditors pointed out that the internal control procedure was not commensurate with regard to size and nature of business in case of Rohanakalan and Saharanpur units. In case of three* other units, the internal control was not found commensurate with regard to purchase of stores including components and movement of the people, and
- Audit Committee constituted in compliance with the provisions under Section 292 A of the Companies Act in September 2001 was required to have discussions with the Statutory Auditors periodically about internal control systems. But no such discussions were held.

Internal Audit

2.2.32 Internal Audit is a system designed to ensure proper functioning as well as effectiveness of the internal control system and detection of errors and frauds. Internal Audit of the Company is being carried out departmentally. Initially one auditor was appointed for each unit for doing concurrent audit. Consequent upon the expansion of the Company some of these internal auditors were promoted and posted in the accounts department. This resulted in decrease in strength of the internal audit wing. Consequently, the periodicity of the internal audit was reduced considerably making it ineffective. The Statutory Auditor of the Company also reported that internal audit procedure was not commensurate with the size of the Company and periodicity needed to be increased.

Management stated (August 2004) that additional manpower could not be employed in view of ban on recruitment and financial constraints.

The matter was reported to the Government in June 2004; the reply is awaited (September 2004).

Conclusion

The performance of the Company was marked by exceptionally high cost of production caused due to payment of higher cost of sugarcane, excessive loss of sugar in production, wastage of energy leading to higher consumption of bagasse and excess manpower. The sales were declining and inventory of sugar reached an alarming level leading to storage problem. In order to improve the performance of the Company, the Management needs to make concerted efforts to improve the operation of the mills by minimising the stoppages, improving recovery of sugar, timely payment to cane growers for ensuring steady supply of sugarcane. Further, efforts are required to be made for liquidation of inventory and rationalisation of manpower. The system of internal control and internal audit needs to be strengthened.

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* Saharanpur, Bijnor and Sakhoti Tanda.