Report of the Comptroller and Auditor General of India

for the year ended March 2011

Union Government (Commercial)
No. 8 of 2012-13
(Compliance Audit Observations)

CONTENTS

CHAPTER/ PARAGRAPH	SUBJECT	PSU	PAGE NO.
	PREFACE		ix
	EXECUTIVE SUMMARY		xi
Chapter I	**DEPARTMENT OF ATOMIC ENERGY**		
1.1	Avoidable loss due to short/ excess payment of advance tax	Electronics Corporation of India Limited (ECIL)	1
1.2	Avoidable expenditure due to non-admittance of claim under defect liability period	Nuclear Power Corporation of India Limited (NPCIL)	3
Chapter II	**MINISTRY OF CIVIL AVIATION**		
2.1	Wasteful expenditure due to non-utilisation of leased premises for cargo warehouse	Air India Limited (AIL)	5
2.2	Extra expenditure in Air India Limited	Air India Limited (AIL)	6
2.3	Review of Operations	Airline Allied Services Limited (AASL)	10
2.4	Irregular Appointment of Consultant	Airports Authority of India (AAI)	13
2.5	Favour to a contractor by awarding a construction contract against unacceptable offer and allotment of land free of charge	Airports Authority of India (AAI)	15
Chapter III	**MINISTRY OF COAL**		
3.1	Non deployment of pay loaders for despatch of coal produced by surface miners in Dipka Open Cast Mine	South Eastern Coalfields Limited (SECL)	18
3.2	Payment of electricity charges at higher rates	Western Coalfields Limited (WCL)	19
Chapter IV	**MINISTRY OF COMMERCE AND INDUSTRY**		
4.1	Irregularities in release of funds to a business associate	STCL Limited (STCL)	22
Chapter V	**MINISTRY OF COMMUNICATIONS AND INFORMATION TECHNOLOGY**		
5.1	Excess procurement of Mobile Switching Centre based Wireless in Local Loop system equipment	Bharat Sanchar Nigam Limited (BSNL)	25

5.2	Inefficient management of procurement of costly Microwave equipment.	Bharat Sanchar Nigam Limited (BSNL)	27
5.3	Loss due to non execution of agreement while providing PRI trunks	Bharat Sanchar Nigam Limited (BSNL)	29
5.4	Avoidable payment of interest on delayed payment for BWA spectrum	Bharat Sanchar Nigam Limited (BSNL)	31
5.5	Interconnect user charges	Mahanagar Telephone Nigam Limited (MTNL)	32
Chapter VI	**MINISTRY OF CONSUMER AFFAIRS, FOOD AND PUBLIC DISTRIBUTION**		
6.1	Non-realisation of storage charges on time-barred bonded goods	Central Warehousing Corporation (CWC)	38
6.2	Avoidable expenditure on procurement of levy rice	Food Corporation of India (FCI)	39
6.3	Loss on Interest Rate Swap transactions	Food Corporation of India (FCI)	40
Chapter VII	**MINISTRY OF DEFENCE**		
7.1	Blocking of funds in Convergent Billing and Customer Relationship Management project	Bharat Electronics Limited (BEL)	42
7.2	Excess payment of performance related pay	Hindustan Aeronautics Limited (HAL)	44
Chapter VIII	**MINISTRY OF FINANCE (DEPARTMENT OF FINANCIAL SERVICES - INSURANCE DIVISION)**		
8.1	Forgoing profit on non-disposal of shares against initial open offer from the promoters	General Insurance Corporation of India (GICL)	46
8.2	Motor Own Damage Portfolio	National Insurance Company Limited (NICL)	47
8.3	Irregular settlement of an aviation claim	National Insurance Company Limited (NICL)	58
8.4	Investment in equities	The New India Assurance Company Limited (NIACL)	59
8.5	Undue favour extended to M/s. Paramount Airways Private Limited in underwriting of credit insurance policies	The Oriental Insurance Company Limited (OICL)	63

8.6	Short Collection of Premium and revenue loss	United India Insurance Company Limited (UIICL)	65
Chapter IX	**MINISTRY OF HEAVY INDUSTRIES & PUBLIC ENTERPRISES**		
9.1	Avoidable expenditure due to inclusion of restrictive clause in tender documents	Bharat Heavy Electricals Limited (BHEL)	67
9.2	Extra expenditure due to non-diversification of the vendor base	Bharat Heavy Electricals Limited (BHEL)	69
9.3	Extra expenditure due to inadequate system of cost estimation	Bharat Heavy Electricals Limited (BHEL)	71
9.4	'Fund Management' in Government Companies Incorporated under Section 25 of the Companies Act, 1956	National Scheduled Castes Finance & Development Corporation (NSCFDC), National Backward Classes Finance & Development Corporation (NBCFDC), National Minorities Development & Finance Corporation (NMDFC), National Scheduled Tribes Finance & Development Corporation (NSTFDC), National Research Development Corporation (NRDC)	72

9.5	Recoveries at the instance of Audit.	National Highways Authority of India, United India Insurance Company Limited, Oriental Insurance Company Limited, The New India Assurance Company Limited, National Insurance Company Limited, Mahangar Telephone Nigam Limited (MTNL), Bharat Earth Movers Limited (BEML), National Thermal Power Corporation, Neyveli Lignite Corporation (NLC), Steel Authority of India and Food Corporation of India	83
9.6	Corrections/rectifications at the instance of audit	Central Warehousing Corporation, National Seeds Corporation (NSC), Bharat Heavy Electrical limited and Hindustan Aeronautics Limited (HAL)	84
Chapter X	**MINISTRY OF MINES**		
10.1	Second Phase Capacity Expansion	National Aluminium Company Limited (NALCO)	85
10.2	Avoidable loss due to continuation of uneconomic operation of Special Grade Alumina plant	National Aluminium Company Limited (NALCO)	91
Chapter XI	**MINISTRY OF PETROLEUM AND NATURAL GAS**		
11.1	Performance of Tours and Travel Division	Balmer & Lawrie & Company Limited	94
11.2	Injudicious investment	Balmer & Lawrie & Company Limited	98

11.3	Export promotion benefit foregone on supply of Aviation Turbine Fuel to foreign bound aircrafts	Bharat Petroleum Corporation Limited & Hindustan Petroleum Corporation Limited (BPCL & HPCL)	100
11.4	Export benefit foregone	Chennai Petroleum Corporation Limited (CPCL)	101
11.5	Undue benefit extended to private power producers	GAIL (India) Limited	103
11.6	Under recovery in gas pool account and excess payment of fertiliser subsidy	GAIL (India) Limited	105
11.7	Non-recovery from RIL	GAIL (India) Limited	106
11.8	Avoidable loss	Hindustan Petroleum Corporation Limited (HPCL)	108
11.9	Extra expenditure due to piecemeal acquisition of land	Oil and Natural Gas Corporation Limited (ONGC)	110
11.10	Irregular hiring of ultra deep water rig from Reliance Industries Limited	Oil and Natural Gas Corporation Limited (ONGC)	112
11.11	Wasteful expenditure on retaining and idling of a survey vessel	Oil and Natural Gas Corporation Limited (ONGC)	115
Chapter XII	**MINISTRY OF POWER**		
12.1	Loss due to non fulfilment of obligations prescribed in Letter of Assurance for supply of coal	Bokaro Power Supply Company Limited (BPSCL)	117
12.2	Transmission and Distribution of Power	Damodar Valley Corporation Limited (DVC)	118
12.3	Fuel Management in Thermal Power Stations	Damodar Valley Corporation Limited (DVC)	129
12.4	Loss due to absence of route planning	NTPC Limited	136
12.5	Follow up of Audit Para titled 'Changes in terms and conditions after opening of bids'	Power Grid Corporation of India Limited (PGCIL)	137
12.6	Extension of extra contractual benefit to a private contractor	Ratnagiri Gas and Power Private Limited (RGPPL)	139

Chapter XIII	**DEPARTMENT OF ROAD TRANSPORT & HIGHWAYS**		
13.1	Review of operations of Special Purpose Vehicles (SPVs) formed for implementation of Port Road Connectivity to major Ports	National Highways Authority of India (NHAI)	142
13.2	Non-recovery of penalty from Concessionaires	National Highways Authority of India (NHAI)	147
13.3	Loss of Revenue due to inordinate delay in construction of toll plaza.	National Highways Authority of India (NHAI)	148
13.4	Loss due to avoidable payment of interest	National Highways Authority of India (NHAI)	150
Chapter XIV	**DEPARTMENT OF SHIPPING**		
14.1	Management of fuel	Dredging Corporation of India Limited (DCIL)	152
14.2	Investment in Joint Venture	The Shipping Corporation of India Limited (SCI)	159
14.3	Avoidable expenditure due to delay in finalization of contract	The Shipping Corporation of India Limited (SCI)	162
Chapter XV	**MINISTRY OF STEEL**		
15.1	Loss in procurement of iron ore fines from NMDC	KIOCL Limited	165
15.2	Irregularities in procurement and inventory management of LAM Coke	KIOCL Limited	167
15.3	Sale of Iron and Steel Products in Domestic Market	Rashtriya Ispat Nigam Limited (RINL)	169
15.4	Material Management of SAIL Refractory Unit	Steel Authority of India Limited (SAIL)	175
15.5	Avoidable loss in IISCO Steel Plant	Steel Authority of India Limited (SAIL)	183
15.6	Investment in pipe coating plant.	Steel Authority of India Limited (SAIL)	185
15.7	Non-recovery of irregular subsidy extended to the employees	Steel Authority of India Limited (SAIL)	186
Chapter XVI	**MINISTRY OF TEXTILES**		
16.1	Sale of land	British India Corporation Limited (BICL)	189

Chapter XVII	**Follow-up on Audit Reports**	197
	Appendix I	199
	Appendix II	204
	Appendix III	206
	Annexures	210

PREFACE

1. The accounts of Government Companies set up under the provisions of the Companies Act (including Companies deemed to be Government Companies as per the provisions of the Companies Act) are audited by the Comptroller and Auditor General of India (CAG) under the provisions of Section 619 of the Companies Act, 1956. The accounts certified by the Statutory Auditors (Chartered Accountants) appointed by the CAG under the Companies Act are subject to supplementary audit by officers of the CAG and the CAG gives his comments or supplements the report of the Statutory Auditors. In addition, these companies are also subject to test audit by the CAG.

2. The statutes governing some Corporations and Authorities require their accounts to be audited by the CAG and reports to be given by him. In respect of five such Corporations *viz.* Airports Authority of India, National Highways Authority of India, Inland Waterways Authority of India, Food Corporation of India and Damodar Valley Corporation, the relevant statutes designate the CAG as their sole auditor. In respect of one Corporation *viz.* Central Warehousing Corporation, the CAG has the right to conduct a supplementary or test audit after audit has been conducted by the Chartered Accountants appointed under the statute governing the Corporation.

3. Reports in relation to the accounts of a Government Company or Corporation are submitted to the Government by the CAG under the provisions of Section 19-A of the Comptroller and Auditor General's (Duties, Powers and Conditions of Service) Act, 1971, as amended in 1984.

4. The cases mentioned in this Report are among those which came to notice in the course of audit during 2010-11 as well as those which came to notice in earlier years. Similarly, results of audit of transactions subsequent to March 2011 in a few cases have also been mentioned.

5. All references to 'Companies/ Corporations or PSUs' in this Report may be construed to refer to 'Central Government Companies/ Corporations' unless the context suggests otherwise.

EXECUTIVE SUMMARY

I Introduction

1. This Report includes important audit findings noticed as a result of test check of accounts and records of Central Government Companies and Corporations conducted by the officers of the Comptroller and Auditor General of India under Section 619(3) (b) of the Companies Act, 1956 or the statutes governing the particular Corporations.

2. The concept of thematic study was introduced during the year 2008-09 to shift to system based quality audit reporting using risk based audit approach. The Report contains 15 theme based audit observations and 49 individual audit observations relating to 44 PSUs under 16 Ministries/Departments. The draft observations were forwarded to the Secretaries of the concerned Ministries/Departments under whose administrative control the PSUs are working, to give them an opportunity to furnish their replies/comments in each case within a period of six weeks. Replies to 34 observations were not received even as this report was being finalised. Earlier, the draft observations were sent to the Management of the PSUs concerned and their replies were considered while finalising this report.

3. The paragraphs included in this Report relate to the PSUs under the administrative control of the following Ministries/Departments of the Government of India:

Ministry/Department (PSUs commented upon)	Number of paragraphs	Number of thematic studies	Number of paragraphs / thematic studies in respect of which Ministry reply was awaited
1. Atomic Energy (ECIL , NPCIL)	2	-	1
2. Civil Aviation (AIL, AASL, AAI)	4	1	5
3. Coal (SECL, WCL)	2	-	-
4. Commerce and Industry (STCL)	1	-	-
5. Communications and Information Technology (BSNL, MTNL)	4	1	3
6. Consumer Affairs, Food and Public Distribution (CWC, FCI)	3	-	2
7. Defence	2	-	1

(BEL, HAL)			
8. Finance (GICL, NICL, NIACL, OICL, UIICL)	4	2	2
9. Heavy Industries & Public Enterprises (BHEL, NSCFDC, NBCFDC, NMDFC, NSTFDC, NRDC)	3	1	3
10. Mines (NALCO)	1	1	2
11. Petroleum and Natural Gas (Balmer & Lawrie, BPCL, HPCL, CPCL, GAIL, ONGC)	10	1	5
12. Power (BPSCL, DVC, NTPC, PGCIL, RGPPL)	4	2	1
13. Road Transport and Highways (NHAI)	3	1	4
14. Shipping (DCIL, SCIL)	1	2	3
15. Steel (KIOCL, RINL, SAIL)	5	2	1
16. Textiles (BICL)	-	1	-
Total	**49**	**15**	**34**

4. Total financial implication of audit observations included in 15 thematic studies was ₹ 1646.21 crore.

5. Individual Audit observations in this Report are broadly of the following nature:

- Non-compliance with rules, directives, procedures, terms and conditions of the contract etc. involving ₹ 858.66 crore in 11 paras.
- Non-safeguarding of financial interest of organisations involving ₹ 543.14 crore in 20 paras.
- Defective/deficient planning involving ₹ 1350.55 crore in 15 paras.
- Inadequate/deficient monitoring involving ₹ 15.52 crore in one para.
- Non-realisation/ partial realisation of objectives involving ₹ 275.94 crore in two paras.

6. The Report also contains a para relating to recoveries of ₹ 83.83 crore made by 11 PSUs and another para relating to corrections/rectifications by four PSUs at the instance of Audit.

II Highlights of significant paras included in the Report are given below:

The Cabinet Committee on Economic Affairs (CCEA) while granting approval in December 2000, to provide four lane connectivity to the major ports in the country on BOT basis through SPVs, had directed National Highways Authority of India to award contracts for Port Road Connectivity (PRC) projects by March 2002. Accordingly, these projects were expected to be completed within a period of 2-3 years of award of contract. NHAI/SPVs, however, did not prepare Corporate/ Strategic Plan for timely implementation of these projects. Delay in formation of SPVs and award of contracts was observed in various projects. Resultantly, none of the projects was completed by the scheduled completion date. Out of total nine projects, only four were completed so far with delays ranging from 12 months (JNPT Phase-I) to 53 months (Cochin) and remaining five projects were yet to be completed (December 2011). At Mormugao and Cochin ports, a road stretch of 1.8 kms and 10 kms, respectively, at the port end could not be upgraded due to non incorporation of these stretches in respective DPRs. Thus upgraded road connectivity to Mormugao and Cochin Ports could not be established. Further, due to ineffective toll collection operations of SPVs, toll collection was either delayed or suspended and SPVs sustained revenue loss of ₹ 127.68 crore. Potential loss of toll revenue, due to delay in completion of PRC projects, worked out to ₹ 873.85 crore (December 2011).

(Para No. 13.1)

Due to non-enforcement of contractual terms regarding supplies of imported coal at the optimum landed cost, NTPC Limited had to incur an avoidable expenditure of ₹ 698.81 crore during 2008-2011 on supplies of coal through routes other than optimum routes.

(Para No.12.4)

The Oriental Insurance Company Limited issued credit insurance policies in violation of IRDA instructions, re-insurance program and insurance principles. Besides, there was significant delay in appointment of surveyors, receipt of survey reports and processing of the claims, which led to further insurance cover by the Company to the benefit of M/s Paramount Airways by ₹ 399.24 crore during the years 2005-06 to 2009-10. Blatant violation of the IRDA instructions coupled with undue delay in processing and finalization of the claims of banks was indicative of absence of proper systemic controls within the Company and considering the fact of several procedural and substantive irregularities on the part of the Company, nexus between Paramount Airways, the banks and the Company may not be ruled out.

(Para No. 8.5)

GAIL (India) Limited supplied natural gas at subsidised rates, in deviation of the Ministry's directives, to ineligible consumers generating and supplying electricity to their consumers at commercial rates through the grid of Tamil Nadu Electricity Board. This led to under recovery of ₹ 246.16 crore in Gas Pool Account for the period from April 2006 to March 2011, undue benefit to such producers to that extent and depriving eligible consumers of subsidised/Administered Price Mechanism gas.

(Para No. 11.5)

Rashtriya Ispat Nigam Limited produces steel in its three million tonne steel plant at Visakhapatnam and has its own marketing set-up. The turnover is mainly from domestic market consisting of normal sales on the basis of monthly operating prices fixed by the Company, E-auction sales and negotiated sales.

Audit observed structural deficiencies in the incentives schemes operated by the Company due to passing of discounts on slab basis instead of incremental basis. As a result, discount of ₹ 33.93 crore was excessively passed to buyers.

Audit further noticed certain deficiencies in actual sales operation of normal sales such as sale of products below the market price, delay in effecting revision of prices, applying pre-revised prices on dispatches affected on subsequent day and extending price reduction retrospectively. Resultantly the Company lost revenue to the tune of ₹ 137.72 crore.

The Company had no procedure for negotiated sales which resulted in short realisation of ₹ 37.73 crore due to sale of products below the applicable operating price. Also the Company was put to loss of ₹ 1.17 crore by not fixing the reserve price for E-auction of secondary products.

(Para No. 15.3)

Oil and Natural Gas Corporation Limited failed to take a holistic view of its space requirements. As a result of piecemeal acquisition of land for office building during June 2004 to July 2007, the Company incurred extra expenditure of ₹ 204.33 crore on increase in offer price of land, penalty for time extension for constructing the office building, stamp duty on swapping of two plots separated by a road for two adjacent plots.

(Para No. 11.9)

Central Warehousing Corporation did not dispose off time-barred bonded goods ranging from two to twenty six years which resulted in non-realisation of storage charges amounting to ₹ 167.29 crore upto 31 March 2011.

(Para No. 6.1)

Dredging Corporation of India provides integrated dredging services to ports, Indian Navy, Shipyards and others through two types of dredgers, viz, Cutter Suction Dredgers (CSDs) and Trailer Suction Hopper Dredgers (TSHDs). The expenditure on fuel and lubricants incurred by the Company constitutes, on an average, 39% of the total operational expenses. For the review, a sample of expenditure on fuel on all the 10 TSHDs owned and three TSHDs hired by the Company that constituted 91-98 % of the total cost of fuel and lubricants, was selected.

Audit observed that, the MoU norms for fuel consumption were not based on a scientific study. These were much higher than the previous year's consumption as well as the builder's norms which led to an excess expenditure of ₹ 85.71 crore. There was excess issue of fuel amounting to ₹ 24.97 crore to the chartered TSHDs by not restricting the supply of fuel rate proportionate to their percentage of achievement.

Audit further noticed that, the Company procured its entire fuel requirement from IOCL alone without inviting open tenders deviating from its own Purchase Procedures. Due to this flawed practice, the Company deprived itself of negotiating better price and payment terms and incurred an opportunity loss of ₹ 9.98 crore. Gaps in issue and consumption of the fuel and lubricants amounting to ₹ 18.66 crore also pointed out lack of internal control measures.

There were delays in raising the fuel escalation claims ranging from 10 days to 319 days. Further there was no contractual provision for levy of interest on delayed payment of fuel escalation claim resulting in interest loss of ₹ 25.31 crore.

(Para No. 14.1)

Bharat Electronics Limited (Company) accepted to execute Convergent Billing and Customer Relationship Management project of MTNL within twelve months from the date of purchase order (February 2006). The contract recognised that in the likelihood of the change in System Requirement Specifications, the changes were to be implemented by the Company without any additional financial implication. Bid for the Project was made by Company after entering into a Memorandum of Understanding with various partners including IBM which had expertise in System Integration (SI) of CRM projects. Company, however, could not ensure performance of SI by IBM. Further, Company failed to incorporate back to back payment terms, corresponding with payment terms of MTNL, with its vendors. Thus, as a result of accepting to execute a turnkey project having fixed delivery schedule coupled with unlimited scope for expansion, failure to ensure performance of SI by IBM and failure to incorporate back to back payment terms with its vendors, the Company failed to execute the above project of MTNL even after five years of its scheduled completion date that resulted in blocking of ₹ 144.85 crore for more than four years (March, 2012).

(Para No.7.1)

KIOCL Limited (the Company) entered (August 2005) into a long term agreement with National Mineral Development Corporation Limited for procurement of iron ore fines from its Donimalai Mines in Karnataka for the period from 2005-06 to 2009-10. The agreement provided guaranteed specification for Fe content of 64 *per cent* in iron ore fines and adjustment of price accordingly. Acceptance of ore with lower Fe content by the Company without exercising the option of getting the umpire sample tested in a neutral laboratory as per provisions of the contract resulted in excess payment of ₹ 23 crore during the period from April 2008 to March 2011. Further, the Company had not fixed any norms for transit and handling losses to serve as a benchmark. The Company had suffered a loss of ₹ 105.24 crore on account of short receipt of quantity during the period from 2005-06 to 2010-11.

(Para No.15.1)

British India Corporation Limited failed to have proper due diligence on the valuation of the properties and the sales process of land. There was unnecessary hurry in concluding the sales of land by getting the 'agreement to sale' registered with the buyers ignoring the legal advice and the warnings of the State Government, which led to loss of ₹ 109.03 crore to the Company on account of increase in value of the properties in 2011 beyond the bid price of 2003, besides the non-generation of fund for modernization of the plant and machineries.

(Para No. 16.1)

Food Corporation of India reimbursed mandi labour charges against the paddy procured at farm gate/mill point which resulted in excess payment of ₹ 107.95 crore to private rice millers during KMS 2007-08 to KMS 2009-10.

(Para No. 6.2)

Failure of National Highways Authority of India to recover penalty for delayed completion of work as per Concession Agreements resulted in non-realisation of ₹ 90.30 crore from Concessionaires and avoidable loss of ₹ 17.15 crore (till December 2011) towards interest on the above amount.

(Para No.13.2)

The contracts for procurement of Low Ash Metallurgical (LAM) coke of the KIOCL Limited were finalized through spot negotiations by an Empowered Joint Committee (EJC) of the Ministry of Steel. With coke prices rising in the global market, two meetings of EJC were held in February 2008 and June 2008. Against projected requirement of eight and five shipments for EJC meetings held in February 2008 and June 2008, the Company placed orders for two shipments and three shipments respectively. The decision of not procuring a third shipment of LAM coke at lower rates offered during the EJC meeting held in February 2008, despite having storage capacity to stock three shipments, resulted in extra expenditure of ₹ 54.85 crore. Further, absence of proper inventory management resulted in shortage of stock of 9,144.153 MT LAM coke valued at ₹ 32.41 crore for which no responsibility was fixed and the write-off accorded was not based on proper justification.

(Para No. 15.2)

Improper planning and consequent excess procurement of equipment by Bharat Sanchar Nigam Limited to expand Mobile Switching Centre based Wireless in Local Loop System led to avoidable expenditure of ₹ 65.51 crore.

(Para No. 5.1)

The total investments (at cost) of The New India Assurance Company Limited as on 31 March 2011 stood at ₹ 13604 crore. Investment in equity constituted 20 percent of the total investments in the market. Upon review of the investment function particularly with reference to investment in equities, non-compliance to investment regulations framed by the Insurance Regulatory and Development Authority were observed. It was further observed that the Company did not have a stop loss policy due to which the market value of equity shares of 29 companies with a book value of ₹ 94.92 crore held by it, deteriorated beyond 25 *per cent* and upto 94.75 *per cent* resulting in erosion of the value to the extent of ₹ 47.02 crore (March 2011). An instance of non-compliance of Investment Policy while deciding to not to accept an open offer made by the promoters of M/s Alfa Laval (India) Limited whose share were held by the Company was also noticed which resulted in foregoing a profit of ₹ 14.27 crore. Further, despite initiating the process of implementation of the Investment Management System in the year 2004, the Company did not have a full-fledged investment management system compliant with IRDA guidelines as on 31 March 2011.

(Para No. 8.4)

CHAPTER I: DEPARTMENT OF ATOMIC ENERGY

Electronics Corporation of India Limited

1.1 Avoidable loss due to short/ excess payment of advance tax

The Company incorrectly worked out the estimated profit resulting in excess/short payment of advance tax which resulted in loss of ₹ 5.34 crore.

The Income Tax (IT) Act provides that a Company has to estimate its income and pay advance tax every year in four instalments of 15, 45, 75 and 100 *per cent* by June, September, December and March, respectively. The IT Department charges penalty on short payment of advance tax and allows simple interest at six *per cent* on refunds, from April of the next financial year. It is the responsibility of the Management to estimate the income tax correctly to avoid penalty for short payment of advance tax or to avoid loss of interest on excess paid advance tax.

Audit scrutiny of the records of Electronics Corporation of India Limited (ECIL) for the Assessment years 2007-12 revealed that the advance tax paid by ECIL was far less than the income-tax due during the years 2007-08 and 2008-09 and far in excess of the actual income tax due during the years 2009-10 to 2011-12 as below:

(₹ in crore)

Assessment year	Advance tax deposited (₹)	Income tax due (₹)	Short(-)/Excess Income tax paid (₹)	Percentage of Income tax paid short/in excess
2007-08	31.09	57.95	(-)26.86	46
2008-09	45.24	58.15	(-)12.91	22
2009-10	50.00	12.98	37.02	285
2010-11	17.75	9.76	7.99	82
2011-12	13.50	nil	13.50	---

Audit observed that the Company had incorrectly worked out the estimated profit resulting in short/excess payment of advance tax in the assessment years 2007-08 to 2011-12. Resultantly, the Company paid interest at higher rate (i) on short payment of advance tax than the interest earned on deposits (ii) on excess payments towards borrowings than the interest earned on refunds from the income tax department amounting to ₹ 5.34 crore as shown below which was avoidable:

(₹ in crore)

Assessment year	Interest paid on tax/ borrowings	Interest earned on deposits/refunds	Differential loss of interest
2007-08 to 2008-09 (short payment of tax)	3.58	2.72	0.86
2009-10, 2010-11 & 2011-12 (excess payment of tax)	11.55	7.07	4.48
Total			**5.34**

Audit observed that incorrect estimation of income was due to the following reasons:

- There was no documented procedure/system in place to estimate the advance tax for each quarter.
- The estimation of taxable income was based on MOU targets and budget estimates for the entire financial year. Actual income varied but the estimated taxable income was not reworked for each quarter which led to excess payment of tax.
- There was no system of revisiting estimated profit and accordingly taxable income in each quarter for the subsequent period of financial year after considering the actuals of previous quarters.

While accepting the audit observation for future guidance, Ministry stated (November 2011) that the incorrect taxable income worked out by the Company was due to the following reasons:

- *The Company is basically a R&D unit and each and every order was first of its kind as per customer specifications/requirements. Hence, it was difficult to estimate the contribution from these projects. Due to volatility in getting orders, it was difficult to estimate profit also.*
- *During the year 2008-09, there was a substantial increase in the provision for wage revision arrears payable to the employees from 1 January 2007. The said provisions for the years 2006-07 (for 3 months), 2007-08 and 2008-09 were made based on the DPEs OM which resulted in lower profit for the year 2008-09. As said provision for wage revision arrears was disallowed by the Income Tax Department, the same was added while computing the taxable income for advance tax purposes.*
- *During the year 2009-10, the contribution level went down to 32 per cent due to change in actual product mix and margins thereof have registered a significant positive change towards the end of this year.*
- *During the year 2010-11, the Company implemented Fringe Benefits to officers and workmen which resulted in additional provision of ₹57 crore. There was also increase in the interest expenditure to the extent of ₹5 crore over the estimates. Expenditure was estimated based on the 2009-10 actuals, however there was an increase in manufacturing, administration and selling expenses of around ₹25 crore over the previous year.*
- *Considering the above factors which were clear at the time of payment of fourth installment of advance tax (FY 2010-11), the estimated taxable income was reviewed and the Company has not made any further payment of advance tax either on 15 March or on 31 March 2011.*

The reply is not tenable on account of the following:

- These orders are customer based specifications and not basic R&D projects. Even for R&D projects, tax relief is given for qualifying revenue costs on eligible R&D activities when calculating their taxable profits. In fact, the estimation of taxable income worked out by the Company was based on MOU targets and budget estimates for the entire financial year. Though, actual income varied, the estimated taxable income was not revisited for each quarter which led to excess payment of tax.

- A review of the estimates vis-a-vis actuals for the FY 2008-09 revealed that material consumption varied by 23.3 *per cent* (₹ 604.17 crore (actual) against ₹ 490 crore (estimates) which had a major impact in the estimation of profit before tax. Other expenditure varied only by 2.18 *per cent* which was very marginal. As per section 43B of income tax Act, 1961, provisions are allowed unless such sums have actually been paid before the due date of filing return. Hence, it is a clear lapse on the part of the Management not to estimate the taxable income correctly by taking into account all provisions and expenditure on quarterly basis that were admissible under the income tax act.
- The material consumption for all the four quarters FY 2009-10 (AY 2010-11) was taken as ₹ 689.40 crore as against the actual of ₹ 712.75 crore. Similarly, there was reduction in Sales during the year. But, the Company did not revise their estimates till the fourth quarter based on these inputs .and therefore the profit before taxes was incorrectly estimated resulting in excess payment of advance tax.
- It is a clear lapse on the part of the Management not to estimate the allowable expenditure under Section 43B of income tax act for FY 2010-11, based on expenditure incurred up to the fourth quarter. Though the taxable income was 'Nil', the Company paid advance tax of ₹ 13.50 crore.

Thus, due to absence of a well defined system for working out the taxable income based on realistic inputs after due consideration of the trends; advance tax was incorrectly assessed which resulted in avoidable loss of ₹ 5.34 crore.

Nuclear Power Corporation of India Limited

1.2 Avoidable expenditure due to non-admittance of claim under defect liability period

Failure to trip the generator resulted in damage to stator and non-admittance of claim under defect liability by supplier necessitating avoidable expenditure of ₹ 31.08 crore.

Nuclear Power Corporation of India Limited (Company) commissioned its 220 MWe Kaiga 3 generating unit in May 2007 at a cost of ₹ 1325.50 crore. The unit stopped generating electricity on 26 August 2007 due to a fault in the Turbine Generator (TG). The unit remained shut till 31 March 2008.

A joint investigation by the Company and the suppliers revealed (October 2007) that failure of a bolt of the rotor caused damage to the cooling system of the stator resulting in interruption of stator water through conductors and escape of hydrogen from generator casing to stator water system. Though the stator water flow low alarm appeared in the control room, the auto trip device did not actuate. By the time the operating personnel involved in fixing the hydrogen escape problem realized the actual situation, there was overheating and damage to the insulation of stator conductors and caused subsequent tripping of the TG.

As the cost of repair (USD 6.171 million) by the suppliers was higher than the purchase price including spares (USD 4.80 million), the Company decided (February 2008) to replace the damaged stator. Accordingly, a fresh purchase order was placed. Meanwhile, stator of Kaiga 4 was used to replace the damaged stator of Kaiga 3 by incurring an additional cost of ₹ 0.86 crore. The new stator was received in March 2009 at a total cost of ₹ 30.22 crore.

Audit observed that though the damaged stator was under defect liability period, the claim for repairs without any cost to the Company was not accepted (October 2007) by the suppliers on the plea that the damage to the stator would not have taken place if the generator had been tripped timely either by automatic means or by operator's action subsequent to failure of rotor components and loss of water flow through stator conductors. The generator continued to operate for 23 minutes from the start of the incident which resulted in tripping of TG on stator earth fault.

The Management stated (October/November 2011) that:

- *The operating personnel accorded priority on attending fluctuation in hydrogen pressure in the stator due to its hazardous nature.*
- *The generator failure occurred due to confluence of several factors and therefore, it was not possible to fix responsibility on any single agency and a negotiated settlement was arrived at for sharing the responsibility. The manufacturer of generator modified all the rotors and software of the other projects and supplied to the Company free of cost.*
- *The potential disruption of schedule of the other upcoming projects in which the supplier was same was also considered.*
- *The cost of the new stator formed a small percentage of the project cost, which was accounted for in working out the tariff and it was decided to repair the damaged stator to keep as insurance spare.*

The reply is not convincing due to the following:

- Management brought (March 2008) to the notice of its Board of Directors that damage to the stator would not have taken place if the generator had been tripped timely either by automatic means or by operator's action.
- Supply of modified rotor and software for other projects, after a failure, was normally expected from the supplier for avoidance of such instances in future.
- Linking of the issue with the possible disruption of schedule of other upcoming projects by the same supplier was not justifiable as the supplier was contractually liable to supply the equipment under those contracts.
- The inclusion of the cost in the tariff resulted in capitalization of the stator cost twice. Moreover, decision to get the damaged stator repaired and use it as insurance spare was not understandable as the initial decision to replace the same was on the ground that the repair cost exceeded the replacement cost.

Thus, failure to trip the generator timely led to non-admittance of claim under defect liability resulting in an avoidable expenditure of ₹ 31.08 crore.

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

CHAPTER II: MINISTRY OF CIVIL AVIATION

Air India Limited

2.1 Wasteful expenditure due to non-utilisation of leased premises for cargo warehouse

Failure to surrender leased premises without usage for the last nine years ended March 2012 resulted in a wasteful expenditure of ₹ 14.30 crore towards lease rent, council tax and utility charges.

Air India Limited (Company) took on lease a plot of land measuring 0.58 acres and a building constructed thereon measuring 25,266 square foot from British Airport Authority (BAA) in April 1968 for a period of 50 years and 9 months, *i.e.*, up to January 2019, to be used as warehouse for handling its cargo at London Heathrow airport. As per terms and condition of lease governed by deed of 8 October 1976, the Company was required to pay annual rent for the premises which ranged between £4,350 (₹ 0.034 crore) in 2003-04 and £4,950 (₹ 0.038 crore) in 2010-11, besides council tax, which ranged between £172,716 (₹ 1.35 crore) in 2003-04 and £285,390 (₹ 2.23 crore) from 2011-12.

Handling of cargo of the Company was being done by Menzies Aviation Limited (MAL) since September 1998. For three years up to 31 August 2001, the Company received royalty of £21 (₹1644) per tonne for the third parties' cargo handled through its warehouse. In April 2004, MAL refused to work from the Company's warehouse due to poor working conditions and started handling the Company's cargo from its own warehouse. In January 2007, the Company entered into another agreement with MAL, effective for five years from 1 September 2006, whereby MAL agreed to refurbish the warehouse at its cost and pay minimum royalty of £30,000 (₹ 0.24 crore) per annum, besides paying 50 *per cent* of the cost of electricity, heating and water for using the Company's warehouse for the third parties' cargo.

The warehouse, being in a poor state, could not be used till completion of necessary repairs by MAL in April 2008 and consequently, royalty amounting to £45,000 (₹ 0.35 crore) (for September 2006 to March 2008) was not paid by MAL. Subsequently, due to withdrawal of the regulated status of MAL by the Department of Transport (the regulatory body of UK) owing to security lapses in the Company's warehouse, MAL could not use the warehouse and handled the exports again from its warehouse since April 2009.

Audit observed (January/April 2011 and February 2012) that:

- The Company's warehouse had barely been used for cargo handling and, instead, was used for storage of few of its stores and accommodating three staff members.
- Despite receiving an offer from BAA in February 2003 for early termination of lease at a market value of £3.35 million (₹ 26.23 crore), the Company inexplicably preferred to hold the asset idle over the years.

- The Company appointed (9 April 2009) a committee of four senior officials at London to examine all options in connection with cargo functioning and to propose action to be taken in respect of the warehouse. The committee, required to submit the report by 24 April 2009, did not submit any report.
- The Company incurred an avoidable expenditure (net) of ₹ 14.30 crore[1] on rent, council tax, and utility charges for the last nine years upto March 2012, after netting off the receipts of ₹ 1.24 crore from MAL towards royalty and utility charges.

The Management in its reply stated (May 2011) that in view of the long term lease, it was not feasible to surrender the warehouse and steps were being taken to utilise the cargo warehouse. The Management while accepting that the committee never submitted any report added that the members of the committee either retired or were transferred out of London.

The reply is not acceptable as the Company had received (February 2003) an offer from BAA for early termination of lease at a market value of £3.35 *million* (₹ 26.23 crore). In March 2009, BAA again offered for early termination of lease and cautioned that with the expiry of lease period coming to end (January 2019), delay in surrendering of warehouse would result in reduction in the values of lease. In fact, delay in surrendering the warehouse has already resulted in reduction in the value of lease to £2.25 million (₹ 17.62 crore), as estimated by the Management in June 2010.

Considering the annual commitment towards rent and council taxes, and the fact that its cargo handling could have been done and was being done from the premises of the cargo handling agent, it was imperative for the Company to act promptly for surrendering or utilising the space. The lackadaisical approach of the Company in taking firm decision for the last nine years ending March 2012 indicated weak governance which resulted in a wasteful expenditure of ₹ 14.30 crore.

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

2.2 *Extra expenditure in Air India Limited*

Cases involving extra/wasteful expenditure and failure to realise revenue by Air India Limited (Company) were highlighted earlier through the CAG's Reports[2] for appropriate remedial action. In brief, these cases covered issues on internal controls to check expenditure and increase the revenue. In particular, Para No.2.2.1 of Report No.CA 24 of 2009-10 pointed out extra payment of ₹ 8.49 crore to a private party by the Company from April 2005 to March 2008 due to acceptance of higher rates for catering services

[1] ***£1,826,455 converted at an average exchange rate of ₹78.309/£ , being the average of monthly exchange rates of Government of India for the period March 2003 to December 2011 as under:***

Expenses			*Less*	*Receipt*		
Council Tax	*: £1,822,172*	*=₹14.27crore*				
Rent	*: £42,750*	*= ₹00.34crore*		*Rent*	*: £102,500*	*=₹0.80 crore*
Utility Charges	*: £120,257*	*= ₹ 00.93crore*		*Utility Charges*	*:£56,223.71*	*=₹0.44crore*

[2] ***Para 2.2.1 of CAG's Report No. CA 24 of 2009 -10 and Paras 2.3.1 to 2.3.5 of CAG's Report No.9 of 2009-10.***

contract concluded for its own flights without availing of the benefit of lower rates concluded on the same date with the same caterer for identical menus for the flights of its subsidiary company-Air India Express involving comparatively lesser volume of business.

Audit observed that cases of extra expenditure due to acceptance of higher and non-competitive rates by the Company continued to occur which indicated persistence of a financial governance deficit. In fact, such cases point towards indifferent attitude of the Management to the financial position of the cash strapped Company as corroborated by the following cases:

(a) Extra payment of ₹75.26 lakh due to acceptance of higher rates in a non-competitive manner for hiring transport

Acceptance of abnormally higher rates in a non-competitive manner by Washington office of Air India for hiring transport for the teams accompanying Special Charter Flights on visits of Prime Minister to USA resulted in extra expenditure of ₹ 75.26 lakh.

(i) The Company operated a special charter flight for the visit of a delegation headed by the Prime Minister to New York in September 2011. Apart from the members of delegation nominated by various Ministries of the Government of India (GOI), the Company detailed a special team comprising of an advance prepositioning team, crew and accompanying team for the event. Though the delegation was scheduled to visit New York, the aircraft was parked at Dover[1]. Part of the crew along with the Special Protection Group (SPG) team had, therefore, to stay at Dover from 22 September to 26 September 2011. Based on the instructions from the Company's Headquarters, the Area Sales Office of the Company in Washington hired transport from a local transport company *viz.* M/s. Empress Limousine for the Company's team detailed at Dover. For the SPG team, the transport was hired by the Embassy of India at Washington (Embassy) from the same transport company through a separate contract.

Audit observed that hourly rates paid by the Embassy for 'Sedan' and '15 Pax Van' types of vehicles were US$ 30 and US$ 50 respectively, whereas the hourly rates paid by the Company for the same type of vehicles were abnormally high, being US$ 75 and US$ 90, as these were 1.8 times and 2.5 times the rates paid by the Embassy. Thus, the Company incurred an avoidable extra expenditure of ₹ 17.86 lakh[2] for this event.

(ii) Similarly, in connection with the earlier two visits of the Prime Minister to Washington in November 2009 and April 2010, when a delegation of the Company had accompanied the Special Charter Flights, Audit observed that transport for the Company's delegation was hired by Area Sales Office, Washington, whereas transport for the members of the delegation from various Ministries of GOI was hired by the Embassy. For both the visits, the Company and the Embassy had hired transport from the same transport

[1] ***Dover is located in Delaware, about 185 miles from New York.***

[2] ***At an exchange rate of ₹48.07/US$ for October 2011. The amount also includes gratuity at the rate of 15 per cent.***

company *viz.* M/s. Empress Limousine. Again, the Embassy hired 'Sedan', '7 Pax Van' and '15 Pax Van' types of vehicles at hourly rate of US$ 40, US$ 50 and US$ 60 respectively, while the Company paid for the same type of vehicles at the rates of US$ 75, US$ 85 and US$ 90 *i.e.* at 1.5 times to 1.88 times (almost double) the rate paid by the Embassy leading to extra payment of ₹ 57.40 lakh*.

Thus, in comparison to the arrangements made by the Indian Embassy, the Company incurred an extra expenditure of ₹ 75.26 lakh due to acceptance of non-competitive and unreasonably high rates for arranging transport for merely three VVIPs visits in 2009, 2010 and 2011.

In response, the Management stated that the market rates for such type of services were flexible and dynamic and, therefore, might vary from one customer to another. It further contended that the Embassy provides regular and voluminous business annually to the transporter and, therefore, it gets a huge volume discount and, thus, comparison of rates was not appropriate.

Reply of the Management is not acceptable as hiring of vehicles for the same purpose during the same period from the same agency at a rate upto 2.5 times the rate paid by the Embassy could not be attributed to dynamics of the market. The contention that the Embassy was being offered discount due to higher volume of business was also not plausible as the rates in contracts concluded by the Embassy and the Company with the transporter were firm and final and irrespective of the volume of business offered. Furthermore, for the VVIP visits in 2009 and 2010, the agreements drawn by the Embassy were for lesser number of hours than the hours indicated in the agreements drawn by the Company in November 2009. This indicated a general absence of concern for the financial health of the Company which was reeling under severe cash crunch during this period.

The matter was reported to the Ministry in January 2012; their response had not been received (May 2012).

(b) Overpayment of ₹63.22 lakh towards port fee to a private party at higher than the applicable rates

Port Authority of New York and New Jersey notified a rate of 8 *per cent* Port Fee to be charged on the permit holders using its resources. Air India Limited, however, paid the Port Fee at a higher rate of 8.7 *per cent* to its catering contractor operating at New York and Newark airports resulting in overpayment of ₹ 63.22 lakh.

For provision of catering services for Air India's flights operating from Newark, New Jersey (EWR) and New York (JFK), the Company entered into separate Memoranda of Understanding (MOU) with M/s Flying Food Group, New York (FFG). The MOU were signed for a period of three years commencing 03 December 2006 and 01 August 2008 for EWR and JFK respectively. For EWR, the MOU was further extended up to 14 August 2010, before a fresh agreement for additional three years was entered into with effect from 15 August 2010 with the same firm. Similarly, for JFK, fresh MOU for a

* *At an exchange rate of ₹46.87/US$ and ₹46.05/US$ for November 2009 and April 2010, respectively. The amount also includes gratuity at the rate of 15 per cent.*

period of three years from 01 August 2011 was signed with FFG. Apart from the rates of each item of supply, the terms of the MOU, *inter alia,* enunciated that FFG would levy a Port Fee, which would be in accordance with the rates notified by the Port Authority of NY and NJ. The Port Authority's notification for levy of Port Fee, which formed part of the MOU, stipulated that from 01 June 2006, Port Fee would be charged at the revised rate of 8 *per cent* of the 'Gross Receipts'. It further clarified that FFG was also required to remit the Port Fee at the same rate of 8 *per cent* to the Port Authority accordingly. The agreement (Privilege Permit) between the Port Authority and FFG was executed. As per the terms and conditions of this agreement, any taxes separately paid by the customer and directly payable to the taxing authority by the Permittee (FFG) would not form part of the 'Gross Receipts' and, hence, payment of Port Fee was to be made only against the amount actually payable to FFG.

Notwithstanding the notified rate of 8 *per cent,* the Port Fee in the subject MOU with FFG was determined by the Company at the rate of 8.7 *per cent* and the Company's Regional Office, New York made the payments to FFG at this rate in respect of both the MOU. The additional element of 0.7 *per cent* was stated to have been worked out construing Port Fee as a component of the Gross Receipts i.e. 8 *per cent* levy over the 8 *per cent* Port Fee.

Audit observed that since the amount of Port Fee was separately charged by FFG as per the actual fee levied by the Port Authority and was in turn to be remitted to the latter, the same did not qualify to be included within 'Gross Receipts' as per the agreement. Further, as the Port Fee did not form part of the income to the Permittee, the levy of 8 *per cent* fee over this amount was not justifiable and tantamount to overpayment.

During the currency of the above MOU from December 2006 to September 2011, an aggregate amount[1] of US$ 21,397,471 at the rate of 8.7 *per cent* was paid to the firm and, thus, an amount of US$ 137,794 (₹ 63.22 lakh[2]) at the rate of additional 0.7 *per cent* was overpaid to the private party. Despite the matter having been pointed out to Air India, New York in January 2011, the Company continued to pay Port Fee at higher rate of 8.7 *per cent* up to September 2011. Though the rate of payment of Port Fee was later rectified in October 2011 after audit re-emphasized the inaccuracy of the rate being applied by the Company, no recovery for the excess amount paid prior to October 2011 had been effected, indicating a favour to the private party.

Thus, due to payment of Port Fee at higher than the applicable rate, Air India overpaid an amount of ₹ 63.22 lakh to the catering contractor (FFG) in respect of the contractual agreements concluded in December 2006 and August 2010 for EWR and August 2008 and August 2011 for JFK.

The matter was reported to the Company and the Ministry in December 2011; their response had not been received (May 2012).

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[1] *Includes port fee of ₹US$ 1,712,585*
[2] *At the average rate of exchange*

Airline Allied Services Limited

2.3 Review of Operations

2.3.1 Introduction

Airline Allied Services Limited (AASL) was incorporated in September 1983 under the Companies Act 1956, as a wholly owned subsidiary of erstwhile Indian Airlines Limited (now Air India Limited-AIL). The main objectives of the AASL were to carry on the business of hotel, flight kitchen, to carry out the business of ground handling at the airports, to establish, maintain and operate International and Domestic Air Transport Services and to buy, sell, hire, let on hire and deal in aero planes, flying machines, aircraft and the component parts thereof.

AASL was envisaged to function as profit centre of AIL. However, the Company was continuously incurring losses (except marginal profits of ₹ 2.05 crore in the year 2003-04) over the last ten years of its operations (2001-02 to 2010-11). The Company had accumulated losses of ₹ 582.90 crore as on 31 March 2011 and has fully eroded its share capital (₹ 2.25 crore). As on 31 March 2011 the Company was liable to pay to its Holding Company an amount of ₹ 462.51 crore

AASL started its operations in April 1996 with the transfer of an ageing fleet of 12 Boeing aircrafts on lease from AIL in a phased manner. As on 31 March 2011 the Company was having a fleet of 17 various types of aircrafts[1]. Audit reviewed operations of AASL during the period 2008-09 to 2010-11 with reference to MOUs/Agreements entered by it with clients to assess efficiency in operations of aircrafts. Major Audit findings noticed were as under:

2.3.2 Audit Findings

2.3.2.1 Freighter aircraft operations

12 Boeing aircrafts received on lease from AIL were initially used for passenger operations on inter regional routes. Subsequently, AIL got converted six aircrafts into freighters during July 2007 to October 2008 and phased out six aircrafts in August 2009(one aircraft had crashed in July 2000). AASL undertook freighter operations under the agreements for the freighter charters between AIL and the concerned parties. AIL provided handling, marketing, sales and booking and other support services for AASL flight operations.

AIL entered into (May 2007) a wet[2] lease agreement, for five of its freighter aircrafts with M/s. GATI initially for a period of five years (July 2007 to July 2012) at a lease rent of ₹ 2.92 lakh per aircraft per hour with a minimum guaranteed utilization of aircrafts to operate 25 days in a month with minimum 17 hours per day on five aircrafts operation i.e. 425 hours per month. The agreement further provided that initially M/s. GATI was to pay lease rental on actual flown hours basis till the induction of fifth aircraft in operation. Meanwhile, the AIL entered into (August 2007) another agreement, with Department of Posts (DOP) for one freighter aircraft on wet lease initially for a period of one year. After agreement with DOP the Company was unable to fulfil its contractual obligation of

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[1] ***Six B-737-200 (Boeing), seven ATR-42-320 (Avion De Transport Regional)-48 seater and four CRJ-700 (Canadair Regional Jet) -70 seater.***

[2] ***In wet lease agreement aircraft is provided along with maintenance and crew support.***

deploying five aircrafts to GATI. Consequently, M/s. GATI was billed only for the average monthly utilization of 55.79 hours per aircraft during the period January 2008 (when two aircrafts were made available to GATI) to February 2009 (i.e. just before termination of the agreement in March 2009) which was much lower than the stipulated minimum guaranteed 85 hours per aircraft (425/5). Subsequently, the Company increased (November 2008) rental charges from ₹ 2.92 lakh per hour to ₹ 3.50 lakh effective from October 2008 due to increase in price of Aviation Turbine Fuel, subject to further revision of these charges every three months. M/s. GATI, however, did not agree for increase in lease rent and terminated (March 2009) the contract citing reasons such as increase in lease rent against the contract provisions, non induction of aircrafts as per agreement, failure to provide aircrafts with agreed payload capacity, long grounding of aircrafts etc.

After termination of contract with GATI, another agreement was entered into (July 2009) with DOP for three freighter aircrafts on wet lease for the period July 2009 to March 2010 which was further extendable on mutual consent. On expiry of the contract period, DOP did not extend the contract due to frequent delays and cancellations of freighter operations. DOP, however, entered a fresh contract (effective from April 2010) only for one aircraft for two years. Subsequently, AIL took the decision (September 2010) for phasing out and disposal of all the six freighter aircrafts and terminated (January 2011) the contract with DOP.

Audit observed that Clause 5.1 of the contract with GATI was against the financial interests of the Company as lease rent was payable for actual flown hours till induction of the fifth aircraft. It was not prudent to agree to the same in view of the ongoing negotiations (February 2007) with DOP for deployment of one aircraft. Even though the Company was aware that in respect of agreements with GATI (May 2007) and DOP (August 2007) six aircrafts would be required to meet the commitment, the Company did not convert the sixth aircraft into freighter till October 2008. Further, agreeing for a fixed amount of per hour lease rental in the contract for a five year term was also not prudent which became non-feasible when price of Aviation Turbine Fuel increased.

The Management stated (October 2008) that the payment of minimum guaranteed hours were to be enforced only after induction of the fifth aircraft into operation with M/s. GATI. The Management further stated (October 2011) that from freighter operations of Boeing aircrafts, net profit was ₹62.05 crore.

The reply was not acceptable as for calculating the above mentioned profits, only direct operating costs were considered and the other costs such as Lease and Maintenance charges of ₹ 22.88 crore of six freighter aircrafts, financing charges of ₹ 12.02 crore at the rate of 10 *per cent* per annum on the cost of conversion of four Boeing aircrafts, charges for various in-house administrative and operational supports including airport and ground handling borne by AIL on behalf of the AASL, cost of painting clients logo on freighter aircrafts, carrying and financing cost of inventory, float of spare engine, Auxiliary Power Unit along with its space rental, insurance and obsolescence were not taken into account which the Audit was unable to quantify in absence of details of these expenses. Moreover, the profit of ₹ 62.05 crore claimed by the Company included the bank guarantee of M/s. GATI Limited amounting to ₹ 30.00 crore, the encashment of which was sub-judice.

2.3.2.2 Passenger aircraft operations

AASL was using ATR and CRJ type aircrafts for carrying out its passenger operations. It acquired ATR 42-320 aircrafts (which were out of production) on dry lease* for a period of five years, four aircrafts in December 2002 from M/s. ATR along with a Global Maintenance and Support Agreement (GMSA) for maintenance and support of spares and major components and three aircrafts in March 2007 from M/s. ATRiam Capital Limited. AASL acquired four CRJ aircrafts on dry lease from four lessors for a period of seven years. AASL also entered into a Component Maintenance Works Agreement (August 2008) with M/s. Lufthansa Technik for support of components of CRJ aircrafts.

Audit observed that while acquiring ATR and CRJ aircrafts AASL did not ensure adequate arrangements for maintenance and engine support. The GMSA for ATR aircrafts was based on four aircraft operation. When three more aircrafts were added to ATR fleet, the inventory level was not increased and GMSA was continued with the existing level of stock. During April 2008 to March 2011, aircrafts remained grounded for 1651 days i.e. 21.54 *per cent* as against 10 *per cent* normally earmarked for scheduled maintenance etc. Out of ₹ 78.39 crore paid by the Company as lease rent for the above period, an amount of ₹ 27.73 crore pertained to aircrafts which remained grounded due to inadequate stock of spares and components.

Due to absence of engine support contract one of the CRJ aircrafts remained grounded from September 2009 to December 2010 and another since December 2010 to June 2011. This resulted in infructuous payment of lease rent amounting to ₹ 15.48 crore in respect of these aircrafts beside loss of opportunity to earn revenues.

Management, in its reply (October 2011), stated that as the ATR aircrafts were of old vintage the availability of spares became difficult. Consequently, one ATR aircraft had to be grounded for cannibalization purposes to make the others serviceable. Management further stated that in respect of CRJ aircrafts, the efforts made for arriving at comprehensive engine support before induction of aircrafts could not materialize.

The Management reply was not acceptable as the Company was aware of these issues while it opted for leasing of old vintage ATR aircrafts. Grounding of aircraft could have been avoided had the Management made appropriate arrangements for maintenance and spare engine.

2.3.2.3 Manpower management

a. Freighter operations

The Company was having 28 Boeing pilots (15 commanders P-1 and 13 Co-Pilots P-2) as on April 2010. After termination of the contract with GATI and curtailment of number of freighters engaged by DOP the Company had contract for one freighter aircraft since April 2010 for which it required only three sets of pilots (i.e. 3 commanders-P1 and 3 Co-Pilots-P2). The Company continued to have 10-22 excess pilots from May 2010 to November 2010. This resulted in infructuous payments amounting to ₹ 5.15 crore to pilots whose services were not availed of during May 2010 to November 2010.

The Management stated (October 2011) that AIL was exploring business opportunities for alternative deployment of freighter aircrafts subsequent to reduction of operations by

**** In dry lease agreement, aircraft is provided without maintenance and crew support***

DOP. It stated further that availability of trained pilots for B-737-200 type of aircraft was highly inflexible and scarce so it was not considered appropriate to terminate the services or send back the pilots to the parent company.

The reply of the Management was not acceptable as operations reduced to three aircrafts in July 2009 itself. The operations did not increase thereafter and reduced further from April 2010.The Company should have reassessed its manpower requirement.

(b) Passenger operations

The Company was having 13 expatriate[♥] commanders for ATR aircrafts as on April 2008, 2009 and 2010 and it was reduced to 11 as on April 2011. The number of Indian commanders was only one, two, four and nine as on April 2008, 2009, 2010 and 2011 respectively. The payments made to Indian commanders were lesser by approx. ₹ 3 lakh p.m. in comparison to expatriates. However, despite receiving a number of applications from Indian commanders and also the Director General Civil Aviation directive to replace expatriate pilots at the earliest, the Company did not hire Indian commanders and continued with a large number of expatriate pilots.

The Management stated (July 2011) that the efforts made by the Company to hire Indian commanders for ATR aircrafts did not succeed due to low salaries offered by the Company in comparison to other private operators.

The reply of the Management was not acceptable as the Company could have hired Indian commanders whose salaries were lower than the expatriates in compliance with the DGCA directive.

Conclusion

The Company was unable to operate cost effectively its fleet of six old vintage freighter aircrafts. As regards passenger operations, the Company did not have adequate stock coverage in the maintenance contract/engine support leading to infructuous payment of lease rent in respect of ATR and CRJ aircrafts. The Company also failed to reassess its manpower requirements timely and continued to have 10-22 pilots in excess of its requirement every month from May 2010 to November 2010. Such imprudent decisions resulted in loss to the Company to the extent of ₹ 48.36 crore during the audited period.

The matter was reported to Ministry in March 2012; reply was awaited (May 2012).

Airports Authority of India

2.4 Irregular Appointment of Consultant

AAI awarded consultancy work by accepting the offer of a private company without inviting competitive bids in contravention of CVC guidelines and incurred extra expenditure of ₹ 26.14 crore.

M/s. Aspire Trading Private Limited (Aspire) approached (October 2002) Airport Authority of India (AAI) with offer of consultancy services to enable AAI to get customs/central excise benefits of saving of duty/excise/other levies payable against

[♥] ***Non-Indian pilots***

procurements. The Board approved (March 2003) appointment of M/s. Aspire without inviting tenders, initially for the year 2003-04, for rejected/disallowed cases only, at a service fee equivalent to 18.5 *per cent* of the financial benefits received by the AAI. Accordingly, letter of appointment was issued on 03 April 2003. Subsequently, AAI extended tenure of M/s. Aspire twice, in August 2006 (for the licensing years 2004-05 and 2005-06) and in August 2010 (for the licensing year 2006-07) at a negotiated rate of 16 *per cent* and 14 *per cent*, respectively, of the financial benefits received by the AAI. On the basis of Custom Duty exemption certificates valuing ₹ 333.00 crore♦ received for the financial years 2003-04 to 2006-07 the AAI paid (up to June 2011) service fee amounting to ₹ 29.20 crore to M/s. Aspire.

The extension granted by the Board in August 2010 to M/s. Aspire was to remain valid till the appointment of a consultant through open tender or till December 2010 whichever was earlier. Accordingly, AAI invited (November 2010) quotations from reputed consultants through open tender for providing consultancy services/advice/assistance on DGFT/Customs matters related to savings/benefits under various Government of India schemes/policies and related works. M/s. Romy Enterprises, being L1, was appointed (December 2010) as a consultant for a period of one year on annual professional charges of ₹ 0.51 crore.

Audit observed that the initial appointment of the consultant (M/s. Aspire) without inviting open tenders was in contravention of the guidelines issued from time to time by the Central Vigilance Commission (CVC) on appointment of consultants which prohibit appointment of consultants on arbitrary or ad-hoc basis and stipulated that public notice should be issued to enlist names of suitable consultants. The guideline dated 25 November 2002 further provided that selection of consultants should be made in a transparent manner through competitive bidding.

Had the Management invited competitive bids in the year 2002 itself, extra expenditure of ₹ 26.14 crore incurred due to higher rates charged by M/s. Aspire could have been avoided.

The Management replied (June 2011) that:

- *Approval for appointment of M/s. Aspire as a consultant for AAI was on identical terms and conditions agreed to by Air India (AI).*
- *Work of the two consultants was for different periods of time; the scope of work was different; hence was neither comparable nor quantifiable.*
- *CVC Guidelines referred to by Audit actually pertain to the appointment/working of consultant in the engineering works/contracts only. Further, none of the instances referred to in the CVC guidelines dated 25 November 2002 were relevant to the present case. Hence the guidelines were not applicable to the appointment of M/s. Aspire and therefore there was no violation of CVC guidelines.*

♦ ***₹ 71 crore for year 2003-04, ₹ 91 crore for year 2004-05, ₹ 88 crore for year 2005-06 and ₹ 83 crore for year 2006-07.***

The reply of the Management was not acceptable in view of the following:

- AI appointed (January 2003) M/s. Aspire on identical terms and conditions for rejected/disallowed cases. When AI did not get any benefits for a few closed cases referred to M/s. Aspire for scrutiny and opinion, the AI stopped corresponding with M/s. Aspire with due approval (17 February 2004) of their Board.

  On the other hand, AAI appointed M/s. Aspire initially for rejected/disallowed cases but subsequently, the AAI availed the services of the consultant in dealing with all the cases relating to Exim Policy 2002-2007.

- While the services assigned to M/s. Romy were detailed in the appointment letter as compared to that of M/s. Aspire, the scope of work assigned to both of the parities was similar and comparable to a great extent.

- Para 4 of the CVC guidelines dated 25 November 2002 clearly stated that list of the instances mentioned in the guidelines was only illustrative and not exhaustive. As such the Management contention, that the instances referred to in the CVC guidelines were not relevant was not acceptable. Further, the various guidelines of CVC issued from time to time stipulated appointment of consultant in a transparent manner through competitive bidding.

Thus, appointment of consultant in contravention of CVC guidelines led to extra expenditure of ₹ 26.14 crore.

The matter was reported to Ministry in January 2012; reply was awaited (May 2012).

2.5 Favour to a contractor by awarding a construction contract against unacceptable offer and allotment of land free of charge

Airports Authority of India awarded a contract to a M/s ITD-ITD CEM JV for (a) construction of Integrated Terminal Building at Kolkata Airport at higher rates in violation of its own guidelines under works manual; and (b) also extended undue favour of ₹ 12.69 crore to the contractor by allotting land free of charge in deviation of its own policy on land allotment.

In order to accommodate growing passenger traffic, the Airports Authority of India (Authority) decided (August 2007) to modernise Netaji Subhas Chandra Bose International Airport in Kolkata by developing an Integrated Passenger Terminal Building and allied facilities (Project).

(a) The price-bids for the project were opened in June 2008 and offer of M/s 'ITD-ITD CEM' JV[1] (contractor) for ₹ 2,102.83 crore was found to be the lowest (L-1). The offer was 53.20 *per cent* higher than the estimated cost (₹ 1,372.62 crore) and 37.23 *per cent* higher than the justified cost[2] (₹ 1,532.40 crore).

As per Authority's Works Manual (April 2007), no tender is to be accepted in case value deviates by 30 *per cent* from the estimated cost. Further, if the tender value is more than

[1] ***A Joint venture of Italian Thai Development Public Company Limited (ITD) and ITD Cementation India Limited (ITD CEM), in which the former is the parent company.***

[2] ***Airports Authority of India prepares justification cost of the work to be awarded for considering the reasonableness of tender value as there may be time gap between the preparation of estimated cost and opening of tender.***

5 *per cent* of the justified cost, the same could be accepted with the approval of the Chairman of the Authority subject to recording of reasons thereof. However, in this case after exclusion of some of the 'items of works'* from the scope of the project, the contact was awarded (October 2008) to the contractor at ₹ 1,602 crore. The project, originally scheduled to be completed by June 2010, has been delayed and is expected to be completed by April 2013.

Audit observed that:

(i) Offer of the contractor did not qualify for acceptance as gap of the offer with reference to both - the estimated cost and the justified cost - was substantially higher than the norm stipulated by the Authority's works manual. The offer was even more than the total project cost (₹ 1,942 crore) that had been approved by the Ministry of Civil Aviation in August 2008 after the project was appraised through the Public Investment Board.

(ii) The process of tender evaluation and award of the contract was flawed due to lack of internal control and complacent project management system as discussed below:-

- In order to bridge the gaps of the estimated cost and the justified cost with reference to the offer price of L-1 (contractor) and to present a better picture for justifying award of the work to the contractor, the Authority adopted a two pronged approach as under:
    - The Authority tweaked certain items of work and excluded some of the items from the scope of the project. This deflated the offer price of L-1 for the residual items of works to ₹ 1,602 crore and the corresponding estimated cost also came down to ₹ 1,123 crore.
    - Simultaneously, the Authority inflated the justified cost by loading it by ₹ 145.07 crore towards service tax (₹ 51.22 crore), works contract tax (₹ 24.86 crore), labour cess (₹12.43 crore), overheads and profit elements (₹ 56.56 crore).
- Audit analysis of the revised justified cost revealed that service tax not applicable to such projects was also loaded to the revised justified cost of the work. Further, to inflate the justified cost artificially, elements of cost like work contract tax; overheads and profit were included twice in the input components of the project. Resultantly, the reduced offer price and the padded justified cost led to reduction of gap between the two, and the project was awarded to the contractor at ₹ 1, 602 crore which was, *de-facto,* higher than the estimated cost and the revised justified cost by 43 *per cent* and 15 *per cent* respectively.

Thus, the project was awarded to a contractor whose offer, in fact, should have been outrightly rejected as per works manual of the Authority.

The Management stated (September 2011) that considering the time bound nature of the project, retendering was not resorted to, and added that the service tax, works contract

* ***O&M works, IT works, Sewerage Treatment Plant, Effluent Treatment Plant, Water Treatment Plant and Aluminium/ Facade work.***

tax and overheads etc. were added on the advice of Engineers India Limited - the independent professional consultant.

The Management argument is not convincing as award of the contract at a price higher than the estimated cost by more than 30 *per cent* was against the Authority's own works manual and was irregular. The Management's plea for not resorting to retendering due to time bound nature of the project also did not hold good as the contract which was scheduled to be completed by June 2010, has already been delayed and is expected to be completed by April 2013. The Management's argument cannot justify award of the contract in an irregular manner by tinkering with the costing structure which only point towards a flawed project management system in the Authority.

(b) Policy of Authority on use of its land by others provided for charging of licence fee at the prevailing rates. The rates[1] were revised by the Board of the Authority in April 2008. Immediately before award of the project to the contractor, the Authority had also clarified[2] in July 2008 that excepting for the land to be allotted to the contractor free of charge for stacking construction material, any land in the Authority's premises required by the contractor for installation of plants, labour camp, cement godown and site office would be charged at the prevailing rates.

Audit observed that:

In deviation of the Authority policy, the terms of the contract provided for allotment of land to the contractor at a nominal rate of ₹ 1 per square metre per annum (psmpa). As a result, for 35,302 square metre of Authority's land utilized by the contractor during November 2008 to December 2011 for installation of 'concrete batching plant'[3], fabrication yard, rebar yard and recreation club *i.e.* for the purposes other than stacking of construction material, the Authority charged the nominal rate of ₹ 1 psmpa to the contractor instead of the applicable rate. This resulted in revenue loss of ₹ 12.69 crore to the Authority and consequent undue benefit of the same amount to the contractor till December 2011. As the project is expected to be completed by April 2013 and the contractor continues to occupy the land, the undue benefit to the contractor would increase further.

On the issue of allotment of land at nominal license fee, the Management, without clarifying the contradiction between the land licensing policy and the terms of the contract, admitted (September 2011) that the terms of the contract allowed recovery of license fee at nominal rates.

In sum, in both these cases, the Authority failed to comply with its own well documented manual prescribing systems for processing the tenders and procedures to be followed. This reflected poorly on its governance and internal controls.

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

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[1] ***₹ 1,035 psmpa as approved by the Board on 7 April 2008.***
[2] ***Technical Order issued by the Authority on July 2008.***
[3] ***A device for making industrial purpose concrete required in modern construction industry.***

CHAPTER III: MINISTRY OF COAL

South Eastern Coalfields Limited

3.1 Non deployment of pay loaders for despatch of coal produced by surface miners in Dipka Open Cast Mine.

Due to non-deployment of pay loaders, SECL despatched 6.5 million tonne of coal of below 100 mm size, produced by surface miner at Dipka Open Cast Mine, through the facilities of the feeder breakers capable of crushing coal below 100 mm size and thereby failed to utilise gainfully the existing crushing facilities and to earn additional revenue of ₹ 12.76 crore during June 2010 to May 2011.

Selling of coal below 100 mm size is always advantageous to the coal companies since over and above the pithead price, crushing charges at the rate of ₹ 61 per tonne is recoverable from the customers as compared to ₹ 39 per tonne recoverable when the coal is crushed to the size of 200 mm-250 mm. It was, therefore, imperative on the part of the Coal Companies to ensure maximum despatch of coal of size below 100 mm to earn additional revenue of ₹ 22 per tonne.

At the Dipka Open Cast Mine (DOCM) of South Eastern Coalfields limited (the Company), coal was being extracted through conventional method of drilling and blasting. The coal so extracted required additional crushing to bring it to the size of below 100 mm or of size 200 mm-250 mm. For crushing and despatch, DOCM uses feeder breakers. In June 2010, under the Dipka OC Expansion project, three surface miners were deployed at another location in the Lower Kusmunda seam. The coal extracted by the surface miners being already of size below 100 mm, it was envisaged to stack and load them to consumer trucks with the help of hired pay loaders.

Audit scrutiny of the records of coal despatches made by DOCM revealed that the surface miner coal of size below 100mm, which could have been despatched to the consumer trucks using pay loaders, were being despatched through feeder breakers meant for crushing of coal resulting in uneconomical utilisation of the feeder breakers. During June 2010 to May 2011 DOCM despatched a total quantity of 24.103 million tonne (MT) of coal to various power generating companies and others, out of which only 13.502 MT was of size below 100 mm. Further, out of 13.502 MT of coal despatched of size below 100 mm, 6.52 MT of such coal was actually produced by surface miners (already of size below 100 mm), but was despatched through feeder breakers having facilities to crush coal below 100 mm size due to non-availability of pay loaders for despatch of coal produced by surface miners. As a result, the crushing capacity of the feeder breakers could not be utilized for crushing oversized coal to below 100 mm size. In the process, the Company lost the opportunity to earn an additional revenue of ₹ 12.76 crore[1] @ ₹ 19.55[2] per tonne of coal.

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[1] ***6524988 tonne of recrushed coal multiplied by ₹19.55 is equal to ₹12,75,63,515***

[2] ***₹22.00 being difference in earning for selling crushed coal below 100 mm and 250 mm size coal plus ₹7.40 being variable cost saved per tonne for not utilising of feeder breaker minus ₹9.85 being estimated variable expenditure for departmental pay loader is equal to ₹19.55 per tonne.***

The Ministry stated (December 2011) that though tendering as well as procurement of pay loaders was initiated by DOCM in December 2010, due to lack of response and offers being received at a very high rate, the tenders could not be finalised. Further the Ministry stated the cost per tonne for deploying departmental pay loaders would be ₹ 16.39 against the expected incremental revenue of ₹ 14.60 on utilisation of feeder breakers for crushing of additional coal to size below 100mm.

The reply of the Ministry is not tenable as the Management initiated the process for tendering of pay loaders only in December 2010 whereas the requirement of 6 pay loaders over a period of five years from 2004-05 to 2008-09 was envisaged as early as March, 2005 in the Dipka OC Expansion project report. Thus, the fact remains that though the surface miners were deployed in June 2010, action for hiring pay loaders required for loading the coal mined by the surface miners was initiated only in December 2010. As regards the additional cost on departmental pay loaders being higher than the incremental revenue earning, the reply is not tenable as the variable cost component was only ₹ 9.85 out of ₹ 16.39 per tonne.

Thus, due to absence of pay loaders for despatch of coal produced by surface miners, the Company lost the opportunity to earn additional revenue of ₹ 12.76 crore during June 2010 to May 2011. The Company should urgently deploy pay loaders at the despatch point for evacuation of coal produced by surface miners to avoid the loss.

Western Coalfields Limited

3.2 Payment of electricity charges at higher rates

Western Coalfields Limited incurred an avoidable expenditure of ₹ 7.62 crore during 2007-08 to 2010-11 on purchase of electricity from two electricity boards at industrial and non-industrial rates instead of availing cheaper domestic rate for domestic consumption of electricity.

The Central Public Sector Enterprises (CPSEs) under various Ministries carrying out industrial operations draw electricity from the electricity distribution companies/Boards of the State governments for their day to day operations as well as to meet the domestic needs of the employees residing in housing complexes located within the premises of the industrial units. Electricity tariff is generally lower for domestic consumption than that for industrial or commercial one. In the recent past, audit observed that some of the industrial units of the CPSE's had been supplying electricity to such housing complexes from a single power connection meant for industrial/commercial consumption leading to significant avoidable expenditure Audit has been raising such issues in its Reports laid before Parliament* with the expectation that the Government of India (GOI) would suitably intervene to stop recurrence of such cases. However, we noticed that such cases continue to occur and indicate lack of adequate and effective oversight by any nodal agency like Department of Public Enterprises in the GOI having mandate to co-coordinate on matters affecting the CPSEs to ensure that various Ministries under the

** Para No. 4.3.1 of CAG's Report No.3 of 2002 and para No.5.3 of Report No. 12 of 2007, Union Government (Commercial) relating to Mahanadi Coalfields Limited and ITI Limited respectively*

Government of India adopt a right approach in such cases so as to avoid exaggeration of the cost of projects and their operations.

Recently, we again noticed that Western Coalfields Limited (Company), which operates its mining activities in the states of Maharashtra and Madhya Pradesh and receives power from Maharashtra State Electricity Distribution Company Limited (MSEDL) and MP Poorv Kshetra Vidyut Vitaran Company Limited (MPPKVVCL) in each state, had not availed of cheaper electricity.

Audit observed (April-2010) that in Pench and Kanhan Areas of Madhya Pradesh, while the Company was using electricity for both industrial and residential purposes, there was no separate metering arrangement for residential colony consumption for 13 supply connections[1] in Pench Area and 11 supply connections[2] in Kanhan Area. As a result, these Areas continued to pay for colony consumption at higher tariff applicable for industrial/non-industrial/coal mines categories. Similarly, in Wani and Wani North Areas in Maharashtra, the residential power requirements for four supply connections[3] had been billed under industrial category which resulted in payment of power bills at higher rates. Thus, due to non-conversion of residential connections from industrial/non-industrial/coal mines to domestic, the Company failed to avail lower electricity tariff applicable for domestic consumption and thus incurred an avoidable expenditure of ₹ 7.62 crore during 2007-08 to 2010-11.

The Management stated (October 2011) that:

- *Application has been made to electricity authorities for conversion from Coal Mines category (HV-2) to Bulk Residential category (HV-6) at Pench and Kanhan Areas. Action has been taken for conversion to Residential category in respect of the four colonies of Wani and Wani North Areas.*
- *Most of the residential colonies of the Pench and Kanhan Areas having more than 300 KVA load require connection at 33 KV, for which overhead lines are to be drawn from MPPKVVCL Sub Station/feeder with segregation of industrial and domestic power lines with separate metering points. As per quick tentative estimate, the amount of expenditure at Kanhan Area would be approximately ₹ 11.08 crore and ₹ 10.84 crore at Pench Area. Further, annual expenditures of ₹ 2 crore at Kanhan and ₹ 2.27 crore at Pench Area for manpower would have to be incurred. The detailed techno economic study would be made for viability for each colony point in Pench and Kanhan Areas.*
- *In respect of four[4] colonies of Kanhan Area, MPPKVVCL returned applications for conversion and clarified that HV-6 (bulk residential) connection was not applicable for coal mines industry as per Tariff Schedule HV-2 for Coal Mines.*

The reply of the Management is not acceptable in view of the following:

[1] ***Nandan Ekhlera, Bhamodi, Chandameta, BDC township, Newton, Rawanwara, Chhinda, Shivpuri, Bhokr, Jhurrey, CGM Office township, Regional workshop township and Barkuhi Hospital township.***

[2] ***Mohan, Sukri, GM Unit township, Datla, Damua, Rakhikol, Nandan No.1-2, Nandan, Tandsi, Kanhan Hospital township and WB office old quarters.***

[3] ***Sundarnagar, Kailasnagar, Bhallar and Kumbarkhani***

[4] ***Ghorawari Colliery No1, Ghorawari Colliery No2, Damua Nandan and Tandsi.***

- The fact, however, remains that Management applied for conversion belatedly (April 2011 to October 2011) for all the supply connections only after the same was pointed out by audit.
- The Company has sufficient infrastructure currently through which the power is being consumed in the residential colonies. As per the tariff notifications of the distribution companies, in case of mixed load, sub-meters are required for arriving at energy charges for different categories. Hence, the quantum of new infrastructure as argued by the Management would not be applicable for the purpose of availing of lower tariff for domestic connection.
- As regards tariff schedule category for HV-6 (Bulk Residential), in fact, the tariff notifications of both Maharashtra Electricity Regulatory Commission and Madhya Pradesh Electricity Regulatory Commission clearly stipulate that this tariff is applicable for supply to Industrial or any other township for domestic purpose. Moreover, the Company is already availing of lower tariff in certain residential colonies viz. Ambara colony of Kanhan Area and Nakoda in Wani Area.

Thus, due to failure of the Management to avail lower tariff applicable for domestic colonies consumption, the Company incurred an avoidable expenditure of ₹ 7.62 crore during 2007-08 to 2010-11. The fact that while some of the residential colonies of the Company were availing of the lower tariff on ground of domestic consumption, the Company should have reviewed the position for other colonies as well and taken pro-active action in line with the Regulatory Commission Guidelines. The Company now needs to vigorously follow with the power distribution companies for obtaining lower rates of electricity for domestic consumption.

The Ministry of Coal forwarded (May 2012) the Action Taken Note explaining the steps being taken by the Company for obtaining lower rates of electricity for domestic consumption.

CHAPTER IV: MINISTRY OF COMMERCE AND INDUSTRY

STCL Limited

4.1 Irregularities in release of funds to a business associate

Release of funds without due diligence and based on inaccurate facts and invalid agreement to a business associate to procure yellow peas resulted in non-realisation of ₹ 24.67 crore by the Company.

STCL Limited (the Company) was approached by R. Piyarelall Foods Private Limited (RPFPL), Kolkata (7 May 2008) to arrange funds of ₹ 45.79 crore to facilitate procurement of 30742 MT of yellow peas for which Letter of Award (LoA) was issued to them by STC Limited (Holding Company) in November, 2007. As per terms of agreement between STC Limited and RPFPL, 85 *per cent* of the payment for the stock valued at ₹ 53.88 crore (i.e. 45.79 crore) was to be remitted by RPFPL within the stipulated time. RPFPL, citing tight financials made (15 May 2008) another request to the Company for additional funds of ₹ 3.63 crore for clearing its own outstanding bills.

The Company concluded an agreement (16 May 2008) with RPFPL (but signed for and on behalf of RPIEL[1]) for the financing of 85 *per cent* of the procurement cost of 30742 MT of yellow peas at an interest of 11.50 *per cent* per annum without approval from the Board. The agreement *inter alia* provided for the following:

- The funds would be released subject to receipt of confirmation by the nominated C&F agent at the port for having received the original shipment documents for taking the delivery of the cargo and storing the same at CWC/Custom bonded warehouse in the name of the Company and stock receipts issued by CWC/SWC in the name of the Company.
- RPFPL was required to discharge its liability by selling the entire procured stock within 180 days from the date of procurement, failing which the Company would dispose balance stock at the cost and risk of RPFPL and collect the difference amount from RPFPL.

Subsequently, a Committee[2] of the Company approved (16-20 May 2008) the proposal for lending of ₹ 49.42 crore (₹ 45.79 crore+₹ 3.63 crore) for purchase of 30742 MT of yellow peas to RPFPL citing past performance and long term business relation at an interest at 11.75 *per cent* per annum on reducing balance and a profit margin of 1.25 *per cent* of the sale value up to 90 days besides service charge at 0.5 *per cent* for every month or part thereof. The Committee did not reconcile the differences in quantity, rate of interest, variation in crucial dates with the agreement dated 16 May 2008 and the relevant documents available. Approval of the Committee was based on a personal guarantee (16 May 2008) for RPFPL's performance from Shri Siddharth Agarwal, a Director of RPIEL and an undated cheque of RPFPL for ₹ 45.79 crore and letter dated 6 May 2008 from

[1] ***R. Piyarelall Import and Export Limited, a sister concern of RPFPL***

[2] ***Committee consisting of General Manager (Marketing), General Manager (Finance) and General Manager (P&A)***

M/s. Baid Shipping Agency confirming receipt of original shipping documents for taking delivery of 30742 MT of yellow peas and store the same at Kolkata Port sheds in the name of the STCL along with copies of B/L duly endorsed by STC in favour of RPFPL in favour of STCL Ltd. The Committee's decision was ratified (22 May 2008) by the Managing Director and on the same day, the entire amount was released to RPFPL.

After initial repayment of ₹ 4 crore (May 2008) against additional amount released, RPFPL commenced repayment from October 2008 and made a total payment of ₹ 27.83 crore till September 2009 when it stopped repayment when the outstanding payments had aggregated to ₹ 27.62 crore[1]. Consequent to a negotiated settlement (December 2009), RPFPL made additional payment of ₹ 11.00 crore up to April 2010. The Company made a provision for the outstanding amount towards doubtful debt for ₹ 17.17 crore[2].

Audit observed the following irregularities in processing and approving the business proposal:

- The agreement between the Company and RPFPL dated 16 May 2008 was signed for and on behalf of RPIEL by one Siddarth Agarwal, Director, RPIEL which rendered the agreement invalid. *The Ministry stated that it was an error.*
- The letter dated 6 May 2008 of M/s. Baid Shipping Agency addressed to the Company confirmed receipt of original documents for 22742 MT under one bill of lading no. VCR/SAG-1 dated 19 October 2007. Both the letter dated 7 May 2008 of RPFPL and the Letter of Award of STC Limited enclosed thereto referred to two bills of lading dated 19 October 2007 in No. VCR/SAG-1 for discharge of 22742 at Kolkata and in No. VCR/VIS-1 for discharge of 8000 MT at Vishakhapatnam. But the Committee's approval was based on a confirmation letter dated 6 May 2008 of Baid Shipping Agency for taking delivery of 30742 MT which was a deliberate misrepresentation.
- The fact that previous defaults by RPIEL had resulted in accumulation of dues of ₹ 44.21crore as of April 2008, duly brought to the notice of RPIEL from GM (Finance) of the Company in letter dated 8 May 2008, was not mentioned in the proposal ratified on 22 May 2008 for extending the above financial assistance to the RPFPL. *The fact was admitted by the Ministry (October, 2011).*
- As per delegation of powers, procurement of commodities for trading with full back to back buying arrangement with the associate buyer required approval of the Board, if the value exceeded ₹ 20 crore. Thus, the financing in the instant case was irregular. *Ministry admitted (October 2011) the irregularity.*
- After defaulting in repayments, RPIEL (not RPFPL, who was the debtor) approached (7 December 2009) the Company for waiver of service charges and reduction in rate of interest to 10 *per cent*. The Company issued the concession letter (10 December 2009) addressed to RPFPL/RPIEL duly arriving at the outstanding amount, charging only interest, at 27.62 crore, pending ratification by the Board for settlement at ₹ 27.62 crore but could realise only ₹ 11 crore. The Company had only a personal guarantee of Shri Siddharth Agarwal and an

[1] ***Principal amount plus interest upto 30 November 2009***
[2] ***Including Principal of ₹16.62 crore***

undated cheque of RPFPL for ₹ 45.79 crore which were not invoked to realise the balance dues.

- Physical verification of stock was never done by the Company indicating absence of proper monitoring mechanism to secure the financial interest of the Company. *The fact of non-verification of stocks by the Company was accepted by the Ministry (October 2011).*
- Neither legal action has been taken against RPFPL/RPIEL nor any responsibility fixed for the lapses so far (January 2012).

Thus, no due diligence was done on the financial integrity of the business associate and on the basic facts of transaction with reference to relevant documents available. The funds were released based on an invalid agreement and in violation of delegation of powers resulting in non-realisation of ₹ 24.67 crore[◊].

[◊] ***Including principal, interest and service charges upto March 2011***

CHAPTER V: MINISTRY OF COMMUNICATIONS AND INFORMATION TECHNOLOGY

Bharat Sanchar Nigam Limited

5.1 Excess procurement of Mobile Switching Centre based Wireless in Local Loop system equipment

Improper planning and consequent excess procurement of equipment to expand Mobile Switching Centre based Wireless in Local Loop System led to avoidable expenditure of ₹ 65.51 crore.

Bharat Sanchar Nigam Limited (Company) operates in a highly competitive telecom environment wherein different technologies are used to provide landline, Cellular mobile[1] and WLL[2] telephone connections to customers. The WLL telephone system has fixed as well as mobile facilities. In the fixed system, the customers' terminals are fixed like landline telephone instruments known as fixed wireless terminals (FWTs) and in the mobile system, the customers' terminals are akin to cellular mobile telephone handsets known as handheld wireless terminals.

Audit scrutiny revealed serious deficiencies in planning and procurement of Mobile Switching Centre (MSC) based WLL system equipment. The Audit findings in this regard are brought out below.

Avoidable procurement for expansion of MSC based WLL System

Audit examination of the records of six[3] telecom circles revealed that capacity of MSC based WLL systems were expanded from 6 lakh lines to 10.5 lakh lines between March 2008 and March 2010 despite availability of spare capacity of 3.34 lakh lines in these circles. Audit noticed that there were a total of 3.13 lakh post expansion working connections in these MSCs which could have easily been provided from the pre expansion capacities of these MSCs. This led to underutilised capacities and consequently avoidable expenditure of ₹ 29.39 crore on the expansion of MSC based WLL system in these circles (**Annexure–I**).

On being pointed out by Audit, the Ministry stated (February 2011) that CDMA network was rolled out to meet the coverage requirement in scattered, remote and rural areas where demand for connection was less. Further, due to customer preference for mobile connection and expansion of BSNL GSM mobile and other operator mobile services in rural and remote areas the demand for WLL connections did not improve.

The reply of the Ministry is indicative of the fact that market survey/customer preferences and alternate services were not considered prior to WLL expansion.

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[1] *Using Global System for mobile communication system*
[2] *WLL system using Code Division Multiple Access (CDMA) technology*
[3] *Andhra Pradesh, Maharashtra, Orissa, Chennai, J&K and Gujarat*

Excess procurement of customer terminals

Integrated Fixed WLL Terminal (IFWT) and Fixed WLL Terminals (FWT) are the customer premises equipment in WLL system. Audit scrutiny of five circles[1] revealed that 7.01 lakh IFWTs/FWTs with internet features were allotted during 2005-06 to 2010-11 by Corporate office even though demand for internet connections on WLL system was insignificant and number of working internet connections was only 54,799 as detailed below. This resulted in 6.47 lakh underutilized/ unutilised IFTWs/FWTs as of March 2011.

Name of the circle	No. of IFWT/FWT purchased/allotted during 2005-06 to 2010-11 (a)	No. of Working connections with internet facility (b)	No. of IFWT/FWT underutilised/ unutilised (a-b)
Tamil Nadu	255229	29947	225282
Gujarat	199383	4403	194980
Andhra Pradesh	158694	12983	145711
Haryana	23130	762	22368
Jammu & Kashmir	65300	6704	58596
	701736[2]	**54799**	**646937**

Further, Audit scrutiny in Tamil Nadu circle alone revealed that despite availability of 82,312 IFWTs/FWTs in stock at the end of 2007-08, the BSNL Corporate office procured and allotted 1.44 lakh such terminals to the circle during the period from 2008-09 to 2010-11. This was despite the fact that there was insignificant variation in the number of working WLL connections during the period from 2007-08 to 2010-11 **(Annexure-II).** This resulted in avoidable expenditure on procurement of 1.44 lakh IFWTs/FWTs worth ₹ 25.33 crore during the years 2008 to 2011. The closing stock of IFWT/FWTs as on 31 March 2011 was 2.15 lakh.

On this being pointed out by Audit, the Ministry stated that difference between cost of IFWT with internet and without internet facility was minimal, hence procurement of IFWTs without internet facility was not done after 2007. Further, Ministry replied that in Tamil Nadu circle customers did not prefer old and recovered IFWT/FWTs and hence new IFWTs/FWTs were given to customers.

The reply of the Ministry should be viewed in the light of the fact that the demand for customer terminals with internet features was minimal and at the same time relatively expensive. In fact during 2007 the cost difference of a single WLL terminal with internet features and without it was ₹ 1,126 which is substantial. Further, in the case of Chennai the Company should have provided the new terminals to customers on cost price instead of on recoverable basis under all kinds of WLL service tariffs.

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[1] ***Tamil Nadu, Gujarat, Haryana, Jammu & Kashmir and Andhra Pradesh.***

[2] ***4,44,203 sets were procured during 2005-06 and 2006-07. The remaining 2,57,533 sets were procured from 2007-08 to 2010-11***

Wasteful expenditure on procurement of Evolution Data Optimize Routers

Evolution Data Optimize (EVDO) is equipment that facilitates wireless communication between customer terminals and WLL network. BSNL Corporate office placed purchase orders (June 2008) for the procurement of 6,000 EVDO routers without Wi-Fi and 6,000 EVDO routers with Wi-Fi costing ₹ 15,244 per unit and ₹ 16,433 per unit respectively for high end customers and business enterprises.

Audit noticed that out of the above, only 3,425 EVDO routers without Wi-Fi and 832 EVDO routers with Wi-Fi were utilized. The balance 2,575 EVDO routers without Wi-Fi and 5,168 EVDO routers with Wi-Fi were lying idle (May 2011) with the telecom circles.

On this being pointed out the Ministry replied that procurement was on trial basis for high end customers and business/ enterprise data connectivity and the routers were used in ATMs of various Banks, educational institutions and universities. Further, the Ministry replied that the balance quantity would be utilized in near future.

The reply indicates failure of the Company to assess demand before the purchase of EVDO routers of substantial value. This resulted in its idling and blocking of capital worth ₹ 10.79 crore. Even after three years of its procurement BSNL could not utilize these routers and substantial stock was lying idle with telecom circles. Further, the Company should have procured limited quantity of EVDO routers especially when it was on trial basis.

Thus, expansion of MSC based WLL system without conducting any market survey and improper planning for procurement of different kinds of equipment also led to wasteful/avoidable expenditure of ₹ 65.51 crore only in the test checked circles.

5.2 Inefficient management of procurement of costly Microwave equipment

Unjustified deviation from prescribed procedures in procurement of Microwave equipment for North East and Jammu & Kashmir regions resulted in abnormal delay and unsatisfactory compliance by the vendors.

The instructions issued by the Department of Telecommunications, which continue to remain in force in Bharat Sanchar Nigam Limited (Company) after its incorporation as a Company, stipulate that "there shall be no changes in specification once tender has been opened and that purchase orders and supplies shall be strictly as per the specifications laid down in the tender". Furthermore, the Procurement Manual of the Company requires that all procurement procedures from the issue of Notice inviting tender (NIT) to placement of supply orders should be completed within a period of 120 days. We observed (February 2010) that the Company had not adhered to the above principles in procurement of equipments for data/voice transmission {Synchronous Digital Hierarchy (SDH)*, Synchronous Transport Modules (STM-1), Microwave (MW) equipment (144 terminals, 168 antennas, 19385 meters Waveguide and 49 automatic dehydrators)} in 6 GHz frequency band, which were procured at an aggregate cost of ₹ 39.97 crore during the period 2007-2008 for use in North East (NE) and Jammu & Kashmir (J&K) telecom

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* ***SDH (Synchronous Digital Hierarchy) is a standard technology for synchronous data transmission on optical media.In digital transmission, synchronous means the bits from one call are carried within one transmission frame. SDH uses Synchronous Transport Modules STM-1 (155 megabits per second).***

circles. The Company changed the generic requirements mid stream in the tendering process resulting in extraordinary delay in actualizing the procurement as explained here below.

The Company issued an NIT for the afore-mentioned procurements in February 2007 adopting the strategy of inviting bids in three covers. While the first cover contained bid security and other eligible key conditions, the second cover contained the commercial and technical offer of the bidder and the third cover was to contain the financial offer. As per the tender conditions the third cover was to be opened only in respect of those bidders who were found to be qualified after evaluation of their commercial and technical offers.

Our scrutiny of the case indicated that the bid document stipulated that the eligible bidder should either be an Indian company registered to manufacture the tendered item in India or an Indian company registered to supply telecom equipment. In case of the latter, the bidder should have signed a Memorandum of Understanding (MoU) with the technology providers/ collaborator for bidding and providing maintenance support for equipment/ technology for a period of minimum 10 years from the date of opening of bid. Further, the bidder/ his collaborator/ technology provider should have supplied the offered equipment to any Telecom Service Provider anywhere in the world at least to the extent[♥] specified vide clause 2.2 of Section II of bid document and as per Section IV of 20 (a), the equipment supplied should be of same technology model/ make for which offer was made and in operation at least for one year on the submission of bid. During pre-bid interaction with the bidders it was clarified by the Management that an MoU was to be submitted for Antenna and Waveguide. Also, as per clause 13 of bid document it was stipulated that no change in either technology or product of radio equipment would be allowed after opening of tender. As per clause 39 of Section IV, it was laid down that the Purchase Order (PO) would be placed subject to availability of spectrum by Wireless Planning and Co-ordination wing.

In response to the tender six bids were received. The first and second cover of all the bids were opened on 13 April 2007 and made available to the Committee for Evaluation of Tender (CET) for evaluation. The CET after obtaining clarifications from the bidders on the initial evaluation of shortcomings/deviations in the bids (June 2007) observed (September 2007) that none of the six bidders met all the technical and commercial conditions stipulated in the bid documents. However, the CET citing the urgent requirement in NE region and J&K as the reason recommended opening of financial bids subject to relaxation from competent authority in respect of certain parameters such as the submission of MoU for antenna and waveguide by all bidders, gain requirement 3.0 meter antenna which was less by 0.4 dB with reference to specification, etc.

After the approval of the competent authority to the relaxation sought, the financial offers of four bidders who were assessed to be technically and commercially responsive were opened in November 2007. The CET, in December 2007, recommended Siemens Public Communication Networks (Pvt.) Ltd. (which later changed its name to Nokia Siemens Networks India Private Ltd.), the L1 bidder, for placement of PO. The Company issued the first order valuing ₹1.88 crore for 'validation purpose' on Nokia Siemens Networks

♥ Sl No.	Type of equipment	Qty
1.	*SDH, STM-1 (3+1) Microwave equipment in 6 Ghz frequency band 15 terminals*	
2.	*High Performance antenna*	*10 numbers*
3.	*Wave guide*	*1000 meters*

India Private Ltd. (L1) after a gap of 15 months from the date of opening of bids and followed with the second order for supply of the microwave equipment on 18 August 2008 on the same firm, for ₹ 17.25 crore.

The Management's action in seeking relaxation of the competent authority was unjustified because neither before nor after obtaining the technical and commercial offers of various bidders had the timelines prescribed under the Procurement Manual of the Company been adhered to. While the technical and commercial evaluation of the bid should have been completed within 35 days, the Company had reached that stage after a lapse of 70 days. Even after the competent authority permitted deviation from the tender specifications on grounds of 'urgency' it took the Management 15 months to issue the supply orders whereas the task should have been completed within four months.

Though the Company should not have placed any further orders on the suppliers till the validation of the main equipment and waveguide was confirmed, the Management placed a repeat order for ₹20.84 crore for supply to Bihar and NE regions in May 2009, a year ahead of the actual validation in June 2010.

The Management had thus not only failed to adhere to general principles of procurement and the prescribed time schedule for effecting procurements but also caused undue delay in supplying necessary equipment to Telecom circles in sensitive areas like NE and J&K despite relaxing tender specifications.

The Ministry in their reply (March 2012) stated that the tender conditions were relaxed with the approval of the competent authority i.e. Chairman and Managing Director due to urgent need for the equipment. The reply, however, does not factor in the fact that non-adherence with timelines before and after seeking relaxation of tender conditions on grounds of urgency and the fact that actual procurement performance did not address the urgency cited in the case.

5.3 Loss due to non execution of agreement while providing PRI trunks

BSNL Jamnagar failed to exercise due diligence while executing special package to Reliance Industries Limited which resulted in loss of revenue amounting to ₹ 7.66 crore.

Primary Rate Interface (PRI) is a telecommunications standard used in Integrated Services Digital Network (ISDN) that enables traditional phone lines to carry multiple voice data and video transmissions between two locations i.e., a private branch exchange operated by the customer and a long distance telephone company. Bharat Sanchar Nigam Limited (BSNL) provides this service to its customers on request and billing for the same is as per plans based on minimum commitment. As per the prevailing tariff, charges payable for each PRI trunk included monthly rental, plan charges and call charges beyond free calls. With a view to prevent the churn of BSNL subscribers to other operator BSNL delegated (March 2004) powers to heads of telecom circles for appropriate modification in existing tariff rates for basic services so as to counter the packages offered by competitors.

Reliance Industries Limited (RIL) requested BSNL (18 July 2006) to providing 15 PRI trunks between their refinery/petro chemical complex at Motikhavadi, Jamnagar and the OCB Exchange of BSNL at Jamnagar. While projecting the monthly call traffic of 25 to 30 lakh metered call units (MCUs) in the PRI trunks, RIL requested BSNL to waive off rent/ other charges and apply only flat rate tariff per MCU. The Chief General Manager Telecom (CGMT), BSNL, Ahmadabad, considered the above proposal and decided to grant (7 September 2006) the customer concessions like zero rental, zero security deposit, zero plan charges (minimum commitments), zero carrier charges and zero installation charges with a flat rate tariff of ₹ 0.72 per MCU without consideration for free calls. The General Manager Telecom District (GMTD) Jamnagar conveyed (September 2006) approval for provision of ISDN-PRIs to RIL at the special flat rate tariff subject to fulfilment of assured MCU of over 25 lakh per month. Subsequently, 10 ISDN PRIs between OCB Jamnagar and Motikhavadi were commissioned in November 2006.

Our scrutiny in the office of GMTD Jamnagar and BD cell of office of CGMT Ahmedabad (December 2009/February 2010) revealed that RIL was billed for actual calls registered in the PRIs at the concessional rate, rather than for assured number of calls as was originally intended by BSNL. During the period from November 2006 to November 2009, a total of 1.60 crore MCUs were registered and billed against the minimum assured calls of 9.25 crore (25 lakh MCUs per month x 37 months). Since the actual traffic was less than the minimum assured calls of 25 lakh per month projected by RIL, there was a loss of revenue to BSNL amounting to ₹ 6.16 crore (inclusive of service tax) for 37 months. The loss does not include the waiver of rental charges given to the customer, which were approximately ₹ 6.47 lakh.

On the loss being pointed out, GMTD Jamnagar issued (December 2009) supplementary bills to RIL for the above amount as well as monthly bills aggregating ₹ 1.50 crore on the basis of minimum assured calls for the subsequent period (December 2009 to May 2010). RIL declined payment of above bills denying any knowledge of a 'special package' allowed to them. Subsequently, the PRIs were disconnected in June 2010 for non-payment of dues.

The GMTD, Jamnagar stated (December 2010) that no agreement was executed at their end with RIL and that the condition of assured calls was not incorporated in the billing system as instructions received from office of CGMT, Ahmadabad were ambiguous in the matter of minimum commitment for payment for 25-30 lakh MCUs per month. The BD cell of CGMT, Ahmadabad stated there was no agreement and clarified that the responsibility of billing as per a special package tariff rests with the concerned Secondary Switching Area, i.e. GMTD, Jamnagar.

The BSNL have thus accepted that the Company despite approving special rates for calls in the ISDN PRI trunks based on a minimum commitment of assured calls did not validate the arrangements with RIL by executing a legally enforceable agreement. Further, in this case under the delegated powers Heads of telecom circles could only offer rates cheaper than the rates of other private service providers up to 5 *per cent* after verification. The delegated powers for giving discounts did not therefore, cover granting "special packages" such as waiver of rental charges (which are in nature of fixed income to the Company). Hence, the exercise of powers without approvals of competent authority and a legally binding agreement was irregular and not in the operational/ financial interests of the Company.

Thus the business move made beyond the extent of delegated powers and without exercise of due diligence in its execution resulted in loss of revenue of ₹ 7.66 crore. Responsibility for the lapses had not been fixed on any official of the Gujarat circle so far (May 2012).

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

5.4 Avoidable payment of interest on delayed payment for BWA spectrum

Delay in payment of ₹ 8,313.80 crore by BSNL to Department of Telecommunications for Broadband Wireless Access spectrum allotted resulted in avoidable payment of interest of ₹ 6.26 crore.

Department of Telecommunications (DoT) in August 2008 issued detailed guidelines on auction and allotment of spectrum for Broadband Wireless Access (BWA). Accordingly, in the same month, DoT sent the details of frequencies earmarked for BWA service to Bharat Sanchar Nigam Limited (BSNL), in various license service areas (LSAs). For the BWA spectrum earmarked/allotted, BSNL was to pay one time spectrum fee at a price equal to the highest bid for the respective service areas. Notice Inviting Applications (NIA) for auction of BWA spectrum was issued by DoT in February 2010. According to Section 4.5 therein successful bidders were to pay the bid amounts within 10 calendar days of the close of the auction.

BWA spectrum auction was completed on 11 June 2010 and the Government approved the results of the auction. The results containing details on winning price and successful bidder in different service areas were issued by DoT on 12 June 2010. On the same day, DoT conveyed to BSNL the total price for spectrum payable, considering the highest bid price approved for the BWA spectrum allotted. The amount of ₹ 8,313.80 crore for 20 LSAs, was to be paid to DoT by 22 June 2010.

Audit observed that BSNL issued sanction for the payment of ₹ 8,313.80 crore on 23 June 2010 and payment made only on 24 June 2010, i.e. two days after the date stipulated for payment. This delay attracted penal provisions and payment of interest on the amount at the rate of 2 *per cent* above SBI Prime Lending Rate (PLR)♥. On 30 June 2010 DoT intimated the interest liability of ₹ 6.26 crore for delayed payment and BSNL paid the amount of interest on 1 July 2010.

In reply to the Audit observation on delay leading to payment of interest, the Management stated that from the date of receipt of demand dated 12 June 2010, BSNL Management had been approaching DoT for exemption from payment of the charges. The efforts continued and decision to finally pay the amount was taken at a Management Committee meeting held on 22 June 2010 i.e. on the stipulated date of payment.

The conditions/time limit for payment of charges towards BWA spectrum was known to BSNL through intimations issued by DoT as early as in August 2008 and also subsequently in February 2010 through the NIA. The chances of getting exemption from DoT was remote particularly when Mahanagar Telephone Nigam Limited, the other public sector telecom operator, had made the payment towards spectrum allotment in time.

Attempts to seek exemption at a stage when the bidding process had been completed and notified resulted only in delayed remittance and avoidable payment of interest of ₹ 6.26 crore by BSNL.

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

♥ *As on 1 April 2010*

Mahanagar Telephone Nigam Limited

5.5 Interconnect Usage Charges relating to MTNL

Non execution of Interconnect agreements, inefficiencies in billing and revenue realisation contributed to huge outstanding of Interconnect Usage Charges (IUC) receivables and payables for MTNL.

Interconnectivity is extremely important not only to service providers but also to the users of telecommunication services. In absence of such connectivity the latter cannot obtain end-to-end, seamless service within the country and beyond. Therefore it is a core attribute of a telecommunication network.

Telecom Regulatory Authority of India (TRAI) issued the first Telecommunication Interconnection (Charges and Revenue Sharing) Regulation in 1999, following these with several other regulations, uptill 2009. These regulations stipulate the terms and conditions of interconnectivity between service providers, ensure effective interconnection between different service providers, and regulate arrangements amongst service providers for sharing revenue earned by providing telecommunication services. Regulations also lay out the basic arrangements for payment by service providers of 'Interconnection Usage Charges' for telecommunication services obtained from other service providers, that include basic services, cellular mobile services, long distance and international long distance services throughout the territory of India.

Interconnection Usage Charges (IUC) are the charges payable by one telecom operator to another for the use of the latter's network either for originating, terminating or transmitting a call. In addition an interconnection seeker is also liable to pay "Port Charges" which are payable by them annually to the interconnection provider for terminating the interconnection links on the network interface of the latter.

Mahanagar Telephone Nigam Limited (Company) is a major telecom operator in the country providing various telecom services in Delhi and Mumbai, including interconnectivity to other telecom operators. It was also the recipient of interconnecting service from other operators for its own subscribers.

Scope and objectives of Audit:

The Annual Accounts of MTNL revealed substantial outstanding dues receivable as well as payable to MTNL on account of IUC. The Statutory Auditors had also commented on these dues, absence of billing/reconciliation systems in the organisation, in their annual certification of Accounts. We, therefore, carried out an audit of MTNL, Inter-connectivity transactions during January to March 2011 covering four year period from 2007-08 to 2010-11, wherein we examined the relevant records of MTNL Corporate office, Delhi and Mumbai units with the following objectives.

- to get an assurance that desired systems and procedures were in place in the form of Agreements with other public/private telecom operators for all aspects governing interconnectivity services;
- to ascertain the level of efficiency of the process of billing and revenue realisation of IUC; and

- to assess adequacy of the monitoring systems for billing and collection of the outstanding charges.

Audit findings:

5.5.1 Huge outstanding of Interconnection Usage Charges

IUC is an important source of revenue as well as expenditure for the Company. MTNL earned approximately ₹ 200 crore on account of IUC charges and paid an equal amount to other service providers during the year 2010-11 as per details below:

(₹ in crore)

	Total IUC received	Total IUC paid	Outstanding IUC Receivable	Outstanding IUC Payable
2007-08	354	467	435	324
2008-09	209	253	651	557
2009-10	148	117	787	788
2010-11	203	217	876	920

(Sources: IUC received and paid from DGM (Accounts) and Outstanding from GM (BB&CA); figures at the end of March 2011 is a cumulative figure)

It can be seen from the table above that though the receipt[1] and payment[2] of IUC of MTNL have declined over the years, the receivables[3] as well as payables[4] on that account have steadily increased.

Despite our repeated requests to MTNL to furnish the details of total IUC billed to various operators, the segregated details have not been furnished to us. We are therefore unable to gain an assurance that an effective billing systems for IUC and the accounting of such dues was in place. Based on examination of related records and Management's response to our queries, our analysis of the outstanding dues reveals that bulk of IUC (₹ 831.51 crore) were due from BSNL; additionally, a sum of ₹ 40.90 crore was disputed by the private telecom operators.

Our scrutiny revealed that non execution of IUC agreement with operators, billing and revenue realisation issues and incomplete data base relating to IUC were the important factors that contributed towards huge outstanding IUC receivable and payable over the years. These deficiencies are brought out in the succeeding paragraphs.

5.5.2 Non execution of agreement with operators

The Register of Interconnect Agreements Regulations 1999 of TRAI provides for Interconnect Agreements between all service providers of telecommunication services throughout the territory of India. The Regulation further provides that all the service providers shall furnish to TRAI two copies each of the Interconnect Agreements along with modification(s), if any, duly authenticated.

MTNL had entered into interconnect agreements with different service providers from year to year, as indicated below.

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[1] ***₹354 crore in 2007-08 to ₹203 crore in 2010-11***
[2] ***₹467 crore in 2007-08 to ₹217 crore in 2010-11***
[3] ***₹435 crore at the end of 2007-08 to ₹876 crore at the end of 2010-11***
[4] ***₹324 crore at the end of 2007-08 to ₹920 crore at the end of 2010-11***

Year	Basic Service Operators	Universal Access Service Provider	Cellular Mobile Telephone Services	National Long Distance Operators	International Long Distance Operators	Total Operators
2007-2008	2	7	2	8	4	23
2008-2009	2	13	2	13	6	36
2009-2010	2	17	2	14	7	42

We however noticed that MTNL had not entered into interconnect agreements with Universal Access Service Provider (UASP) like BPL Communication Limited (now Loop Mobile Limited), Bharat Sanchar Nigam Limited and Reliance Communication Limited (Reliance). It was also noticed that in the absence of IUC agreements with these service providers pre-BSNL period's arrangement in respect of E1* links between MTNL and erstwhile DoT still continue to be relied upon for the purpose of billing and other revenue related matters. Consequently the Company, by continuing business arrangements with these operators without legally binding Agreements being in place, has been carrying significant risk in realising the IUC from the above service providers.

The Management in their response stated that:

- draft agreement was sent many times to BPL but every time new objections were raised by BPL and hence the agreement with BPL could not be concluded. However, MTNL was billing for IUC charges and getting payment from Loop Mobile Ltd. the successor company to BPL.
- neither MTNL nor BSNL wanted to sign the agreement and MTNL was billing for IUC charges and adjusting /netting there off against charges payable to BSNL.
- the Reliance after migrating to Unified Access Service License (UASL) had failed to execute a fresh agreement as a UASL service provider and the matter was sub-judice. MTNL was therefore billing and receiving the payment for IUC charges from Reliance.

As the reply shows a certain degree of comfort on the part of the Management with old DoT arrangement we feel the Company was not serious in its efforts to have valid agreements in place with other operators. MTNL had obviously not taken up the matter seriously with either DoT or TRAI or the licensee for Agreements on IUC. Since as per IUC agreement, there was no provision for settlement of IUC by netting off receivables against payables and as in a regulatory regime governing the telecom sector having such valid agreement in place is absolutely essential to sustain transactional relationship between different service providers it is inconceivable how MTNL allowed itself to be locked in disputes with certain operators over basic issues. In our opinion MTNL needs to show more vigour and seriousness in addressing this situation which is fraught with risk to its revenue stream.

E1 link common in most telephone exchanges and are used to connect to medium and large companies. It operates over two separate sets of wires, usually a twisted pair of cables and is ideal for voice telephone calls.

5.5.3 Billing and realisation issues

5.5.3.1 Delay in issue of Bills

The interconnect agreement between MTNL and certain other telecom service providers provides for issue of IUC bills by the 10th of every month.

Delhi Unit of MTNL

Our scrutiny of the records at MTNL Delhi relating to issue of IUC bills revealed that there were delays in the issue of IUC bills on a number of occasions[1] during the period April 2007 to March 2010. We noticed that the bills were issued to the operators from 11th to 28th of the month at General Manager (Telephone Revenue) instead of 10th of the month. In GM (TR) (Wireless Service) delays in issue of bills relating to mobile services ranged up to 18 months during the period from April 2008 to July 2009.

The GM (TR) accepted (December 2010) that since the bills were not received in time from the IT Unit of the Company, issue of bills to the operators was delayed and that the new convergent Billing System, Company expected that delay in issue of Bills would be reduced. Incidentally as seen from records for the period April 2011 to March 2012 the delays in issuing of bills continued as in the past.

Mumbai Unit of MTNL

Our scrutiny of the Mediation System of Convergent Billing and Customer Relation Management at Mumbai unit revealed that the IUC data files of GSM[2] and CDMA[3] were collected from the switch online. Though the share of IUC revenue in MTNL Mumbai relating to PSTN was substantially high being 72 *per cent* during 2010-11 the PSTN[4] data files were not collected online. The IUC data for PSTN exchange was instead downloaded through cartridges and processed further. This lead to creation of huge number of duplicate records and the data files did not contain full Call Detail Records[5] (CDRs). Reprocessing of this data file inevitably lead to delay in IUC billing.

On this being pointed out, the Mumbai Unit of MTNL agreed with our observation and stated that the issue regarding convergent billing had been sorted out and that necessary corrective action had been taken at the exchange level for non generation of duplicate CDR's. It was confirmed that the bills were being issued on target dates without much delay.

5.5.3.2 Short payment of IUC Bills by private operators

Further, scrutiny of the records of Delhi unit relating to payment of IUC bills by private operators for the year 2005-06 to 2010-11 revealed 124 occasion on which five operators[6] had not paid the amount billed by MTNL and as of November 2011 there was short receipt of ₹ two crore.

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[1] ***In 69 IUC bills test checked.***
[2] ***Global System for Mobile Communications***
[3] ***Code Division Multiple Access***
[4] ***Public Switched Telephone network***
[5] ***CDR is the computer record produced by a telephone exchange containing details of all phone calls that passed through it.***
[6] ***Reliance, Bharti Airtel, Vodafone, IDEA and Tata TeleServices Limited***

While admitting the short recovery, MTNL in their reply stated that it had recovered ₹ 71.43 lakh (₹ 37.76 lakh from M/s Bharti Airtel and ₹ 33.67 lakh from M/s TTSL) whereas the balance amount pertains to disputed call data record, and the relevant data files were being examined.

We observed that the short payment by private operators ab-initio was due to inadequate review of actual receipts against the billed amount and the same needs to be strengthened.

5.5.3.3 Non-billing of ports surrendered by the private operators.

(i) IUC agreement between MTNL and other operators provide for a minimum commitment period of three years in hiring of ports and if the ports are surrendered pre-maturely, pro-rata rental for the un-expired portion of the committed period shall be payable by the operators.

Our Scrutiny of records of the General Manager (TR), Delhi unit for the period 2005-06 to 2009-10 revealed that out of 3,756 ports relating to seven[1] private operators, 285 number of ports were surrendered by them before expiry of three years. Instead of billing the service providers for the complete three years the relevant bills for the port charges were issued by MTNL only up to the date of surrender resulting in short recovery of Port charges of ₹ 1.19 crore[2].

The Management while accepting the facts and figures stated that realization of these dues were being pursued and shall be netted against amount due to these operators.

The Management's reply is not convincing considering that the dues of ₹ 1.17 crore were old and they could have been "netted off" long time back. The Company had thus far not taken any action on its own to recover the dues.

(ii) Our scrutiny of Delhi unit also revealed that the unit did not have a consolidated database of ports working for private operators as on 31 March 2010. Different Units of the company viz. GM (Electronics), GM (Transmission Planning) and GM (Telephone Revenue) had varying 3,718, 3,688 and 3,756, ports respectively. In the absence of a single confirmed number of ports provided to the Private Operators, the billing and realisation of port charges from all the operators could not be effectively ensured. Hence, an integrated and common data base relating to ports should have been maintained by all the above mentioned engineering and telephone revenue units. Further, periodic reconciliation of ports actually being billed was not being carried out done with the integrated data base to ensure that all the ports were billed correctly. Similarly, Mumbai unit also did not have a system of reconciling the actual number of ports provided to the Service providers resulting in non/short billing of port charges from the service providers.

On this being pointed out, the Management replied (November 2011) that the case in Delhi unit was under examination and the Telephone Revenue branch had billed for 3,655 ports as of March 2011. The Mumbai unit stated that data base was being maintained in excel format and updated as and when a provisioning was made and intimated to billing unit for billing purpose and a quarterly reconciliation was being done to avoid non billing of ports.

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[1] ***Reliance, TCL, Bharti Airtel, Vodafone, IDEA, Aircel and Sistema Shyam TeleServices Limited***

[2] ***M/s Idea Cellular Limited (CMTS) - ₹ 0.21 crore, M/s Bharti Airtel Ltd (BSO) - ₹ 0.02 crore and M/s Reliance Communications Ltd - ₹ 0.96 crore***

The above replies are not acceptable in view of continuing differences in the number of ports as per records of different units of MTNL, absence of integrated database and non reconciliation of data amongst various units.

Conclusion

The examination of IUC reveals that MTNL Management had not achieved the expected level of efficiency in its interconnecting services as evident from absence of valid agreements with public/ private telecom operators in place, non bill/short billing of IUC charges and maintenance of incomplete data base relating to IUC, leading to accumulation of huge IUC receivables of ₹ 876 crore and payables amounting to ₹ 920 crore, at the end of March 2011.

The plea of the Management that (i) the IUC payments were higher than IUC receivables, (ii) the settlement was done by netting off payments due against receivables and (iii) no opportunity loss had occurred was merely an attempt to make light of what was a significant lack of internal control in its business operations.

The Management by netting-off receivables/payables and defaulting in issuing bills in time was jeopardising the timely recovery of its revenue and risking its cash flows and manoeuvrability to meet committed liabilities and improved their cash flows.

The Company needs to address these issues on priority so that there is no leakage of IUC revenue. Any further outstanding IUC coupled with netting off of payable, with receivable will render these accounts complex and difficult to reconcile with passage of time.

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

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

Central Warehousing Corporation

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

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

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

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

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

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

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

Food Corporation of India

6.2 Avoidable expenditure on procurement of levy rice

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

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

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

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

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

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

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

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

6.3 Loss due to Interest Rate Swap transactions

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

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

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

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

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

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

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

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

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

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

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

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

CHAPTER VII: MINISTRY OF DEFENCE

Bharat Electronics Limited

7.1 Blocking of funds in Convergent Billing and Customer Relationship Management project

Accepting to execute a complex project, having fixed delivery schedule coupled with unlimited scope for expansion, without having expertise for the same, failure to enforce performance of the consortium partner and absence of back to back payment clause with vendors led to blocking of ₹ 144.85 crore for more than four years.

Mahanagar Telephone Nigam Limited (MTNL) floated a tender (April 2004) for implementation of Convergent Billing System and Customer Relationship Management (CRM) project. As per the tender conditions, teaming agreements with partners were required if the lead bidder was not an experienced integrator either in billing or in CRM. Accordingly, in order to bid for the project, Bharat Electronics Limited (the Company) entered (August 2004) into a Memorandum of Understanding (MoU) with various partners[1] including IBM which had expertise in System Integration (SI) for CRM projects.

Bid for project was submitted by the Company (August 2004) and, after a series of negotiations, MTNL placed (February 2006) a Purchase Order (PO) valuing ₹ 503.51crore (amended to ₹ 493.08 crore in February 2008) on the Company for executing the above project on turnkey basis to be completed within 12 months[2] from the date of PO. The scope of work included supply of hardware, software and system integration of different Lines of Business (LOBs) viz. IUC, GSM, CDMA, PSTN[3], Broadband, Leased Line etc to enable common billing for various services being offered to customers by MTNL at Delhi and Mumbai. Further, the contract recognized that in the likelihood of change in SRS[4], the changes were to be implemented by the Company without any additional financial implication and SRS was to be within the scope of the tender document.

Audit observed the following:

1 *Selection of System Integrator:*

- MoU on the basis of which the Company had made the bid for the project mentioned IBM as the supplier of Hardware for lead applications as well as supplier and integrator of CRM and ORG as networking integrator.

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[1] *IBM, ORG, Independent Technology Systems Limited (INTEC), Ushacomm India Private Limited, Peoplesoft India Private Limited and Xalted Information Systems Limited (SYSTEAM)*

[2] *Supplies were to be completed within seven months and installation and commissioning were be completed within 12 months from date of PO.*

[3] *IUC-Inter Operator Billing, GSM-Global Systems for Mobile Communication, CDMA-Code-Division Multiple Access, PSTN-Public Switched Telephone Network*

[4] *System Requirement Specifications*

- A Committee constituted by the Management (January 2006) for negotiating prices, terms and conditions with the vendors, was of the view (March 2006) that as good exposure and experience of handling complex integration were essential criteria for selection of a System Integrator (SI), the task can be carried out by IBM to the satisfaction of MTNL. However, IBM was not willing to take the responsibility and suggested that order for SI be placed on ORG.
- Company placed (27 March 2006) the order for SI on ORG and after three months (20 June 2006) entered into a Teaming Agreement with ORG wherein ORG was made responsible for overall SI but it could sub-contract the work to M/s. Satyam Computers.
- ORG sub-contracted the SI work to M/s. Satyam Computers Services Limited. Subsequently, the crisis in M/s Satyam computers resulted in delay in execution of work. Further, M/s ORG also went out of operation due to its internal financial crisis and the Bank Guarantee of ₹ 1.62 crore was encashed.

2 ***Acceptance of unfavorable payment clause:***

- Though payments to the Company by MTNL were to be made in stages[♥] based on completion of work as prescribed in the contract, the purchase orders by the Company on the vendor provided for payments towards supply of hardware and software through Letter of Credit (LC) for full value of the supplies against dispatch documents.
- Supply of hardware and software (except for ORACLE RDBMS that was ordered in February 2008) was completed by March 2007. The cost incurred towards the project was approximately ₹ 293.12 crore (September, 2011) crore which included material supplies of ₹ 254.17 crore for which full payment was made by the Company. However, the work of installation and commissioning was only partially completed (January 2012) by ORG due to which the Company could not raise bill for supplies amounting to ₹ 144.85 crore despite making full payment to its vendors.

Management stated (October 2011) that the tender/SRS was generic in nature and new processes and business rules were revealed at the time of implementation and acceptance testing. The new services, network elements, call detail search system etc., were added, though within the scope of work. Further, at the time of bid, only limited services of MTNL were operational and envisaged in the scope of work. However, as a business enhancement, MTNL continuously launched many new services and expected the Company to deliver all the new services as a part of convergent billing.

The reply of the Management was not acceptable as:

- The Company should have taken adequate financial safeguards while accepting a project with open ended scope for expansion and a fixed delivery period

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[♥] ***Hardware- 60 per cent on supply, 20 per cent on satisfactory I&C and 20 per cent after one year of successful I&C; Software- 20 per cent on supply, 20 per cent on functional testing, 40 per cent after successful I&C and 20 per cent after one year of successful I&C; Services- 30 per cent after stage I SRS, 50 per cent after successful I&C, 10 per cent after stage II SRS and 10 per cent after implementation of changes as per stage II of SRS.***

- In the absence of expertise/experience in the field of SI, the Company should have protected its interest by fixing the responsibility on M/s. IBM for execution of the contract in full, and
- When contract was obtained on the basis of teaming agreements with various partners the Company should have also ensured incorporation of back to back payment clause corresponding with payment terms of MTNL

Meanwhile, it was ascertained from MTNL that as of January 2012 there has been no progress in the Project in the last seven months.

Thus, as a result of (a) acceptance to execute a turnkey project having fixed delivery schedule coupled with unlimited scope for expansion ; (b) failure to ensure performance of SI by IBM, the experienced consortium partner, inspite of its commitment, and (c) failure to incorporate back to back payment terms with its vendors, the Company failed to execute a prestigious and important project of MTNL even after five years of its scheduled completion date which resulted in blocking of ₹ 144.85 crore for more than four years (March 2012).

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

Hindustan Aeronautics Limited

7.2 Excess payment of Performance Related Pay

Inclusion of interest income in the profit for calculation of Performance Related Pay in violation of Department of Public Enterprises (DPE) guidelines resulted in excess payment of ₹ 43.18 crore.

Department of Public Enterprises (DPE), Ministry of Heavy Industries and Public Enterprises approved (November 2008) Performance Related Pay (PRP) form January 2007 for Board level and below Board level executives and non-unionised supervisors in the Central Public Sector Enterprises (CPSE), which is to be directly linked to the profits of the CPSE for the year, incremental profit over the previous year, and performance of the executives. Each CPSE was to constitute a Remuneration Committee headed by an Independent Director to decide the annual bonus/variable pay pool and policy for its distribution across the executives, etc. within the prescribed limits. Further, while clarifying on the elements of Profit Before Tax (PBT) for computation of PRP, DPE recommended (November 2010) that profit of CPSEs is expected to come out from their specified objectives and core activities and that extraordinary items like valuation of stock, grant waived by Government, sale of land etc (list of items is not exhaustive) will not be included in calculation of PBT as far as PRP is concerned.

The Board of Directors of Hindustan Aeronautics Limited (HAL) approved (August 2010) a scheme of PRP for implementation from 2009-10, which specified adoption of a performance index with three elements of individual performance based on Performance Appraisal Report Score, divisional performance based on value addition, sales, cost reduction, outsourcing and standard man hour (SMH) output, and organisational performance based on MOU rating of the company as a whole by the Ministry of Defence (MoD) with distribution of weightages. PRP estimate of ₹ 105.52 crore for 2009-10 was notified (May 2011) by the Company and ₹ 101.27 crore was finally paid to the executives during May 2011.

We observed (September 2011) that the Company's PBT of ₹ 2,688.43 crore for 2009-10 which was considered for computation of PRP, included interest income of ₹ 1525.60 crore (56.75 *per cent* of PBT) earned on short term deposits of funds received mainly as advances from MoD for various projects entrusted to the Company. Ministry of Defence had provided to HAL an advance of ₹ 29,977.00 crore as on 31 March 2010 which rose to ₹ 35,147.00 crore as on 31 March 2011. Since the interest income was derived largely from extraordinary magnitude of advances received from MoD that is clearly disproportionate to the actual sales turnover of the Company averaging ₹ 12,286 crore between 2009-10 and 2010-11, it is illogical to reckon such income as one arising from the normal business and core activities of the Company. Therefore, due allowance should have been made for such extra ordinary income for the purpose of computation of PRP. It also needed to be reckoned that investment of surplus funds on advances received from defence customers is an incidental activity and not a core activity for the Company. If PBT had been arrived at only from income related to the core activities of the Company, PRP payable would have been ₹ 58.09 crore instead of ₹ 101.27 crore paid finally to the executives (May 2011).

Incidentally in the financial year 2007-08 and 2008-09, i.e. prior to this scheme the Company was implementing the Performance Improvement Pay (PIP) scheme which did not include the component of interest income.

In reply, Management stated (October 2011 and March 2012) that interest income qualified for PRP since it was from prudent working capital management of funds received through contractual terms of sale and therefore it was very much within the objective of the Company. The Ministry of Defence endorsed the Management's reply.

The Ministry's endorsement of the Company's PRP Scheme is unacceptable because uptill 2008-09 Company never reckoned interest on advances from MoD for computation of PBT for payment of PIP more so when the matter was clarified by DPE in November 2010 beyond any doubt and the Ministry (Department of Defence Production) ought to have clearly advised the Company to exclude "interest income" for purpose of working out the incentives.

CHAPTER VIII: MINISTRY OF FINANCE

General Insurance Corporation of India

8.1 Forgoing profit on non-disposal of shares against initial open offer from the promoters

The decision of General Insurance Corporation of India not to accept open offer of promoters of Alfa Laval (India) Limited for acquisition of shares at ₹ 1300 per share in May 2007 without comprehensive analysis as envisaged in its Investment Policy resulted in forgoing profit of ₹ 12.56 crore on subsequent disposal.

General Insurance Corporation of India (GIC) was holding 4, 18,532 shares of Alfa Laval (India) Limited (AL) as of May 2007. In order to increase their stake from 64 *per cent* to 90 *per cent* of total equity shares of AL, promoters of AL made an open offer (7 May 2007) to its shareholders for acquiring shares at a price of ₹ 875/- per share with an option to revise the offer price upward by 17 May 2007. It revised the offer price to ₹ 1300/- per share on 16 May 2007. The market price of the share at that time was around ₹ 1200/- per share. Thus, this offer presented an exit option for the existing shareholders of AL at a price higher than the market price of the share.

GIC decided to not to exercise the exit option on the ground that Life Insurance Corporation of India and New India Assurance Company Limited (LIC and NIA) who were also holding shares of AL, did not participate in the above offer.

In January 2009, the promoters of AL again made an open offer for acquiring its shares at a price of ₹ 950/- per share which was improved further to ₹1000/- per share. The market price of the share at that time was around ₹ 925/- per share. This time, GIC decided to accept the offer as LIC and NIA had decided to accept the same. Accordingly, the Investment Committee of GIC permitted (January 2009) the sale which was completed during February 2009.

Though the investment policy of the GIC for the period 2007-2008 provided that off-market offers for purchase or sale of bulk shares would be decided by the Investment Committee, it was observed in Audit that the decision to not to exit at ₹ 1300/- per share as per the first offer, was taken by the then General Manager of the GIC. Audit further observed that the policy provided for taking decision for sale of shares of a company on the basis of its profitability, current market price, exposure in the company, technical analysis of the scrip, future prospects etc., but while taking the decision of not accepting the open offer of ₹ 1300/- per share in May 2007, these factors were not considered and action taken by LIC and NIA was considered the deciding factor. It was noted that as the share price was not moving beyond ₹ 1300/- before closing date of the first offer, various other mutual funds and financial institutions holding AL shares had taken advantage and off loaded their major holding in May 2007. The combined investment of mutual funds and financial institutions came down to 3.15 *per cent* (June 2007) from 12.34 *per cent* (March 2007).

Thus, GIC's failure to avail the exit option in May 2007 resulted in forgoing an additional profit of ₹ 12.56* crore.

The Management stated (June 2011) that the offer price of ₹ 1300/-per share in May 2007 was considered low in view of the significant scope for earnings growth of AL over the long term and bright prospects in power sector due to Central Government's plan for large investment. It further justified acceptance of the second offer in February 2009 on the ground of bearish market situation in 2009, bleak industrial scenario and low liquidity of the stock.

The reply of the Management is not acceptable in view of the following:

- Earnings growth of AL over the long term and future prospects of the power sector were not considered while taking the decision for not offloading the shares in May 2007. These justifications are an after-thought as the decision was based merely upon the action taken by LIC and NIA.
- The low liquidity should have been considered in May 2007 itself as the promoters of AL had intended to increase the shareholding in AL from 64 *per cent* to 90 *per cent* of the total equity shares which was bound to result in low liquidity of the shares.

Thus, the decision taken without a comprehensive analysis as envisaged in the Investment Policy 2007-08 of the Company and without obtaining the approval of the Investment Committee, was not in the financial interests of the GIC and resulted in forgoing an opportunity to earn profit of ₹ 12.56 crore.

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

National Insurance Company Limited

8.2 Motor Own Damage Portfolio

8.2.1 Introduction

Motor Own Damage (OD) insurance is a policy that indemnifies the insured against damage or destruction caused to the insured vehicle arising from collision in transit, flood or any act of arson. It may also be a part of a comprehensive package policy where the compulsory coverage towards motor third party is also included at the option of the insured.

In 2010-11, motor OD premium constituted 27.63 *per cent* of the total general insurance industries premium of ₹ 42,594.81 crore. As per the industry forecasts, motor premium is expected to reach 52 *per cent* of the industry's total premium in the next two to three years, based on the expected growth of the automobile sector in the country. The total net premium collected by National Insurance Company Limited (NICL) during 2007-08 to 2010 recorded a steady growth and it increased from ₹ 3,018.52 crore in 2007-08 to ₹ 4,763.96 crore in 2010-11. Similarly, the net premium collected in motor OD portfolio increased from ₹ 1,141.93 crore in 2007-08 to ₹ 1,399.60 crore in 2010-11 and ranged

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* *418532 shares x ₹300 = ₹12,55,59,600/-*

between 37.83 *per cent* to 29.39 *per cent* of the total net premium earned by the Company in the respective year.

8.2.2 Audit objective, scope and methodology

Though NICL attained negative growth during 2007-08 and 2008-09 and negligible growth during 2009-10 in motor OD portfolio and the growth was significant (31.71 *per cent*) in 2010-11 as compared to previous year, the Company continued to register losses over the same period.

The topic was selected for audit with a view to assess whether adequate measures were taken by NICL to ensure sustained growth of business and profit in motor OD portfolio and whether underwriting of motor OD policies was prudently carried out. Audit also covered whether controls were effective in respect of motor OD claims settlement, and Information and Communication Technology (ICT) was effectively used to enhance efficiency and controls.

Audit was conducted during July 2010 to October 2010, and in July 2011, covering the period from 2007-08 to 2010-11 and records maintained at corporate office, regional, divisional and branch offices under the eastern region of the Company were reviewed in audit.

Selection of units were made after conducting a preliminary study, on the basis of random sampling of three out of five regional offices in eastern region covering 60 *per cent* of the population, and divisional offices were selected on the basis of stratified sampling of the amount of claims paid covering $33^1/_3$ *per cent* of the population. Thereafter, IDEA software was utilized for sampling of files and dockets employing stratified random sampling technique at 95 *per cent* confidence level and 5 *per cent* error of estimation, covering 15 *per cent* of the population.

8.2.3 Audit Findings

Motor OD portfolio of NICL, like all other portfolios, is governed by the instructions and guidelines issued from time to time by the regulatory authority *viz.* Insurance Regulatory and Development Authority (IRDA). Besides, the Company had its own 'Underwriting and Claims Facilitation Guidelines (Motor)' to assist in the day to day operations. The decisions of the Board of Directors of NICL, too, play a pivotal role in the functioning of the Company.

During the course of audit, it was observed that growth in the portfolio was not commensurate with profitability; Incurred Claims Ratio (ICR) *i.e.* claims to premium ratio was high especially in tie-up business with Maruti Udyog Limited (Maruti), deficiencies persisted in control and monitoring of claims, and Information and Communication Technology (ICT) was not optimally utilised.

Audit findings are discussed in the subsequent paragraphs in detail.

8.2.3.1 Growth not commensurate with profitability

NICL garnered the maximum motor OD premium amongst all the general insurance companies, whether in the public or the private sector during 2006-07 to 2010-11. However, the growth of motor OD portfolio of NICL was negative during 2007-08 and 2008-09 and negligible during 2009-10, but had a significant turnaround in the year 2010-11 as shown in **Chart-1** and **Chart-2** below.

Chart 1

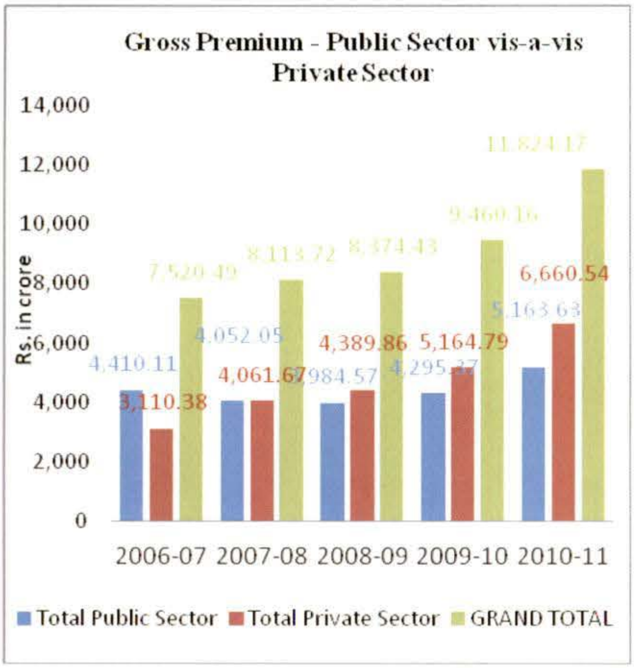
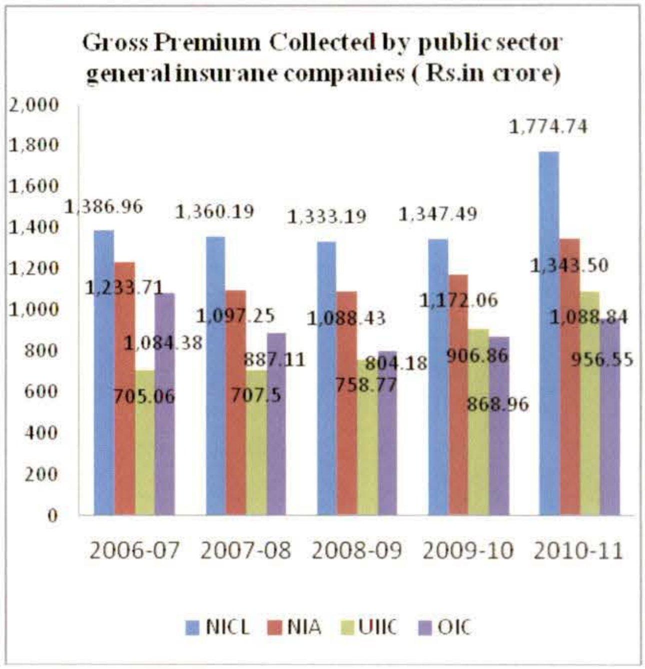


Chart 2

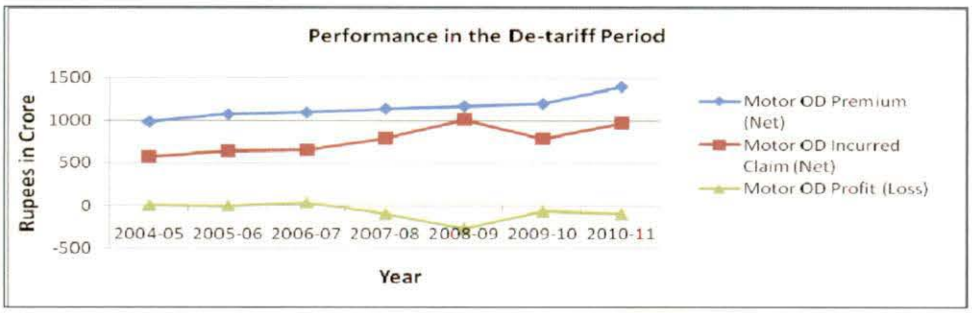


NIA > New India Assurance Company Limited; UIIC > United India Insurance Company Limited and OIC > Oriental Insurance Company Limited.

Pricing for Motor OD and other portfolios of general insurance business was regulated by the Tariff Advisory Committee in the tariff regime. It was, however, de-tariffed with effect from 1 January 2007 and insurers were given liberty to fix prices of products based on market competition.

Performance of the Company in motor OD portfolio in the tariff period (2004-05 to 2006-07) and de-tariff period (2007-08 to 2010-11) is depicted in **Chart-3** below:

Chart 3



While the net motor OD premium did not register any fall post de-tariff (1 January 2007), the underwriting loss[♠] increased substantially in the de-tariff regime. As against the profit of ₹ 1.13 crore, loss of ₹ 3.60 crore and profit of ₹ 31.35 crore in the years 2004-05, 2005-06 and 2006-07 respectively, NICL suffered loss of ₹ 97.42 crore, ₹ 270.78 crore,

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[♠] ***Motor OD Profit/Loss=Net Premium–Net Incurred Claims–Commission–Expenditure of Management.***

₹ 67.61 crore and ₹ 99.15 crore in the de-tariff regime, *i.e.* in the years 2007-08, 2008-09, 2009-10 and 2010-11 respectively.

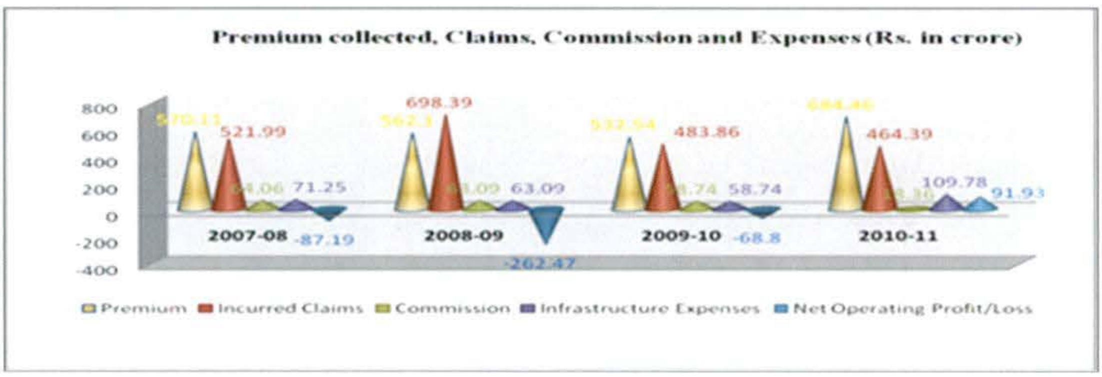
In sum, although there was significant growth in business during 2010-11, profitability declined in all the years.

The Management stated (January 2011) that market competition compelled lowering of motor OD premium rate for every class of vehicle though there was not enough cushion. Every insurer employed price reduction strategy to retain their market share.

Audit is of the view that underwriting loss in the motor OD portfolio of NICL was mainly due to ineffective control over claims settlement, especially in its tie-up business with Maruti. Whereas the Motor OD premium collected by NICL from Maruti tie-up during 2007-08 to 2010-11 was only 47.80 *per cent* of the total Motor OD premium, net operating loss (₹ 326.53 crore) in Motor OD segment suffered by NICL from this tie-up during the same period was 61.12 *per cent* of the total net operating loss (₹ 534.96 crore) of the Company from the same business segment as may be seen from the following **Chart**:

In fact, while the overall increase in motor OD premium collected by all the companies in 2010-11 was ₹ 2,364.01 crore, NICL grabbed a major share of ₹ 427.25 crore when 18 other companies in public and private sectors were competing with it. However, NICL could not maintain the ICR within reasonable limits which led to ultimate loss in this portfolio.

Chart 4



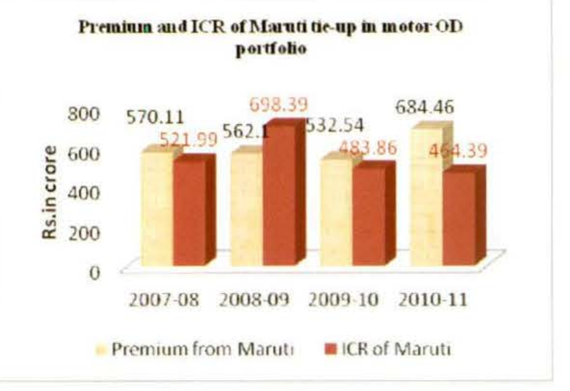
Though overall ICR declined from 86.65 *per cent* in 2008-09 to 69.47 *per cent* during 2010-11, it remained high within a range of 65.40 *per cent* to 86.65 *per cent* during 2007-08 to 2010-11.

8.2.3.2 High ICR and consequent loss in respect of Maruti Udyog tie-up

A major portion of the motor OD premium of NICL comes from the motor tie-up business with different automobile and finance companies for procurement of business through their dealers across the country. During 2007-11, motor OD premium from tie-up with Maruti accounted for nearly 80 *per cent* of the total motor tie-up business and nearly 48 *per cent* of the total motor OD premium collected by the Company. Premium earned and ICR of NICL in the major tie up business with Maruti have been depicted in the following **Charts**:

Chart 5

Chart 6



Incurred Claims Ratio (ICR) *i.e.* claims to premium ratio, in respect of Maruti tie-up ranged between 68 *per cent* to 124 *per cent*. As a result of high ICR, Maruti tie up was a major contributor to the total operating loss for the period from 2007-08 to 2010-11.

Audit observed that, in fact, the major reason for high ICR in respect of Maruti tie-up was ineffective control over the claims-settlement being done by the Maruti dealers which indicated governance deficit. Further, absence of timely and reliable database regarding premium and claims made it difficult to control the business spread across the country and leverage the synergy for optimal operational efficiency.

The Management stated (December 2010/April 2011) that NICL had devised action plans (November 2008) to control ICR, which included pruning of surveyor empanelment list on the basis of their quality and integrity, their redeployment, proper reporting from them and their quality assessment, identification of the best dealers and the worst dealers, verification and monitoring of repair facilities and visit of senior officials to the dealers where ICR was very high. The action plan was being regularly followed up.

Audit observed that ICR in respect of Maruti tie-up business did come down to 67.85 *per cent* in 2010-11 and unlike previous years, there was a profit of ₹ 91.93 crore. However, the Company needs to bring down ICR in all areas of business in motor OD.

8.2.3.3 Loss from underwriting of Motor OD Business

Motor OD portfolio suffered underwriting losses in all these years. The underwriting loss of motor OD for the years 2007-08, 2008-09, 2009-10 and 2010-11 was ₹ 97.42 crore, ₹ 270.78 crore, ₹ 67.61 crore, and ₹ 99.15 crore respectively, totalling ₹ 534.96 crore.

> Audit took into consideration the commission and management expenses paid during 2010-11 for arriving at the break-even ICR for NICL. As the Commission and Management expenses came to 31.96 *per cent* of gross direct premium income, the Company should maintain its ICR below 68.04 per cent to break even. ICR needs to be brought much below that to give NICL the competitive strength to price aggressively.

In fact, underwriting losses of NICL were partially bridged by the net income from investments which stood at ₹ 270.20 crore, ₹ 267.95 crore, ₹ 254.53 crore and ₹ 369.56 crore for the years 2007-08, 2008-09, 2009-10 and 2010-11 respectively.

Besides underwriting loss in respect of tie-up business with Maruti, other factors responsible for underwriting losses are discussed in succeeding paragraphs:

8.2.3.4 Inadequate pricing

On de-tariff of non-life insurance business with effect from 1 January 2007, insurers were given liberty to fix prices of their products based on market competition. Efforts made by the Company to sustain the competition were reviewed in audit and the observations are discussed below:

(i) Insufficient attention to claim experience in pricing

The underwriting losses suffered by the motor OD portfolio in NICL were mainly a result of high ICR. Hence, claim experience should have been made an important element in pricing. As per the existing pricing procedures, this would involve extrapolation of claim experience to prospective loss experience through suitable adjustments by way of 'loading'[1] in existing premium as well as imposition of 'policy excess'[2].

This necessitated availability of adequate and reliable data with the operating offices and Head office of the Company on the claim experience of the vehicles insured by the Company to ascertain whether underwriting was appropriate.

However, as discussed later, Audit observed that the database had not been centralized and use of Information and Communication Technology (ICT) system was not effective in the Company, and the Company had not taken adequate effective steps to equip itself for benefitting from the claims experience of various tie-up, groups or individuals through an effective ICT system and to consider possibility of revising the premium(s) by way of 'loading', or imposition of deterrent provisions like 'policy excess' and 'malus'[3], to avoid loss in portfolios like motor OD.

(ii) Absence of actuarial inputs in pricing

IRDA directed (August 2009) that each insurer should appoint an Actuary to certify that each product is financially viable, after carrying out various analyses regarding pricing, underwriting impact, profitability, etc. IRDA also emphasized the need for maintaining a comprehensive and reliable database for such analyses. Actuarial analyses for pricing have also been emphasized internationally.

Audit observed that although NICL appointed an Actuary for actuarial valuation of all the portfolios for ascertaining future liabilities (IBNR), the actuarial inputs were not proactively used for the purpose of pricing.

The Management stated (January 2011) that actuarial analyses could not be done very often or every year to project future pricing because of complexities in motor claims.

The reply is not tenable as non-consideration of actuarial inputs stands in the way of 'careful risk selection' and exposes the Company to greater possible risks.

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[1] ***Additional amount to the existing premium in view of adverse claim experience.***

[2] ***Proportion of loss to be borne by the insured in the event of a claim.***

[3] ***'Malus' stands for the necessity of appropriate loading in view of adverse claims experience. It is an important element of 'risk-based pricing', which is a pricing method stipulated by IRDA for guidance of insurance companies in de-tariff scenario.***

8.2.3.5 Weaknesses in efficient monitoring of claims

Claims outgo is a major part of insurer's expenses, apart from management expenses and future liability reserves. Hence, controls around the claims have to be very stringent for manageable ICR, sustained underwriting profits and overall financial health of an insurance company. Efficient management of claims by way of quick settlement at optimal costs helps to keep the price competitive. Claims settlement would also serve as a marketing tool through increased customer satisfaction and increased market share.

The net premium income, net incurred claim and incurred claim ratio (ICR) of NICL vis-à-vis other general insurance companies for the period 2007-08 to 2010-11 indicated that NICL had the highest net premium income, net incurred claims and ICR amongst all the general insurance companies. For the years 2007-08 and 2008-09 while the aggregate ICR of private general insurers stood at 39.33 *per cent* and 55.57 *per cent* respectively, the aggregate ICR of general insurance companies in public sector for the same period was 62.98 *per cent* and 69.03 *per cent*. NICL's ICR was 69.04 *per cent* and 86.65 *per cent* respectively for the stated period. ICR of NICL for the year 2010-11 was also considerably high (69.47 *per cent*).

The Management stated (January 2011) that it is the endeavour of the Company to contain ICR well below 60 per cent through robust controls on underwriting and claims and by speeding up processing of claims.

Despite steps taken by the Management to control the high ICR, certain deficiencies in the claims management process persisted, which are discussed in the subsequent paragraphs.

(i) Lack of control over surveys and appointment of surveyors

Whenever any claim is received, the insurer has to decide on two basic issues *viz.* (a) whether the claim is tenable and (b) the exact quantum of liability. It is here that the surveyor's performance becomes crucial and most important. Hence, a very tight control and supervision is required over the survey and the surveyors' performance at every stage.

The survey process involves three types of survey *viz.*, spot survey, final survey and re-inspection survey. If these are systematically conducted and controlled, it would ensure the accuracy of assessment of the liability. Any dilution, especially in the process of spot survey and re-inspection survey, would lead to unhealthy results.

A few illustrations indicating governance deficit and lack of control on the accomplishment of surveys and appointment of surveyors in NICL, as observed by Audit, are discussed below:

- Spot survey is necessary to ascertain the condition of the damaged vehicle and the circumstances giving rise to the occurrence of the accident to determine the correct liability. Out of 2,992 claims test-checked in audit in 11 divisions, it was observed that spot survey was not conducted by the concerned operating office in 193 cases (6.45 *per cent*) involving claims payment of ₹ 1.60 crore.
- Delay in the process of appointment of surveyor vitiates assessment of the liability. Out of 2,176 claims test-checked in audit in eight divisions, there were

delays in the appointment of surveyors in 85 cases (3.91 *per cent*) involving claims payment of ₹ 2.06 crore.

- According to IRDA Regulations, spot and re-inspection surveyors should submit report within seven days of their appointment and final surveyor should submit report within 30 days of appointment. Out of 2,448 claims test-checked in audit in nine divisions, there were delays in submission of reports in 270 cases (11.03 *per cent*) involving claims payment of ₹ 3.58 crore.
- Exercising close control over the survey process requires that the same surveyor is not appointed for two surveys (spot-final or final-re-inspection) for the same claim. However, out of 816 cases test-checked in audit in three divisions, it was observed that in 17 cases (2.08 *per cent*) involving claims payment of ₹ 0.16 crore, operating offices appointed the same surveyors for two surveys of the same claim.

Existence of the above cases indicated that recommendation of the CAG in Report No. PA 15 of 2008 relating to appointment of surveyors and timely submission of reports by them to ensure adherence to the requirement of IRDA (Protection of Policyholders' Interests) Regulations, 2002 had not been implemented by the Company. Further, a formal periodic and well documented process, on a company-wide basis, had also not been introduced for evaluating the work of the surveyors.

The Management stated (January 2011) that the Company is trying to revamp the panel of surveyors based on their past performance for better control.

In sum, since role of the surveyors is very crucial in the claim settlement process, stringent controls would ensure accuracy in the claims outgo in the fraud prone[♥] insurance sector. In fact, fraud may take place in motor OD portfolio by incorporation of previous minor unclaimed damages in the present claim through connivance with the workshop, deliberately causing accidents to replace partially damaged vehicles, false reports of stolen vehicles, fabricating close proximity claims, concealing unauthorized driving etc. As mentioned earlier, one of the major reasons for losses out of Maruti tie-up was inadequate control over claims settlement by the dealers, which in great part arose out of weaknesses in control over the survey process.

(ii) Customer satisfaction

In a competitive environment, no insurance company can ignore customer satisfaction. Customer satisfaction, *inter alia,* entails prompt settlement of claims and speedy redressal of grievances. NICL has also emphasized on the objective of 'customers-delight' along with growth and profitability.

In a competitive environment, it is important for every insurer to not only improve its claim-settlement but also perceived to be doing so by facilitating through speedier redressal of grievances.

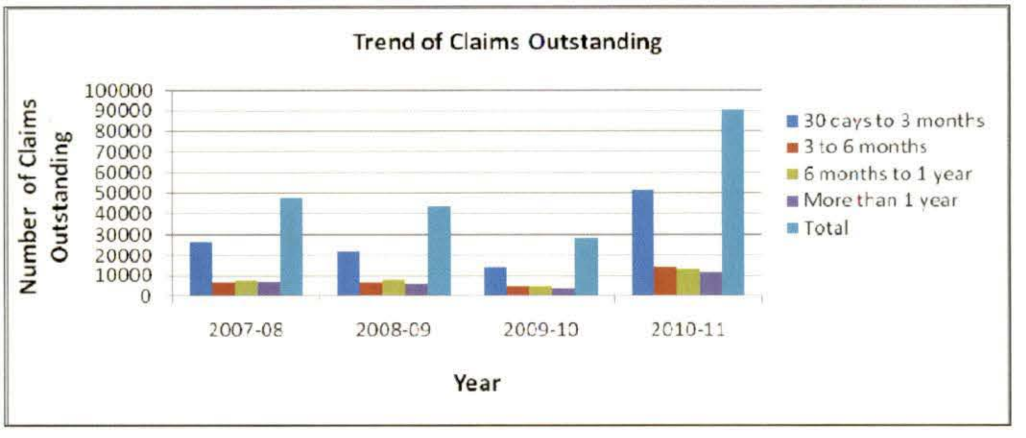
[♥] ***IRDA Journal (August 2010 issue) stated "A latest survey conducted by the India Forensic Research, which is a Pune based consultancy firm for fraud investigations, research and due diligence, revealed that insurance companies in India bear a loss of about ₹ 15,171 crore due to different frauds every year. Motor and Health Insurance are most prone to insurance related frauds........."***

(iii) Settlement of claims

Regulations 9(5) and 9(6) of the IRDA (Protection of Policyholders' Interests) Regulation, 2002 states that the insurer shall within 30 days of receipt of the survey report offer a settlement of claim to the insured and make payment of the amount due within seven days from the acceptance of the offer by the insured.

As on 31 March 2011, 1,01,052 motor OD claims valued at ₹ 354.49 crore were outstanding, of which 11,704 claims valuing ₹ 55.61 crore were outstanding for more than one year. The position of outstanding claims at the end of each year during 2007-08 to 2010-11 is given in the following **Chart**:

Chart 7



As would be seen from the Chart, the number of claims outstanding decreased over the years but increased substantially in 2010-11. Out of 1,904 cases test-checked in audit in seven divisions, delays were found in 114 cases (5.99 *per cent*) involving claims payment of ₹ 1.91 crore.

The spurt in the number of outstanding claims, particularly those outstanding for more than six months, indicated lack of appropriate measures for expeditious settlement of claims, while even the earlier Report (No.PA 15 of 2008-09) of the CAG had stressed the need for adoption of such measures.

(iv) Grievance redressal

As per Regulation 5 of the IRDA (Protection of Policyholders' Interests) Regulations, 2002, every insurer shall have in place proper procedures and effective mechanism to address complaints and grievances of policyholders, promptly and efficiently. The redressal ratio in respect of motor OD declined from 70 *per cent* in 2007-08 to 58 *per cent* in 2010-11, although the overall redressal ratio of NICL improved from 83 *per cent* in 2007-08 to 93 *per cent* in 2010-11. While settlement of claims improved during 2007-08 to 2009-10 except 2010-11, the redressal ratio of grievances declined during the period.

The Management stated (March 2011) that a separate department had been set up under a Director for the control of the 'turn-around time' i.e. time taken for settlement of claims and redressal of grievances.

8.2.3.6 Ineffective use of information & communication technology

NICL operated on 'GENISYS' software, on Oracle platform since 2002. The Company initiated (2007-08) IT-enabled Business Process Reengineering (BPR) through Enterprise Architecture Solution for Insurance (EASI). The project costing ₹ 390.56 crore was scheduled to be implemented by September 2009. An expenditure of ₹ 101.67 crore had been incurred on the project till March 2011 but the same was yet to take off till December 2011. Consequently, the activities under motor OD portfolio were being carried out through the 'GENISYS' software. NICL implemented (March 2008) the centralized 'Claims Settlement Module' for monitoring the Maruti tie-up business.

The existing 'GENISYS' software was inadequate for the above purpose and there was an urgent need for NICL to operationalise EASI system at the earliest. Observations of Audit in this regard are discussed in the subsequent paragraphs:

(i) Distributed database

NICL needed to have a centralized database with provisions for on-line processing and reporting for efficiencies in processing and monitoring. Although all the functions of motor OD portfolio were computerized through the 'GENISYS' software, the database was distributed and not centralised, thereby restricting the usefulness of the computerised system for exercising internal control on vital issues such as:

- Identifying whether or not particular vehicle(s) and surveyors were involved in preferring multiple claims under motor OD insurance and Third Party insurance with different operating offices and thereby detecting and discouraging possible fraudulent claims;
- Detecting self-contradictions, if any, in the claims where a motor Third Party claim had its genesis in a motor OD claim;
- Benefitting from the experience gained from claims preferred by various business tie-ups, group(s) or individual(s) and to consider possibility of revising the premium(s) appropriately by exercising available options such as 'loading', or imposition of deterrent provisions like 'policy excess' and 'malus', to contain the ICR and avoid recurring losses in portfolios like motor OD.
- Avoiding extension of undue 'No Claim Bonus'.
- Exchange of information with other public sector companies in the same business to identify possible duplicate and fraudulent claims.
- Effective control on management expenses by comparing and analyzing these expenses being incurred by various operating offices within the same and different portfolios of the Company.
- Effective control on the receivable and payable incidental to reinsurance.

The Management agreed (January 2011) to the need for a centralised system.

(ii) Inadequacy of validation controls in respect of underwriting and claims

The underwriting and claim processes should be technology-enabled. An integrated claim and policy management system is critical for enabling the claim officer to have online access to history of a policy and to confirm its validity, coverage and other key policy endorsements which might have a bearing on the claim-decision. A computerised system should have infallible controls to ensure correct data-feeding and processing, reliable output to facilitate underwriting, claims settlement and monitoring thereof.

Audit observed the following deficiencies in the 'GENISYS' software which indicated lack of internal controls and governance:

- In 11 (4.04 *per cent*) out of 272 cases test-checked, policies were issued without registration number.
- In 81 (7.44 *per cent*) out of 1,088 cases test-checked, engine number and chassis number of the vehicles were not recorded in the policy documents.
- In 76 (2.79 *per cent*) out of 2,720 cases test-checked, inspection for break-in policy was not conducted.
- In 17 (1.04 *per cent*) out of 1,632 cases test-checked, claims were settled by the insurer in spite of load challans not being available and/or without proper verification of driving license.
- At the time of settlement of a claim, the data-sheet generated from the system did not indicate the date of realization of cheque for the premium paid, which had to be entered manually, which not only led to inefficiency but also rendered the system prone to mistake.

The Management stated (January 2011) that serious efforts were being made to curb the OD losses, wherein the above issues are being taken care of.

Audit is of the view that unless ICT was utilised optimally without manual intervention, these issues were not likely to be fully taken care of.

Conclusion

Competition from the private general insurance companies adversely affected the growth of the motor OD business of all the general insurance companies in public sector, including NICL. The strategic alliances with different automobile and finance companies, especially with Maruti helped NICL to garner motor OD policies and premium, but the high ICRs resulted in underwriting losses in all the years from 2007-08 to 2010-11. Thus, the growth of motor OD business had little rationalization and did not result in profits.

In conclusion, the survey process and appointment of surveyors is required to be streamlined to bring down the ICR. Customer satisfaction has to be improved through speedier settlement of claims and redressal of grievances.

The existing software has distributed database and no on-line processing facilities are available and the database was not reliable for monitoring and analyses. The controls were inadequate, leading to inefficiencies in underwriting and claims-processing. Operationalisation of EASI software and optimal utilisation of Information and Communication Technology coupled with deployment of trained and sensitised staff would immensely help the Company in gaining a competitive edge through competitive pricing, prudent underwriting, effective control over claims, reduced 'turn-around time' and customer satisfaction.

Recommendations
In sum, the Company should:

- ***direct its efforts towards further bringing down the ICR in respect of tie-up businesses, especially that with Maruti Udyog Limited, through (i) greater control over the claims-settlement being done by the dealers and maintenance of a reliable database for effective monitoring.***
- ***adopt a policy of zero-tolerance coupled with strong deterrents in respect of the survey process.***
- ***train the staff dealing with claims-processing and customers' grievances and also sensitize them towards the need to ensure greater customer satisfaction.***
- ***implement the EASI software at the earliest and have a centralized and integrated computerized system with on-line processing facilities and reliable database to reap the benefits of ICT and gain competitive advantage.***

The matter was reported to the Ministry of Finance in February 2012; reply was awaited (May 2012).

8.3 Irregular settlement of an aviation claim

Settlement of a claim by ignoring the policy conditions led to a loss of ₹16.62 crore

The Divisional Office, Nagpur of the National Insurance Company Limited (Company) issued (January 2007) an Aircraft Hull/Liability policy covering the hull risk of a helicopter owned by the Director, Directorate of Aviation, Government of Chhattisgarh for a sum insured of ₹17.50 crore. The period of insurance under the policy was from 31 December 2006 to 30 December 2007.

The helicopter which was on a flight from Bhopal to Raipur on 14 July 2007 was found crashed on 16 July 2007. In order to assess the loss, a surveyor was engaged by the Company, who recommended (June 2008) for an interim payment of ₹ 9.97 crore. The same was paid (December 2008) by the Company. In April 2009, the surveyor assessed and recommended the net loss at ₹ 16.62 crore. The Company finally paid (October 2009) ₹ 6.65 crore in full settlement of the claim.

It was observed in audit that one of the conditions of the insurance policy which required compliance on the part of the insured stated that the insured should, at all times, use due diligence and do and concur in doing everything reasonably practicable to avoid or diminish any loss. Another condition called upon the insured and its employees/agents to comply with all air navigation and airworthiness orders and requirements.

It was noticed in audit that the Director General of Civil Aviation (DGCA), which conducted an enquiry on the cause of the accident in June 2008, indicated following deficiencies signifying lack of due diligence:

- The flight was being operated in monsoon season and the Bhopal aerodrome could not give en-route forecast and terminal forecast, as it did not have adequate facilities. The pilots filed the flight plan without taking into account the weather at the destination point.
- The flight planning was very unprofessional and casual.

- The crew did not follow the Standard Operating Procedures and did not maintain adequate terrain clearance. The helicopter deviated from the track to avoid the encountered bad weather.

Further, audit scrutiny revealed that air safety circular No. 02 of 2006 dated 03.01.2006 issued by the DGCA stressed that:

- Route weather forecast must be obtained and studied before undertaking flight.
- Crew deputed to fly in hilly terrain in monsoon weather should have necessary experience and that as far as possible only experienced crew members be deputed for such flying.

The pilots did not obtain route forecast which was in violation of the above circular. Also, the co-pilot flying the aircraft had experience of only 07:12 hrs as Pilot-in-command on type which again was not in consonance with the above air-safety circular.

The Company, however, overlooked the above aspects and made a payment of ₹16.62 crore towards the claim, which was against the conditions of the insurance policy.

The Management in its reply (February 2012) stated that the claim was dealt with as per the policy conditions and there was no violation of the terms and conditions of the policy. It further stated that the pilots had valid license issued by the DGCA to fly the helicopter and the clearance given by the Air Traffic Control (ATC), Bhopal for flying tantamounted to compliance of conditions of aviation. It asserted that the pilot's error was covered under the scope of the policy. The Ministry endorsed (May 2012) the views of the Management.

The reply is not convincing as it did not address the issue of negligence and non-observance of due diligence by the insured in taking adequate precautions before embarking on the flight schedule. There was failure on the part of the pilots to obtain route weather forecast before undertaking flight which was a violation of the air safety circular issued by DGCA and also against the terms of the insurance policy. Further, ATC, Bhopal's clearance could not be a sufficient reason for overlooking the negligence of the insured.

Thus, the settlement of claim which was beyond the scope of the cover, resulted in loss of ₹ 16.62 crore.

The New India Assurance Company Limited

8.4 Investment in equities

8.4.1 Introduction

The New India Assurance Company Limited (NIA) is a Public Sector Undertaking engaged in General Insurance business. It is governed by Insurance Regulatory and Development Authority (IRDA) regulations for its entire gamut of activities. In respect of investment activities, IRDA (Investment) Regulations, 2000 as amended from time to time formed the basic framework for governance.

The financial performance of the Company for the three years ending 31 March 2011 was as under:

Table 1

(₹ in crore)

Details	2008-09	2009-10	2010-11
Premium	5249.30	5710.86	6473.33
Underwriting Profit/(loss)	(1439.84)	(1719.74)	(2643.45)
Investment income	1686.82	2139.69	2329.99
Other Income/ (expenses)	50.26	(60.66)	(97.91)
Profit before Tax(loss)	297.24	359.29	(411.37)

It can be seen that the underwriting losses of NIA mounted during 2008-2011. It could post profits during two out of three years because of investment income. The total investments (at cost) of NIA as on 31 March 2011 stood at ₹ 13604 crore. Out of this, investment in equity constituted a sizeable portion of investments in the market. The share of equity in the total investment portfolio of NIA during 2008-11 was as under:

Table 2

(₹ in crore)

Details	2008-09	2009-10	2010-11
Total Investments	10771.7	11851.03	13604.63
Equity Investments	2295.20	2375.02	2630.57
Percentage of equity investment to total investment	21.30	20.04	19.34
Market value of equity investment	9698.70	17999.75	19348.40
Equity Income	237.82	238.39	310.81
Gross Yield on Equity	10.61	10.21	12.42

A study was undertaken to assess the adequacy of systems for investments, compliance with regulatory requirements and the adequacy of risk mitigation measures mainly with reference to investment in equities. The study covered a period of three years from April 2008 to March 2011. It was seen in audit that despite the overall appreciation of investments in equities as shown above, there were areas that needed closer monitoring to achieve better results, as discussed below:

8.4.2 Non-Compliance with regulatory requirements

In terms of the IRDA (Investment) Regulations 2000, NIA was to form an Investment Committee (IC) consisting of two Non-Executive Directors (NED), Chief Executive Officer (CEO), Chief of Finance (CFO), Chief of Investment division (CIO) and an appointed actuary, if employed. The CIO and CFO were to be different individuals in the IC. NIA was also required to draw up an annual Investment Policy (IP) with the approval of the Board of Directors (BOD), which was to be implemented by the IC. Further, as a measure of internal control, NIA was required to segregate operations and functions between front[1], mid[2] and back office[3].

Audit observed that the CIO of NIA was not represented in the IC for three years ending 31 March 2011. One post of NED was also lying vacant since August 2010. Further, in the Standard Operating procedures (SOP) approved in March 2010, the DGM and Chief Manager of Investment department were designated as CFO and CIO respectively, although they were not the members of the IC. The post of DGM (Investment) i.e. the designated CFO as per SOP, also remained vacant since September 2010 to-date (November 2011). NIA also did not have a separate mid office for investment management and the same was clubbed with the back office resulting in non-compliance with investment risk management systems and processes mandated by IRDA.

NIA stated (October 2011) that the vacancy in the post of independent directors arose due to their non-appointment by Government of India (GOI) and the post of DGM (Investment) was vacant since September 2010 due to transfer of the official.

The Ministry replied (June 2012) that two Independent Directors had since been inducted in the IC. It further stated that NIA allocated (January 2012) the Investment Operations to a DGM for front office functions.

8.4.3 Stop loss limits

The IP of NIA states that there would be constant churning of the scrips not only to make profit on sale but also to minimize loss on the existing scrips as per the IRDA guidelines as a measure of mitigation of risk. IRDA Investment Regulations, 2000 mandated stop loss as part of IP.

It was observed that NIA did not have a stop loss policy. A practice in this regard was observed in another similarly placed company[4], which prescribed that when the market price of any scrip fell below 40 *per cent* of the highest purchase price, the head of investment would take a decision to hold or sell with recorded reasons.

Audit observed that on account of non-existence of stop loss policy, the market value of equity shares of 29 companies with a book value of ₹ 94.92 crore deteriorated beyond 25 *per cent* and upto 94.75 *per cent* resulting in erosion of the value to the extent of ₹ 47.02 crore (March 2011), as given in **Annexure-III.**

NIA in its reply (October 2011) stated that investments were made with long term perspective and given the unexpected movement in stock, applying stop loss policy would not help in achieving the investment objectives. It was further stated that if stop loss policy was applied it would have resulted in the entire equity portfolio being wiped out in due course.

The Ministry in its reply stated (June 2012) that stop loss policies played a major role in trading environment. It was further stated that all the Company's investments were for long term and thus temporary fluctuations in the equity valuation without booking losses could be absorbed.

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[1] ***Front office – Responsible for putting through deals in the market.***
[2] ***Mid office – Supplement the function of the front office and monitor regulatory and internal norms.***
[3] ***Back office – Establishing contact with the back end of counter-parties and broker***
[4] ***SBI Life Insurance Company Limited***

The above replies were not convincing as the stop loss policy stipulated by the IRDA guidelines was aimed at assessing the risk at the stop loss price level. NIA was not expected to liquidate the shares with the fall in price to stop loss level but required to take a decision for holding or exiting with justification.

8.4.4 Non-acceptance of open offer

NIA was holding 475858 Equity Shares of Alfa Laval (India) Limited (face value of ₹ 10 each) valuing ₹ 1.79 crore (at the book price of ₹ 37.53 per share) as of May 2007. The promoters of Alfa Laval (India) Limited offered to purchase the shares at the rate of ₹ 1300 per share in the month of May 2007 when the market price of the same was around ₹ 1250 per share. NIA decided (May 2007) not to accept the offer on the ground that there was no significant difference between the then prevailing market price and offer price and further that other Public Sector Insurance Companies, which were also holding shares of the Company, were also not exiting. The disposal of shares at that point of time would have resulted in realisation of ₹ 61.86 crore.

It was observed that the above decision was taken by the CMD of the NIA without referring the matter to the Board of Directors (BOD), which was against the IP of 2007-08. The IP provided that only the IC/Board of Directors (BOD) was competent to decide on investment or disinvestments in equity shares above ₹ 20 crore.

In January 2009, the acquirers once again offered to purchase the shares at the rate of ₹ 1000 per share. At this juncture, NIA accepted the offer and disposed off the share resulting in realization of ₹ 47.59 crore.

Thus, taking a decision of not disposing off shares at a higher price of ₹ 1300 per share without obtaining the approval of the competent authority and disposal of the same at ₹ 1000 per share at a later date resulted in foregoing of a profit of ₹ 14.27 crore.

NIA, in reply stated (October 2011) that it was decided to not to opt for open offer based on the then prevailing Indian and global uptrend; that sudden negative trend and stock market crash led to offering the shares subsequently. It further stated (December 2011), that the initial proposal of not exiting was approved by the CMD in May 2007 as no investment or disinvestments was involved. The Ministry endorsed (June 2012) the reply of the management.

The reply is not convincing as the decision to not to exit on the first occasion was based more on the stand taken by other Companies and without obtaining approval of the competent authority. Offering of shares to the promoters was in the nature of sale only and the financial limits set out in IP were applicable to disinvestment or sale of the respective instruments.

8.4.5 Delay in implementation of Investment Management System

NIA placed a work order (February 2004) for implementation of Investment Application Software on M/s. Wipro Limited at a cost of ₹ 0.63 crore with a timeline of 19 weeks. The system was expected to provide total systems solution taking into account the enterprise-wide book keeping, information and reporting requirements of Investment Department catering to a wide array of investment products. The implementation of the system was fraught with shortcomings like frequent changes in the user requirement, non-integration of investment accounting with the corporate accounting module of NIA etc. The system was not able to generate the required reports though an amount of ₹ 0.48

crore had been released (upto August 2010). Taking into account the limitations, NIA decided (October 2010) to go in for upgraded version of the software to be commissioned by 31 March 2011 at an additional cost of ₹ 0.30 crore. However, the system was yet to be completed (September 2011).

The non-completion of the project resulted in non-compliance to the IRDA's regulations on 'Investment Risk Management Systems and Processes' as there was no seamless transfer of data from front office to back without manual intervention, non-monitoring of group and industry exposure norms through the system, incapability to upload corporate actions such as stock splits, dividend, rights issue etc.

NIA agreed (October 2011) that there was delay in implementation of the application software and attributed the same to changes in composition of the supplier's and company's team, cost over run and difficulties in changing from legacy to the new system.

The Ministry stated (June 2012) that the company (NIA) would ensure full implementation of the project during the current year.

The fact remained that despite initiating the process seven years ago, NIA did not have a full-fledged investment management system compliant with IRDA guidelines.

The Oriental Insurance Company Limited

8.5 Undue favour extended to M/s. Paramount Airways Private Limited in underwriting of credit insurance policies

The Company issued credit insurance policies in violation of IRDA instructions, re-insurance program and insurance principles. Besides, there was significant delay in appointment of surveyors, receipt of survey reports and processing of the claims, which led to further insurance cover by the Company to the benefit of M/s. Paramount Airways.

Insurance Regulatory & Development Authority (IRDA) on 27 March 2003, while drawing attention to section 40(B) of the Insurance Act 1938 on any new insurance product to be launched into the Indian market, directed that no insurer shall launch any insurance product in Indian market without filing the same with IRDA and without complying with the prescribed procedure.

During the years 2005-06 to 2009-10, two Mumbai based divisional offices of The Oriental Insurance Company Limited (Company) issued credit insurance policies viz. "Trade Credit–Single Debtor Policy" to banks covering non-payment by M/s. Paramount Airways Pvt. Limited (PAPL) for fuel, spares and ancillary services including lease/rental charges. The policies were issued covering risk of default by PAPL to the credit facilities extended by five public sector banks viz. Andhra Bank, IDBI Bank, State Bank of India, Indian bank and Bank of India. Reinsurance support was initially provided by General Insurance Corporation of India (GIC) for 12 months from June 2007 to May 2008, and extended upto 30 June 2008 only. Since the Company failed to bring the individual policies in line with Re-insurance terms & conditions stipulated by GIC, even during the extended period, GIC withdrew re-insurance support. The Company, however, continued to issue policies up to January 2010 by taking on the entire risk.

Audit observed that during the period 2008-09 onwards, 20 claims amounting to ₹ 399.24 crore had been reported to the Company by five public sector banks but all these claims were repudiated by the Company in March/April 2011 on the basis of Surveyor's Report pointing out various lapses on the part of the public sector banks.

A review of the records revealed that the Company extended undue benefit to PAPL as highlighted in following paragraphs:

- By issuing the above credit insurance policies, the Company violated the instructions of IRDA. There was no insurance product filed with IRDA specific to the credit risk and, accordingly, there were no IRDA guidelines/directions on such insurance product. The Company was not supposed to issue the credit insurance policies till it filed the new insurance product with IRDA and have their directions/guidance on the same.

- As per the re-insurance program of the Company, in case of any risk above ₹ 10 crore, there has to be a re-insurance support to mitigate the high risk. In case of PAPL, though the insurance risk exceeded ₹ 10 crore and GIC withdrew its re-insurance support after June 2008, the Company continued to provide the insurance cover by splitting the sum insured of the entire risk in insurance policies of ₹ 10 crore or less. Audit opines that the risk could not be reduced just by splitting an insurance policy into several policies of smaller amount for the same risk and, as such, the Re-insurance Program was not complied with and significant risk was retained by the Company to the undue benefit of PAPL.

- There was nothing on record to establish that the credit worthiness of PAPL was reviewed at any stage in the Company as warranted under the financial prudence norms. While taking decision to provide further insurance cover, the Company did not review the financial position and credit worthiness of PAPL even though IDBI Bank reported its first claim in April 2008 to the Company and GIC had also declined re-insurance support subsequent to June 2008, as it had raised a concern on the financial position of airlines companies and credit worthiness of PAPL due to the claims of banks.

- The earliest claim for ₹ 8.05 crore was lodged by IDBI Bank in April 2008, which was repudiated by the Company in April 2011 i.e. after delay of 3 years, whereas IRDA Regulations prescribed that the claims should be processed and finalized within 99 days from the date of intimation of loss. Audit opines that, if the claim were processed and finalized on time, the Company would have known the financial position and credit worthiness of PAPL and other factors relating to genuineness of the claims through the report of surveyors/investigators. As such, the delay in processing and finalizing the claim points towards facilitating continuation of the insurance cover to the undue benefit of PAPL since the public sector banks were taking comfort from the insurance cover while providing credit facility to PAPL.

- Before renewal of insurance cover to the banks, the Company was putting pressure on PAPL to get the IDBI claim withdrawn. However, even though IDBI did not withdraw its claim, the Company extended the insurance cover. Thus, far from being insurer, the Company appeared to have acted to facilitate PAPL to get more credit from the banks.

- As per IRDA regulations, surveyor has to be appointed within 72 hours of intimation of loss, surveyor report should be finalized within 66 days of the appointment and the claims should be finalized within 30 days of the surveyor report. Thus, each claim should be finalized within the overall period of 99 days after the date of intimation of loss. However, Audit noticed significant delay at every stage in processing and finalizing all the 20 claims. Though all these losses were intimated by banks to the Company between April 2008 and June 2010 for a total amount of ₹ 399.24 crore, the Company repudiated the same only in March/April 2011 i.e. after delay of 6 months to 3 years.

The Management stated (December 2011) that in the year 2005-06, there was no separate provision of credit insurance policies in Re-insurance Program of the Company and no product was filed with IRDA specific to this risk, as such; the policies were issued as special contingency policy. Management further stated that acceptance of all such risks was done by Head Office, a competent authority, on reference from Underwriting Office/Regional Office. The Ministry endorsed (February 2012) the views of the Management.

The above reply is not tenable because the decision of Head Office was in gross violation of IRDA's instruction which require every insurer to have re-insurance program for each class of insurance underwritten, and in this case the Company had accepted all such risks without filing the product with IRDA.

The fact, that the Company blatantly violated the IRDA instructions as also ignored the basic reasons for withdrawal of re-insurance support by GIC, coupled with undue delay in processing and finalization of the claims of banks, suggests the absence of proper systemic controls within the Company. However, considering the fact of several procedural and substantive irregularities on the part of the Company nexus between PAPL, the banks and the Company may not be ruled out.

United India Insurance Company Limited

8.6 Short Collection of Premium and revenue loss

Non compliance with policy guidelines resulted in short collection of premium of ₹ 5.49 crore leading to revenue loss of ₹3.96 crore

Tamil Nadu State Marketing Corporation (TASMAC), Chennai invited quotations (July 2009) for Marine and other* insurances for the period from 1 September 2009 to 31 August 2010 to cover the risk of transport of Indian Made Foreign Spirit (IMFS) worth ₹ 9200 crore (approximately) from factories inside and outside the State to its 41 depots located throughout the State besides inter depot transfer of stocks. The tender document included a key input, namely, the depot wise percentage of transit loss incurred during 1998-2009 (up to July 2009) to enable bidders to quote.

United India Insurance Company Limited's (Company) Underwriting Policy (August 2007) stipulated that the price of every product would be so fixed that sufficient margin for profit was available after taking into account the business procurement expenses,

* *Fire, Burglary, Money in Transit, Money in Safe and Fidelity Guarantee*

claim cost, management expenses and other statutory reserves. Three years[1] average transit loss of TASMAC, which is considered generally for calculation of premium, was 0.143 *per cent*. Accordingly the probable loss worked out to ₹ 13.16 crore[2]. To achieve break even, the premium to be quoted by the insurer should therefore have been ₹ 13.16 crore.

However, four operating Offices[3] of the Company quoted ₹ 4.90 crore, ₹ 8.40 crore, ₹ 9.12 crore and ₹10.69 crore respectively. Chennai Divisional Office-15 of the Company emerged as the lowest bidder. The Company informed (September 2009) TASMAC that the premium quoted by Chennai DO-15 was unworkable and incorrect. TASMAC did not accept this initially. After discussions by the Company, TASMAC accepted the second lowest rate of ₹ 8.40 crore quoted by Mettupalayam Branch of the Company. The Branch issued an Insurance policy to cover the risk commencing from 1 October 2009 to 30 September 2010.

The Company collected a premium of ₹ 7.67 crore[4] against the probable loss of ₹ 13.16 crore resulting in short collection of premium of ₹ 5.49 crore. The Company did not provide working sheets of the premium quoted by the four Operating Offices to Audit.

In response to the audit observation on short collection of premium, the Management stated (October 2011) that as the claim ratio of TASMAC showed a decreasing trend, average claim ratio for three years might not be the correct basis. The Ministry (February, 2012) while endorsing the Management's views added that the Company is addressing the issue of lack of coordination amongst its various operating offices while quoting premium against a particular tender.

The replies of the Management and Ministry are not acceptable as claim cost is a parameter stipulated by the Underwriting Policy of the Company. Of all the parameters mentioned in the Policy, claim cost is the direct cost element. The data on the same was made available to the Company by the insured. The actual claim of ₹ 11.63 crore was also somewhere near the estimate for probable loss as above. Thus there was a loss of ₹ 3.96 crore.

Thus, non compliance with the policy guidelines on underwriting resulted in short collection of premium of ₹ 5.49 crore leading to revenue loss of ₹ 3.96 crore.

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[1] ***2005-2008***

[2] ***Sum Assured for marine policy ₹9200 crore x 0.143 per cent***

[3] ***DO 15 Chennai (L1), BO Mettupalayam (L2), DO 8 Chennai (L3) and DO 2 Salem (L4)***

[4] ***Premium actually collected towards marine open declaration insurance based on declared value and distance.***

CHAPTER IX: MINISTRY OF HEAVY INDUSTRIES & PUBLIC ENTERPRISES

Bharat Heavy Electricals Limited

9.1 Avoidable expenditure due to inclusion of restrictive clause in tender documents

Due to acceptance/inclusion of restrictive clause in the tenders for boiler vertical packages, the Company deprived itself of the benefit of competitive rates and had to incur an avoidable expenditure of ₹ 27.77 crore.

Bharat Heavy Electricals Limited (Company) was awarded a contract (December 2008) for supply, erection, testing and commissioning of Main Plant Equipment by NTPC Limited (NTPC) for their Mauda Thermal Power Station (2 units of 500 MW) project in Maharashtra. After submission of the bid by the Company (August 2007) and during pre-award discussions, NTPC insisted (November 2007) that the erection agency for the first unit boiler shall not be deployed for the next unit which was agreed to by the Company.

During execution of the above order, Power Sector Western Region, Nagpur unit (PSWR) of the Company awarded (September 2009) the boiler vertical package for Unit-I at ₹ 47.37 crore to Sunil Hi-Tech Engineers Limited who had emerged L1 in the open tender.

For boiler vertical packages of Unit-2 of the Mauda project and for two other units (Unit Nos. 8 and 9) of Chandrapur project of Maharashtra State Power Generation Corporation Limited, the PSWR of the Company issued (August 2009) a consolidated limited tender enquiry to 11 vendors. In the tender enquiry (August 2009), the Company included a condition (restrictive clause) that "One bidder shall get only one job per location, *i.e.* if a bidder is awarded the job for one of the units in any location, then the bidder is not eligible for the same job of other unit at the same location and his price bid shall not be opened". In response to tender, eleven offers were received. The price bid of Sunil Hi-Tech Engineers Limited for Unit-2 of Mauda project, was not considered (December 2009) because they had already been awarded the job of Mauda Unit-1. In all, price bids of only four vendors were opened (2 bids rejected due to late receipt, 3 bidders were not approved by the customers, 1 bidder withdrew the bid, and 1 bidder was not considered due to restrictive clause) and amongst them, Power Mech Projects Limited who emerged L1 at a total value of ₹ 60.63 crore was awarded the work (February 2010). The departmental estimate was same for both units (₹ 56.52 crore) and there was no change in the nature, scope and location of both the works.

Acceptance of the restrictive clause in the contract with NTPC, led to an additional expenditure of ₹ 13.26 crore for unit-2 boiler which was 28 *per cent* more than the cost of unit-1 of Mauda project.

Audit further observed that there was no contractual condition between the Company and Maharashtra State Power Generation Corporation Limited to award the work of different units of Chandrapur Project (2 units of 500 MW) to separate parties. However as discussed above, the Company clubbed this work in tender of Mauda-II unit of NTPC and applied the restrictive clause to Chandrapur project as well. This resulted in awarding (February 2010) of the Unit No. 9 work at Chandrapur to Texcel Engineering Private Limited for ₹ 48.94 crore whereas the Unit No. 8 of Chandrapur project was awarded (November 2009) to Sunil Hi-Tech Engineers Ltd. at a lower contractual value of ₹ 44.17 crore resulting in avoidable expenditure of ₹ 4.77 crore.

The Company also floated between November 2009 and May 2010 two tender enquiries for boiler packages with restrictive clauses for awarding work of one block to one contractor, though there was no such insistence from the customers resulting in avoidable expenditure of ₹ 9.74 crore* .

The Company while accepting the incurrence of extra expenditure and assuring to be more vigilant in future in agreeing to restrictive clause of customers, stated (October 2011/January 2012) that:

- *Complexities of executing two or more units in parallel means mobilization of all resources as many times which requires a very high level of preparedness, and working with large number of labour for the entire period of the contract is very daunting;*
- *Each contractor draws power from a central or identified power source lines through their own dedicated lines (overground or partly underground) which need to be frequently re-routed to allow for and accommodate the other construction activities which results temporary disruption in the construction activities. When two or more agencies are deployed, it is ensured that only one line is re-routed/relaid at a time so that work is not stopped altogether in a Project;*
- *There are limited number of contractors equipped to carry out such large works involving mobilization of large number of manpower, deployment of skilled technicians, deployment of large cranes. etc. required for this work. Since it is a huge risk for any agency to manage such complexities even for one unit, awarding of two or more units to a single vendor only further increases the risk;*
- *Though there is an apparent increase in cost, the financial implication of non-performance by a single agency would be much more for the Company;*
- *Executing all the units through a single agency would aggregate the risks and in case of default by vendor the whole project will be affected; and*
- *In case of NTPC the condition had been agreed to by the Company at pre award stage and was, therefore, binding on the Company.*

The reply of the Company is not acceptable in view of the following:

Being the difference between the awarded price and L1 price accepted for similar units at the same location for India Bulls Realtech Ltd. (Awarded price of ₹24.28 crore per unit less L1 price of ₹20.59 crore per unit. Avoidable expenditure for 2 units was 2X₹3.69 crore= ₹ 7.38 crore) and Hindalco Industries (Awarded price of ₹42.46 crore for Block II less L1 price of ₹40.10 crore for Block I. Avoidable expenditure was ₹2.36 crore). Thus total avoidable expenditure was ₹9.74 crore i.e. ₹ 7.38 crore+₹2.36 crore.

- The operational and logistic difficulties and non-performance by a single agency, realignment of power lines, risks of contractors involving mobilization of large number of manpower, deployment of skilled technicians, deployment of large cranes, etc. indicated by the Company are not insurmountable issues in any contract management and a Navratna Company like BHEL should be able to deal with such situations by appropriate planning, monitoring and efficient project management. Such issues do not justify the decision of one contractor for one unit involving extra financial burden on the Company.
- At the time of award of works the Company neither had any well defined policy for deploying more than one contractor for different units nor any separate technical criteria for assessing the execution capacity of the bidders. Audit observed that the Company had also awarded work of more than one unit (Mauda unit 1 in September 2009 and Chandrapur unit 1 in November 2009) to the same contractor (Sunil Hi-Tech Engineers Limited) almost at the same time.
- The policy guideline for deploying more than one vendor for different major works was issued in October 2010. The same had the approval of only three out of four Regional Executive Directors. Such a policy which applies to all major contracts and involves significant financial implications requires approval of the Board level.
- Further NTPC insisted for the restrictive clause only in the negotiation/pre award stage and not in the bidding stage. Accepting a post bid clause during negotiations that has cost implications reflects adversely on the contract management system in the Company.

Thus, due to acceptance/inclusion of restrictive clause in the tenders, the Company deprived itself of the benefit of competitive rates and had to incur an avoidable expenditure of ₹ 27.77 crore.

The matter was referred to Ministry (October 2011); their reply was awaited (May 2012).

9.2 Extra expenditure due to non- diversification of the vendor base

The Company lost an opportunity to save ₹ 11.50 crore due to laxity on the part of the Management to add a known vendor to its vendor base.

The Heavy Electrical Equipment Plant, Haridwar, one of the four major manufacturing units of Bharat Heavy Electricals Limited (the Company) procured Flexible Terminal Connections (FTCs) from Siemens Limited (M/s. Siemens) on single tender basis till December 2009. FTC is a critical and sophisticated current transfer component which serves as a flexible joint application between bushing and bus bar connections in generators.

Audit observed (April 2011) that the Company was aware in August/September 2002 itself that M/s. Geitzenauer was supplying FTCs to M/s. Siemens. In order to widen its list of approved suppliers, the Company made a formal enquiry to M/s.Geitzenauer in September 2002. However, in response M/s. Geitzenauer informed that the enquiry had been forwarded to M/s. Siemens for an offer. The Company, subsequently, neither followed up the case with M/s. Siemens nor took up the issue again with M/s Geitzenauer till 2009. Under the technical collaboration agreement, M/s. Siemens was responsible for intimating the Company of the possible sub-suppliers. Later in March 2006 M/s. Siemens furnished a list of their sub suppliers for generator assembly which included M/s. Geitzenauer as a sub supplier for the FTC. However, the Company did not even scrutinise the information received from M/s. Siemens till October 2008. Subsequently, in December 2009, when the Company again approached M/s. Geitzenauer for supply of FTCs they quoted their price and were added as a registered vendor for FTCs in the product material directory of the Company.

Subsequent to registration of M/s. Geitzenauer as an approved vendor, the Company floated (February 2010) limited tender enquiry to both the approved vendors viz., Siemens and M/s. Geitzenauer for supply of FTCs. The comparative rates quoted by both the vendors revealed that M/s. Geitzenauer was L1 with quoted price of Euro 7,250 and Euro 7,950 per unit whereas Siemens was L2 with quoted price of Euro 24,756 and Euro 23,021 per unit for the 500 MW FTC and 660 MW FTC respectively. The price quoted by M/s. Geitzenauer was significantly lower than the prices of Siemens for 500 MW FTC and 660 MW FTC respectively and accordingly, purchase orders were placed (February 2010) on M/s. Geitzenauer.

Audit further observed that in the meanwhile, 144 FTCs were procured during January 2007 to October 2009 from M/s. Siemens on a single tender basis for ₹ 17.48 crore. As the price quoted by M/s Geitzenauer was nearly one-third of Siemens, the Company lost an opportunity of saving ₹ 11.50 crore♥ due to procurement of FTCs from Siemens during January 2007 to October 2009 on single tender basis.

Management while accepting that M/s. Geitzenauer as a vendor for FTCs was known to them since 2002, stated (February/June 2011) that:

- *When the vendor was approached in February 2003, they declined to make a direct offer and advised the Company to obtain the same from M/s. Siemens.*
- *The approved list of updated suppliers received from M/s. Siemens in March 2006 was part of thousands of drawings and documents in soft copy. Different Engineering Groups initiated scrutinizing of information received only after the Company had received first firm order of 800 MW rating generator in October 2008.*
- *Even if M/s. Geitzenauer had been approached earlier, they were not in a position to deal directly with BHEL till November 2009 due to capacity constraints as informed by their agent.*

We do not agree with the Management because:

- As per agreement (August 2002) between M/s. Siemens and the Company, M/s. Siemens was under an obligation to inform the latter of the possible sub-suppliers. However, neither M/s. Siemens informed the Company about M/s. Geitzenauer nor the Company made any effort with Siemens despite M/s. Geitzenauer's confirmation in September 2002 that they were the suppliers of FTC to M/s. Siemens. In fact, the Company did not follow it up with either M/s. Siemens or M/s. Geitzenauer for more than six years from 2003 to December 2009.

♥ ***Based on the difference of 65.47 and 70.71 per cent between the prices quoted by M/s. Siemens and M/s. Geitzenauer against tender floated in February 2010 for 500 MW FTCs and 660 MW FTCs respectively.***

- The Management took abnormal time of more than two years to scrutinise the information received from M/s. Siemens in March 2006. The Management's argument that the Engineering Groups initiated scrutiny of information only after the Company had received first firm order of 800 MW rating generator in October 2008 reflects adversely on the system of vendor development to get the best price. This was despite the fact that vendor information was already available.
- The issue of capacity constraint was never raised by the vendor in their correspondence with the Company nor did the agent's letter of November 2009 get reflected anywhere in the minutes of the meeting relating to registration of M/s. Geitzenauer held in December 2009. In fact, these minutes indicated that the correspondence was done directly with the vendor.

Thus, due to negligence on the part of the Management to add a known vendor to its vendor base despite the availability of information about vendor, the Company lost an opportunity to save an expenditure of ₹ 11.50 crore.

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

9.3 Extra expenditure due to inadequate system of cost estimation

Due to non adherence to its 'Works policy' and inadequacies in the system of cost estimation, Bharat Heavy Electricals Limited could not avail the benefit of competitive rates and incurred an avoidable expenditure of ₹ 8.64 crore in a work in Sudan.

Bharat Heavy Electricals Limited (Company) invited (July 2006) open tenders for the work of design and construction of two numbers reinforced concrete twin flue[1] steel lined chimneys and four cooling towers at Kosti Thermal Power Plant, Sudan of M/s. National Electric Corporation, Sudan (NEC).

Three technically responsive bids received by the Company were opened and the lowest tenderer (L1) M/s. Simplex Infrastructure Pvt. Limited was found to be 61 *per cent* higher than the estimated cost. The Company rejected the tenders and retendered the work in December 2006 after deletion of design from the scope of work. Three bids received (March 2007) were again cancelled (July 2007) by the Company as the quoted price of L1 (M/s. Gammon India Limited) was 36 *per cent* higher than the estimated cost. The work was retendered third time (August 2007) and price bids of two technically responsive parties namely M/s. Bygging India Limited, Mumbai (BIL) and M/s. Progressive construction Limited, Hyderabad were opened. BIL was L1 at Euro 9.23 million (equivalent to ₹ 53.55 crore[2]) which was 27.5 *per cent* higher than the estimated cost of ₹ 42 crore. As BIL refused to offer any discount during negotiation, the Company decided (March 2008) to revisit the estimates and retender the work.

While retendering the work for the fourth time in March 2008, the Company revised the estimate from ₹ 42 crore to ₹ 50 crore mainly on the basis of price of BIL for two items *viz.* concrete and form work for cooling towers quoted in third round of tender in August 2007. On retendering, the Company received three bids out of which two were

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[1] ***a pipe for conveying exhaust gases***

[2] ***1 Euro = ₹58.047 as taken by the Management in their calculations.***

technically responsive. BIL was again L1 and the work was awarded (June 2008) to them at the negotiated price of US$ 14.5 million (Equivalent to ₹ 62.19 crore*).

Audit observed that as per the 'Works policy', the Company was required to re-examine the estimates in case of variance in rates beyond 20 *per cent* of the estimates. However, the Company revised the estimated rates for two items for cooling towers in April 2008 even though the market price of these items was known to them in March 2007 itself when tendering for these items had already been carried out twice. Due to overlooking the available market information and retendering the work for the third time in August 2007 without realistic estimates and in deviation of its 'Works policy', the Company deprived itself of the benefit of competitive rates and had to award the work to the same contractor in the fourth round of tendering at a higher price of US$ 14.5 million (equivalent to ₹ 62.19 crore) resulting in an extra expenditure of ₹ 8.64 crore.

The Management stated (August 2010) that they had no back up data of other similar projects in Sudan. As the items in the tender were not general in nature due to quality and quantity issues, independent survey was also not possible.

We find it difficult to accept the Management's contention as the Company had already discovered the price of these items twice before tendering for the third time in August 2007. A realistic cost estimation which was required as per the Company's Work policy before tendering third time could have saved an extra expenditure of ₹ 8.64 crore for getting the work done through the same contractor.

Thus, despite the fact that there was a Works policy in place in the Company, the Management failed to comply with it. As a result, the Company could not avail the benefit of competitive rates and incurred an avoidable expenditure of ₹ 8.64 crore.

The matter was reported to Ministry in September 2010; reply was awaited (May 2012).

9.4 'Fund Management' in Government Companies Incorporated under Section 25 of the Companies Act, 1956

9.4.1 Introduction

The Companies incorporated under Section 25 of the Companies Act, 1956 are 'not for profit' entities. The profit earned by these Companies, if any, is required to be applied for promoting its objectives only i.e. to provide concessional finance to promote economic and development activities of their target groups, those living below double the poverty line (DPL), mainly through State Channelizing Agencies (SCAs) in case of four social sector Companies; and to promote, develop and commercialize the technologies in case of research Company. The following Government Companies (Companies) incorporated under Section 25 of the Companies Act were selected for 'Audit of Fund Management'.

* *1 US$= ₹42.89 as per RBI reference rates on date of award*

(₹ in crore)

Sl. No.	Name of the Company	Year of Incorporation	Administrative Ministry	Paid-up Capital (31-3-11)
Social Sector Companies				
1.	National Scheduled Castes Finance & Development Corp. (NSFDC)	1989	Ministry of Social Justice & Empowerment	596.80
2.	National Backward Classes Finance & Development Corp.(NBCFDC)	1992		602.35
3.	National Minorities Development & Finance Corporation(NMDFC)	1994	Ministry of Minority Affairs	933.17
4.	National Scheduled Tribes Finance & Development Corp. (NSTFDC)	2001	Ministry of Tribal Affairs	277.33
Research & Development Company				
5.	National Research Development Corporation (NRDC)	1987	Ministry of Science & Technology	4.42

9.4.2 Audit Objectives, Scope and Methodology

The thematic audit was conducted to assess whether the funds of the social sector Companies were managed in an efficient and effective way for economic upliftment/development of beneficiaries and encourage technological innovations in case of the research Company. Audit primarily covered a period of last three years ended 2010-11.

Audit examined records of social sector companies to have assurance that the funds in the companies were managed efficiently and effectively to achieve its corporate objectives. Audit also reviewed the role of Ministry of Social Justice and Empowerment in achievement of the Companies' objectives. In case of NRDC, royalty collection and angel investments were reviewed in audit.

9.4.3 Audit Findings

Audit findings in respect of the four social sector companies and one research & development company are organized separately in this report under Group-A and Group-B respectively considering the diverse nature of activities and audit findings.

A: Fund Management in Social Sector Companies

Background: State Channelizing Agencies (SCAs), nominated by the State Governments, formulate and implement financial assistance schemes for target groups of the beneficiaries. The Companies sanction loans to SCAs based on the annual action plans submitted by the latter and disburse the funds on demands raised by the SCAs.

The Companies send the proposal to their respective Administrative Ministries for release of equity based on fund available with them and loan allocated for disbursement to SCAs. Further action to sanction and disburse loan to SCAs is undertaken by the Companies reportedly without any interference from the Administrative Ministry and the disbursement of fund to target groups (beneficiaries) is done by SCA under various schemes.

The Companies charged low interest rates from SCAs depending on the scheme and the latter charged little higher interest rates from the beneficiaries, but much below the market rate.

The process flow of fund/information is depicted in the chart placed in **Annexure-IV.** Financials of the Companies for the last three years ended 2010-11 may be seen in **Annexure-V.**

A.1 Loan to SCAs

(i) Sanction and disbursement of loan

The Companies sanctioned and disbursed loans to SCAs considering the available fund. Audit observed sizable difference between the amount of loans sanctioned and the amount of fund disbursed to SCAs, which led to substantial funds being surplus and parked in fixed deposits with banks. Ratio of fixed deposits to funds disbursed by the Companies ranged between 18.55 *per cent* and 47.29 *per cent* during the last three years ended 31 March 2011 (refer details in **Annexure-VI***)*. The details of loan sanctioned and disbursed during the three years ended 31 March 2011 are given below.

Name of the Company	Loan Sanctioned (₹ in crore)	Loan Disbursed (₹ in crore)	Percentage (%) of loan disbursed to loan sanctioned
NSTFDC	474.76	271.68	57.22
NBCFDC	812.23	484.84	59.69
NMDFC	949.53	561.74	59.16
NSFDC	635.92	476.62	74.95
Total	**2872.44**	**1794.88**	**62.48**

It may be seen that in case of NSTFDC, NBCFDC and NMDFC the loan disbursed was less than 60 *per cent* of the sanctioned loan. This was indicative of deficiencies in loan sanction process. A review of records of the Companies for year 2010-11 revealed that some loan were sanctioned in an irrational manner as highlighted below:

- **NMDFC** sanctioned loan for some SCAs in States of Andhra Pradesh, Jammu & Kashmir, Manipur, Madhya Pradesh, Mizoram-Zidco, Orissa, and Uttar Pradesh even though these SCAs had not availed loan for last several years and, except in Andhra Pradesh, were chronic defaulters. During 2010-11, NMDFC allocated funds of ₹60.38 crore for these SCAs but no disbursement was made.
- **NBCFDC** sanctioned loan of ₹ 36.47 crore to nine SCAs who were in the list of chronic defaulters and disbursed only ₹ 2.02 crore during the year 2010-11.

If the above fund were sanctioned to SCAs with good track record, more beneficiaries could be covered under financial assistance schemes.

***NMDFC** stated (February 2012) that allocation was made on assumption that SCAs would clear outstanding dues during the year. NBCFDC attributed (December 2011) the low disbursement to non-availability of adequate guarantee to cover the fresh disbursements and poor record in terms of repayment and utilization of funds by some SCAs. The reply is not acceptable as the flawed process of loan sanction also caused the non-disbursement of some fund as highlighted above.*

***NSTFDC** stated (December 2011) that SCAs were requested to comply with the norms regarding outstanding dues, utilization of funds and guarantee; hence, there was a gap* *between sanctions and disbursement. The Company's contention is not sustainable as the loan disbursed was only 57.22 per cent of the loan sanctioned for last three years taken together.*

In conclusion, fact remains that there is a scope for making the loan sanction process more rational so that the available funds are disbursed to the target beneficiaries to the maximum extent instead of parking substantial funds in fixed deposits.

(ii) Non-utilization of loan fund by SCAs

As per lending policy of the Companies, SCAs are required to disburse the funds to target group within a prescribed period of three to six months as per schemes. The unutilized money lying with SCAs for more than six months as on 31 March 2011 is stated below:

(₹ in crore)

Company	**Unutilized funds lying with SCAs**			
	Six month to one year old	**One to three years old**	**More than three years old**	**Total**
NSFDC	64.82	57.74	44.16	**166.72**
NSTFDC	3.76	43.25	14.37	**61.38**
NBCFDC	3.37	10.16	4.78	**18.31**
NMDFC	7.92	4.76	0.24	**12.92**
Total	**79.87**	**115.91**	**63.55**	**259.33**

It may be seen from above that funds amounting to ₹ 259.33 crore remained unutilized with SCAs for more than six months including ₹ 63.55 crore for more than three years.

Audit observed that, as a disincentive for delay in utilization of funds by SCAs, **NBCFDC** and **NMDFC** charged higher rate of interest on the amount lying unutilized with SCAs beyond the prescribed period. The Ministry, in respect of **NMDFC** stated (May 2012) that as on date ₹ 7.92 crore indicated by audit has been utilised. **NSFDC**, however, discontinued charging of higher rate of interest from April 2010 and such interest of ₹ 76.37 crore charged up to March 2010 was not effectively pursued for recovery. **NSTFDC** did not have any policy of charging higher rate of interest, but it stipulates that unutilized funds should be refunded within a period of one year from the date of drawal of fund.

***NSTFDC** stated (December 2011) that the matter of utilization of funds had been taken up with SCAs at regular intervals. **NSFDC** stated (December 2011) that the Company did not release further funds to any SCA unless cumulative utilization level of 80 per cent was achieved.* However, these two Companies did not furnish reasons for not taking effective action for recalling the unutilized loans or to charge higher rate of interest to discourage SCAs from keeping funds unutilized for long period.

(iii) Non-recovery of over dues from SCAs

Recovery of principal loan and interest in time is necessary to ensure that the financial assistance is provided to more beneficiaries. The loans are given by the Companies to SCAs against the guarantees by the respective States.

Audit noticed that a substantial amount of the fund was blocked for long periods with SCAs as a result of non-recovery of over dues. The details of total over dues (principal and interest) and the chronic defaulters, as on 31-3-2011, are given below.

(₹ in crore)

Company	**Total over dues**	**Number of defaulting SCAs**	**Chronic defaulters ***	
			Over dues	**No. of SCAs**
NSFDC	299.11	23	185.40	5
NBCFDC	186.66	38	136.03	9
NMDFC	173.28	22	121.55	9
NSTFDC	101.09	30	76.75	12
Total	**760.14**	**123**	**519.73**	**35**

** Detail of chronic defaulters (i.e. non payment for more than 3 years) is given in* **Annexure-VIII.**

It may be seen that chronic default in payment of dues by few SCAs constituted a major part of total over dues in the Companies. Out of total over dues of ₹ 760.14 crore from 123 SCAs, an amount of ₹ 519.73 crore was due from 35 chronic defaulters. SCAs from the States of Uttar Pradesh, Madhya Pradesh, Andhra Pradesh, Gujarat, Bihar, Assam and Mizoram were the major chronic defaulters (₹ 452.77 crore), as per details given below.

(₹ in crore)

Sl. No.	**Name of State of SCAs**	**NSFDC**	**NBCFDC**	**NMDFC**	**NSTFDC**	**Total**
1	Uttar Pradesh	43.94	34.73	61.10	0.00	**139.77**
2	Madhya Pradesh	51.22	30.43	7.76	15.53	**104.94**
3	Andhra Pradesh	79.15	-	-	-	**79.15**
4	Gujarat	-	23.90	20.72	-	**44.62**
5	Assam	9.72	4.74	4.90	22.80	**42.16**
6	Bihar	-	21.91	-	-	**21.91**
7	Mizoram	-	-	11.72	8.50	**20.22**
	Total	**184.03**	**115.71**	**106.20**	**46.83**	**452.77**

Audit observed that in spite of chronic default in payment of over dues by some SCAs, the Companies did not invoke State guarantees available with them to enforce the recovery. This resulted in blockage of substantial fund which otherwise could be provided to more beneficiaries.

NSFDC stated (December 2011) that such legal action was never initiated as it viewed the same to be a sensitive issue. NSTFDC stated (January 2012) that it was taking up the matter of over dues with the respective State Governments at various levels. However, the fact remains that the guarantees taken to secure its funds served no purpose if the same were not intended to be enforced in appropriate cases. Such situation may not deter SCAs from committing defaults in future and deprives potential beneficiaries of the fund.

The Ministry of Minority Affairs stated (March 2012) that NMDFC had since taken extreme steps of invoking government guarantee to realize the over dues and same was expected to yield positive results. NBCFDC stated (January 2012) that it was since considering invocation of the State guarantees.

A.2 Inadequate assurance on achievement of objectives

The Companies are dependent on SCAs for achieving their respective objectives i.e. to extend concessional finance to target groups for their economic upliftment and development. Therefore, the Companies ought to have devised an effective system to ensure that the loan reached the eligible beneficiaries in complete form, was utilized for intended purpose and impacted positively on earning capacity of beneficiaries. The Companies test verified the financial assistance provided to beneficiaries by SCAs and also got evaluation studies conducted on SCAs' capabilities/schemes.

However, Audit noticed serious deficiencies as discussed below.

(i) Insufficient eligibility verification:

The Companies and their administrative Ministries did not play an effective role in ensuring that the concessional finance reached eligible beneficiaries only i.e. the persons who were living below double the poverty line (DPL) and belonging to a particular target group i.e. caste, tribes, minority or backward class. The Companies do communicate income criteria to SCAs but do not specify how the same should be verified and documented by the SCAs before providing loan to beneficiaries. Even the beneficiaries' verification process does not require such eligibility verification with reference to any authentic document or reliable method. Most of the verification reports only indicated the income, before and after the concessional finance, as informed by the beneficiary.

Audit noticed following instances which indicate the need for an effective system in ensuring eligibility of the beneficiaries.

- An evaluation study conducted (June 2008) in 10 States for NMDFC by Agriculture Finance Corporation (a multi-disciplinary consultancy public entity in agriculture and rural development segments of the economy) indicated that almost 22 *per cent* of the loan was availed by person above DPL. The report further mentioned that "by and large SCAs are observing the DPL income limit but the authority issuing the 'below poverty line' certificates differs from States to States. While in Punjab, an affidavit signed by notary public is enough, in West Bengal a simple affidavit signed by beneficiary serves as entitlement for the loan. A village officer in Kerala, and at other places income certificate from Tehsildar or DC is enough to make them eligible. In SCA like MP Handloom, Nagaland Handloom and Kerala Fisheries Development Corporation, membership of the society is the norm for the eligibility. At most places anyone can obtain a DPL certificate with contacts or through middleman by paying them the required amount. Thus, most of the beneficiaries were found to be above the poverty line and many in well off category."

- An internal beneficiary verification conducted by NSFDC in Assam in the year 2008-09 reported (January 2009) that 'most of the beneficiaries obtained loan for schemes in transport sector and majority of them used the vehicles for private purpose and not as means of earning'. Audit opines that these people might have obtained the concessional finance though they were not under DPL category.

- An internal beneficiary verification report (2008-09) by NSFDC in Jalgaon district of Maharashtra State covering 17 beneficiaries stated that 11 of the 17 units were not in operation, including a case where the beneficiary was not honest and was a small political leader; three beneficiaries were wilful defaulters and diverted the money to their other activities. Audit opines that these cases were indicative of misuse of the public fund by economically well off person.

- An evaluation study of NBCFDC schemes in Assam Sate during the year 2010-11 reported that "No assessment as regards beneficiaries' skill was done and disbursement was done haphazardly with the result that needy applicants were left out of the programme altogether and even families well off economically availed the benefits like materials and machineries".
- An internal verification report of NSTFDC (2008-09) found that scheduled tribe members in Kuvarshi Co-operative Society in Gujarat constituted only 69% against the requirement of minimum 80 *per cent* to be eligible for the financial assistance.
- An internal verification report of NSTFDC (2010-11) mentioned that, 'in Chhattisgarh State, according to the circular issued by SCA, those applicants who do not have tribal certificate with them, in their cases the certificates issued by Sarpanch/local representative are valid'.

The Companies contended that the release of fund to eligible beneficiary only is the responsibility of SCAs. The contention is not acceptable as the Companies are not commercial entities but 'not for profit' organizations established for specific social objectives.

Ministry of Minority Affairs (May 2012) for NMDFC has accepted CAG's suggestion for a reliable mechanism for identification of DPL status but feels creating such a database would amount to carrying out a mini survey which does not come under its purview.

In conclusion, audit opines that the Companies and the Administrative Ministries together need to ensure that a reliable mechanism, as to methodology and documentation, is recognized in identification/verification of DPL status and target group. The Companies should make it mandatory for SCAs to follow such mechanism in all cases. In absence of such mechanism, it may not be appropriate to assume that the objectives of the Companies are being achieved.

(ii) Inadequate beneficiaries' verification

The Companies did not have any policy on determining the extent of beneficiaries' verification required to have realistic assessment of the achievement of objectives. The verification was largely based on the targets fixed in memorandum of understanding (MOUs) by the Administrative Ministry. Also, there was no well considered policy on sample selection methodology.

Audit opines that above practice lacked objectivity with regard to quantum of verification as well as the sample selection. NSFDC covered 7 SCAs as per the MOU target for the year 2010-11, but it verified a meagre 135 beneficiaries which was only 0.28 *per cent* of the total number of beneficiaries financed during the year 2010-11. Also, the detail of population from where the beneficiaries were selected was not made available to Audit.

Further, the annual number of beneficiaries covered in the verification process was too low to have a reasonable assurance on the achievement of the Companies' objectives. The beneficiaries' verification was only 0.98 *per cent* of the total beneficiaries in NSFDC, 1.61 *per cent* in NBCFDC, 4.26 *per cent* in NMDFC and 3.34 *per cent* in NSTFDC during last three year ending 31 March 2011 (refer details in **Annexure-VIII**).

The Companies contended that they conducted beneficiaries' verification every year and the evaluation studies on beneficiaries from time to time.

Fact however remains that the Companies need to evolve a scientific/well considered mechanism for identifying the extent of verification and method of sample selection in order to have realistic assessment of the achievement of objectives.

(iii) Inadequate evaluation study

The Companies engaged outside agencies to carry out evaluation of the capabilities of SCAs and the effectiveness of the loan scheme in different areas. Audit observed that the periodicity of the evaluation studies was too low and the selection of SCAs was not rational as would be evident from following.

- NSFDC conducted (2009-10) only one evaluation study in the last three years ended 2010-11 and this study covered only 4 SCAs out of 21 SCAs.
- NMDFC conducted last evaluation study in 2006-07. Prior to this, such study was conducted long back in 1998-99. ***Ministry of Minority Affairs replied (May 2012) that an Evaluation & Impact Assessment Study Report is expected by 1st June, 2012 for NMDFC***
- NBCFDC conducted evaluation study in each of last three years. However, none of the studies included SCAs of Maharashtra and West Bengal though they were disbursed significant amount aggregating to ₹46 crore in last three years, whereas SCA of Pondicherry was covered twice even with a loan of ₹7 crore.
- NSTFDC also conducted the evaluation studies in each of last three years but covered 8 SCAs only. SCAs of Delhi, Chhattisgarh and Madhya Pradesh were not covered in the studies of last three years though these SCAs were disbursed significantly higher fund (₹84 crore) compared to many of SCAs covered in these studies i.e. States of J&K, Sikkim, Meghalaya Rajasthan and West Bengal.

Thus, in NSFDC and NMDFC, the frequency of evaluation study was very low. In NBCFDC and NSTFDC, though evaluation studies were conducted every year, the coverage was low and the selection of SCAs was not satisfactorily rational.

Audit opines that the evaluation studies reveal valuable feedback on deficiencies/irregularities post disbursement of loans to SCAs. Hence, the frequency of the evaluation studies should ensure that all SCAs/loan schemes are covered at least once in 3 to 5 years. The Companies may carry out an ABC analysis on SCAs and loan schemes on considerations of materiality and risk profile. SCAs and loan schemes with high materiality and risks should be covered more frequently than the others.

(iv) Absence of effective action on reports of verification and evaluation study

The Companies were forwarding the findings of beneficiaries' verification and evaluation study to the SCAs for necessary action. However, the Companies did not analyse and determine the action that is needed on part of the SCAs in most cases. Also, there was no effective follow up on the action taken by SCAs.

For instance, (i) NSFDC sent (January 2009) findings of internal verification reports to 11 SCAs during the year 2008-09, but only SCA of Assam replied (April 2009) that the they were in the process of taking action wherever possible without specifying the action. Audit did not find any other case where SCAs responded to the findings/suggestions of any report forwarded to them by NSFDC. (ii) In case of NMDFC, the last evaluation report was submitted in June 2008 and the Company forwarded the concerns raised therein to concerned SCAs in September 2009 for necessary action. Only one SCA assured (September 2009) to take the necessary action, but the detail of action was not received by the Company.

Audit opines that the Companies should specify/suggest the action to be taken by SCAs on the concerns raised in the reports, instead of just forwarding the reports' content. An appropriate follow up action mechanism should be formulated to ensure the intended action occur and the action taken report is regularly submitted to the Board/Ministry till the intended action on part of the SCAs/Companies occur.

Further, where serious irregularities are noticed during the course of beneficiaries' verification/evaluation study, the sample size should be appropriately increased in the ongoing as well as the future studies. Some of such serious concerns noticed in audit are pointed out below:

- As per internal inspection report (January 2009) of NSFDC's Zonal office – Mumbai, covering 17 beneficiaries as sample (from Jalgaon district), in four cases the assets supplied under the schemes were defective / uncompetitive. Two illiterate beneficiaries received only ₹ 4,500 through middleman out of sanctioned loan of ₹ 25,000.
- An internal verification of four States by NSFDC revealed (January/March 2009) wilful default in transport and service sector in all the four States.
- An evaluation study of 'NBCFDC schemes in Assam' during the year 2010-11 reported that "in many cases credit was not extended to the beneficiaries but materials of inferior quality and of less value compared to the official records were made available to the evaluation team".
- An internal verification report of NSTFDC (2010-11) found that, in Karnataka, some beneficiaries' incomes appear to be reasonably good yet wilfully not repaying the dues.
- The beneficiary verification report of NMDFC for 2009-10 stated that, out of 3690 beneficiaries' interviewed, 367 (10 *per cent*) beneficiaries had diverted the fund.

In view of the serious irregularities based on sample test check, the Companies need to carry out more beneficiaries' verification as also investigate and take appropriate action.

Audit is of the opinion that the beneficiary verification and evaluation studies were oriented more towards achieving the MOU targets rather than ensuring optimum utilization of fund to achieve the objectives.

A.3 Absence of public awareness of loan assistance schemes

Most of the verification and evaluation studies reported that awareness about the loan assistance schemes and follow up of activities/technical support/training among the underprivileged masses/illiterates was very poor. Awareness generation is required on a larger scale for benefits to flow among poorest of the poor. An evaluation study conducted by Agriculture Finance Corporation for NMDFC indicated (June 2008) that more publicity of NMDFC schemes should be carried out amongst the illiterate population as majority of target beneficiaries were illiterate. It further reported that nearly 85 *per cent* of the loan had been cornered by literate person. One of the studies conducted by NBCFDC in Gujarat (2010-11) stated that SCAs did not have proactive approach for involving people in the schemes, they only wait for application without making advertisement in the low addressed districts.

The details of expenditure incurred by the Companies on advertisement/public awareness and the respective weightage/targets units in MOU during last three years was as follows.

Year	NSFDC	NBCFDC	NMDFC	NSTFDC	Total
Expenditure on advertisement and public awareness (Amount in Rupees)					
2008-09	56,92,619	52,33,171	80,218	80,439	1,10,86,447
2009-10	20,35,190	20,95,305	44,033	10,020	41,84,548
2010-11	10,62,731	98,87,030	0	3,41,486	1,12,91,247
Total	**87,90,540**	**1,72,15,506**	**1,24,251**	**431,945**	**2,65,62,242**
MOU for public awareness: Weightage as points (major target units)					
2008-09	7 points (12 camps)	2 points (22 camps)	Nil	7 points (15 camps)	Weightage (target units)
2009-10	6 points (20 camps)	5 points (25 camps)	Nil	5 points (15 camps)	Weightage (target units)
2010-11	6 points (20 camps)	5 points (5 camps)	Nil	5 points (3 camps)	Weightage (target units)

Thus, the Companies collectively spent only ₹ 2.66 crore during the last three years ended 2010-11 against loan of ₹ 1795 crore disbursed during this period. The spending on advertisement/public awareness was only 0.15 *per cent* of loans disbursed, despite regular findings in all evaluation studies about lack of awareness of financial assistance schemes amongst illiterate people. MOU targets were mainly in terms of 'camps to be organized' in case of NSFDC, NSTDFC and NBCDFC. There was no separate MOU target in NMDFC for advertisement/public awareness and the expenditure was also negligible. ***Ministry of Minority Affairs stated (May 2012) that SCAs have been extended Grant-in-Aid through NMDFC of upto 10 per cent of the amount for advertisement, publicity etc. during the 11th plan period.***

Audit observed that the MOU targets for loan sanction and disbursement to SCAs in terms of amount was given weightage ranging between 22 to 35 points (out of total of 100 points) in these Companies during the last three years ended 2010-11, as against 2 to 7 points for the advertisement/public awareness. Hence, the Companies efforts were oriented more towards quantitative achievement than the qualitative performance.

Further, the MOU target units in terms of camps significantly varied from Company to Company and year to year, indicating absence of any rational basis in fixation of the targets. Audit opines that without public awareness among the poorest of poor in the target group, the implementation of the schemes is likely to be more subjective. Hence, MOU weightage/targets need to be suitably worked out so as to be commensurate in terms of target population coverage in the awareness programs.

NSTFDC stated (January 2012) that since, in most of the cases, the medium of other institution was utilized, the expenses incurred by NSTFDC were low. Audit is of the opinion that the Companies need to have a well considered policy on advertisement/public awareness, considering the findings/recommendations of the evaluation studies.

A.4 Need for transparency as part of good governance practice

The Companies have their respective websites for dissemination of information about their activities. The website also displayed details about the schemes and SCAs. However, Audit noticed that, except NMDFC, none of the Companies' website had data of basic details of the beneficiaries and the reports of the beneficiaries' verification/evaluation studies. Hence, there could not be any public feedback as to the impact of schemes on target groups (individual/cluster beneficiaries).

Audit feels that the website of the Companies and SCAs should display the basic details of the beneficiaries' (their names & address, loan amount/assets disbursed etc) and the findings of beneficiaries' verification and evaluation studies, for getting public acknowledgement and support. The public participation, particularly from the social organizations working for the welfare of under-privileged groups in the society, could compensate for the inadequate infrastructure in the Companies and the SCAs. Further, Audit noticed that the evaluation studies have time and again raised concerns on the inadequate infrastructure in the Companies as well as the SCAs in terms of field set-up and manpower, which was a constraint in proper implementation of the schemes. The display of aforesaid details and reports would also work as deterrent in curbing malpractices.

B: Fund Management in National Research & Development Corp. (NRDC)

B.3 Royalty collection:

NRDC is engaged in commercialization of inventions, technologies and processes emanating from various national research and development institutions. Licensing of technology was a major source of income of NRDC. As per the license agreement, licensees were required to file royalty return periodically and pay royalty on production. The licenses were liable to be terminated in case of non-payment of the due royalty. NRDC had 550 licensees as on 31 March 2011 and earned ₹ 18.81 crore as royalty from 70, 59 & 79 licensees respectively during the last three years ended 31 March 2011. *Out of remaining 471 licenses, as per reply of the Ministry (May 2012) to audit, 301 licensees did not file royalty return, royalty was not due from 120 licensees due to various reasons, 40 license cases were in disputes and 10 licensees for defence technologies are in production but royalty is not payable on defence supply. Audit observed that NRDC neither took any effective action for determination and recovery of the royalty from 301 licensees nor terminated the license. Management assured (December 2011) that efforts were since being made to strengthen royalty collection system to increase its revenue through royalty. Ministry in its reply (May 2012) stated that NRDC is assessing the commercialization status of the remaining 301 licences and pursuing with them to file royalty returns.*

B.4 Angel Investments

Under angel funding scheme, NRDC is making investment in the share capital of incubate companies out of grants received from the Government under technology/invention promotion programs. A total amount of ₹ 90 lakh (₹ 30 lakh each) was invested in three companies so far under the scheme. As per guidelines for angel funding, an expert committee or investment committee was to be appointed by NRDC to review the progress of the incubate companies, but no expert/review committee was appointed so far. *Ministry replied (May 2012) that NRDC plans to set up an independent Monitoring Committee by July 2012.*

Conclusions

- **Social Sector Companies needed to exercise more efficiency and effectiveness in sanction of loan, discouraging non-utilization of Funds for long period by SCAs, and recovery of over dues from chronically defaulting SCAs.**
- **Companies did not have a well considered mechanism for ensuring that the concessional finance reached the eligible people only.**
- **Beneficiaries' verification was not inadequate and frequency & coverage of evaluation studies was too low, to have reasonable assurance on achievement of the Companies' objectives. Appropriate action on the findings of evaluation studies and beneficiaries' verification was not taken.**
- **The Companies did not display the basic details of beneficiaries and reports of inspections/studies on its website, which is necessary to invite public acknowledgement and participation for effective implementation of the schemes.**
- **NRDC failed to ascertain and recover the royalty due from most of the licensees.**

Recommendations

- ***Improve upon the process of sanction of loan to SCAs, discouraging non-utilization of loan funds by SCAs beyond the prescribed period and the recovery of over dues from chronic defaulters.***
- ***Formulate well considered parameters on eligibility identification, beneficiaries' verification, evaluation studies, action on the findings and public awareness on the welfare schemes.***
- ***As a part of good governance and tenets of transparency, the Companies should display basic details of beneficiaries and reports of inspections/studies along with action taken status on website.***
- ***NRDC to take action to assess and recover royalty due from 301 licensees.***

National Highways Authority of India, United India Insurance Company Limited, The Oriental Insurance Company Limited, The New India Assurance Company Limited, National Insurance Company Limited, Mahangar Telephone Nigam Limited, Bharat Earth Movers Limited, NTPC Limited, Neyveli Lignite Corporation Limited, Steel Authority of India Limited and Food Corporation of India

9.5 Recoveries at the instance of Audit.

During test check, several cases relating to non-recovery, short recovery, excess payment, short charging of premium etc by Central Public Sector Undertakings (PSUs) were pointed out. In 36 such cases pertaining to 11 PSUs, audit pointed out that an amount of

₹ 84.39 crore was due for recovery. The Management of PSUs had recovered an amount of ₹ 83.83 crore during the year 2010-11 as detailed in **Appendix I.**

Central Warehousing Corporation, National Seeds Corporation Limited, Bharat Heavy Electricals Limited and Hindustan Aeronautics Limited.

9.6 Corrections/rectifications at the instance of audit

During test check, cases relating to deficiencies in the systems, policies and procedures etc were observed and brought to the notice of the Management. Details of cases where the changes were made by the Management of the PSUs in their policies/ procedures at the instance of audit are given in **Appendix II**.

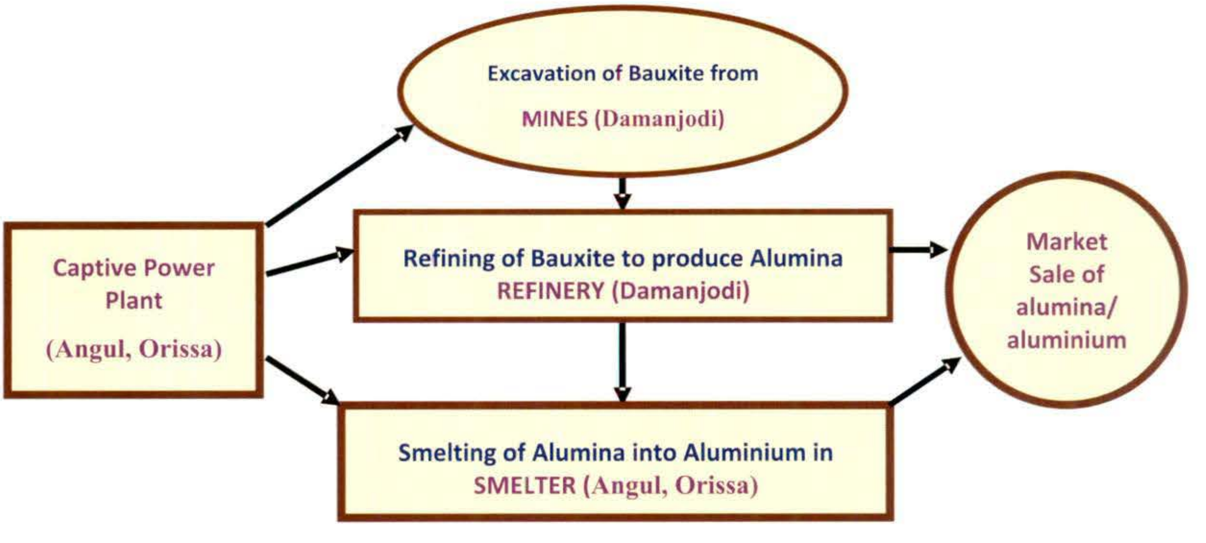
CHAPTER X: MINISTRY OF MINES

National Aluminium Company Limited

10.1 Second Phase Capacity Expansion

10.1.1 Introduction

National Aluminium Company Limited (Company), a Navratna Company, under the administrative control of Ministry of Mines, Government of India (GOI), was incorporated in January 1981 to exploit the bauxite reserves located in India for production of Alumina and Aluminium. Since inception, the Company has been adopting technology provided by M/S Aluminium Pechiney (AP), France for production of alumina and Aluminium. The chart below briefs the process of production of Alumina and Aluminium.



In order to meet the growing demand of its products, the Company for the first time expanded its production capacity in the year 2003. The Company is in the process of expanding its production capacity further through second phase expansion plan with an estimated project cost of ₹ 4091.51 crore with the aim of increasing the export and domestic sale of its products and to have a competitive edge over its global and domestic peers.

The table below indicates the initial capacity of Mines, Refinery, Smelter Plant and Captive Power Plant (CPP) and the expanded/expandable capacities after implementation of 1st and 2nd phase expansion plans.

	Mines (Bauxite)	Refinery (Alumina)	Smelter (Aluminium)	CPP
Initial	2.4 MMTPY*	0.8 MMTPY	0.23 MMTPY	720 MW
First Phase	4.8 MMTPY	1.575 MMTPY	0.345 MMTPY	960 MW
Second Phase	**6.3 MMTPY**	**2.1 MMTPY**	**0.46 MMTPY**	**1200 MW**

10.1.2 Audit Scope, Objectives and Methodology

The audit reviewed the activities relating to planning, execution and monitoring of the second phase capacity expansion of the Company. The sample consisted of 25 contracts for refinery (28 *per cent*) and 10 contracts for smelter (33*per cent*) out of total of 88 contracts and 30 contracts respectively.

The audit was conducted to ascertain whether the pre-implementation planning activities were carried out diligently, the project and contracts were managed with due economy and efficiency, an effective monitoring mechanism was in place and the objectives of the project as envisaged in the expansion plan were actually fulfilled.

10.1.3 Audit Findings

10.1 3.1 Delay in Completion of Project

The second phase expansion project which included expansion of Refinery, Smelter and Captive Power Plant, was scheduled to be completed by December 2008 but audit noticed that due to various gaps and inadequacies in planning and execution of project, the completion of expansion of Smelter, Captive Power Plant and Refinery was delayed by 12 months, 23 months and 36 months respectively. Audit analysed the reasons for these delays and observed the following shortcomings in implementing the project:

(i) Belated adoption of improved technology

In the first expansion plan, the Company used AP technologies viz. AP-18 for smelter and conventional gravity clarifiers for refinery. The technologies used being old, the Board of Directors (Board) of the Company while reviewing the status of expansion plans directed the Management (January 2002) to interact with AP for exploring availability of improved technologies before preparing the Detailed Project Report (DPR) for second phase expansion .

Audit, however, observed that though the improved technologies were available with AP, the Company, without exploring their availability, awarded the work of preparation of DPR with existing technology (30 January 2002) to Engineers India Limited (EIL) which was finally prepared in June 2002 and approved by the Board in July 2002.

Subsequently, AP, in a meeting (December 2003) with the Company, followed by a written confirmation (March 2004) intimated the availability of improved technology for production of Alumina and Aluminium and suggested its adoption in second phase expansion. The proposed technologies were stated to optimize capital expenditure, operating cost and space. The Board of the Company while according (March 2004) 'In Principle Approval' decided to engage EIL again for conducting a techno-feasibility study on the suggested improvement which submitted its report in August 2005 and after

* *Million Metric Tonnes Per Year*

clearance from GOI, the order on AP was placed on December 2005. AP submitted its Basic Engineering Packages[1] (BEP) between February 2006 and September 2006.

Audit observed that the delay in exploring improved AP technology resulted in delayed finalization of DPR by 17 months[2] which had a cascading adverse impact effect on the completion of project. Consequently, the entire project schedule got delayed and the works for basic civil & structural jobs at Refinery and Smelter, the critical activities [3]could only be awarded in March 2007 after a delay of 19 months from the scheduled date of completion.

Management stated (October 2011) that the Company came to know about the availability of improved technology of AP only in December 2003 and had they waited for improved technology, the entire process of preparation of the DPR and various statutory approvals would have been delayed further.

The reply is not acceptable as the improved technology was already available prior to July 2002 and the Company did not explore the same by interacting with the supplier (AP) despite such directions by the Board. The Management's contention that exploring the improved technology would have delayed the commissioning of the Project is also unfounded as the Company ultimately adopted the improved technology at a belated stage.

Management, however, agreed to explore the availability and use of improved technology in future projects.

(ii) Award of the Contracts without considering the Past Performance of Contractors

Audit observed that the Company did not consider the past performance of the contractors in executing earlier contracts before awarding fresh contracts for critical activities. As a result, a number of contracts were awarded to inefficient contactors who failed to adhere to the contractual time schedule, thus, leading to abnormal time overruns as discussed below:

(a) Civil & Structural Works at refinery and smelter

The Company had awarded (February 2006) the civil and structural works for potrooms at smelter to M/s. Era Infra Engineering Limited (ERA) for ₹ 19.71 crore to be completed by April 2007. Despite the fact that the contractor had delayed in mobilization of resources, the Company, after receiving commitments for early mobilization of resources, awarded three more contracts to ERA in May 2006 and June 2006 for civil & structural works at Refinery and Smelter. The Contractor could achieve only 49 *per cent* of progress by March 2007 against the target of 70 *per cent*. Ignoring the under-performance, the Company awarded two more contracts (March 2007 and May 2007) for civil and structural works at a total cost of ₹ 27.36 crore.

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[1] ***Comprehensive technical data that allows a third-party contractor to carry out the detail design engineering and procurement/supply of equipments***

[2] ***From July 2004 (appointment of EIL to carry out feasibility study for adopting AP's improved technology) to December 2005 (placement of order on AP).***

[3] ***The sequence of activities that must be completed on schedule for the entire project to be completed on schedule. If an activity on the critical path is delayed by one day, then entire project will be delayed by one day.***

The Contractor could complete only two works (Package – I & II) of refinery with a delay of 34 months and the other four contracts (Package - III of refinery and three works of smelter) were still to be completed (July 2011) even after a delay of 38 to 47 months.

Audit observed that the progress of contracts in all these cases was slow mainly due to failure of contractor in deploying adequate resources at widely dispersed sites (537 kms). As these civil and structural works were critical for timely completion of the Project, the performance of the contractor in the earlier contacts should have been considered before awarding any subsequent contracts.

The Management while pleading (October 2011) that the existing manual and procedures of the Company did not permit the rejection of L 1 offers, assured to consider the incorporation of 'Bid Capacity Assessment' in the Contract manual to address the issue raised by Audit.

(b) Mechanical and Piping work at refinery and composite works at mines

- The contract for mechanical & piping job at the refinery was awarded to M/s. Kirloskar Construction & Engineering Limited (KCEL) in August 2007 at a cost of ₹ 20.88 crore with scheduled completion by October 2008. Though in March 2008, the progress of this work was only 7.40 *per cent* as against the scheduled progress of 67 *per cent,* another contract for civil, structural & mechanical (composite) works at mines was awarded to KCEL at a total value of ₹ 11.53 crore for completion by March 2009. This contractor could only execute 22 *per cent* of Refinery works (April 2009) and 8 *per cent* of the works at Mines (June 2009). In view of its slow progress of work, the contract was terminated in June 2009 but at the request of the Contractor, termination was withdrawn in August 2009. As even after resumption of work, the contractor failed to improve its performance and could complete only 21 *per cent* work at Mines (April 2010) and 30 *per cent* work at Refinery, the Company ultimately had to terminate these contracts in April 2010 and June 2010 respectively.

  Thus, non-consideration of the poor performance of the contractor before awarding fresh contracts and delay in termination of the contract adversely affected the overall completion schedule of the second phase expansion by 28 months[*].

Management stated (October 2011) that the subsequent contract was awarded to the KCEL due to poor response against the tender.

- For the balance civil, structural and mechanical portion of the composite works estimated at ₹ 11.97 crore, three parties quoted their rates and the offer of M/s. Zeppelin Mobile Systems India Ltd. (Zeppelin) for ₹ 3.97 crore was the lowest while the offers of other two parties were 92 and 132 *per cent* higher than the estimated price respectively. Though Zeppelin being a contractor in the field of communication towers and shelters only had no experience in Mining works, the contract was awarded (December 2010) to Zeppelin. The contractor failed to mobilize adequate manpower and other resources and could achieve less than 1

[*] ***From scheduled date of completion (March 2009) to July 2011***

per cent progress of the work; The Company, as such, had to terminate the contract in May 2011. The new contract was yet to be awarded (January 2012).

Thus, due to selection of an inexperienced contractor at an abnormally low price, the progress of expansion project works at mines was further adversely affected.

The Management contended (October 2011) that (i) the nature of work involved did not require any special experience and (ii) the approved procedures of the Company do not permit rejection of abnormally low offers.

The plea of the Management is unfounded as quoting of unreasonable and abnormally lower rates (33 *per cent* of the estimated cost) by the bidder was indicative of their inexperience. Acceptance of such unworkable rates ultimately resulted in losses to the contractors and consequential stalling of the work. The procedures of the Company, therefore, need revision.

The Management accepted the audit recommendation and assured to formulate fresh guidelines for monitoring poor performing contractors and take remedial measures.

(c) Inordinate delay in commissioning of mining equipment

The DPR for 2nd phase expansion plan envisaged concurrent mining at Central Block Sector–I (CB I) and North Block Part–II (NB II) in Panchpatmali Mine in equal ratio from 2008-09. As per the existing mining practice, the excavated bauxite is transported to the primary crusher by dumpers for crushing to facilitate transportation of the same to the refinery by conveyor belt. However, as the distance between the mining faces and the primary crusher in case of NB II was more, in order to save the transportation cost, it was decided that the excavated bauxite would be crushed by a Semi-Mobile Crusher Plant (SMCP) and dispatched to the primary crusher through a 4.5 km. Fixed Long Distance Conveyor (FLDC). Accordingly, the Company procured SMCP and FLDC at a cost of ₹ 42.15 crore and ₹ 60.94 crore respectively for commissioning by September 2008.

Audit, however, observed that these equipments were not yet commissioned (January 2012).

The inordinate delay in commissioning of the equipments had the following adverse consequences:

- The delay in commissioning of SMCP and FLDC defeated the very purpose of their procurement at a total cost of ₹ 103 crore as the progress of the works was very slow and till January 2012 only 48 *per cent* of the work of SMCP was completed. By the time the work of SMCP and FLDC would be completed, the mining faces may reach the SMCP area and the advantage of installing the equipment may be lost.
- The expenditure of ₹ 3.74 crore* already incurred by the Company towards civil, structural, mechanical, electrical and insulation works for SMCP and FLDC would also remain unutilized till these equipments are commissioned.

* ***₹ 3.59 crore paid to M/s. KCEL and ₹ 0.19 crore to M/s. Lloyds (upto May 2011)***

- The Company incurred a recurring transportation cost of ₹ 55.60 crore[1] during the period from September 2008 to March 2011 for transporting excavated bauxite (5.42 MMT) from the mining area to the primary crusher.

The Management attributed the delay to unsatisfactory performance of the contractors and maoist attack (April 2009) at mines and pleaded that since considerable quantity of bauxite still remains to be excavated where these equipments will be used, the investment has not gone waste. As regards additional transportation cost due to non- commissioning of the equipments, the Company admitted that it would have incurred transportation cost of ₹ 29.18 crore for crushing and transporting the excavated bauxite of 4.56 MMT.

The contentions are not acceptable as:

- Non completion of civil, structural, mechanical, electrical and insulation works which delayed the installation of SMCP and FLDC was on account of flawed contract management as already discussed in the preceding paragraphs.
- There would be limited scope of utilization of the equipment in NB–II as the mining faces were approaching close to the SMCP area.
- The Annual Progress Report of the Company for the year 2010-11 indicated that the delays in commissioning of the equipments would defeat the very purpose of their procurement.
- Due to the delay in commissioning of mining equipments, the Company incurred an extra expenditure of ₹ 26.42 crore[2].

(iii) Absence of Component- wise Milestones in Consultancy Agreement

The Company engaged (March 2005) EIL for providing Project Management, Basic Engineering, detailed Engineering, Tendering, Procurement Services and Supervisory Commissioning Assistance for implementation of Second Phase Expansion Project at a lump sum fees of ₹ 129.60 crore, enhanced subsequently to ₹ 134.82 crore due to addition in the scope of work. In terms of the agreement, the expansion works of Mines, Refinery and Smelter were to be completed by April 2008, August 2008 and December 2008 respectively.

Audit observed that the agreement entered with EIL was in contravention of the CVC guidelines (November 2002) as it did not include component-wise schedule. In the absence of such a clause in the agreement, the Company was not able to monitor the progress of component wise milestones of the project. Resultantly, despite inordinate delay in completion of various components of work as discussed in preceding paragraphs, the Company could not hold EIL responsible for the delay.

Further, due to delay in completion of project, the Company had to extend the services of EIL beyond the contractual completion date for which the Company had already agreed (September 2011) for a compensation of ₹ 30 crore and so far (January 2012), has released an adhoc payment of ₹ 17 crore to EIL.

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[1] ***Cost per MT per Km. = ₹22.80 (₹5.2 crore cost for transporting 4.56 MMT of bauxite for 500 meters). Therefore, cost for transporting 5.42 MMT for 4.5 Km = ₹55.60 crore***

[2] ***(₹55.60 crore - ₹29.18 crore)***

*The Management assured (*October 2011*)* to prepare component-wise schedule in future projects.

Conclusions

The second capacity expansion plan was very vital for the growth of the Company and also for the Country for attaining self sufficiency in the field of Aluminium. Audit observed a number of inadequacies and gaps in formulation and implementation of the plan. While formulating the Project, the Company did not explore the availability of improved technology as a result, the DPR had to be revised which led to delayed commencement of project which had a cascading effect on the completion of the Project. While awarding the contracts, the Company did not learn from its past experience and awarded the critical contracts to the contractors having a poor track record in executing earlier contracts. The Company also awarded the contract for another critical activity to an inexperienced contractor by accepting its abnormally low offer. These system weaknesses contributed significantly in delaying the completion of the project. Further, due to delay in completion of related civil and electrical works, the mining equipment procured in the year 2008 at a cost of ₹ 103 crore for saving transportation cost of bauxite could not be commissioned so far (January 2012).

The above gaps and inadequacies in project formulation and project execution point towards a Governance deficit in the Company which needs to be addressed appropriately.

The matter was referred to the Ministry (November 2011); their response was awaited (May 2012).

10.2 Avoidable loss due to continuation of uneconomic operation of Special Grade Alumina plant

The Company continued to operate the uneconomical SGA plant without ensuring sustainable supply of critical consumables (saggers) resulting in avoidable loss of ₹ 19.08 crore.

National Aluminium Company Limited (Company) is one of the leading alumina & aluminium producer and exporter in the Country. The Damanjodi refinery of the Company processes bauxite for producing calcined alumina, a part of which is processed further for producing aluminium and the remaining is sold directly in the market.

In 1995, in view of customers' demand, the Company decided to produce Special Grade Alumina (SGA) by processing calcined alumina and accordingly, a SGA plant of annual production capacity of 13000 MT was commissioned in Damanjodi (September 2005) at a cost of ₹ 59.18 crore .The Company also imported 15000 saggers*, which are essential and critical consumables for production of SGA, from the Original Equipment Manufacturer (OEM). The plant required 13,300 saggers annually to run at 100 *per cent* rated capacity.

* ***Ceramic, box like containers used for protecting ware in kilns and can withstand a temperature of 1600°C. Calcined alumina are filled in these ceramic containers and placed in the kiln cars for production of SGA.***

Audit observed (June 2011) that though saggers were non standard ceramic items, not readily available in the market, the Company did not secure sustainable supply of the same for operating the plant at full capacity. Consequently, the Company faced shortage of saggers since inception particularly when a number of saggers were damaged during the commissioning/process stabilisation. By September 2006, the Company was left with only 6000 saggers out of 15000 procured from the Original Equipment Manufacturer. Company's efforts to procure fresh saggers from the OEM did not yield any result as the latter initially refused to deal with the Company because of unresolved commercial disputes relating to supply and commissioning of the plant and subsequently quoted higher rates which were found economically unviable by the Company. Hence, the Company could not tie-up with the OEM for long-term procurement of saggers.

Audit also observed that till 2006-07, the Company did not initiate any action for exploring any alternate source of supply of this critical item. It was only in September 2006, that the Company initiated efforts for developing indigenous suppliers of saggers and as a result, by August 2011 only three such suppliers could be developed but they were not able to supply the requisite number and quality of saggers. Consequently, due to non-availability of sufficient saggers, the capacity utilisation of the plant remained low and ranged between 17 *per cent* and 58 *per cent* only during 2006-07 to 2010- 11.

Audit analysed the cost of production of all the Aluminium products and observed that the cost of production of the SGA was so high as compared to its market price that the Company could not even get the variable cost[1] of production from its sales realisation and thus had to suffer a cash loss of ₹ 7.21 crore[2] by way of negative contribution[3] during the period from 2006-07 to 2010-11. In addition, the Company also suffered loss of profit of ₹ 16.87 which it could have earned by selling the calcined alumina directly rather than processing the same for producing Special Grade Alumina. The Company, thus, suffered a loss of ₹ 24.08 crore due to continuation of uneconomic operation of SGA plant which is indicative of weak governance and inadequate monitoring of the Company's operations by the Management. Had the Company discontinued the uneconomic operations of SGA plant even after initial stabilisation period of two years (2005-06 and 2006-07), it could have avoided a loss of ₹ 19.08 crore.

Admitting that sourcing of saggers to the required quantity and quality was a problem since commissioning, the Management stated (September 2011) that with the increased customer base and cost control initiatives such as reduction in fuel consumption, reduction in the cost of saggers by developing indigenous vendors and outsourcing a part of operations, the Company was confident of improving the profitability of the operations and also of making up the losses incurred during stabilisation period.

The fact, however, remains that the Company did not secure a sustainable supply of the critical consumable before commencing the production of SGA. Further, the contention of the Management about improvement of the profitability and making up the past losses is unfounded as the Company in its Annual Accounts for the year 2010-11 has itself recognised the plant as economically unviable. This is especially of concern as calcined alumina had a favourable market and the Company earned profit from its sales. **The**

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[1] ***Variable cost included cost of raw material, power & fuel, consumables, repair& maintenance of the plant.***

[2] ***Based on cost audit report of the SGA.***

[3] ***Difference between variable cost of production and average sales realization***

avoidable loss of ₹ 19.08 crore in this case points towards a weak inventory procurement system and a general governance deficit.

The matter was referred to the Ministry (September 2011); their response was awaited (May 2012).

CHAPTER XI: MINISTRY OF PETROLEUM AND NATURAL GAS

Balmer & Lawrie & Company Limited

11.1 Performance of Tours and Travel Division

11.1.1 Introduction

Balmer Lawrie & Company Limited (Company), a company under the Ministry of Petroleum and Natural Gas (MOP&NG), has diversified portfolio of business. The Tours and Travel division (Division) of the Company mainly deals with the sale of air and railway tickets to the Government of India (GOI) departments and Public Sector Enterprises.

Presently, the Company is facing sustainability threats due to emergence of private online ticketing agents (Cleartrip, Makemytrip etc), reduction of commission by airlines, tie up between banks and airlines to give higher discounts to the clients, direct online marketing by airlines. The table below indicates the performance of the Division during last three years:

(₹ in crore)

Year	Total Turnover of the Company	Share of TT Division (Percentage)	Total profit of the Company before tax	Share of TT Division) (Percentage)
2008-09	1711.23	662.63 (38.72)	151.56	10.91 (7.20)
2009-10	1688.85	608.81 (36.05)	152.98	12.59 (8.23)
2010-11	2071.22	874.43 (42.22)	181.04	19.66 (10.86)

11.1.2 Audit objectives and Methodology

The audit was conducted to assess whether (i) the Company had built up adequate marketing strategy to withstand competition from private players in the area of travel and tourism and (ii) the system of collection of revenue was effective. Audit covered examination of records of all the 12 branches spread across the country for the three years from 2008-09 to 2010-11.

11.1.3 Audit Findings

Audit observed the following shortcomings/ inadequacies in the governance and internal control procedures of the Division.

11.1.3.1 Dependence on Government/CPSEs

The Company is one of the approved travel agents of Government of India for procurement of tickets for its officials on duty. The transaction with the GOI departments and CPSEs ranged between 91 *per cent* and 93 *per cent* of the total transaction of the Division during 2008-09 to 2010-11 as indicated in the table below:

(₹ in crore)

Year	Total sales*	Sales to GOI & PSU		Other Sales	
		Amount	percentage	Amount	percentage
2008-09	651.73	606.57	93.07	45.16	6.93
2009-10	592.93	541.73	91.37	51.20	8.63
2010-11	842.61	769.97	91.38	72.64	8.62

excluding revenue earned from money changing business

Audit observed that the Company did not diversify its clientele base like state governments, reputed private/corporate sector, bank/insurance sector and public at large and acted merely as an agent of GOI/CPSEs. Any change in GOI policy to book tickets through other agents may impact the performance of the Division adversely.

The Management assured (September 2011) to give more focus on non-governmental business, particularly large corporate bookings and promotion of tours.

11.1.3.2 Non- achievement of targets envisaged in strategic plan

In order to transform the Division from a mere ticketing agent to a service provider, the Company formulated (July 2005 and January 2010) its strategic plans (2005-06 to 2009-10 & 2010-11 to 2014-15) which included the Creation of hub by March 2011 for bulk booking of tickets from airlines at a negotiated special discounted price and distribution of the same through branches, Reaching out to new markets through setting up of franchised outlets, Creation of online portal for direct marketing of air tickets and other tourism related services and expansion of tourism activities like package tours, booking of chartered flights, cruises and hotels/resorts.

Audit, however, observed that the Company could not achieve any of these targets (September 2011).

Management stated (September 2011) that creation of hub was not found commercially prudent and steps have been taken to create an 'on-line' portal and implementation of franchisee system and added that focus has been increased towards its tourism business.

11.1.3.3 Lack of initiatives for competing with private players

Traditionally the business of the Company for air ticketing with CPSEs used to be on nomination basis. However, after liberalisation of the aviation sector by the GOI, a number of private airlines emerged which offered air tickets on 'Apex fares'* with differential pricing. Several CPSEs, therefore, resorted to tendering for selection of ticketing agents to avail of the benefit of maximum discount.

Though the Company, while finalising (January 2010) its strategic plan for 2010-11 to 2014-15, decided to formalise a discounting policy and institutionalise a process for collecting market intelligence for making their quotations against tenders more competitive, no such policy was formalised nor any such market intelligence system was developed (July 2011). As a result, out of 20 tenders submitted during 2010-11, the Company could succeed only in 7 tenders.

* ***Advance Purchase Excursion fare air ticket at a heavy discount.***

While admitting that the Company could not match the discount offered by their competitors, the Management stated (September 2011) that standard discounting policy was not formulated due to very low margins in the business.

As air ticketing business, which account for more than 95 *per cent* of the turnover of the Tours and Travel Division of the Company, is the core activity of the Division, the Company should formulate and adopt a suitable strategy not only to retain its market share but also to expand and compete with private players.

11.1.3.4 Gaps in the Credit Policy.

The Company being a member of IATA♥, procured air tickets from airlines on credit and settled its dues with the airlines on fortnightly basis as per IATA's Billing and Settlement Plan. Audit observed that the credit policy of the Division, formulated in December 2003, which allowed 30 days credit to CPSE customers and no limit of credit period to the GOI Ministries/Departments, was not in conformity with the credit facility extended by IATA.

Further, as per its credit policy, the Company was required to review the credit limits extended to customers vis-à-vis the outstanding on quarterly basis and to identify the reasons for overdue outstanding, if any, for taking remedial measures. Audit, however, observed that in the quarterly review of CPSEs debtors balances, the Company did not identify the reasons for the outstandings and rather, the credit limits of the outstanding dues were extended in order to regularize the overdues without assigning any reasons. In case of GOI Ministries/Departments, no review was conducted for identifying the reasons for accumulation of outstanding dues.

The Management assured that (September 2011) every possible effort would be made to adhere to the credit policy.

11.1.3.5 Accumulation of outstanding dues against the Ministries and Departments

The table below indicates position of debtors at the end of last three years

(₹ in crore)

Year	Debtors of Tours and Travel Division	
	< 6 months	> 6 months
2008-09	68.25	19.02
2009-10	74.56	21.02
2010-11	87.10	44.95

Audit observed that the outstanding debtors of the Division has increased gradually. Detailed examination of the debtors balances revealed that as on 31.03.2011, an amount of ₹ 32.87 crore was outstanding from 24 ministries/ departments of GOI, **(Annexure–IX)** of which, ₹ 5.15 crore remained un-recovered for more than two years.

During the last three years, the Company in the financial statements recognised ₹ 5.89 crore as doubtful of recovery and written off ₹ 0.30 crore as bad debts, out of the total outstanding against the Ministries and CPSEs due to non-recovery of cancellation charges, retirement/transfer of passengers, issue of tickets without authorisation .

♥ ***International Air Transport Association***

The gradual increase in outstanding dues and consequent blockage of funds led to increased requirement of working capital (from ₹ 70 crore in 2008-09 to ₹ 101.25 crore in 2010-11) which was met by the other Divisions.

Management accepted (September 2011) that the performance of the Division would have been better if the outstanding amount were reduced and assured (September 2011) that every possible effort would be made for collection of old debts. Management further informed that reconciliation of outstanding customer balances had now been taken up.

11.1.3.6 Deficient accounting of debtors

Audit observed that the payments received from the customers against the dues were not accounted for properly and a substantial amount which ranged between 34 *per cent* and 41 *per cent* of total debtors balances during the last three years, was lying as 'unadjusted credit balances' in the debtors ledgers. Further, during the last three years, such credit balance of ₹ 7.02 crore was accounted for as 'income' which was 16 *per cent* of the total profit of the division. In fact, this distorted the profitability position of the Company from 'air ticketing'.

Management stated (September 2011) that accumulation of unadjusted credits were due to non-receipt of bill-wise details with payment for which necessary instructions have been issued.

Conclusions

The Company, being an approved travel agent of GOI, concentrated on selling air-tickets to the Departments/Ministries of GOI and CPSEs only. In fact, the Company is not equipped with an effective strategy to address the challenges in the post liberalisation regime of aviation sector. Resultantly, in 2010-11, in majority of the tenders (65 *per cent*) floated by CPSEs for appointment of travel agent, the Company failed to match its quotes with the competitors and consequently, lost substantial business to the private players. The credit policy of the Company was imprudent as credit extended to the customers was not in conformity with the credit extended by IATA and even the credit limits of the policy were not complied with. Further, despite the fact that the business of sales of air tickets was mainly on credit basis, there existed no system in the Company for regular reconciliation and confirmation of outstanding dues and regular follow up with the customers for recovery. As a result, the outstanding dues were mounting and getting accumulated which in fact, led to blockage of funds.

In sum, the Company lacked a proactive and aggressive approach to deal with the post liberalisation challenges posed by the private competitors.

Recommendation

In order to address the gaps pointed out in audit, the Company may streamline its internal control systems and procedures and may review and redefine its policy covering inter alia, measures to approach new clients and tap the growing market share.

The matter was referred to the Ministry (November 2011); their response was awaited (May 2012).

11.2 Injudicious investment

The Company made an injudicious investment of ₹ 33.93 crore in its joint venture viz., Transafe Services Limited (TSL) to facilitate exit of ICICI Venture from it without conducting any due diligence despite being aware of gross financial irregularities in TSL.

Balmer Lawrie & Company Limited (Company) was one of the promoters of Transafe Services Limited (TSL), which was incorporated in 1990 with the primary objective of promoting inter-modal containerised freight transportation within the country. In March 2008, the Company held 29.09 *per cent* shares in TSL while the rest were held by two financial investors[1] represented by ICICI Venture Fund Management Company Limited (ICICI - Ven). As turnover and profitability of TSL was on the rise during the preceding four years, the Company planned to invest more funds in the business. However, the debt-equity ratio of TSL, did not permit it to draw further loans and as such, it planned (March 2008) for fresh infusion of equity through rights and public issue of shares.

Meanwhile, in February 2009, the ICICI -Ven informed the Company about its desire to exit from TSL stating that ICICI was under pressure from Reserve Bank of India to divest its shareholding in TSL as their holding in the latter came entirely from the ICICI Bank. They also informed that if the Company was not interested in acquiring their share they would offload their shares to a private sector company. In March 2009, when TSL made a Rights offer of shares, ICICI- Ven did not participate and only the Company subscribed to its entitlement in the offer (at a premium of ₹ 6 per share) by paying ₹ 2.92 crore and consequently, its shareholding in TSL increased to 34.78 *per cent.*

Taking a plea that induction of private strategic investor into TSL could give rise to conflict of interests with Company's own business in the logistics field, it acquired (July 2009) shares of ICICI - Ven for ₹ 5.53 crore thereby increasing its stake in TSL to 50 *per cent.* The Company also disbursed a loan of ₹ 7.30 crore to TSL for repayment **of loan** to ICICI- Ven. In addition, the Company further paid (July/ September 2009) a loan of ₹ 18.18 crore to its joint venture, Balmer Lawrie Van Leer Limited (BLVL) for acquiring remaining 50 *per cent* shares of TSL from ICICI- Ven with the condition to repay the loan by utilizing the sale proceeds of these shares.

Thus, ICICI-Ven exited (September 2009) from TSL by taking away its entire investments alongwith return thereon amounting to ₹ 31.01[2] crore which was in fact, eventually financed by the Company.

Audit observed the following inadequacies and governance issues in the acquisition process of the Company:

- The Company went ahead with the acquisition of shares in TSL from March 2009 to September 2009 without carrying out any due diligence despite being aware of several anonymous complaints (since October 2008) on serious financial irregularities such as forged accounts, fake invoices, padded turnovers and misuse of TSL resources by the top management.

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[1] *ICICI Trusteeship Services Ltd. (47.27per cent) and The Western India Trustee & Executer Co Ltd. (23.64 per cent).*

[2] *₹7.30 crore + ₹5.53 crore + ₹18.18 crore = ₹31.01 crore*

- These complaints were addressed to the Board of Directors of the TSL which also included the directors nominated by the Company.
- Though the irregularities had been continuing in TSL since 2006-07, the Company through its nominee directors failed to safeguard its interests in the entire process.
- TSL on the recommendation of ICICI - Ven decided (May 2009) to appoint KPMG to investigate into such allegations. The investigation process, however, could not commence till September 2009 as KPMG, being the auditor of ICICI Group, waited for ICICI-Ven's shareholding in TSL to come down below 20 *per cent* before taking up the assignment. By that time, the Company had already purchased the stake of ICICI - Ven and the latter had exited from TSL.

The entire process of stake acquisition in TSL by the Company was, thus, below the best practices for risk mitigation, good governance and reflected lack of synergy with the nominated directors.

After investigations, KPMG confirmed the alleged irregularities and reported (May 2010) that:

- The Financial Statements were fraudulently misrepresented in substantial amounts, across the multiple accounting periods.
- Weak internal controls due to non segregation of duties.
- Manipulation of accounts by way of recording of fraudulent transactions, fictitious sales and corresponding costs, creation of dummy and inflated debtors, understatement of expenses etc to achieve desirable balances in Balance Sheets and Profit & Loss Accounts. As a result, the actual profits for the years 2006-07 and 2007-08[1] were much lower than what was reported in the financial statements of TSL.

The accounts of TSL were, therefore, recast resulting in erosion of net worth and jeopardising its debt servicing ability. Subsequently, TSL opted for corporate debt restructuring for which the Company, being its promoter, had to infuse ₹ 6 crore further as preference shares (February 2011) and ₹ 1.80 crore as unsecured loan (November 2010). The earlier loan of ₹ 7.30 crore given to TSL was also converted (March 2011) into preference shares.

Thus, acquiring stake of ICICI Ven in TSL without conducting any financial due diligence despite being aware of serious financial irregularities in TSL resulted in the entire investment of ₹ 15.75 crore[2] of the Company getting sunk. The recovery of a loan of ₹ 18.18 crore extended to the joint venture company (BLVL) also became doubtful.

The Management and the Ministry while confirming that no due diligence was conducted before making the investments pleaded (July/ September 2011) that TSL being a group company, the investment was made in good faith and the Company was not aware of the financial irregularities in TSL while taking the investment decision.

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[1] ***₹ 1.32 crore against the reported profit of ₹ 4.92 crore in 2006-07 and loss of ₹ 5.31 crore against the reported profit of ₹ 8.69 crore in 2007-08***

[2] ***₹ 7.30 crore + ₹ 2.92 crore + ₹ 5.53 crore = ₹ 15.75 crore***

The replies are not acceptable in view of the fact that:

- In the backdrop of alleged financial irregularities and decision of ICICI Ven to exit from TSL, financial prudence warranted that the Company should have carried out due diligence and taken appropriate risk mitigation measures before investing funds in TSL.
- Despite the fact that the financial irregularities in TSL were continuing for past few years, the Company through its nominee Directors not only failed to secure its financial interests but also did not hold them accountable for not safeguarding the interests of the Company.

Thus, the decision of the Company to invest ₹ 33.93 crore[*] in TSL without any financial due diligence and ignoring blatantly the persistent financial irregularities committed by TSL, reflects poorly on the governance of the Company. In fact, the Company went ahead with the acquisition process without waiting for the KPMG report. Thus, absence of internal control systems to check such imprudent investment decisions, point towards obvious systemic flaws in the decision making. The possibility of a nexus in facilitating the safe exit of ICICI Ven from TSL cannot be ruled out.

Bharat Petroleum Corporation Limited & Hindustan Petroleum Corporation Limited

11.3 Export promotion benefit foregone on supply of Aviation Turbine Fuel to foreign bound aircrafts

Two oil marketing companies suffered revenue loss of ₹ 30.26 crore due to failure in claiming export incentives on supply of ATF to foreign bound aircrafts.

Bharat Petroleum Corporation Limited (BPCL) and Hindustan Petroleum Corporation Limited (HPCL) supply Aviation Turbine Fuel (ATF) to foreign bound aircrafts on a regular basis through their Aviation Fuelling Stations (AFS) at Chennai. ATF is purchased from Chennai Petroleum Corporation Limited (CPCL), which included import duty component and is eligible for export incentives under various schemes of Government of India (GOI). The export promotion schemes are exemption of customs duty on crude imports under Advance Authorisation Scheme (AAS) or Duty Free Import Authorisation (DFIA) or reimbursement of customs duty paid on the imports or excise duty paid on indigenous inputs under Duty Drawback Scheme (DDBS).

Customs duty on import was withdrawn from June 2008 and reintroduced from 27 February 2010 and once again withdrawn from 25 June 2011. Hence export benefits were available upto June 2008 and for the period from 27 February 2010 to 24 June 2011. From a review of exports of ATF from the AFS and the corresponding benefits availed during 2004 to 2010, Audit observed that BPCL and HPCL started claiming benefit under DFIA from December 2010 and AAS from November 2010 respectively. They did not avail of the export promotion schemes benefit of ₹ 30.26 crore as detailed below.

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[*] *₹15.75 crore + ₹18.18 crore = ₹33.93 crore*

Name of the Company	From	To	Quantity of ATF exported (in KL)	Amount (₹ in crore)
BPCL	January 2004	May 2008	59359	4.68
BPCL	1 March 2010	21 December 2010	82363	8.83
HPCL	July 2004	May 2008	156746	11.68
HPCL	1 March 2010	October 2010	48,866	5.07
		Total		**30.26**

In response, BPCL stated (November 2011) that there was no duty drawback rate established for ATF; and sales to domestic airlines were not eligible for Duty Drawback unless payment was received in foreign currency or repatriable Indian currency as per the Foreign Trade Policy (FTP). It added that complex documentation procedures were involved in claiming the benefits since the ATF had been supplied by CPCL. HPCL stated (November 2011) that the procedure for claiming the benefits under AAS was not clear, the sales to domestic carriers were not eligible for the benefits as deemed exports and the Customs agent for the purpose was finalised only in October 2010.

Replies of BPCL and HPCL are not acceptable as supplies to aircrafts proceeding to foreign destinations were classified as exports under Duty Drawback Rules, 1995. For similar exports IOCL had claimed the benefits under DDBS up to June 2008 and under AAS from March 2010 for ATF supplies from its AFS at Chennai to foreign bound aircrafts.

Thus, due to procedural delays, BPCL and HPCL failed to claim the benefits available under export promotion schemes resulting in forgoing of revenue of ₹ 30.26 crore.

The matter was referred to the Ministry (November 2011); their response was awaited (May 2012).

Chennai Petroleum Corporation Limited

11.4 Export benefit foregone

Company's failure to avail incentives on export of Petroleum products resulted in a loss of ₹ 7.44 crore.

Chennai Petroleum Corporation Limited (Company) exports petroleum products on a regular basis and is eligible to avail incentives under export promotion schemes like Advance Authorisation Scheme (AAS) and Duty Drawback Scheme (DBS) of the Government of India (GOI). Under the AAS, an exporter may utilise advance authorization to import goods without payment of any duty but with a commitment to export goods of equivalent quantity or value within a specific period. Under DBS, a refund, known as drawback, of element of excise duty paid on indigenous inputs or customs duty paid on imported inputs included in the export of output is allowed. The Company generally exported finished products immediately after filing application for advance licence and getting the file number and availed the benefit of incentives after completion of exports of products (like Naphtha, Furnace Oil (FO) and High Speed Diesel (HSD) under AAS.

It was noticed in Audit that in respect of the following licences received during February 2008, the Company did not avail the benefit of duty free imports of crude till 3 June 2008[1].

- No: 0410094019 dated 25 February 2008:

  This authorisation covered export of 1,23,325 MT Naphtha made from August to December 2007. Against 1,50,614 MT crude, the Company availed duty free import of only 1,38,704 MT crude (February 2008). The duty that could have been saved on the balance quantity was ₹ 1.56 crore.

- No: 04100940020 dated 25 February 2008:

  The Company was to export a quantity of 2 lakh MT of FO with a maximum FOB value of ₹ 304.76 crore. The value of ₹ 301.68 crore was, however, reached with the export (January to March 2008) of 1,64,720 MT. Against this, the Company imported duty free crude of 1,15,500 MT (February and March 2008). The Company exported (01 April 2008) 32,963 MT of FO without applying for revalidation which was initiated after two years in May 2010. Thus, the Company's failure to obtain revalidation of authorisation in time resulted in foregoing import duty benefit of ₹ 3.73 crore in respect of this additional export.

- No: 0510217250 dated 29 February 2008:

  Under this authorization, import of 189,750 MT crude was allowed for an export of 150,000 MT naphtha. The Company exported (February to June 2008) 131,110 MT naphtha and availed incentive (till 3 June 2008) only for 1,38,391 MT crude imported. The balance incentive of ₹ 2.15 crore was not availed.

Audit observed that during 1 April to 3 June 2008, the period in which the above three cases occurred, the Company imported 16.82 lakh MT crude on payment of duty of ₹ 262 crore. Further to enable the exporters to tide over situations like those brought out in the above instances, GOI had also allowed (January 2004) conversion of shipping bills from AAS to another scheme i.e., DBS.

In response, the Management stated (September 2011) that downward revision of duty was not anticipated, revalidation of licence at serial number (ii) applied in May 2010 was rejected on account of the increase (August 2009) in the minimum limit of value addition to 15 per cent as per extant Foreign Trade Policy and that conversion of AAS shipping bills to DBS was not allowed as they had to be applied for within three months. The Ministry further stated (December 2011) that due to the Custom Department Circular of September 2010, the Company could not exhaust the limit of eligible quantity/value of import in full as the conditions of the licence stood revised viz. value addition norms, SION[2] norms etc. They stated that the inordinate delay of eight months at the office of the Joint Director General of Foreign Trade, Chennai was the principal reason for not availing advance licence in the first 2 cases covered above.

The replies of the Management and the Ministry were not convincing as in respect of (ii), the Company could have applied for revalidation of licence immediately after export but before introduction of norm of value addition (15 *per cent*) from 27 August 2009. Since

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[1] ***From 4 June 2008 GOI reduced the rate of customs duty on crude oil to zero.***

[2] ***Standard input output norms***

the Company was importing after exporting, issues of compliance with SION had already been taken care of. The revised circular quoted by the Ministry was not applicable to the facts of the case which related to failure to convert benefits earned in 2008 which pertained to Foreign Trade Policy of 2004-09.The incentives could have been availed of against the crude imported during the period. Indian Oil Corporation Limited had claimed (April 2010) such benefits left un-availed (2008), by converting the relevant shipping bills and obtained (June and July 2011) refunds from the Customs Department. Though licences were received late (February 2008), the Company could have exported the products and the issue raised did not relate to delay in obtaining licence but to delay in availing the benefits after export of the products.

Thus, the Company's failure to avail the export incentives resulted in a loss of ₹ 7.44 crore.

GAIL (India) Limited

11.5 Undue benefit extended to private power producers

GAIL supplied natural gas at subsidised rates, in deviation of the Ministry's directives, to ineligible consumers generating and supplying electricity to their consumers at commercial rates through the grid of Tamil Nadu Electricity Board(TNEB). This led to under recovery of ₹ 246.16 crore in Gas Pool Account, undue benefit to such producers to that extent and depriving eligible consumers of subsidised/APM gas.

GAIL was supplying natural gas to its consumers under Administered Price Mechanism (APM) at prices determined by the Government of India. To dismantle APM in a phased manner over next three to five years, the Ministry restricted (June 2005) use of APM gas for fertiliser production and for power generating companies which were supplying electricity to the grid for distribution to the consumers through public utilities/licensed distribution companies. Consequently, in June 2006, the Ministry revised the rates of APM gas supplied to certain categories of companies, other than power and fertiliser sector consumers, from ₹ 3,200/MSCM[1] to ₹ 3,840/MSCM for rest of north-east consumers. This rate was again revised to US$ 4.2/MMBTU[2] (₹ 7,619/MSCM average price) with effect from June 2010 in respect of consumers having allocation up to 50,000 SCMD and US$ 4.75/MMBTU (₹8,587.85/MSCM average price) to consumers having allocation more than 50,000 SCMD with effect from July 2010. GAIL, while implementing the government directives, segregated its gas consumers in Cauvery Basin under four categories viz.

- Category A–State Electricity Boards (SEBs) & Government Companies generating power for supply to Grid for distribution to consumers
- Category B–Private companies generating power and selling to SEBs as IPP
- Category C–Consumers generating electricity for captive consumption without supplying to Grid; and

[1] ***MSCM means Metric Standard Cubic Meter***
[2] ***MMBTU means Million Metric British Thermal Unit***

- Category D–Consumers generating electricity and supplying to various consumers using wheeling arrangement with SEBs.

GAIL charged gas consumers under Category A & B @ ₹ 3,200/MSCM and also category D @ ₹ 3,200/MSCM up to May 2010 and, thereafter, @ ₹7,619/MSCM from all consumers on provisional basis irrespective of the quantity of allocation. GAIL sought (June 2006) clarification from the Ministry whether Category D consumers were entitled for APM price.

As there was no ambiguity in the Ministry's directives regarding applicability of APM gas price to consumers generating power for supply to the Grid for distribution through public utilities/licensed distribution companies only (and not Category D consumers supplying power at commercially agreed rates), it was pointed out in Para 12.2 of Report no.3 of 2011-12 of the Comptroller and Auditor General of India that the extension of undue benefit to Category D consumers resulted in under recovery in Gas Pool Account to the extent of ₹ 227.37 crore from seven consumers during the period from April 2006 to March 2010. Despite its being pointed out, Audit observed (July 2011) that GAIL was still extending the undue benefit to these ineligible consumers. Consequently, the undue benefit to aforesaid ineligible consumers increased to ₹ 246.16 crore by March 2011 and would continue to increase if no immediate corrective action is taken by the GAIL/Ministry. Further, such supplies at APM rates to ineligible consumers deprived the eligible consumers of the APM gas, which was in short supply.

Management stated (September 2011) that GAIL had taken up the above issue with the Ministry on a number of occasions, since July 2006, and their advice/clarification was awaited.

Management's reply is not tenable because the consumers falling under Category D were utilising TNEB services only for wheeling of electricity for which wheeling charges were paid and the electricity generated was being supplied to end users at commercially agreed rates. Hence, being custodian of Gas Pool Account, it was GAIL's primary responsibility to charge the correct rate instead of creating the confusion which led to the undue benefit to ineligible consumers.

The Ministry stated (June 2012) that subsequent to MoPNG's letter dated 17 November 2011 regarding action taken for recovery of dues GAIL is invoicing at market price to the relevant seven Power Consumer w.e.f. 16 November 2011 and debit notes have been raised for the period from 1 July 2005 to 16 November 2011. The matter is sub-judice as the above consumers have approached Hon'ble High Court of Delhi and Chennai for obtaining injunction against recovery of dues. Further, the above consumers are paying market price after 16 November 2011 under protest, except one consumer[*] whose LC is being encashed regularly to realize the differential amount of APM and non-APM price. While audit appreciates corrective action taken by the Ministry/Management, the fact remains that due to delayed implementation of Government directives by GAIL, no past recoveries could be affected by the Company so far.

[*] Arkay Energy

11.6 Under recovery in gas pool account and excess payment of fertiliser subsidy

GAIL failed to evolve a suitable system to ascertain the quantity of natural gas utilised by fertiliser companies for manufacturing non-fertiliser products and its billing at market price instead of subsidised price. This led to non-implementation of Ministry's directives and consequent substantial under recovery in Gas Pool Account besides extra avoidable burden on Government subsidy towards fertiliser production.

GAIL was supplying natural gas to its customers at prices determined by the Government of India. Effective from July 2005, the pricing structure restricted the sale of the gas at subsidised price to power, fertiliser and other eligible usage. Considering usage of the subsidised gas by fertiliser companies, like Rashtriya Fertiliser and Chemicals Limited (RCF) and Deepak Fertilisers & Petrochemical Limited (DFPCL), in manufacturing chemicals not covered under Government orders, Ministry of Petroleum directed GAIL to charge market price for the gas used for non- fertiliser products. As the fertiliser companies did not provide the details of gas used by them for the non-fertiliser products, Ministry of Fertiliser and Chemicals proposed (April 2009) the usage of the gas for the non-fertiliser products in Trombay unit of RCF at 20 *per cent* of total consumption and recommended for its implementation from January 2009. Ministry of Petroleum approved (October 2009) for billing of the gas as follows:

- The gas used for non-fertiliser products to be charged at market price from I January 2009
- As regards period prior to January 2009, financial implication of charging subsidised gas price for the chemicals, both for Gas Pool Account and GAIL in terms of revenue foregone, as well as for the Government subsidy and losses to the concerned fertiliser companies to be worked out by GAIL and intimated to the Ministry.

As GAIL failed to implement the directives of the Ministry in regard to the billing of gas at market price, it was pointed out in Para 13.2.1 of the Report no.9 of 2009-10 of the Union Government (Commercial) of the Comptroller and Auditor General of India that the non-implementation of the Ministry's directives resulted in under-realisation of ₹ 40.48 crore in the Gas Pool Account in respect of Trombay unit of RCF for the period from January 2009 to October 2009. Considering all the units of RCF, other fertiliser companies and the period prior to January 2009, there was considerable revenue foregone by GAIL/Gas Pool Account as well as excess payment of fertiliser subsidy by the Government of India.

Despite being pointed out in the aforesaid Audit Report, it was observed (July 2011) in Audit that GAIL did not work out the financial implication of charging the subsidised price for the gas used for the non-fertiliser products for the period prior to January 2009, taking shelter under the excuse of non-availability of requisite information from the fertiliser companies. Further, for the period from January 2009 onwards, GAIL charged the market price from RCF, DFPCL and Gujarat Narmada Valley Fertilisers & Chemicals Limited on the basis of self certification given by these fertiliser companies in regard to the usage of gas. GAIL did not evolve any appropriate system to ascertain the actual quantity of gas used in manufacturing of the non-fertiliser products.

The Management replied (September 2011) that it was not possible for them to devise any system for monitoring the gas usage downstream of the custody transfer meter within individual fertiliser units. Also, it would not be possible to work out the financial implications for the period prior to January 2009.

The reply is not convincing as:

- Being a custodian of Gas Pool Account, GAIL was primarily responsible for monitoring the gas usage and evolving a system of ascertaining the gas used for non-priority products.
- The self certification on the gas usage by fertiliser companies suggests that there exists some basis to ascertain the gas quantity used in manufacturing of the non-fertiliser products. GAIL could have reviewed the basis of self certification adopted by various fertiliser companies, ascertained the most appropriate basis and instituted a mechanism for verification of the self certified gas consumption.
- Above situation was indicative of sub-optimal management of Gas Pool Account by its custodian i.e. GAIL.

Thus, there was laxity on the part of GAIL in ascertaining the usage of gas in non-fertiliser products and working out the financial implications as per the direction of the Ministry of Petroleum. There was also lack of effective co-ordination between the Ministry of Petroleum and the Ministry of Fertilisers & Chemicals in resolving the issue. This situation led to under recovery in the Gas Pool Account as well as excess payment of subsidy on fertiliser production by the Government, for the period from July 2005 to December 2008. Further, for the period from January 2009 onwards, the chances of sub-optimal recovery in Gas Pool Account and excess payment of the Government subsidy on fertiliser production could not be ruled out in absence of any mechanism to test verify by GAIL of the gas usage as self certified by the fertiliser companies.

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

11.7 Non-recovery from RIL

GAIL's failure to make effective a regular clause in gas supply agreement with Reliance Industries Limited (RIL) as well as absence of effective steps towards the recovery of outstanding dues resulted in non-recovery of ₹ 29.78 crore being the additional charges towards over drawal of gas beyond daily nominated quantity (DNQ).

GAIL entered into a gas supply agreement (GSA) with Reliance Industries Limited (formerly Indian Petrochemicals Corporation Limited) in March 2000 for supply of natural gas at Dahej in Gujarat. Article no. 10 of the GSA stipulated that seller shall have the right to fix gas price as per directives, instructions and orders of the Government of India (GOI) and article no. 17 stipulated that amendment to any of the clauses could be made, if both parties agreed in writing. The agreement was originally valid upto 1 January 2005, which was extended by GAIL by way of side letters from time to time and the last extension was till 31 August 2008.

Considering the reduced availability of gas and following the directives of GOI, GAIL formulated a mechanism of fixing 'Daily Nominated Quantity (DNQ)' to each customer to ensure that total supplies match with the total gas availability and accordingly informed the same to the customers. In July 2006, GAIL communicated to all its customers including RIL not to draw gas in excess of DNQ and, in the event of over drawal, the gas would be charged at 120 *per cent* of the highest priced gas present in its gas supply system. However, GAIL neither obtained acknowledgement of its letters of July 2006 from RIL nor incorporated this issue while extending the GSA with RIL after every one to three months during 2006-07 and every two to four months during 2007-08.

In view of further reduction in gas availability, it became necessary for GAIL to strictly implement the DNQ mechanism and the same was done in case of RIL with effect from 12 July 2008. Accordingly, GAIL informed RIL (July 2008) that drawal of gas should be restricted to DNQ conveyed by it on day to day basis. However, RIL drew the gas in excess of DNQ during the months of July and August 2008. While RIL paid the charges levied by GAIL at 120 *per cent* of the highest priced gas for the month of July 2008, it refused to pay the over drawal charges for the month of August 2008 amounting to ₹ 29.78 crore contending that there is no mention of DNQ mechanism in the GSA.

An Internal Committee of GAIL, constituted in October 2008, investigated the matter and reported (March 2009) that the amount outstanding on account of DNQ linked invoicing is recoverable from RIL. Despite this, GAIL did not take any effective and expeditious step for recovery of the outstanding dues. GAIL did not even invoke the letter of credit amounting to ₹ 7.50 crore (valid upto 30 September 2009) to reduce its dues to that extent, though the same was provided by RIL under the provisions of GSA for such eventuality. Further, in normal circumstances, GAIL takes decision on continuation of gas supply to defaulting customers, whose value of letter of credit becomes insufficient against the outstanding dues, in consultation with the Ministry. However, Audit did not find any documentary evidence of any such step taken by GAIL against RIL.

In July 2010, GAIL agreed to consider RIL's proposal of referring the matter to arbitration. After 14 months of deliberations on RIL's proposal, GAIL took the decision to refer the matter to Arbitration in September 2011. The arbitrator was appointed in December 2011.

The Management stated (July 2011) that communication was issued to all its consumers including RIL regarding DNQ mechanism/over drawal charges and acknowledgement of the letters was also requested but RIL did not provide acknowledgement of the same.

The reply is not acceptable because GAIL did not take effective and expeditious steps either for inclusion of the relevant clause in the renewed GSA or for recovery of outstanding dues as is evident from the following facts:

- GAIL did not follow up with RIL for acknowledging receipt of its letter of July 2006 for having accepted the DNQ mechanism/over drawl charges.
- GAIL took more than 3 years to refer the dispute to arbitration, even though it had a strong case considering the facts that RIL was duly informed of the DNQ mechanism/over drawal charges and the latter had also paid the over drawal charges for the month of July 2008 which indicated that RIL had taken cognizance of and accepted the over drawal charges. RIL, in fact, raised the dispute only for the month of August 2008 as the gas was priced at the spot gas

available in pipeline during this period which was very costly i.e. USD 20.72/MMBTU as against USD 5.73/MMBTU charged at Panna-Mukta-Tapti (PMT) gas price for the month of July 2008.

- The provision/comfort which was available with GAIL under GSA in the form of letter of credit was also not availed. In fact, GAIL also did not initiate any action in consultation with the Ministry for exploring other measures for recovery as was the normal procedure in the Company for such defaults.

The fact remains that although a system did exist for levy and recovery of over drawal charges, the same was not implemented effectively in the above case resulting in non-recovery of ₹ 29.78 crore.

The Ministry in its reply (June 2012) has given the same views as were already furnished by the Management in July 2011.

Hindustan Petroleum Corporation Limited

11.8 Avoidable loss

Procurement of Naphtha from ONGC at higher rates while exporting Naphtha produced at Visakh Refinery at lower rates led to a loss of ₹ 14.83 crore to HPCL.

Hindustan Petroleum Corporation Limited (HPCL) was supplying Naphtha to Lanco Kondapalli Power Limited (Lanco) at Vijayawada since January 2007. HPCL was also exporting surplus Naphtha from its Visakh Refinery (VR). The Regional Office of HPCL at Secundrabad received indents on 7 and 21 November, 2008 containing month-wise naphtha requirements of Independent Power Producers (IPPs) including Lanco for supplies upto March 2009. Accordingly, the allocation of 2.20 lakh MTs of Naphtha from December 2008 to March 2009 was made in the Monthly Marketing/Refining Planning Meetings held at Mumbai which were attended by the representatives of VR, Mumbai Refinery and Marketing Headquarters.

During December 2008 to March 2009, HPCL supplied 1.34 lakh tonnes of Naphtha to Lanco comprising 0.92 lakh tonnes from VR and 0.42 lakh tonnes by procuring the same from Oil and Natural Gas Corporation Limited (ONGC), Hazira. During the same period, HPCL also exported 1.44 lakh tonnes of Naphtha, including optional/spot quantity of 0.59[1] lakh tonnes which it was not under obligation to export, while procuring 0.42 lakh tonnes from ONGC to meet the demand of its domestic customer, i.e., Lanco.

We observed that the average price (₹ 16,775 per tonne) realized in export was lower than the Basic Ceiling Selling Price (BCSP) paid to ONGC (₹ 20,393 per tonne) which led to a loss of ₹ 14.83 crore[2].

We further observed that VR, while preparing its monthly evacuation plan, did not take into account requirement of IPPs as shown below:

[1] ***(a) Additional cargo (B/L dated 23 December 2008) against term tender (7 July 2008) and (b) Single cargo (B/L dated 2 march 2009) against spot tender (16 January 2009).***

[2] ***0.41 lakh tonnes (0.28 lakh tonnes available for export in December 2008; 0.13 lakh tonnes in March 2009) X ₹ 3618 per tonne=₹ 14.83 crore.***

(lakh tonnes)

Month	Requirement of IPPs for supply by VR as per Marketing meetings	Supply planned by VR	Actual supply by VR to IPPs
December 2008	0.58	0.15	0.26
January 2009	0.84	0.30	0.35
February 2009	0.38	0.40	0.41
March 2009	0.40	0.40	0.36
Total	**2.20**	**1.25**	**1.38**

Thus, VR's failure to allocate adequate quantity of Naphtha for supply to Lanco resulted in purchase from ONGC to meet Lanco's demand at higher prices. In fact, since the corresponding export of Naphtha was at lower price than the purchase from ONGC, this led to a consignment loss with consequential loss of ₹ 14.83 crore to HPCL

The Ministry replied (January 2012) that HPCL has noted the suggestions given by Audit and endorsed the reply of the Management as under:-

- *Since Naphtha evacuation is critical for VR functioning and inventory build-up leads to crude throughput reduction, advance action is planned by finalizing term tender (July 2008) for export of one cargo plus one additional cargo per month during August 2008 to January 2009. Due to low domestic demand, export quantities for November-December 2008 were finalized in September-October 2008.*
- *As VR requested for export of two cargoes in December 2008, option of one additional cargo was exercised much before the receipt of indent for Lanco and spot cargo of January 2009 was finalized considering maximum pumpable quantity through VVSPL.*
- *Huge expenses in modifications are the reasons for not reviving naphtha wagon-loading facility at Visakha Terminal.*
- *The possible quantity was supplied to IPPs by pumping through Visakh pipeline and exports were made only after meeting the same. HPCL recovered the freight incurred from Hazira and made profit for the additional quantity supplied by sourcing from ONGC.*

The reply is not tenable as:-

- The Company was aware that against the firm orders it was to supply 2.07 lakh* tonnes to local IPPs during the period November 2008 to March 2009. Despite having capacity to pump 2 lakh tonnes@ 40 thousand MT per month through dedicated Visakha pipeline, the Company pumped 1.53 lakh tonnes only during the same period. The installed capacity to pump adequate quantity of Naphtha was, thus not a constraint in evacuation of Naphtha for local IPPs and exports at lower rates could have been avoided.

***** *November-41,000 MTs; December-42,470 MTS (revised to 64,170 MTs); January-42,470 MTS (revised to 64,170 MTs); February-38,360 MTs and March-42,470 MTs (revised to 60,000 MTs);***

- In fact the audit observation pertains to additional cargo (23 December 2008) of term tender and single cargo (2 March 2009) of spot tender, but not the committed quantities. When firm demand was established before lay days were to be finalized for additional cargo of term[1] tender as well as for spot tender, proper planning for supply of Naphtha to Lanco should have been ensured by pumping upto 40 TMT per month. This could have avoided purchase from ONGC.
- Modifications to load Naphtha at Visakh Terminal as was done at Vijayawada Terminal were not explored and were not quantified by the Company.
- Loss worked out by audit excluding freight element and by ensuring pumping of Naphtha upto 40 TMT during November 2008 to March 2009 which would have avoided purchase from ONGC and on the contrary, made additional profit to the same extent.

Thus, due to inadequate planning and co-ordination, the Company realised a low price for exports of Naphtha and instead the Company had to purchase Naphtha comparatively at higher rate from ONGC to meet the local demand and sustained avoidable loss of ₹ 14.83 crore.

Recommendation

VR should take into account the domestic requirement of Naphtha while preparing its evacuation plans and the marketing division should keep in view the domestic requirement before finalizing the export quantity.

Oil and Natural Gas Corporation Limited

11.9 Extra expenditure due to piecemeal acquisition of land

Oil and Natural Gas Corporation Limited failed to take a holistic view of its space requirements. As a result of piecemeal acquisition of land for office building during June 2004 to July 2007, the Company incurred extra expenditure of ₹ 204.33 crore on increase in offer price of land, penalty for time extension for constructing the office building, stamp duty on swapping of two plots separated by a road for two adjacent plots.

Oil and Natural Gas Corporation Limited (Company) had been operating in Mumbai Region from different locations scattered over Mumbai. Its offices at Vasudhara Bhavan, 11-High and Panvel are housed in their own premises, while the office premises at Rashtriya Chemicals & Fertilizers Limited (RCF), National Stock Exchange (NSE) and Bengal Chemicals Bhavan are rented.

In order to de-hire the rented premises in RCF and to construct its own building, the Company acquired (June 2004) a plot C-13 admeasuring 7,131 square metres (sqm) in Bandra Kurla Complex (BKC) from Mumbai Metropolitan Region Development Authority (MMRDA) at a total cost of ₹ 39.21 crore[2]. In September 2006, the Company

[1] ***Term tender of July 2008 stipulated that lay days were to be confirmed not less than 20 calendar days for additional cargo, if offered by the seller.***

[2] ***Includes stamp duty and registration charges of ₹3.56 crore***

acquired another plot C-8 admeasuring 5,952 sqm at a cost of ₹ 208.15 crore[1] to de-hire other rented premises as well as to meet the growing requirement for office space.

Within one month of purchasing the second plot, the Company decided (October 2006) to have a combined plot to construct a single building instead of two buildings so that the Company could have an integrated office catering to the latest technology and infrastructure facilities. Accordingly, the Company requested (November 2006) MMRDA for allotment of one large plot in lieu of plots C-13 and C-8 and MMRDA allotted (July 2007) two adjacently located plots (C-69A and C-69B)[2] equivalent in area to C-13 and C-8. After two rounds of tendering, the contract for construction of the building at BKC was awarded (January 2011) at a cost of ₹ 240 crore, with a scheduled date of completion as July 2012.

Audit Observed that:

- While approving the acquisition (June 2004) of the initial Plot C-13 at Bandra Kurla Complex, the Board had desired to bring all the offices at Mumbai in the vicinity of Bandra area and to de-hire the office space taken on hire by ONGC in South Mumbai.
- Since the Company had adequate Cash Flow with Cash on Hand amounting to ₹ 55,734.48 million as on 31 March 2004, the Company could have acquired a single large Plot in 2004 itself since the Company did not have any constraints in respect of cash availability.
- Though ONGC has a dedicated set up for Human Resource Development headed by a Director, the HRD Department did not have a system to plan holistically to acquire a single large plot of land in 2004 itself to facilitate consolidation of its offices which were scattered all over Mumbai.
- At the time of acquiring (June 2004) the first plot, the Company had the same requirement for office building as it had in October 2006 when it decided to buy a single large plot.

Due to absence of a systematic approach and adoption of adhoc and piecemeal planning, the Company had to incur an extra expenditure of **₹ 204.33 crore** towards (i) extra premium and penalty **(₹ 21.39 crore)** for non construction on plot C-13 as per terms and conditions of MMRDA, (ii) swapping of two plots (C-8 and C-13) separated by a road for two adjacent plots (C-69A and C-69B) in July 2007 by paying extra amount of **₹ 181.16** crore[3] in comparison to the rates that prevailed in June 2004 and (iii) stamp duty and registration charges **(₹ 1.78 crore)** due to swapping of the plots.

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[1] ***The expenditure towards stamp duty and registration charges for C-8 Plot was ₹10.41 crore. The total cost of acquisition of C-8 Plot was ₹218.56 crore***

[2] ***Plot C-69 A (5,952 sqm. of plot area with permissible built up area of 13,600 sqm.) was allotted in exchange of Plot C-8 and Plot C-69 B (7,131 sqm. of plot area with permissible built up area of 14,262.30 sqm.) was allotted in exchange of plot C-13.***

[3] ***Actual cost of acquisition of plot C-13 in September 2006 minus the cost had the same plot been acquired in June 2004 at the rates applicable to plot C-13 i.e. ₹218.56 crore minus ₹37.40 crore.***

The Management in reply (May 2009) stated that the Company took a considered decision to construct one large building instead of two small buildings as it would not only result in financial savings but also the intangible benefits like synergy in working, ease of operation and maintenance of building. The Management also added that MMRDA had agreed to return an amount of ₹14 crore against the additional premium of ₹21.39 crore paid by the Company.

The reply is not tenable in view of the following:

We are of the view that Management could have and should have taken the considered decision to construct one large building in the first place in June 2004. The chronology of events shows lack of proper planning and failure to take a holistic view. We also believe that the refund of ₹ 14 crore from MMRDA may not be admissible, since the payment of additional premium of ₹ 21.39 crore on swapping of plots was subject to completion of building by June 2010. As the scheduled date of completion of building on C-69 plot is July 2012 the Company may not get a refund of ₹ 14 crore from MMRDA. On the contrary, it may be liable to pay further additional premium of ₹ 14.26 crore due to delayed construction of the building.

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

11.10 Irregular hiring of ultra deep water rig form Reliance Industries Limited

Oil and Natural Gas Corporation Limited (Company) deviated from the standard tendering procedure and hired a rig *viz.* Dhirubhai Deepwater KG 1 (DDKG 1) from Reliance Industries Limited (RIL) without calling for competitive bids for a period of four years on untenable grounds. Besides, irregularity of the entire transaction, the Company had to incur extra expenditure of ₹ 9.36 crore due to deviation from standard norms and had to bear expenditure of ₹ 29.32 crore due to frequent breakdowns of the rig.

Oil and Natural Gas Corporation Limited (Company) projected (December 2008) requirement of a rig capable of drilling in ultra deep waters (water depth of 10,000 feet) by December 2010 to meet its Minimum Work Programme (MWP) commitments. On the plea that no ultra deep water rig was available with it before December 2010, the Company hired (May 2009) a rig viz. 'Dhirubhai Deepwater KG -1[1]' (DDKG-1) from M/s Reliance Industries Limited (RIL) for four years ending July 2013 without calling for competitive bids at an Operating Day Rate (ODR) of USD 495,000 for the first 180 days and at USD 510,000 from 181st day onwards. The Effective Day rate (EDR) worked out to USD 563,488. The rig was mobilised in July 2009 in terms of the tripartite assignment agreement effective from May 2009 and signed on 2 November 2009. In fact, the rig had been earlier hired by RIL from M/s Deepwater Pacific 1 Inc (contractor) in October 2007 for a period of five years commencing July 2009[2] and ending July 2014. Upon RIL's willingness (March 2009) to share the rig with the Company, the latter obtained the same rig from RIL under a tripartite assignment agreement[3] on the same rates, terms and

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[1] ***Earlier its name was 'Deepwater Pacific 1'. The name was changed in April 2008 only after it was hired by RIL.***
[2] ***Date of mobilisation.***
[3] ***A tripartite agreement among the Company (Assignee), RIL and M/s Deepwater Pacific 1 Inc. (Contractor).***

conditions as were applicable to RIL. The period of Company's tripartite agreement with RIL is almost coterminous with the RIL's commitment with the contractor.

Audit observed that:

> In sum, as of July 2009, there was no need for the Company to have an ultra deep water rig on urgent basis and there was no panic situation to acquire the rig from RIL in deviation of the standard tendering procedure.

- The Company did not obtain competitive bids and decided to acquire the rig from RIL in an opaque and irregular manner.
- In July 2009, the Company projected a situation of emergency to acquire an ultra deep water rig by deviating from the standard tendering procedure of competitive bidding. However it was noticed that seven ultra deep wells were drilled by rig DDKG-1 till December 2010. Of the seven wells, three were appraisal wells. In December 2009, the Company itself had expressed its inability to the Ministry of Petroleum and Natural Gas in committing a definite development plan for these wells stating that demonstrable technology implementation analogues were not available in the world in such ultra deep waters. Hence, in the absence of technology, drilling of these appraisal wells was not crucial to decide their commercial viability by December 2010. The remaining four wells drilled by this rig related to NELP blocks. These wells could have been drilled after December 2010 when another rig *viz.* 'Platinum Explorer' was scheduled to be mobilised by the Company. Moreover, the Government of India had already granted extension of time to the Company to drill these wells by March/May 2011 under the rig moratorium policy.
- The tripartite agreement signed by the Company contained a number of terms and conditions, which deviated significantly from the standard contractual terms and conditions. The major deviation included, *inter alia,* are discussed below:
  - **a)** As per standard terms and conditions, the Standby Day rate (SDR)/Non Operating Day Rate (NODR) should not be more than 95 *per cent* of Operating Day Rate (ODR). However, the Company agreed to pay SDR at 98 *per cent* of ODR. As a result, it had to make extra payment of USD 1,802,005 (₹ 8.11 crore) for 2,836.5 standby hours during the period from July 2009 to October 2011. Similarly, for Rig Moving Day Rates (RMDR) the Company paid at 98 *per cent (*as against 90 *per cent*) *of ODR* for 169.50 hours during the same period resulting in an excess expenditure of USD 279,675 (₹ 1.25 crore)[♠].
  - **b)** As per the prudent and standard terms and conditions, the Company should have accepted the rig only after an inspection agency nominated by the Company carried out inspection and confirmed that the rig was suitable as per the scope of work. However, the Company's compromised its interest and accepted the rig based on an inspection carried out by an inspection agency appointed by RIL.

[♠] *At the rate of ₹45/USD*

- Though DDKG-1 was a newly built rig, it suffered from frequent breakdowns right from the date of its mobilization. The rig remained under breakdown for 3.21, 26.15, 11.46 and 1.88 days during August, September, October and November 2009 respectively as against the norm of 1.33 days per calendar month. Consequently, the Company had to incur an additional expenditure of ₹ 29.32 crore on idling of the support services. The Company in its communication to RIL admitted that there were unduly frequent shutdowns in the operation of the rig and its performance was shockingly poor as compared to even much older generation rigs. The frequent breakdowns and the extra expenditure borne by the Company may be viewed in the background of the fact that, in deviation from the standard procedure, the rig was accepted by the Company based on the inspection of the rig carried out by RIL.

As such, the Company hired the DDKG-1 rig in an uncompetitive, opaque and irregular manner. The deviation from the standard terms and conditions resulted in an extra expenditure of **₹ 9.36 crore** besides additional expenditure of **₹ 29.32 crore** on idling of support services due to abnormal breakdown time of the rig.

The Management replied (May 2011) that the rig DDKG-1 was hired from RIL on assignment basis as an outcome of shortage of rigs in the market for drilling ultra deepwater acreages. As regards frequent breakdowns of the rig, the Management stated that due to huge size of offshore rigs having complex mix of equipment, machinery and technology, interruption of operations on account of equipment breakdown could not be avoided.

The Ministry, in its reply (March 2012), while endorsing and re-iterating the reply furnished by the Management (May 2011), further stated that the decision to hire the rig DDKG-1 was taken in the light of early availability of the Rig as also the pressing need to ensure completion of Minimum Work Programme (MWP) of drilling exploratory wells in the NELP Deep Water Blocks as per the respective Production Sharing Contracts (PSC) of the blocks signed with the Government of India. The Ministry further stated that as the rig DDKG-1 was hired on assignment basis, the same rates, terms and conditions of the already existing contract were agreed to.

In respect of the frequent breakdown of the Rig, the Ministry stated that due to large number of equipments, the rig had initially taken 4-5 months for proper synchronization and tuned functioning. There was a cumulative 44 days break down period in DDKG-1 in the initial 5 month period of its deployment due to BOP problem and due to fire in Top Drive system. However, the onward performance of the rig since December 2009 to December 2011 had been very good as the cumulative breakdown of the rig was only 42 days in a period of 25 months, i.e., a breakdown rate of 1.7 days/month.

Reply of the Management/Ministry is not tenable in view of the following:

- Considering the rig moratorium granted by the GOI and availability of an alternate rig by December 2010, the situation did not warrant acquiring of the rig on emergency basis by deviating from the standard bidding procedure.

  Breakdown of the rig has to be viewed in light of the fact that actual number of rig breakdown days in the months of August, September, October and November 2009 were 3.21, 26.15, 11.46 and 1.88 days respectively as against the norm of

1.33 days per calendar month. The same was not acceptable in view of the fact that the rig DDKG-1 was a newly built rig.

11.11 Wasteful expenditure on retaining and idling of a survey vessel

The Company retained a survey vessel in February 2010 for acquisition of 3D seismic data in a deep water block in deviation of the minimum work programme and kept it idle, without obtaining approval of the Director General of Hydrocarbons to deploy the vessel for the survey. This led to wasteful expenditure of ₹ 10.16 crore on idling of the survey vessel as DGH did not approve the Company's proposal.

Oil and Natural Gas Corporation Limited (Company) was awarded a deep water block viz. KK-DWN-2002/2 by the Government of India on 6 February 2004 in the fourth round of New Exploration Licensing Policy. Phase I and Phase II of the exploration activities committed by the Company were ending by 16 September 2007 and 16 March 2010, respectively. Exploratory performance of the Company in this block, amongst others, was reviewed in audit and audit findings were included in the CAG's Report No.PA 9 of 2008, Union Government (Commercial). Audit had observed, *inter-alia*, that the Company had not completed the acquisition, processing and interpretation (API) of 1,000 Line Kilometres of 2D seismic data till March 2007 though it had committed the same at the time of securing the block from the Government of India (GOI). Further, API of the seismic data was to be completed by the Company in time so as to arrive at an appropriate decision for drilling of an exploratory well within Phase II *i.e.* by 16 March 2010.

However, the Company could not complete the API till December 2009 and, instead, planned to acquire only the additional volume of 3D seismic data and not to drill the exploratory well under Phase II. This additional work and waiver from drilling of a well in deviation of the MWP required approval from the Director General of Hydrocarbons (DGH). In fact, the Company approached the DGH on 24 December 2009 for obtaining the approval and deployed a survey vessel *viz.* 'Western Pride' for acquisition of 3D seismic data in the deep water block pending approval of the DGH. The survey vessel was deployed on 22 February, 2010 and remained idle for six days *i.e.* upto 27 February, 2010 without acquiring any data. On 27 February, 2010, DGH verbally communicated its denial to the proposal of the Company, which was formally communicated on 10 March 2010. Thus, injudicious decision of the Management to retain the survey vessel for acquiring 3D data in this block without approval from DGH led to a wasteful expenditure of ₹ 10.16 crore on idling of the survey vessel hired from a private party. This reflected adversely on the planning and governance of exploration activities in the Company.

The Management stated (December 2011) that 'since the proposal was under consideration at MOPNG, the Company had made provision for data acquisition and mobilized the survey vessel for the same. The Management contended that the proposal was technically justified and attributed idling of the seismic vessel to the delayed decision by the Nodal agency viz. DGH on the Company's proposal.

The argument of the Company only endorses the audit point. Though the exploratory well was to be drilled by 16 March 2010, the Company failed to even complete API of the seismic data well in time to arrive at a decision for drilling of an exploratory well and made a reference to the DGH only when the time limit for Phase II was to expire within 3 months. Acquisition of the additional seismic data and related cost was not contemplated within the Minimum Work Programme (MWP) and acceding to the proposal of the Company by the DGH would have implied waiver of drilling of a well under Phase II. Therefore, it was obligatory for the Company to have obtained prior approval of DGH for any deviation in the MWP before deploying the survey vessel.

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

CHAPTER XII: MINISTRY OF POWER

Bokaro Power Supply Company Limited

12.1 Loss due to non fulfilment of obligations prescribed in Letter of Assurance for supply of coal

The Company could not adhere to the time bound milestones laid down in the Letter of Assurance for supply of coal leading to forfeiture of bank guarantee of ₹ 15.52 crore by Central Coalfields Limited.

In consideration of the request by Bokaro Power Supply Company Limited* (Company), Central Coalfields Limited (CCL) issued two Letters of Assurance (LsOA) on 2 February 2009 to the Company for supply of coal for the proposed 75 MW and 2x250 MW power plants. The LsOA were valid for 24 months i.e. up to 1 February 2011. As per the terms of LsOA, the Company was required to complete all activities including approval of investment decision, detailed project report, land lease agreement, environment final clearance, forest clearance, water allocation, funding of investment etc. within the validity period and submit 10 *per cent* of the base price of coal as commitment guarantee. Failure to fulfil all the activities/milestones within 24 months from the date of issue of LsOA empowered the assurer to cancel/withdraw the LsOA and encash the bank guarantee (BG).

The Company submitted two BGs of ₹ 3.17 crore and ₹ 12.35 crore in November 2008. The milestones were not achieved within the validity period of the LsOA, and hence CCL cancelled the LsOA and encashed the bank guarantees of ₹ 15.52 crore in March 2011.

Audit scrutiny revealed that while clearance from Ministry of Environment and Forest (MOEF) was due in respect of 75 MW project, in respect of the 2X250 MW power plant the following milestones were not achieved:

- The Company obtained the right to use of land for the proposed plant from SAIL but failed to get it transferred in its own name. The right was ultimately cancelled in November 2010.
- The Company was indecisive about the size of power plant and the number of units to be set up. The changes delayed the preparation of the DPR. The DPR though prepared in July'08 was submitted to CCL partially.
- Airport Authority of India (AAI) issued NOC for erection of chimney of 181.6 meter height (August 07) against 275 meter applied for by the Company. The Company was silent for 14 months and took up the matter with AAI only in Novemver'08. The NOC was finally issued for 275 meter chimney in August'09.

* ***Bokaro Power Supply Company (P) Limited is a 50:50 joint venture company of Steel Authority of India Limited and Damodar Valley Corporation***

Thus, there was inordinate delay in obtaining NOC which further delayed submission of documents to MOEF for environment clearance.

- The Company could not submit the details of land for NOC to be issued by the Jharkhand State Pollution Control Board. In the absence of NOC, environment clearance from MOEF could not be obtained.

Thus, due to lack of proper planning, inadequate co-ordination with SAIL and delay in obtaining statutory clearances the Company could not achieve the milestones.

Management stated (October 2011) that all the documents except MOEF clearance in respect of 75 MW Project had been submitted and that it expected revalidation of LOA in the meeting of the Standing Linkage Committee (SLC) for Power. As regards 2x250 MW Project, management brought out various reasons for non achievement of milestones and stated that grant of lease of land from SAIL was pending.

Management's reply is not acceptable as CCL had encashed the bank guarantees as per conditions of the LsOA. In fact, the Company was aware (March 2008) of the requirement to complete the stipulated milestones in a time bound manner and that failure would result in termination of LsOA and forfeiture of commitment guarantee in terms of the New Coal Distribution Policy of October 2007 and the model LsOA available in CCL's website.

The Ministry stated (January 2012 and March 2012) that the 75 MW Project has been recommended for environment clearance and proposal for revival of coal linkage will be place before the coal linkage committee in the forthcoming meeting of SLC (LT). As regards 25X 250 MW Project, the Ministry has reiterated the views of the Management.

The reply is not acceptable as the revival of coal linkage can only be done after revalidation of the LoA which is still pending (June 2012). As regards 2X250 MW Project there is no change in status.

Damodar Valley Corporation Limited

12.2 Transmission and Distribution of Power

12.2.1 Introduction

Damodar Valley Corporation (Corporation) was set up in July 1948 under the Damodar Valley Corporation Act, 1948 with the objective of securing unified development of the Damodar valley falling within the states of Jharkhand and West Bengal. The capital requirement of the Corporation is met jointly by Union Government, Government of West Bengal and Government of Jharkhand. The Corporation is managed by a Board which consists of a Chairman and two other Members appointed by the Union Government in consultation with the Government of West Bengal and Government of Jharkhand.

The Corporation generates power from its four thermal and three hydel power plants. In addition, it also purchases power from other power generating companies such as NTPC Limited and Tata Power Co. Ltd. The power generated and purchased is transmitted to State Electricity Boards, Railways, Coal Companies, Steel Plants and other Industrial Consumers in the States of West Bengal and Jharkhand.

Up to the 9th Plan period, the Corporation was undertaking the transmission system schemes on an *ad-hoc* basis without any systematic study of the system requirement and integrated approach as highlighted in our earlier Audit Report*.

In September 2001, the Corporation approached Central Electricity Authority (CEA) to take up a consultancy work for development of the transmission system. The CEA, in consultation with the Corporation, finalised a load flow and short circuit study (May 2002) of the transmission network and recommended construction of additional sub stations and transmission lines to meet the load growth within the Valley (1420 MW) and evacuation of surplus power (4000 MW) from the proposed generating stations (5420 MW) after obtaining commitments from the various beneficiaries. Accordingly, the Corporation prepared its master plan (September 2002).

12.2.2 Audit Framework

12.2.2.1 Past Coverage and Scope of Present Audit

A Performance Audit on ' Implementation of transmission system construction projects undertaken by the Corporation during the 9th Plan' was conducted and the findings included in the CAG's Audit Report appended with the Annual Report of the Corporation for the year 2003-04. The significant audit findings were:

- Deficient contract management leading to time overruns in completion of projects on account of delays in providing Right of Way to contractors, change in scope of work/ route profile, placement of orders to technically and financial unsound contractors and other procedural delays.
- Inadequate load growth to match with the capacity expansion on account of commissioning of 4 new sub stations.
- Deficiencies in Renovation and Augmentation of Transmission Network viz. inordinate delays in augmentation of transformer capacity and Reconductoring of transmission lines

The Action Taken Note (ATN) on these issues has not been received so far (November 2011).

In order to ascertain the action taken on the audit issues, a follow up audit has been attempted which also covers development of the Transmission & Distribution (T&D) infrastructure including operation and maintenance during the period 2005-06 to 2010-11.

12.2.2.2 Audit Objectives

The objectives of Audit were to assess whether:

- The Corporation has taken appropriate follow up action on the Audit Report of CAG of India on 'Implementation of transmission system construction projects undertaken by the Corporation during the 9th Plan' appended with the Annual Report of the Corporation for the year 2003-04.
- The assessment of growth for demand of power was realistic and the expansion targets were planned accordingly.

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* ***Reported in CAG Audit Report for the year 2003-04***

- The Corporation made adequate efforts to achieve the planned targets for completion of the projects.
- The transmission/distribution network created was adequate and utilized optimally and that it synchronized with generation capacity.
- The transmission/distribution network was being operated and maintained efficiently so as to minimize the loss of energy.

12.2.2.3 Audit Methodology

Based on a preliminary study and collection of background information, a random sample of cases to be examined in audit was drawn. The sample consisted of 21 major contracts[1] out of total 22 contracts (95 *per cent*) and 4 minor contracts[2] out of 16 such contracts (25 *per cent*) relating to T&D works. In addition, 15 Sub-stations out of a total 35 sub stations (42 *per cent*) were also selected for assessing the adequacy of operation and maintenance of T&D system of the Corporation.

Audit was conducted during the period from April 2010 to August 2010. The draft report was issued to the Management (August 2010) and Ministry of Power, Government of India (Ministry) in March 2011. The response of the Management/ Ministry (August 2011) have suitably been incorporated in the report and the status of the issues has been updated up to March 2011.

12.2.3 Audit Findings

12.2.3.1 Unrealistic Assessment of Power Demand in the Valley

Audit observed that though the Corporation was formed and mandated by DVC Act for unified development of the Damodar Valley, the Corporation ignored the pending demand (2005) of 102 consumers for 1062 MW[3] of power within the valley. During March 2006 and May 2007 it entered into Power Purchase Agreements (PPA) with electricity agencies of the States of Delhi, Punjab, Haryana and Madhya Pradesh for a period of 25 years for the export of 4000 MW of power. As a result, the Corporation ultimately decided (August 2010) not to supply power to the 189 valley consumers for a contract demand of 1721 MW.

The Ministry stated (August 2011) that Power Purchase Agreements (PPAs) were signed in the year 2006 and the Corporation could not anticipate the massive growth of load in the valley which started from 2007-08 onward. Ministry, however, assured to revisit the export agreements for reduction of export of power.

12.2.3.2 Non-achievement of Plan Targets for Capacity Expansion- 10th Plan (2002-07) and 11th Plan (2007-12)

In the last performance audit it was noticed that the Corporation was unable to achieve the ninth Plan expansion targets due to various weaknesses in planning and execution of the projects. Audit observed that in the subsequent periods also, similar flaws continued and as such the performance of the Corporation in achieving the expansion targets (10th and 11th plan) remained dismal as indicated below:

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[1] ***Valuing ₹5 crore and above***
[2] ***Valuing less than ₹5 crore***
[3] ***1118 MVA (1MW = 1MVA *0.95)***

	10th Plan (year 2002 to 2007)				11th Plan (year 2007 to 2012)		
	Plan	Revised Plan	Actual (upto March 2007)	Achievement % age	Plan	Actual (upto March 2011)	Achievement %age
Generating Capacity (MW)	5420	1210	210	17	5220	500	10
Sub-station (Nos.)	9	9	4	44	14	1	7
Transmission Lines (ckm)	3650	1760	415	24	2876	293	10

To match with 5420 MW of capacity addition planned during the 10th plan period, Corporation's master plan initially included construction of 9 new sub stations and 3650 circuit kilometer (CKM) of transmission lines. However, due to non-preparation of DPR for generating stations and non-availability of land, the target for expansion of generating capacity was curtailed to 1210 MW with consequent reduction of transmission lines to 1760 ckm in the revised plan.

The Corporation, however, during the 10th Plan period could expand only 210 MW of generation capacity and 415 ckm of transmission lines. Similarly, of the 9 sub stations planned for the 10th Plan, only 4 Sub Stations♣ were constructed. Consequently, the left over target spilled over to the 11th Plan.

Reasons as analysed in audit for non-achievement of targets are discussed in the succeeding paragraphs.

As the Corporation has so far (March 2011) achieved only 10 *per cent* of the expansion targets for generating capacity and transmission lines and only 1 substation out of 14 planned for 11th plan has been constructed, the possibility of achieving the 11th plan targets by 2012 (closing year of the 11th Plan) appears very remote.

Thus, the overall physical achievement of the Corporation for construction of transmission lines and sub stations during the 10th and 11th plan period remained dismal which had an adverse cascading impact on the comprehensive development and strengthening of the transmission network.

12.2.3.3 Gaps in Execution of Projects

Audit examination revealed that the following inadequacies/ shortcomings in execution of expansion projects noticed and reported in our earlier Report were still persisting:

(a) Delays in Construction of Transmission Lines

Audit observed that out of 6 contracts selected in audit, the Corporation could not adhere to the scheduled dates of completion in any of the contracts. As on 31 March 2011, 4 contracts were completed with a time overrun of 4 to 27 months while the other 2 contracts, scheduled to be completed by September 2009, had not been completed till March 2011.

Audit examination of records revealed that the delays were mainly due to improper estimation of work involved, delay in award of contacts, delay in issue of drawings, delay

♣ ***Hazaribag, Ramgarh, Barjora, Burnpur Sub Stations*** in supply of material to the contractor, delay in handing over of clear site to the contractor, change in route alignment and Right of Way (ROW) problems. The reasons for delays in completion of each contract are indicated in **Annexure-X and XI**. These delays not only led to time overrun but also led to increase in the cost of the projects by ₹ 19.92 crore.

The Ministry stated (August 2011) that the delay in completion of sub stations and transmission lines were on account of absence of forest clearances, ROW problems and local resistance during physical possession of land which necessitated resurvey of route and consequential modification thereof which were beyond its control.

The contention is not tenable in view of the fact that obtaining of statutory clearances, land acquisition including ROW are the pre-requisites of any project and, therefore, have to be resolved before entering into any contract. Further, as regards ROW related problems, a committee constituted by Ministry of Power recommended (January 2002) the use of multi-circuit towers wherever ROW constraint existed. However, the Corporation could not do away with the ROW constraints due to non-commissioning of the multi-circuit towers (March 2011).

(b) Delays in Construction of Sub-Stations

In a sample of 8 Sub Stations selected for audit, only 4 were completed during April 2005 to March 2011 with a total order value of ₹ 70.97 crore. Audit observed that these Sub-Stations were commissioned with a time-overrun ranging from 22 to 28 months. Of the remaining 4 Sub Stations, 1 (Panagarh sub station) was abandoned due to inadequate load growth and 3 Sub Stations were yet to be completed (March 2011) **(Annexure-XI and XII).**

The delays were mainly due to delays at various stages viz. surveys, preparation of feasibility reports, estimation, drawings, tendering and changes in the scope of work and Right of Way (ROW) and land acquisition problems. The reasons for delays in completion of each contract are indicated in **Annexure-XI and XII**. The delayed completion of the sub stations led to increase in the cost of the project by ₹ 4.38 crore.

(c) Delays in Installation of New Transformers

For evacuating power to match with the future load growth during the 10^{th} Plan, the Corporation decided to procure 12 transformers at a cost of ₹30.59 crore for various sub-stations.

Audit observed that by the end of 10th Plan (2002-07) only 1 transformer was installed and the remaining 11 transformers were installed between September 2008 and March 2011 with the delays ranging between 29 months and 60 months due to abnormal delays at each stage of procurement process viz. issue of NIT, release of purchase orders & dispatch clearances **(Annexure- XIII).**

The delayed installation of transformers resulted in:

- Breakdown of existing transformers at Putki and Durgapur sub stations for 235 hours during 2008-2009 and 2009-10.
- In the absence of adequate number of transformers, power plants had to resort to backing down of generation of 258 million units of power during the period from 2006-07 to 2010-11

Ministry stated (August 2011) that system constraint and consequential backing down of generation was very rare.

Ministry's contention is not tenable because:

- Corporation's record indicated the constraints in the grid leading to back down of generation.
- Even the Management admitted the existence of system constraint in response to an audit query and intimated that additional lines were being constructed for evacuation of power and removal of system constraints.
- Existence of system constraints is also established from the fact that the Management itself has stated (Para 3.3 (d)) that the reconductoring[1] of transmission lines was delayed as necessary shut down could not be provided to the contractors due to generation and load management.

(d) Delays in Reconductoring of Transmission Lines

During the 10th plan, the Corporation took up three[2] lines for reconductoring of which the contracts for two lines (BTPS-Konar Barhi and CTPS-Putki line) were examined in audit. The work relating to these lines was completed after a delay of 6 and 24 months respectively due to delay in providing required shut down to the contractors. These delays caused 98 cases of tripping of lines.

The Management stated (September, 2010) that it could not provide shut down to the contractor due to requirement of generation and load management.

Management's admission only reconfirms Audit's contention.

(e) System Energy Measurement Accounting & Audit (SEMA)

In order to facilitate the accounting for the energy generated, transmitted, distributed, consumed and lost in the various segments of the power system, the CEA notified (March 2006) that every power utility has to install 0.2S accuracy class metering equipment for identifying and containing energy loss.

Audit observed that even after a lapse of more than 5 years, the Corporation was yet to initiate the process for installation of metering equipments in the Sub Stations (March 2011).

The Management stated (September 2010) that the delay was due to non-standardization of foundation of equipments due to different site requirements.

Non installation of metering equipment even after more than 5 years of the notification by the CEA, is indicative of lack of seriousness on the part of Management to take adequate remedial measures.

In sum, the Corporation failed in achieving its expansion targets due to persistent deficiencies in contract management, handing over of clear site to the contractor, change in route alignment and Right of Way (ROW) problems etc which indicates that the Corporation did not take any concrete follow up action for analysing and arresting the reasons of such inordinate delays in creating transmission and

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[1] ***Replacing the old transmission wires with new one.***

[2] ***CTPS-Putki, BTPS-Konar Barhi and Putki- Nimiaghat lines***

distribution infrastructure for providing uninterrupted and secure power supply to the consumers. This is despite the fact that Audit had pointed out these gaps earlier in the CAG's Audit Report 2003-04.

12.2.3.4 Inadequacies in Project Monitoring System

Audit observed that the existing Project Monitoring Mechanism of the Corporation was also not effective for containing time and cost overruns of the projects. The shortcomings noticed in audit are indicated below:

- The Corporation did not prepare feasibility reports/detailed projects report of the transmission projects to serve as a benchmark for the cost of various elements.

  The Ministry assured (August 2011) that henceforth these reports will be prepared for all major transmission projects.

- Though the Corporation entered into long term contracts, it had not fixed any annual physical targets for effective monitoring and to take mid course corrections in the event of delays.

  The Ministry stated (August 2011) that the matter regarding annual physical target would be taken care of in the upcoming projects

- Unlike PGCIL, there was no clause in the contracts which required the contractors to submit monthly progress report on the status of the activities, procurement of materials, manufacturing, testing & inspection, dispatch of equipment/materials, payment received etc for monitoring the progress of the work and for taking mid course corrective actions, if necessary.

  The Management agreed (September 2010) that PGCIL's standard clause can be included in the contracts for better monitoring

12.2.3.5 Operation and Maintenance of Transmission and Distribution System

Audit observed the following weaknesses in the operations and maintenance of transmission & distribution system:

(i) Tripping /Breakdown of Transmission Lines & Sub Stations

Audit observed that in 12 sub stations selected in audit out of total 35 sub- stations, the duration of tripping/ breakdowns/shut downs of transmission lines increased from 4028.36 hours in 2006-07 to 12089.33 hours in 2010-11 **(Annexure-XIV)** which indicates that the Corporation did not take effective measures to contain the incidence of tripping/break downs/shut downs.

Sl. No.	Year	Number of hours
1	2005-06	8349.94
2	2006-07	4028.36
3	2007-08	5253.34
4	2008-09	5785.75
5	2009-10	6528.4
6	2010-11	12089.33

Ministry stated (August 2011) that the trippings and break-downs were due to man-power constraints and insufficient redundant transformers and it could be minimized after augmentation of transformer capacity.

Audit analysis, however, revealed that the higher incidence of trippings and breakdowns were attributable to the following reasons:

(a) Improper Maintenance of Transmission and Distribution of Equipments

As per CEA guidelines, important components of the transformers are to be checked monthly, quarterly, half-yearly and annually for smooth operation of the transformers. Audit scrutiny, however, revealed that in 7 Sub-Stations[1] out of 15 Sub-Stations selected for audit, there were abnormal delays in checking of the transformers as these were checked at irregular intervals (3-47) months.

(b) Improper Maintenance of Relays

As per CEA's guidelines, to ensure proper and effective functioning of relays and associated equipments, certain checks are to be carried out at regular intervals viz., once in six months.

Test check of records of 4 Sub Stations out of 15 sub-stations selected for audit revealed that during the period from 2005-06 to 2010-11[2] these checks were not carried out regularly.

Audit examination of records of Thermal Power Stations further revealed that improper maintenance of relays led to the failure/ tripping of the system resulting in outage on 68 occasions for 592.464 hours and thereby causing loss of 92.56 Million Units of power.

(c) Overdrawal of Power

The overdrawal[3] of power leads to breakdown of transformers and violation of grid discipline and necessitates import of power. It was observed that in 6 sub stations out of 15 sub-stations selected for audit, the incidence of overdrawal of power increased from 36.187 MVA in 2005-06 to 152187.73 MVA in 2010-11 resulting in purchase of power at higher rates under unscheduled interchange (**Annexure- XV**).

In order to discourage overdrawal of power, West Bengal Electricity Regulatory Commission, had notified (December 2007) 60 *per cent* extra charges on overdrawal of power. The Corporation was, however, charging only 10 *per cent* extra on this account from private consumers and was not imposing any such charges in case of State Electricity Boards as no such clause existed in the Power Purchase Agreements signed with them.

While admitting the facts, Ministry stated (August 2011) that after introduction of GSM Metering scheme, it will be possible to identify consumers who were overdrawing power above their schedule and corrective actions would be taken accordingly in order to maintain grid discipline.

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[1] ***Burdwan, Belmuri, Kalipahari, Ramkanali, Kalyaneswari, Kumardubi and Burnpur***

[2] ***2005-06 to 2010-11 (Belmuri & Burdwan SS), 2008-09 to 2010-11 (Koderma) and 2009-10 2010-11(Konar)***

[3] ***When power is drawn in excess of contract demand***

(ii) Load Restriction/Load Shedding

Audit observed that due to various transmission system constraints as discussed in the preceding paragraphs, the Corporation could not supply uninterrupted and quality power to its consumers for 491341.08 hours during the period from 2005-06 to 2010-11. Consequently, the load restriction/load shedding increased to 171721.63 hours in 2010-11 from 4810 hours in 2005-06 **(Annexure-XVI).**

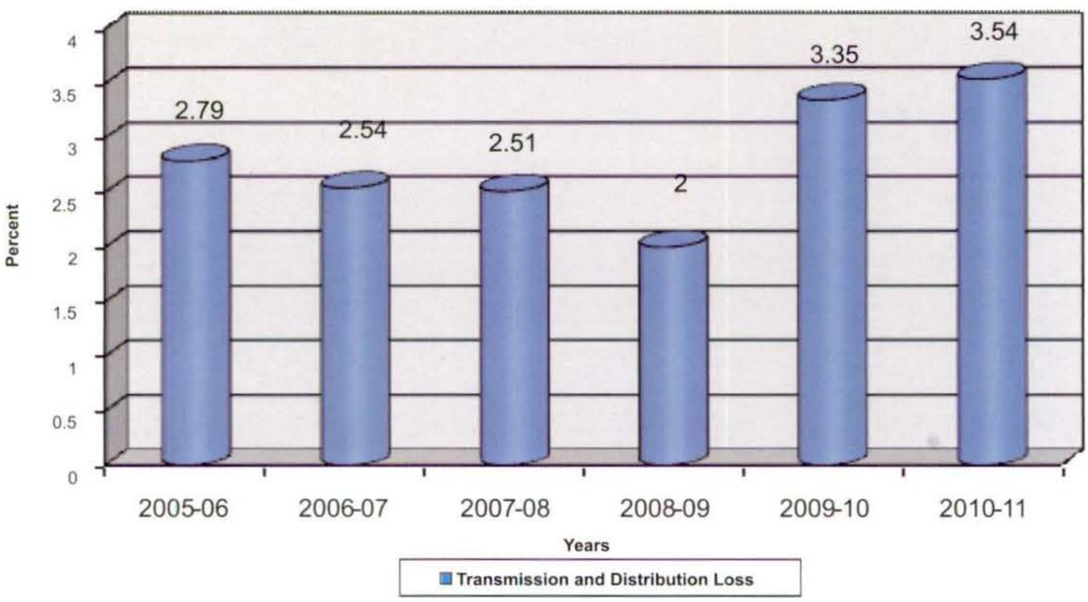
The Ministry attributed (August 2011) the same to the wide gap between demand and generation of power.

The fact remains that apart from demand-generation gap, transmission system constraints and overdrawal of power significantly impact the load restriction/load shedding which needs to be contained.

(iii) Transmission and Distribution (T&D) Losses

(a) The graph below indicates the quantum of transmission and distribution loss during the period from 2005-06 to 2010-11:

Graph



The aggregate T & D loss which had decreased from 2.79 *per cent* in 2005-06 to 2.00 *per cent* in 2008-09, had again increased and reached up to 3.54 *per cent* in 2010-11 against a benchmark of 2 *per cent* as fixed by the Management.

Ministry stated (August 2011) that the increase in the T&D loss was due to changed methodology of including the station loss and construction power for ongoing projects in the T&D loss and added that after implementation of SEMA, T&D loss would be minimized.

The contention that loss due to of change in methodology is unfounded as the records indicated that the station loss was still being included in auxiliary consumption. Further examination of records revealed that the Corporation was not able to segregate transmission and distribution losses distinctly as the meters at the incoming end of the all the sub stations were not installed.

In case of 93 consumers where check meters were installed, the distribution loss was higher than the benchmark (2 *per cent*) for 28 consumers resulting in loss of ₹ 33.15 crore (**Annexure-XVII**).

Ministry stated (August 2011) that distribution losses were well within the national level of 4% except some feeders where loss varied from 4 per cent to 6 per cent due to ageing, under rated conductor and excessive overloading. It further stated that action had already been initiated to install the check meters for every consumer.

The fact remains that had the Corporation installed check meters both at the incoming end of the Sub Stations and at the consumers' end, it would have been possible to segregate the transmission and distribution losses separately and control measures could have been taken accordingly.

(b) In order to bring down the T& D loss below 2 *per cent,* the Corporation constituted (April 2007) a Committee* which in its Interim Report (April 2007) recommended, that recording of different auxiliary consumptions (station load, colony load, etc) should be adopted for identification/ segregation/monitoring of losses.

Audit observed that in three Sub Stations viz., Burdwan, Kumurdubi and Kalyaneswari, the actual auxiliary consumption could not be measured due to absence of meters and thus the excess consumption, if any, could not be measured.

The Ministry stated (August 2011) that recording of different auxiliary consumption was being taken care of by implementation of the SEMA Project.

In sum, the operation & maintenance system of transmission and distribution network of the Corporation needs to be strengthened. The Corporation did not adhere to the periodicity of checking of the various equipments such as transformers, relays and other associated equipments as per the guidelines of CEA. The Corporation was also not able to discourage the consumers from overdrawing of power by imposing adequate punitive measures so as to minimize the instances of trippings and break downs. As a result, the incidents of tripping/breakdown, violation of grid discipline, transformer breakdown etc and consequential load restriction/load shedding were on the rise and the Corporation could not provide uninterrupted and quality power to the consumers.

(iv) Delay in Power Supply to New Consumers

Audit observed that the Corporation failed to adhere to its time frame of six months prescribed (August 2006) for processing the applications for providing new connections and delays noticed was upto 97 months. Further, Audit also observed that despite the commissioning of two new generating stations (500 MW) during 2006-07 to 2010-11, the annual rate of power supply provided to new consumers during the period 2005-06 to 2010-11 fell down from 302 MW in 2006-07 to 65.5 MW in 2010-11 mainly due to delay in construction of sub stations, transmission lines & feeder lines, bays, transformers and reconductoring of lines etc.

Ministry stated (August 2011) that the delay in giving new connections was due to inordinate delays by the prospective consumers in the erection of feeder/ service lines due to ROW problem , delay in getting bank loans, financial crisis etc.

**** Technical committee constituted for improvement of T&D loss in DVC system.***

The fact remains that for effective use of its generating capacity, the Corporation needs to facilitate and monitor the construction of feeder lines.

Conclusions

Audit noticed that gaps pointed out earlier existed even now in contract management, Right of Way to contractors, change in scope of work, change in route profiles and placement of orders to technically and financially unsound contractors etc.

Though the Corporation was formed and mandated by DVC Act for unified development of the Damodar Valley, the Corporation entered into power purchase agreements (PPA) with electricity agencies of other States for providing power despite pending demand in the valley.

The performance of the Corporation on expansion of its capacity to overcome the demand-generation gap remained dismal as it could not achieve the targets set for 10th Plan and 11th Plan due to persistent weaknesses in the planning and execution of projects leading to inordinate delays in construction/installation of various segments of the transmission and distribution network viz. transmission lines, sub stations and transformers etc. The Project Monitoring System of the Corporation was also not effective in containing the time and cost overruns of the projects.

The operation & maintenance system of transmission and distribution network of the Corporation needs to be strengthened. The Corporation did not adhere to the periodicity of checking of the various equipments such as transformers, relays and other associated equipments as per the guidelines of CEA. The Corporation was also not able to discourage the consumers from overdrawing the power by imposing adequate punitive measures. As a result the incidents of tripping/transformer breakdown, violation of grid discipline etc and consequential load restriction/load shedding were on rise and the Corporation could not provide uninterrupted and quality power to the consumers.

Further, despite the fact that transmission and distribution losses were above the norms, the Corporation had not implemented SEMA notified by CEA in March 2006 in all the Sub Stations for taking corrective actions.

Recommendations

- ***The Corporation needs to strengthen its contract management system to avoid persistent gaps.***
- ***The Corporation should prepare annual physical target for all major works for proper monitoring and timely completion of the projects.***
- ***The Corporation should carry out preventive maintenance of equipments as per schedule to reduce the trippings/ breakdown and suitable penalty clause should be incorporated in the power purchase agreement for overdrawal of power.***
- ***The Corporation should implement SEMA as notified by the CEA for identification and minimization of energy losses at various points of supply.***

12.3 Fuel Management in Thermal Power Stations

12.3.1 Introduction

Damodar Valley Corporation (Corporation) set up for securing unified development of the Damodar valley falling within the states of Jharkhand and West Bengal, generates power mainly from its four thermal power stations located at Bokaro (BTPS), Chandrapura (CTPS), Durgapur (DTPS) and Mejia (MTPS). As on 31 March 2011, the Corporation had an installed thermal capacity of 2710 MW.

12.3.2 Audit Scope, Objectives and Methodology

The efficient and economic use of the fuel assumes a very significant role in power generation as the cost of fuel (coal and oil) constitutes 70 *per cent* of the total cost of power generated.

A performance Audit on 'Fuel Management in Thermal Power Stations of DVC' was conducted earlier which covered the period of 2001-02 to 2005-06 and the findings included in the CAG's Audit Report appended with the Annual Report of the Corporation for the year 2005-06. The significant issues highlighted were:

- Shortfall in receipt of coal from coal companies.
- Absence of penal provisions for oversized coal, grade slippage etc. in the agreements with the coal companies.
- Imperfect combustion of coal leading to higher percentage of unburnt coal in ash
- Payment of detention/demurrage charges to Railways
- Consumption of costlier oil
- Excess consumption of oil

The Action Taken Note (ATN) on these issues has not been received so far (January 2012).

In the backdrop of above, this follow up audit of fuel management of the Corporation was undertaken which covered five years period from 2006-07 to 2010-11.

The Audit was carried out to assess whether the Corporation has taken appropriate action on the earlier Audit Report of CAG on 'Fuel Management in Thermal Power Stations of DVC' and whether the assessment for requirement of fuel was based on realistic norms; and procurement and transportation of fuel was done economically and efficiently. In addition, audit assured whether the consumption of fuel was economically done and cost correctly recovered through tariff.

Audit examined the records relating to the procurement, transportation and consumption of fuel of all the existing power stations of the Corporation located at Bokaro (BTPS), Chandrapura (CTPS), Durgapur (DTPS) and Mejia (MTPS) for arriving at the audit conclusions.

12.3.3 Audit Findings:

12.3.3.1Unrealistic assessment of requirement of coal

In October 2007, Ministry of Coal (MOC), Govt. of India, notified a New Coal Distribution Policy (NCDP) and as per this policy, the Fuel Supply Agreements with the coal companies are to also cover the coal requirement for power plants yet to be commissioned, in addition to the existing power plants.

Audit observed that the Corporation, however, while assessing the total coal requirement (149 lakh MT) of the Corporation in February 2008, did not consider the requirement[1] of coal for the 4 new units for inclusion in the FSA. These four new units commenced their trial run operation in phases during the period between September 2009 and March 2011 and consumed 3.32 lakh MT of coal of which 0.79 lakh MT, in fact, was diverted from the coal allocation of the existing units as the same was not available under any FSA.

The Management, while being silent on the reasons for improper assessment, of coal requirement, stated (December 2011) that the availability of coal was a national problem and the Corporation was not an exception.

12.3.3.2 Grade slippage of coal received

- **In two thermal stations test checked, in more than 90 *per cent* cases the quality/grade of coal received was found inferior to that indicated in the joint sampling reports prepared at the loading point.**
- **The Corporation is likely to have incurred additional expenditure of ₹ 1188 crore for the coal received during the years 2008-09 to 2010-11.**

Coal is classified into different grades on the basis of useful heat value (UHV) / gross calorific value (GCV). Accordingly, the prices of the coal, based on the grade/quality of coal, are notified by the collieries. The quality of coal supplied by the coal companies is determined on the basis of joint sampling at loading point. Audit noticed that the Corporation received coal from Eastern Coalfields Limited (ECL), Bharat Coking Coal Limited (BCCL), Central Coalfields Limited (CCL) and Mahanadi Coalfields Limited (MCL). While the Corporation has appointed joint samplers (private contractors) at each loading point of coal supplied by ECL, BCCL and CCL, no such joint sampler was engaged for the coal received from Mahanadi Coalfields Limited (MCL). The Coal companies raised coal bills on the basis of the grade determined in the joint sampling reports at the loading points and accordingly payment was made. The Corporation also analyses the quality and grade of the coal in its laboratories after the coal is unloaded in the power stations.

In detailed examination of two power stations (MTPS and CTPS) out of four, audit observed that in more than 90 *per cent*[2] of cases, the quality and grade of the coal was found inferior to that indicated in the joint sampling reports prepared at the loading point. As the coal bills were raised by the coal companies and paid by the Corporation on the basis of grade and quality of coal determined in joint sampling at loading points, the Corporation incurred an avoidable additional expenditure of ₹ 1188 crore, being the difference of price of the type of coal stated to be loaded and the price of actual quality and grade received at the power stations during the period from 2008-09 to 2010-11 **(Annexure-XVIII).**

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[1] ***Against the annual coal requirement of 75 lakh MT for the four new thermal units (MTPS Unit7&8 and CTPS Unit7&8), the MOC had allocated (March 2005 and January 2006) an annual coal linkage of only 40 lakh MT and thus there was an annual deficit of 35 lakh MT of Coal for the new plants. .***

[2] ***99 per cent in CTPS and 92-97 percent in MTPS***

While accepting the grade slippage, the Management contended (December 2011) that payment for coal was made on the basis of sampling at loading point on which the coal companies had more control. The Management also stated that action has been initiated for deputing own personnel for witness of samples and engagement of joint sampler at MCL loading point.

In brief, the Corporation needs to institutionalise the arrangement for a system for providing assurance on the quality of coal received from the coal companies and payment made to the latter based on the type of quality of coal supplied. This is essential in view of the fact that in thermal power plants, the quantum of electricity generated is directly related to the quality of coal consumed. Since joint samplers are appointed by the Corporation for collection and analysis of samples at loading points, the onus of ensuring the correct sampling lies with the Corporation and, therefore, the system should be made transparent and accountable.

12.3.3.3 Receipt of oversized stones and extraneous materials with the coal

Due to lack of effective monitoring at coal loading points –

- **The Corporation was yet to recover an amount of ₹ 59.07 crore, from coal companies on account of oversized stones received in the coal.**
- **The Corporation also suffered a loss of ₹ 135.08 crore due to receipt of extraneous materials in the coal.**

As per the agreement with the coal companies, the coal is to be delivered within the specified size of 250 mm without any extraneous materials and the seller should make efforts to remove stones from coal. Purchaser should also segregate and stack separately stones received along with coal for the purpose of joint assessment by the representative of the seller and the purchaser. However, the purchaser would be compensated for the value of the oversized stone.

Audit observed that during the period from 2006-07 to 2010-11, the Corporation received 3.17 lakh MT of oversized stones valuing ₹ 61.99 crore and incurred additional ₹ 6.05 crore for segregation of these oversized stones from the coal. The Corporation, so far (January 2012) was compensated only for ₹ 8.97 crore and an amount of ₹ 59.07 crore[1], remained un-recovered from the coal companies on account of oversized stones received in the coal.

In addition to oversized stones, a large quantity of hard coal shells and foreign materials/stones (less than 250 mm) were also received with coal in the power stations which, while passing through coal mills, were rejected and sold in the market as Coal Mill Rejects (CMR).

In two power stations viz. CTPS and DTPS, the quantity of CMR generated during the period from 2006-07 to 2010-11 was 9.71 lakh MT valuing ₹ 145.74 crore[2]. As the Corporation could fetch ₹ 10.66 crore by selling the CMR, it suffered a loss of ₹ 135.08 crore on this account. In the remaining two stations viz. MTPS and BTPS, the quantity of such material in the coal was not ascertained as CMR mechanism in these stations was not in place.

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[1] ***Cost of stone equivalent to coal(₹61.99 crore)+ Additional expenses (₹6.05 crore)- Adjusted (₹8.97 crore)***

[2] ***Value of equivalent quantity of coal as these were the part of coal purchased.***

Audit further observed that the corporation had engaged (February 2007) a private contractor[1] at MTPS for ensuring loading of coal free from extraneous materials and paid ₹ 11.24 crore during the period from 2007-08 to 2010-11. Though the Corporation suffered a loss of ₹ 19.42 crore due to receipt of extraneous materials in the coal at MTPS during such period, no penalty was imposed on the contractor as the agreement with the contractor did not contain any such provision for non fulfilment of the obligation.

While acknowledging the audit concern, the Management stated (December 2011) that the supply of stones and extraneous material with the coal cannot be eliminated completely due to adoption of mechanized mining procedure in open cast mines. It was also stated that monthly joint assessment for oversized stones/boulders (+250mm) with coal companies were being carried out from May 2010.

The fact, however, remains that the Corporation, despite the engagement of contractor at loading points for ensuring the supply of coal free from oversized stones and extraneous material, failed to arrest the incidences of stones and extraneous material in the coal and could not recover the same from the contractor in absence of penal clauses in the contract in this regard and also failed to recover the loss from the coal companies.

12.3.3.4 Transit loss of coal

The Corporation received the coal for its four power stations mainly through railway wagons. During the period 2006-07 to 2010-11, the Corporation suffered transit loss of 12.33 lakh MT of coal valuing ₹ 257 crore (**Annexure-XIX**) over and above the norms fixed by CERC[2].

The above loss is indicative only as during the period from 2008-09 to 2010-11, the in-motion weigh bridges at the three power stations viz. MTPS, DTPS and BTPS malfunctioned (137 to 184 days) at different points of time and the Corporation could not ascertain the exact quantity of coal received through railway wagons during the malfunctioning of weighbridges. The Management, however, estimated the transit loss on the basis of average transit loss suffered when the weighbridges were functional.

Audit observed that of the above loss, the Corporation incurred transit loss of coal valuing ₹ 163.04 crore for MTPS alone. Despite the recurring incidence of thefts in MTPS bound coal rakes, the Corporation did not take any effective remedial measure for arresting pilferage of coal.

While acknowledging the loss, the Management pleaded (December 2011) that the Corporation had no control over transit loss as the coal was transported in open wagons on owner's risk basis.

Audit further observed that the transit losses in case of road transportation of coal were also higher than the CERC norms and the excess loss ranged between 0.02 and 3.25 *per cent* during the period from 2006-07 to 2010-11. As per road transport agreements, transit losses in excess of 1 *per cent* were recoverable from the transporters. Thus, the corporation not only had to absorb transit loss of ₹ 15.60 crore in excess of the CERC norms but also upto 1 *per cent* as the same was neither recoverable through tariff nor from the transporters as per the agreement.

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[1] ***CISC- ESSAR Eng. Consortium***

[2] ***0.8 per cent for MTPS and DTPS (non pit head power station) and 0.3 per cent (upto March 2009) and 0.2 per cent (from April 2009) for BTPS and CTPS (Pit head stations)***

The Management assured to amend the allowable transit loss in line with the CERC norms in the agreements with the road transporters.

The fact, however, remains that, the Corporation, being the ultimate owner and user of the coal, cannot absolve itself from the responsibility of containing the transit losses of coal and therefore needs to streamline its internal control systems. In fact, the Corporation needs to address this issue by reviewing the practices and systems adopted by the generation units of other Power Majors such as NTPC where the quantum of transit loss are contained within the CERC fixed norms.

12.3.3.5 Payment of demurrage charges

Audit observed that during the period from 2006-07 to 2010-11, the Corporation paid ₹ 24.28 crore to the railways as demurrage for detention of wagons beyond free time allowed by Railways which reflects on the inefficiency of the Management responsible for securing the financial interest of the Corporation.

Of the total demurrage of ₹ 24.28 crore paid to Railways, an amount of ₹ 4.62 crore pertained to MTPS where the contractor engaged (February 2007) for unloading of coal was responsible for timely unloading of coal rakes. The Corporation, however, started recovering the demurrage from the dues of the contractor from October 2008 only and recovered an amount of ₹ 3.60 crore out of total amount of ₹ 4.62 crore.

Though the Management stated (December 2011) that the entire amount of demurrage for MTPS was recovered from the contractor, audit verified that an amount of ₹ 1.02 crore was still to be recovered from the contractor (January 2012).

The payment of demurrage to Railways for delayed unloading of Railway wagons and short- recovery/ delayed recovery of amount from the contractor indicates the need for improvement in the internal controls and cost control procedures.

12.3.3.6 Excess un-burnt Carbon in the ash

Operation constraints in the thermal plants of the Corporation, such as inefficient boiler and furnace and turbine operations, resulted in higher percentages of un-burnt coal in fly ash and bottom ash which led to:

(a) Wastage of about 12.19 lakh MT of carbon, equivalent coal valuing ₹ 547.49 crore.

(b) Loss of generation of 4423.15 MU of power

In thermal power stations the coal is fed to the boiler in the pulverized form and in this form about 80 *per cent* of ash goes out as fly-ash and the remaining 20 *per cent* ash is collected as bottom ash. Incomplete combustion of pulverized coal leads to discharge of unfired pulverized coal along with ash resulting in wastage of fuel. The increase of un-burnt carbon in ash also reduces the boiler efficiency.

Audit observed that due to inefficient operations of boilers, furnaces and turbines, the actual quantum of un-burnt carbon in all the four power stations were inordinately higher[1] *as* against the norm[2] of 3 and 1 *per cent* of un-burnt coal in fly ash and bottom ash. The higher quantum of unburnt coal in both the fly ash and bottom ash resulted in wastage of about

[1] ***(a) BTPS bottom ash upto 20-23 percent, fly ash 14 percent (b) MTPS- bottom ash ranged 5-8 percent and fly ash ranged between 1.5 percent to 2.9 percent.***

[2] ***As mentioned by NTPC in their gap report***

12.19 lakh MT of carbon and ₹ 547.49 crore, being the cost of unburnt coal in the ash (**Annexure-XX**) besides loss of generation of 4423.15 MU of power.

It was also noticed that the Corporation engaged NTPC for preparing a Gap Report after analysing the reasons of constraints in achieving higher plant load factor and to suggest measures for increasing the efficiency of operations of thermal units. The NTPC in its Gap Report (December 2010 – May 2011) confirmed the higher percentage of unburnt coal in the ash due to various operational inefficiencies.

Management stated (December 2011) that higher unburnt coal is probably due to receipt of inferior coal.

Audit, however, observed that excess generation of un-burnt carbon was mainly due to operation constraints of the thermal plants such as inefficient operations of boilers, furnaces and turbines which need to be controlled through regular maintenance, renovation and modernization of plants.

Management assured that Renovation & Modernisation (R&M) of plant would be undertaken to increase efficiency of the turbine and boiler to address the issue of high un-burnt carbon in ash.

12.3.3.7 Incorrect reporting of coal consumption

Consumption of coal in thermal power stations is measured either by gravimetric meters or on the basis of turbine heat rate (THR) and boiler efficiency (BE). Thus, gravimetric meter is required to be installed in each thermal power unit which is to be operated in gravimetric mode and synchronized with the coal integrator. However, in case the gravimetric meter is not in operation, the THR and BE are required to be measured on monthly basis for arriving at the actual consumption which is also recommended by NTPC in its Gap Report.

It was, however, observed that in the absence of gravimetric meters/ non synchronization of meters with coal integrators and non measurement of turbine heat rate and boiler efficiency of power plants on regular basis, the coal consumption was measured by the Management on the basis of estimation of receipt and availability of coal at each power station. This deficiency in the system of measurement of coal consumption in all the four power stations was also reported by NTPC in the gap report.

As the consumption of coal is one of the important ingredients in the fixation of power tariff and affects the consumer, the Corporation should have calculated the same very precisely using latest scientific methods.

The Management assured (December 2011) that action was being taken for early installation of latest coal measuring devices in all thermal power stations in phased manner.

12.3.3.8 Excess consumption of oil over CERC norms

In thermal power stations, Oil is used for start-up and stabilization processes. The Central Electricity Regulatory Commission (CERC) has fixed norms for consumption of oil for different thermal for different periods. Audit observed that during the period under review, 3 out of 4 thermal stations consumed 84,820 KL oil in excess of the norms. As the excess consumption of oil was not recoverable through tariff, the corporation suffered loss of ₹ 291.99 crore being the cost of excess consumption of oil.

Management stated (December 2011) that excess consumption of oil was due to non-receipt of designed coal and rainy season when moisture was excessively high and also due to frequent start up of the units.

Examination of records, however, revealed that operational problems in coal mills, coal handling plants, boilers etc were primarily responsible for excess consumption of oil which could have been taken care by regular maintenance of stations.

12.3.3.9 Extra expenditure due to use of costlier fuel oil

The boiler of thermal power station can be operated by using either Light Diesel Oil (LDO) or Furnace Oil (FO). Though the use of FO was comparatively economical and necessary infrastructure of its use was available in three thermal power stations, during the years 2006-07 to 2010-11, the Corporation used LDO in these stations and thus, incurred an extra expenditure of ₹ 162.69 crore. As FO is the main secondary fuel oil for the above units for determination of tariff, this extra expenditure was not recoverable from the consumers.

Management stated (December 2011) that LDO was mainly used during boiler start-up, winter and rainy seasons and due to difficulty in handling of high viscosity FO.

The Management's plea of high viscosity FO is not tenable as the Corporation had already used 0.66 lakh KL of FO during the above period.

12.3.3.10 Absence of Energy Audit

As per the Energy Conservation (EC) Act, 2001, all the power stations are required to carry out energy audit on regular basis for conservation of energy, detection of its wastage and excess consumption of fuel and other consumables for taking remedial action. It was, however, observed that the corporation did not conduct energy audit in any of its power plants (September 2011).

The Management stated (December 2011) that energy audit was being started.

Conclusions

Audit observed that despite the fact that the cost of fuel constituted 70 *per cent*, the Management failed to take appropriate cost control measures to economise the cost of generation of electricity. In fact, proper Systems, and effective internal controls procedures were not in place and, therefore, the fuel management system of the Corporation needs streamlining in all the processes viz. procurement of fuel, transportation of fuel and consumption of fuel. In the absence of an effective sampling system, penal provisions in the agreements with the joint samplers , adequate monitoring of the quality of coal received and follow up action with the coal companies, the Corporation continued to receive inferior grade of coal from the Coal companies which besides having lower calorific value, contained oversized stones and extraneous materials. The Corporation also continued to incur a substantial wasteful expenditure on account of demurrages due to delays in unloading of coal from railway wagons and transit losses of coal due to coal pilferages enroute. Further, due to various operational inefficiencies, a large quantity of fuel was wasted as it remained un-burnt in ash due to imperfect combustion. The consumption of coal was also not measured scientifically for tariff purpose.

In sum, though the Corporation continues to encounter problems relating to procurement, transportation and consumption of fuel, it is yet to conduct energy audit of its power plants to address the issues of conservation of energy, detection of its wastage and excess consumption of fuel etc.

The matter was referred to the Ministry (December 2011); their response was awaited (May 2012).

NTPC Limited

12.4 Loss due to absence of route planning

Due to non-enforcement of contractual terms regarding supplies of imported coal at the optimum landed cost the Company had to incur an avoidable expenditure of ₹ 698.81 crore during 2008-11 on supplies of coal through routes other than optimum routes.

NTPC Limited (Company) entered into an agreement with STC Limited in December 2008 for procurement of 8.25 Million Metric Tonnes imported coal on 'FOR Destination basis' at NTPC Power Stations through various ports in India. The agreement provided that STC shall import the coal through various discharge ports in India in such a way that the landed cost of coal at Power Station(s) is optimum considering the technical viability of coal movement by Railways from port(s) to power station(s). The agreement further provided that in case of port constraints, the import of coal for a particular power station may be routed through alternate suitable ports, with prior permission from NTPC. An agreement with similar terms was entered into by the Company with MMTC Limited also in November 2009 for import of 12.5 Million metric tonnes of coal in 2009-10. STC and MMTC supplied 8.49 Million Metric tonnes and 12.78 Million Metric Tonnes of coal respectively under these agreements to the Company over the period from 2008 to March 2011.

Audit however, observed that during the period 2008 to March 2011, 11.95 Million Metric Tonnes of imported coal (*i.e.* 56 *per cent* of total quantity of coal imported) was supplied by STC/MMTC to various power stations of the Company from the ports other than those which involved least total transportation cost (ocean freight plus inland freight). Excess cost incurred by Company on account of such supplies of coal through non-optimum routes amounted to ₹ 698.81 crore and the supplies from non-optimum routes were made by the MMTC/STC without any permission from the Company. The Company on its part only obtained certificates from the MMTC/STC to the effect that the landed cost of coal supplied was optimum considering the technical viability of coal movement. The Company, however, did not impress upon MMTC/STC to seek its prior permission for such supplies in terms of the agreements. It was further observed that out of total quantity of 11.95 MMT supplied through non-optimum ports, 4.85 MMT (41 *per cent*) was supplied through Mundra port belonging to M/s Adani Enterprises Limited.

Management stated (November 2011/May 2012) that NTPC was importing coal based on delivery at power station and the most optimum route was decided by supplier based on the location of the power station, railway logistic plan, port capability for handling coal cargo, rail freight etc. NTPC had no role to play in deciding the port through which coal was supplied. The question of seeking permission by the supplier from NTPC for supply through other than 'optimum ports' did not arise.

The Ministry endorsed (May 2012) the reply of the Management.

The reply is not acceptable as the Company failed to monitor and enforce the contractual provisions under which the supplier was obliged to supply imported coal to various power stations at optimum landed cost. As the transportation cost is borne by the Company, it should have ensured that the coal is supplied at the least/optimum overall transportation cost by the supplier and any deviations from the least cost/optimum port on account of port or logistic constraints should be permitted only after appropriate cost benefit analysis. The very objective of including the protective clause for a prior permission to import from a non-optimum port, thus, stands defeated.

Power Grid Corporation of India Limited

12.5 Follow up of Audit Para titled "Changes in terms and conditions after opening of bids"

Audit appreciates the action initiated by the Ministry of Power, Government of India in restoring the process of competitive bidding which was vitiated by them/Company due to post bid changes in the tendering process for award of work in two transmission projects.

During 2009-10, Audit had examined the system of bidding carried out by Power Grid Corporation of India Limited (Company) and Ministry of Power, Government of India for award of transmission projects for 'Parbati-II and Koldam hydro projects' and 'Western Region System Strengthening Scheme-II'. We observed that transparency of the bidding process was vitiated by the Company/Ministry by changing bid conditions from 'Build Own Operate transfer' (BOOT) to 'Build Own Operate' (BOO) in both these projects after opening of the bids.

We had recommended that the tender terms and conditions should not be changed after opening of the bids so as to maintain transparency.

Audit Objectives and scope

The objective of audit was to assess the follow-up action initiated by the Company/Ministry on the audit recommendations made in the above audit para.

Gist of Audit Findings

The Audit findings as detailed in Para No.14.3.1 titled "Changes in terms and conditions after opening of bids" of the CAG's Report No.9 of 2009-10 are summarized below:

PGCIL decided to execute two transmission projects[*] through private sector participation on Build, Own, Operate and Transfer (BOOT) basis. International competitive bids *inter alia* providing for buy-out of these projects at the end of licence period of 25 years were invited in February 2004 and November 2005 respectively. Reliance Energy Limited (REL) and Reliance Energy Transmission Limited (RETL) were respectively adjudged as successful bidders for Project 1 (September 2004) Project 2 (November 2006) respectively.

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[*] ***'Part of transmission system for Parbati II & Koldam hydro project' (Project 1) and Projects B and C of Western Region System Strengthening Scheme-II (Project 2)***

Meanwhile, the Government of India issued (January 2006) guidelines for Public Private Partnership (PPP) projects which required clearance of Public Private Partnership Appraisal Committee (PPPAC) for PPP projects with capital costs exceeding ₹100 crore if the projects entailed any contingent liability on the Company by way of buy-out, *etc.*

Against this background, Ministry of Power, Government of India constituted (May 2007) an in-house committee to look into various aspects of competitive bidding for transmission projects which suggested (May 2007) deletion of buy-out provisions (during construction and operation period).

Subsequently, in a meeting taken (6 August 2007) by Secretary Ministry of Power, GOI, it was decided that if the bidders agreed to deletion of the buyout provisions, the case may not require PPPAC approval. Re-tendering was also not considered necessary as deletion of buy-out provisions was seen as hardening of contract conditions for the bidders. Accordingly, the negotiations were held by the Company with the bidders on 29 August 2007 wherein it was agreed to change the project model from BOOT to BOO without any change in bid price.

Audit observed that the bidding process was vitiated on account of change of bid conditions after opening of the financial bids. Though the in-house Committee did not recommend deletion of buy-out provisions at the end of the licence period, this was done by the Company by changing the projects from BOOT model to BOO model by negotiating with RETL/REL after opening the bids.

Action Taken by MOP/ PGCIL on the Audit Para

The Ministry furnished the first Action Taken Note in October 2010 and subsequently, again responded in February 2011 and April 2011. However, the Action Taken Notes were explanatory to the facts stated in the Para and as such no corrective actions were proposed/ taken by the Ministry/Company. In June 2011, Audit sought clarification from the Ministry on the Action Taken stating that change in the terms and conditions after opening of the bids was a violation of the Central Vigilance Commission guidelines and had resulted in undue favour to the licensee.

On being pointed out by Audit during vetting of Action Taken Notes, Ministry approached (August 2011) Central Electricity Regulatory Commission (CERC) requesting them to decide the tariff at the end of the licence period on the basis of buy-out price of ₹ 5 crore quoted by RETL at the end of the concession period as the RETL (the L1 bidder) was selected based on the least NPV of the quoted tariff and the buyout price considered together. Based on the communication from the Ministry and after hearing the concerned parties, CERC issued an order (4 January 2012) in a *suo moto* petition directing that the tariff after the concession period of 25 years (3 years for construction and 22 years for operation) shall be determined on the basis of the buy-out price of ₹ 5 crore quoted by the licensees at the time of submitting their bids for the project.

Audit appreciates the action initiated by the Ministry in restoring the process of competitive bidding which was vitiated by the Company/Ministry due to post bid changes in the tendering process. This action of the Ministry at the behest of Audit would promote transparency in the system of award of contracts.

Ratnagiri Gas and Power Private Limited

12.6 Extension of extra contractual benefit to a private contractor

Ratnagiri Gas and Power Private Limited extended extra contractual benefit of ₹ 12.28 crore to a private joint venture by paying them extra for a repair work which was already their responsibility under the work awarded to them.

Ratnagiri Gas and Power Private Limited (Company), a joint venture of NTPC Limited, GAIL (India) Limited, MSEB Holding Company Limited and Indian Financial Institutions[1] was incorporated in July 2005 to take over and revive the project of Dabhol Power Company.

The job for completing the unfinished work and reviving the LNG Terminal (non-marine works), was divided by the Company (November 2005) in two phases. Phase I involved assessment of balance unfinished work and services at LNG Terminal and Phase II involved the execution of the balance work. The Company, awarded (January 2006) the Phase-I work to the joint venture (contractor) of Whessoe Oil and Gas Limited (UK), Punj Lloyd Limited and Aker Kvaerner Power Gas on nomination basis at a contract price of ₹ 10.89 crore[2]. The work was completed by the contractor in March 2006. The contract for Phase-II work of execution of the balance work, was also awarded (August 2006) to the same contractor on nomination basis at a contract price of ₹ 425.88 crore[3].

As per terms of the contract for Phase-I work, any omission in carrying out correct and adequate assessment, which could impact Phase II cost, was to be made good free of cost by the contractor in the event of phase II contract also awarded to him. Further under terms of Contract for Phase-II work, the Contractor confirmed that the lump sum price of phase-II work was inclusive of any cost that might arise as a result of omission in carrying out correct and adequate assessment in Phase-I work.

Audit observed that during execution of Phase-II, base insulation of LNG Storage Tank T-200 (tank) was found damaged (December 2006) in several areas and water had entered into the tank and seeped into the sand underneath the secondary bottom plates in a section of the tank base. However, in disregard of the contractual obligations, the Contractor refused to make good these defects within the awarded Phase-II contract price stating *inter alia* that it was not possible to verify the damage during assessment as only visual inspection was carried out as per the scope of work. The technical committee constituted by the Company in July 2007 to deal with the issue did not reach any conclusion regarding timing and reasons for the damages and moisture ingress in the tank and recommended for negotiation with the contractor for the cost of removal of moisture ingress and insulation material to complete the base insulation job. The Company constituted (January 2008) another committee to further examine the issue and recommendations of the first technical committee. The second committee also endorsed (June 2008) the findings of first technical committee. The recommendations and findings of the committee were also made available to the contractor by the Company.

A committee negotiated with the Contractor and recommended (January 2009) for award of the rectification job of T-200 tank to the contractor at ₹ 2.92 crore and US$ 1.798

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[1] ***IDBI Limited, State Bank of India, ICICI Bank and Canara Bank***
[2] ***GBP 1,400,000 (1 GBP = ₹ 77.76 on 19.01.2006)***
[3] ***₹ 1,844,251,200 + US$52,038,720 (taking 1 US$ = ₹ 46.40 as on 10.08.2006)***

million. The work was awarded (March 2009) to the Contractor at the negotiated cost of ₹ 12.28 crore*.

Thus, by making extra payment for repair of damage to base insulation of the tank and moisture ingress which was the responsibility of the contractor, the Company extended extra contractual benefit of ₹ 12.28 crore to the contractor.

The Management, while agreeing (January 2011) with Audit that as per contractual provision any defects found at a later stage were to be made good free of cost by the contractor, stated that since the issue was not getting resolved for more than two years despite various efforts, a prudent approach of negotiation was adopted for commissioning of the terminal without any arbitration and litigation. Ministry further stated (January 2012) that Phase-I contractual provision inter alia excluded deconstruction, disassembly and testing for determination of health of plant and equipment and warranties etc. It was also not envisaged to go for such in depth assessment on account of the time and cost consideration and such a damage underneath the tanks could not have been anticipated by any reasonable diligence. Moreover, the Board had considered available technical advice, contractual provision, contractor's view point and possible choices at the time of taking the decision of awarding the rectification work of T-200 tank.

We do not agree with the Management/Ministry because:

- Non-resolution of the issue for more than two years does not justify Management's decision to get the rectification done at their own cost particularly when delay in the tank repair was in fact, not delaying the entire revival project.
- Exclusion provision of Phase-1 contract as referred in the reply stated that extra liability of the Company because of any deconstruction, disassembly and testing at site or in vendor's shop for determination of health of plant and equipment and warranties etc. would arise only when such activities were carried out at the instance of the Company. It did not limit the scope of the contractor who was responsible for identification of equipment requiring inspection by respective vendor during the assessment study.
- The Phase-II contract was awarded at a lump sum price higher than the estimated cost by 11.2 *per cent* and as per terms of the agreement, this was inclusive of any cost that might arise as a result of omission in carrying out correct and adequate assessment. This corroborates the fact that the contractor had already loaded the above risks in the price.
- As per contract provision it was entirely the responsibility of the contractor to rectify the damages to the T-200 tank at his own cost. Further, it was amply clear from the legal opinion on the issue sought by the management that the Contractor was bound to honour his commitments set out in the contract. Therefore, Management's decision to accept extra cost beyond the contractual provision was not justified. In fact, making available to the contractor a copy of the Report of the technical committee which recommended negotiations with the contractor undermined Management's position to firmly deal with the contractor and direct him to carry out the work as per contractual provisions. The entire process, thus, lacked transparency in resolution of the issue.

Thus, the Company made an extra payment of ₹ 12.28 crore to the contractor for repairing the damage to base insulation and moisture ingress of tank which was, in fact, the responsibility of the contractor under the terms of the contract. The Management's acceptance and payment of an extra amount to the contractor reflects adversely on its purchase governance systems and negotiating acumen.

CHAPTER XIII: DEPARTMENT OF ROAD TRANSPORT & HIGHWAYS

National Highways Authority of India

13.1 Review of operations of Special Purpose Vehicles (SPVs) formed for implementation of Port Road Connectivity to major Ports

Introduction

The National Highways Authority of India, constituted by an Act of Parliament in 1988 is responsible for the development, maintenance and management of National Highways. The Cabinet Committee on Economic Affairs (CCEA) approved (December 2000) a proposal of the Ministry of Surface Transport (November 2000) to provide four lane connectivity to the major ports in the country on Build, Operate and Transfer (BOT) basis through Special Purpose Vehicles (SPVs). Accordingly, NHAI formed nine[♠] SPVs for implementation of Port Road Connectivity (PRC) projects envisaging construction and up gradation of PRC of 393 kms. at an estimated cost of ₹ 1824 crore.

Audit examined records of SPVs, made available by them at NHAI Corporate Office and at their respective project offices, with a view to assess effectiveness of SPVs in implementing PRC projects at major ports.

Audit Findings

13.1.1 Planning

It was observed in audit that no defined Corporate or Strategic Plan was prepared for execution of SPV projects with the result none of the project was completed by its scheduled date of completion. NHAI while admitting (November 2009) the fact of not having a separate plan for PRC projects stated that the same was included in the NHAI plan. It is worthwhile to mention that the NHAI got prepared its Corporate Plan only in May 2009 which was approved by NHAI Board in August 2009.

13.1.2 Sources of Funding

As per CCEA's approval, NHAI was required to contribute only 30 *per cent* of the total project cost of ₹3157.05 crore as equity, which worked out to ₹ 947.12 crore. However, NHAI contributed 54 *per cent* of funds amounting to ₹ 1716.32 crore (Equity - ₹749.11 crore, Borrowing/Sub-debt-₹ 967.21 crore) which led to additional financing of ₹769.20 crore for these projects. Thus adequate financial arrangements from sources other than NHAI were not explored prior to execution of projects. CCEA further deliberated that cess funds were not to be utilized for PRC projects. However, NHAI utilized cess funds towards the project cost in contravention of CCEA approval for which no action was initiated to obtain ex-post facto approval. *Management in its reply (January 2010)*

[♠] ***(i) Mumbai JNPT Port Road Company Limited-MJNPTPRCL(ii) Vishakhapatnam Port Road Company Limited-VPRCL (iii) Paradip Port Road Company Limited-PPRCL (iv) Cochin Port Road Company Limited-CPRCL (v) Mormugao Port Road Company Limited-MPRCL (vi) New Mangalore Port Road Company Limited-NMPRCL (vii) Calcutta-Haldia Port Road Company Limited-CHPRCL (viii) Chennai-Ennore Port Road Company Limited-CEPRCL (ix) Tuticorin Port Road Company Limited-TPRCL*** *confirmed the facts of the para.* Thus the very purpose of creation of SPVs for sourcing funds on project recourse basis, other than from cess funds, was defeated.

13.1.3 Delay in formation of SPV

The CCEA in its approval to the proposal for implementation of PRC projects had stipulated award of these projects by March 2002. Audit, however, observed that only five[1] SPVs were incorporated in December 2000 and remaining four[2] in January 2004 i.e. after 21 months of the date stipulated above. This resulted in delay in award and execution of projects. In case of Paradip project, bids were received in March 2003, however, the contract was awarded after elapse of ten months time (January 2004) when SPV was formed. *The Management stated (January 2010) that delay up to January 2004 occurred due to delayed formation of SPV as there was no site office to initiate proceedings and thereafter due to litigations related to land acquisition.*

13.1.4 Detailed Project Reports

Preparation of accurate and realistic Detailed Project Report (DPR) is critical factor for project planning. However, the following deficiencies were noticed in the preparation of DPR:

(i) The Mormugao PRC project was initially being executed by Mormugao Port Trust (MPT). Subsequently, GOI, Ministry of Surface Transport (MOST) transferred (March 1999) the project to NHAI. Accordingly, Mormugao Port Road Company Ltd. (MPRCL) took over execution of the project from 1 April 2001 onwards. Audit observed that a stretch of 1.8 km. between Gate No. 1 of Mormugao Port and the nearest end of the above road project i.e. Sada junction, was neither included in the initial DPR prepared by MPT nor in the PRC project undertaken by MPRCL, which resulted in non establishment of full connectivity to the Mormugao Port.

Management stated (January 2010) that as Sada junction was in centre of Gate No. 1 and 9, it could be approached from either gate.

Management's reply confirmed that the stretch of 1.8 kms would remain un-connected even after completion of PRC project. Thus, because of non-inclusion of this 1.8 kms stretch in the scope of work, the objective of providing connectivity to the port could not be achieved.

(ii) Cochin

The DPR prepared for Cochin PRC project envisaged upgradation of 16.750 kms. of NH-47 from Edapally to Aroor. The above stretch passes through Kundannoor which is the nearest point to Cochin Port. The Port is about 10 kms. away from Kundannoor and connected by two lane road. The DPR, however, did not incorporate upgradation of this road. Thus despite completion of PRC project by CPRCL in January 2011, the objective of developing adequate road connectivity to the Port remained unachieved due to non upgradation of the existing two lane road connecting the port.

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[1] ***(i) Calcutta-Haldia PRCL (ii)Vishakhapatnam PRCL (iii)Chennai-Ennore PRCL (iv)Mormugao PRCL and (v)Mumbai JNPT PRCL***

[2] ***(i) Paradip PRCL ((ii))Cochin PRCL(iii)Tuticorin PRCL and (iv)New Mangalore PRCL***

13.1.5 Project Management

13.1.5.1 Though NHAI set up nine separate SPVs for timely connectivity of the ports but there were cases wherein time as well as cost overrun were observed in completed[1] as well as incomplete[2] projects. Reasons for delays were mainly attributable to land acquisition problems, Resettlement and Rehabilitation (R&R) problems, traffic congestions on port road and termination of contracts. Out of nine projects, the original contract was terminated in case of four[3] projects, between April 2007 (Calcutta-Haldia) and November 2009 (Tuticorin) due to slow progress of work, land acquisition and R&R issues. These contracts were re-awarded during April 2008 (Calcutta-Haldia) to January 2011 (Chennai-Ennore) which led to delay in completion of the projects. The actual cost of four completed projects was ₹ 1146.86 crore against the initial estimated cost of ₹ 947.40 crore, with cost overruns of 21.05 *per cent*. As regards five incomplete projects, ₹ 879.05 crore was incurred against initial estimates of ₹ 946.00 crore.

13.1.5.2 Works Manual of NHAI stipulated that entire process from the date of receipt of bids to award of contracts should generally be completed within 40 days. Audit however observed that in contravention to the above provisions the Management took 52 to 321 days beyond the above stipulated period, for finalization of contracts in following projects:

Sl. No.	Project	Date of opening of bids	Date of finalisation of contract	Days taken in finalisation beyond 40 days	Reasons for delay
1	New Mangalore	28-02-05	31-05-05	52	Procedural delays
2	JNPT - Phase II	30-01-04	28-09-04	201	Procedural delays
3	Paradip	21-03-03	29-01-04	274	Delay in formation of SPV
4	Haldia	06-09-07	01-09-08	321	Revision in cost after opening of bids.

The delays in finalisation of contracts led to delay in completion of the above projects.

13.1.5.3 Reasons for time and cost overrun observed in the following projects were as under:

(i) The JNPT–Phase II project was completed on 31 December 2008 except for a stretch of 2.350 Kms (from 10.650 Kms to 13.000 Kms) at State Highway-54. The non-completion of the stretch was due to non-acquisition of land of the desired width. As per DPR, the land width required was 60 meters while the land available with City and Industrial Development Corporation of Maharashtra Ltd (CIDCO) was of 30 meters width only. Audit observed that actual verification of the available land was not done by the SPV while taking over the land from CIDCO. This issue remained unresolved and the required land was yet to be acquired (January 2012). The delay of 19 months in

[1] ***Mumbai JNPT, Vishakhapatnam, Paradip and Cochin***

[2] ***Mormugao, New Mangalore, Calcutta-Haldia, Chennai-Ennore and Tuticorin***

[3] ***(i)Calcutta-Haldia (ii) Chennai-Ennore (iii) Tuticorin and (iv)Cochin projects were terminated between April 2007 and November 2009***

completion of the project resulted in cost overrun of ₹ 35.41 crore up to the date of completion (December 2008) i.e. by 24.76 *per cent* of original cost.

(ii) In Paradip Port Road project, the truck handling capacity of the port was limited which was not foreseen by the Company, though the increase in cargo traffic was projected in the DPR. Despite increase in cargo traffic, Paradip Port Trust (PPT) did not increase its truck handing capacity and this led to frequent traffic jams on the existing two lane road. The assurance given (May 2005) by the Government of Orissa (GoO) to make available 16 acres of land for parking trucks also did not materialise in the absence of State Support Agreement. PPRCL could not formulate adequate remedial measures for traffic congestion at the construction site. As a result, the project completion was delayed by 28 months resulting in escalation of the project cost by ₹ 88.16 crore, i.e., by 20.62 *per cent* of the original cost.

(iii) In case of Mormugao project, out of total 18.3 kms. stretch only 13.1 kms. was completed in May 2004. The balance 5.2 kms. could not be completed so far (February 2012) for want of encumbrance free land. Further, the work was not likely to be completed in near future also for the reasons like unanimous decision passed (August 2008) by the Legislative Assembly of Goa for not taking up the remaining work involving displacement of hundreds of people, non existence of State Support Agreement with the State Government of Goa and withdrawal (June 2011) of clearance by Coastal Reserve Zone Management Authority. Therefore the adequate port road connectivity, as envisaged in NHDP Phase-I, was not established.

13.1.6 Toll Collection Operations

13.1.6.1 Completed Projects

As per Rule 3(1) of National Highways Fee (Determination of Rates and Collection) Rules 2008, the Central Government may by notification, levy fee for use of any section of National Highways. Rule 3(2) of the aforesaid Rules provided further that collection of fee (i.e. Toll) should commence within 45 days from the date of completion of the project. Audit, however, observed short realization of revenue amounting to ₹ 127.68[1] crore due to delay in collection of toll in the following cases:

(i) ***Mumbai JNPT:*** The project road being a State Highway the toll notification was to be issued by the Government of Maharashtra (GoM) as per Memorandum of Understanding between NHAI, JNPT, CIDCO and GoM. The Mumbai JNPT-II was completed on 31 December 2008. The Notification was however issued (November 2010) after delay of 21 months and toll collection of user fee started from 25 November 2010. After collection of user fee for 33 days, the toll collection was stopped (27 December 2010) due to agitation by local people who raised various demands including widening and completion of stretch of 2.350 kms. As already mentioned at Para 13.1.5.3(i) above, the said stretch of road was left incomplete due to lapse on the part of the NHAI in verifying the land of desired width while taking over the same from CIDCO. Based on the average revenue earned during the period of 33 days toll collection, the SPV incurred revenue loss of ₹ 21.73[2] crore due to 21 months' delay in issue of Notification. The SPV also incurred loss of ₹ 12.37[3] crore due to non resumption of toll

[1] ***₹127.68 crore = ₹21.73 + ₹12.37 + ₹1.34 + ₹90.32 crore + ₹1.92 crore***

[2] ***Revenue loss of ₹21.73 crore = ₹3,35,427 x 648 days***

[3] ***Revenue loss of ₹12.37 crore= ₹3,35,427 x 369 days***

collection from 28.12.2010 to 31.12.2011. The SPV would be incurring further losses till resumption of toll operations.

(ii) ***Cochin***: The project was completed on 31 January 2011, however, Toll Notification was issued (31 March 2011) after 59 days and toll operations commenced (17 June 2011) after 77 days from the date of such Notification were suspended on the very first day due to agitations by local people. The Toll collection could be resumed (17 July 2011) after a period of 29 days. Based on the user fee collected on the first day, the Company short realized revenue to the extent of ₹ 1.34 crore[1].

(iii) ***Paradip***: As brought out in Para 13.1.5.3(ii) above, completion of the Project was delayed by 28 months due to non-cooperation by PPT and GoO. Based on the revenue projections made in the detailed Traffic Survey Report (May 2006) of the Project, the Audit worked out an amount of ₹ 90.32 crore, towards loss of potential toll revenue for the above period, which remained unrealized. Further, in absence of State Support Agreement with the Government of Orissa, the Company was unable to enforce (4 July 2009 to 30 September 2009) collection of toll fee from vehicles bearing Orissa registration number, till a decision was taken in a meeting held by the Chief Secretary, GoO to start collection of toll fee since 1 October 2009 from all vehicles. The Company, however, sustained revenue loss of ₹ 1.92 crore[2] due to non collection of toll.

13.1.6.2 Incomplete Projects

The initial scheduled date of completion of Mormugao, Calcutta-Haldia, New Mangalore, Chennai-Ennore and Tuticorin projects was March 2003, March 2005, December 2007, April 2006 and August 2006. However these projects could not be completed in time due to reasons like termination of original contracts and re-award of work, slow progress, land acquisition and R&R issues etc. and the work was still (December 2011) in progress.

Based on traffic /revenue projections given in DPR and Traffic Surveys got carried out by NHAI, from time to time through various agencies, the Audit worked out potential loss sustained by the concerned SPVs so far (December 2011), due to non-completion of these projects in time, as ₹ 873.85 crore[3].

Conclusion

CCEA while granting approval in December 2000, to provide four lane connectivity to the major ports in the country on BOT basis through SPVs, had directed NHAI to award contracts for PRC projects by March 2002. Accordingly, these projects were expected to be completed within a period of 2-3 years of award of contract. NHAI/SPVs, however, did not prepare Corporate/Strategic Plan for timely implementation of these projects. Delay in formation of SPVs and award of contracts was observed in various projects. Resultantly, none of the projects was completed by the scheduled completion date. Out of total nine projects, only four were completed so far with delays ranging from 12 months (JNPT Phase-I) to 53 months (Cochin) and remaining five projects were yet to be completed (December 2011). At Mormugao and Cochin ports, a road stretch of 1.8 kms. and 10 kms.,

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[1] ***Revenue loss of ₹ 1.34 crore=₹ 1,11,520 x 120 days {Total delay (59+77+29)– 45 days required for commencement of toll = 120 days)}***

[2] ***₹ 1.92 crore=89 days x ₹ 2.16 lakh per day***

[3] ***Mormugao ₹ 20.54 crore, Calcutta-Haldia ₹ 294.64 crore, New Mangalore ₹ 172.73 crore, Chennai-Ennore ₹ 173.66 crore and Tuticorin ₹ 212.28 crore= Total ₹ 873.85 crore***

respectively, at the port end could not be upgraded due to non incorporation of these stretches in respective DPRs. Thus upgraded road connectivity to Mormugao and Cochin Ports could not be established. Further, due to ineffective toll collection operations of SPVs, toll collection was either delayed or suspended and SPVs sustained revenue loss of ₹127.68 crore. Potential loss of toll revenue, due to delay in completion of PRC projects, worked out to ₹ 873.85 crore (December 2011).

The matter was reported to Ministry in March 2012, reply was awaited (May 2012).

13.2 Non-recovery of penalty from Concessionaires

Failure of Management to recover penalty for delayed completion of work as per Concession Agreements resulted in non-realisation of ₹ 90.30 crore from Concessionaires and avoidable loss of ₹ 17.15 crore (till December 2011) towards interest on the above amount.

National Highways Authority of India (the NHAI) signed three Concession Agreements (CAs) dated 30 January 2006, 20 April 2006 and 30 June 2006 for up-gradation of Namakkal–Karur, Karur-Dindigul and Ulundurpet-Padalur road stretches, respectively, in the State of Tamilnadu, on Build, Operate and Transfer (BOT) basis.

As per an identical clause 16.5 included in the aforesaid CAs, the Independent Consultant (IC) could, at the request of the Concessionaire, issue a provisional certificate of completion (PCC), after obtaining approval from NHAI, in respect of work completed substantially. The IC was required to append to the PCC a list of outstanding items (Punch List items) prepared in consultation with NHAI and signed jointly by the IC and the Concessionaire. All Punch List items were required to be completed by the concessionaire within 120 days from the date of issue of the PCC. The above clause further stipulated that Certificate of Completion of the work would be issued by the IC, only after completion of Punch List items by Concessionaire to the satisfaction of the IC. NHAI was entitled to terminate the agreements if the Concessionaire failed to complete Punch List items in the manner set forth in the above clause.

In case of any delay in completion of the Punch List items beyond the aforesaid period of 120 days, NHAI was entitled to get the Punch List items completed based on the cost estimated by the IC and recover the cost of completion of Punch List items from the concessionaire. In addition NHAI was also entitled to recover directly from the Escrow Account, a sum equal to 200 *per cent* of such cost (subject to minimum of ₹ 0.10 crore) towards penalty.

The PCCs in respect of three stretches were issued on 21 August 2009 (Namakkal-Karur), 04 November 2009 (Karur-Dindigul) and 04 September 2009 (Ulundurpet-Padalur) respectively. However, the concessionaires did not complete Punch List items within the stipulated period of 120 days after issue of PCC. Therefore, the concerned ICs recommended penalty, in terms of provisions of clause 16.5 of CAs, amounting to ₹ 1.37 crore (Namakkal–Karur), ₹ 52.00 crore (Karur-Dindigul) and ₹ 36.93 crore (Ulundurpet-Padalur) on 16 August 2010, 18 June 2010 and 11 December 2010, respectively. Subsequently, the pending Punch List items in respect of all the three sections were completed/almost completed by the respective Concessionaires, though after the stipulated period of 120 days. Final completion certificates in respect of the three sections were yet to be issued. The NHAI, however, did not recover the recommended amount of penalty of ₹90.30 crore from the concessionaires due to indecisiveness of the Management. The loss of interest on the above amount was ₹ 17.15 crore[1] (till December 2011).

The Management stated (January 2012) that opinion from legal consultants as to "whether NHAI in terms of clause 16.5 of concession agreement entitled to recover the penalty of 200 per cent of the cost of the work remaining balance after 120 days, even if the balance work was continued and completed by the concessionaire itself" had been obtained. NHAI further stated that as imposition of penalty was of general nature and would affect almost all the BOT projects of NHAI, the legal opinion would be put up to Executive Committee for deliberation and taking a final decision.

The above reply was not acceptable in view of the fact that while on the one hand, the PCCs enabled the Concessionaires to collect huge toll revenues amounting to ₹ 192.25[2] crore without extending the benefit of complete infrastructure facility to the public at large during the period August 2009 to June 2011, on the other hand they failed to fulfil their contractual obligation of completing Punch List items within the stipulated period of 120 days. Further, there was no ambiguity in the agreement as clause 16.5 prescribed completion of work in its entirety within a stipulated time frame and gave exclusive rights to NHAI to recover penalty, which was in addition to recovering cost of completion of Punch List items which were delayed.

Thus indecisiveness of the Management on recommendations made by ICs, for recovery of penalty from Concessionaires resulted in non-realisation of ₹ 90.30 crore from the Concessionaires and consequent avoidable loss of ₹ 17.15 crore (till December 2011) towards interest on the above amount.

The matter was reported to Ministry in January 2012; reply was awaited (May 2012).

13.3 Loss of Revenue due to inordinate delay in construction of toll plaza

Mismatch in completion of road stretch and toll plaza with required number of lanes resulted in avoidable loss of toll revenue of ₹ 28.38 crore (up to September 2011). The Authority would be suffering further recurring loss of ₹ 1.75 crore per month till toll collection is resumed.

National Highway Authority of India (the Authority) executed the work of four laning on Purnea-Dalkhola section (62.14 Kms.) of NH-31 in the State of Bihar and West Bengal, under East-West Corridor of National Highways Development Programme (NHDP) Phase-I and completed the work on 7 April 2010. The Government of India notified in Gazette notification (5 January 2010) commencement of collection of fee on the above section of NH-31 within 45 days from the date of publication of the notification or within 45 days from the date of completion of the notified stretch, whichever was later.

The Authority started collecting user fee at Surjapur toll plaza on the above stretch from 19 August 2010. However, due to resentment among locals against the toll rates and traffic congestion due to non provision of adequate lanes, the District Magistrate, Uttar Dinajpur directed (28 August 2010) NHAI to suspend operation of toll plaza on grounds

[1] ***At 10 per cent per annum***

[2] ***Ulundurpet-Padalur ₹118.17 crore, Dindigul-Karur ₹43.09 crore and Namakkal-Karur ₹30.99 crore***

of law and order problem till resolution of these problems. Accordingly the Authority suspended operation of toll plaza since 10.25 AM on 28 August 2010.

Audit observed that:-

- The location of the toll plaza was not planned initially at the DPR stage. After deciding the location in September 2007, the intention to acquire the land under Section 3A of National Highways Act, 1956 was notified two years later (October 2009), while 3 D notification for land acquisition was issued (September 2010) after delay of one year. Even after lapse of another one year, handing over of the additional land acquired for Surjapur toll plaza to Authority was awaited (August 2011). This indicated inadequate planning of the Management in acquisition of land leading to delayed construction of the toll plaza.
- There were inordinate delays in tendering of OMT (Operation, Maintenance and Tolling) package under which Surjapur toll plaza was initially proposed to be constructed. After deciding the location of toll plaza in September 2007, the Authority took 18 months in initiating tendering process by inviting RFQ from the prospective bidders in March 2009. After opening bids the package was scrapped (September 2010) as the bids received were not considered viable.
- The Authority was required to start collecting user fee by 23 May 2010 i.e. within 45 days from the date of completion (7 April 2010) of the aforesaid four lane stretch, in line with the GOI notification dated 5 January 2010. However, the process of appointment of a fee collecting agency for the above stretch was kept in abeyance as the new policy for appointing such agency was under consideration by the Authority. Subsequently, the new policy framed in June 2010 authorised field units to collect toll departmentally for three months or till the fee collection agency was appointed through open competitive bidding, whichever was earlier. The Authority started collecting user fee departmentally from 19 August 2010. This indecisiveness led to delay of 88 days in starting toll operations.
- Thus due to imprudent planning and indecisiveness on the part of the Management the user fee could not be collected on the above stretch in contravention of the GOI Gazette Notification dated 5 January 2010. Based on the average daily collection of ₹ 5.84[1] lakh the revenue loss to the public exchequer was to the extent of ₹ 28.38[2] crore (up to September 2011).

Management replied (May, 2011) that:

- *Construction of a permanent toll plaza 4+4 lane with one additional lane at Surjapur toll plaza was earlier in the scope of another OMT package which was not finalized. Selection process of toll agency was stopped in view of a new policy under consideration. Thereafter, the user fee collection was started departmentally with 2 lane temporary booth which had been suspended.*

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[1] ***Total toll collection during period 19-8-2010 to 28-8-2010 = ₹58.43 lakh/ 10 days= ₹5.84 lakh per day***

[2] ***Loss for 88 days (i.e. 23-5-2010 to 18-8-2010)= 88 days*₹5.84 lakh = ₹5.14 crore***
Loss for 398 days (i.e. 29-8-2010 to 30-9-2011)= 398 days* ₹5.84 lakh =₹23.24 crore
Total ₹28.38 crore

- *Due to non-construction of a permanent toll plaza, the tollable section is not complete as per fee rules.*

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

- The Authority failed to comply with its own circular dated 30 September 2003 which stipulated construction of toll plaza, inclusive of plaza office complex, toll booths, extra lanes, paving of medians etc. which should be completed prior to the publication of the fee notification and preferably within 90 days prior to the anticipated completion of 4 laning of the section.
- Completion certificates for different sections of the whole stretch were issued between March 2004 and April 2010 and toll collection was also started with effect from 19 August 2010 by the Authority. As such, contention of the Management regarding incompleteness of tollable section was not acceptable.

Thus, mismatch in completion of road stretch and toll plaza with required number of lanes resulted in loss of toll revenue of ₹ 28.38 crore (up to September 2011). The Authority would be suffering further recurring loss of ₹ 1.75 crore per month (₹ 5.84 lakh*30 days) till the toll collection is resumed.

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

13.4 Loss due to avoidable payment of interest

Moradabad Toll Road Company Limited (Company) was formed in August 1998 by NHAI as its subsidiary Company to construct, develop and maintain two lane Moradabad Bypass. The Company became unviable due to insufficient toll collection and Government's subsequent decision for upgradation of Moradabad–Bareilly section of NH-24 (which included the above Bypass) under NHDP. In view of the above, MTRCL Board decided (September 2008) to wind up the Company and requested NHAI (December 2008) to release funds for settlement of term loans of SBI/IDFC. However, the NHAI delayed its decision, till August 2011, to release funds as desired by the Company. Eventually, the Company incurred an additional expenditure of ₹8.64 crore towards interest on the aforesaid term loans.

National Highways Authority of India (NHAI) formed (August 1998) under the Companies Act, 1956 a special purpose vehicle (SPV) viz. Moradabad Toll Road Company Limited (Company) as its subsidiary Company with equity capital of ₹ 30 crore, with the purpose to construct, develop and maintain the two lane Moradabad Bypass from Km. 148.43 to Km. 166.650 of NH-24. The estimated cost of the project was ₹ 103.50 crore.

The Company availed, during January 2001 to June 2002, term loan of ₹ 50.65 crore from Industrial Development Finance Corporation (₹ 28.10 crore) and State Bank of India (₹ 22.55 crore) to meet the gap of funding. Phase-I and Phase-II of the project were completed on 20 June 2001 and 02 July 2002, respectively and commercial operation was started from next day of completion. However, due to wide variation in envisaged and actual toll revenues, the revenue of the Company remained insufficient even to meet its expenses like office and administrative expenses, toll operation and maintenance expenses etc. which were met out of the loan extended by NHAI to the Company from time to time. Resultantly, the Company sustained losses since beginning and its share capital was fully eroded in the year 2007-08.

In the meantime, the Government of India, Ministry of Road Transport and Highways approved (April 2007) four laning of Moradabad–Bareilly section (including Moradabad Bypass) of NH-24 on BOT basis, under Phase III B of National Highways Development Programme (NHDP). The Board of Directors of the Company, in its meeting held in September 2008, considered that in view of the above developments, existence of the Company would become unviable and decided to wind up the Company after working out exact modalities for takeover of Company's project by NHAI. After award (December 2009) of the work by NHAI the Company handed over (December 2010) its assets to the concessionaire M/s. Moradabad Bareilly Expressway Limited for four-laning of the above stretch. Subsequently, the Company availed loan from NHAI and re-paid (August, 2011) the entire amount including interest on outstanding term loans of ₹ 17.82 crore to IDFC (₹ 9.93 crore) and SBI (₹ 7.89 crore).

Audit observed that NHAI was aware that apart from the fact that the Company was incurring losses since beginning due to insufficient toll collection, its existence had further become unviable due to Government's decision of four laning of Moradabad–Bareilly section of NH-24 under Phase III B of NHDP. NHAI was also aware about the decision (September 2008) of the MTRCL Board to wind up the Company and Company's further decision (December 2008) to request NHAI to release funds for settlement of above mentioned term loans of SBI/IDFC. However, despite having sufficient surplus funds and also knowing the fact that the Company had become unviable in the changed scenario, the NHAI delayed its decision to release the amount to repay the loan of the Company taken from SBI and IDFC. Finally in August 2011, it released funds as desired by the Company.

The Company had to bear an additional expenditure of ₹ 8.64 crore towards interest on the aforesaid term loans which would have been avoided had a timely decision been taken by NHAI.

The Management of the Company stated (April, 2010) that it being a separate entity, the loans taken by it were the exclusive responsibility of the Company and NHAI was not bound to take over the liability. The views of the Company were also endorsed by NHAI (July 2010).

The reply was not acceptable as MTRCL was a 100 *per cent* owned subsidiary of NHAI and had become unviable as its income from the only source, namely toll operations, became inadequate to repay the loans. The assets were transferred to another concessionaire in December 2010, thereby defeating the possibility of any profitable operation. The chances of realisation of the amount of loan as well as interest thereon shown by NHAI in its accounts as recoverable from MTRCL, are remote.

Thus, due to delay in releasing loan by NHAI to the Company for repayment of outstanding loan of the later, the Company incurred an extra expenditure of ₹ 8.64 crore towards interest and sustained an avoidable loss to the same extent.

The matter was reported to Ministry in April 2012; reply was awaited (May 2012).

CHAPTER XIV: DEPARTMENT OF SHIPPING

Dredging Corporation of India Limited

14.1 Management of fuel

14.1.1 Introduction

14.1.1.1 Dredging Corporation of India (the Company) provides integrated dredging services to ports, Indian Navy, Shipyards and others. The Company operates two types of dredgers, viz., Cutter Suction Dredgers (CSDs) and Trailer Suction Hopper Dredgers (TSHDs). CSDs are used for capital dredging works which involves channel deepening and widening to accommodate larger vessels. TSHDs are used for maintenance of dredging which ensures that channels and berths are maintained at the required depth. The Company owned three CSDs and 10 TSHDs as of 31 March 2011.

14.1.1.2 The expenditure on fuel and lubricants constitutes, on an average, 39 *per cent* of the total operational expenses as shown below:

Year	Operational expenditure (₹ in crore)			*Per cent* of cost of fuel and lubricants to total cost
	Fuel and Lubricants	Others	Total	
2007 – 08	202.35	320.36	522.71	39
2008 – 09	202.75	468.22	670.97	30
2009 – 10	172.17	312.62	484.79	36
2010 – 11	199.48	129.79	329.27	61*
Total	**776.75**	**1230.99**	**2007.74**	**39**

Abnormal increase in per cent in 2010-11 was due to high cost of fuel coupled with low expenditure on spares and stores and repairs & maintenance.

14.1.1.3 The audit was conducted covering the activities of the Company relating to planning, procurement, consumption, monitoring etc. of fuel and lubricants to assess its impact on the profitability of the Company during 2007-08 to 2010-11. The sample selected for the study was fuel expenditure incurred by the Company on all the 10 TSHDs owned and three TSHDs hired by the Company which constituted 91 *per cent* to 98 *per cent* of the total cost of fuel and lubricants.

14.1.2 Audit Findings

14.1.2.1 Planning

The Company has been in the business of dredging for the past 35 years but has not done or commissioned a study to determine norms for fuel consumption by dredgers to achieve fuel efficiency, more so given that fuel and lubricants cost nearly $2/5^{th}$ of the operational expenditure of the Company. Further, it is seen that the MoU norms for fuel consumption decided by the Company were much higher than the previous year's consumption as well as the builder's norms. The year – wise details are presented below:

Dredge No.	Builder's norm of fuel consumption (at Company's operating level of up to 70*per cent* MCR) KL/ day	2007-08		2008-09		2009-10		2010-11		Average of best performance for 6 years ending 2010-11 KL/day
		MoU norm KL/day	Actual consump-tion rate KL/day	MoU norm KL/day	Actual consump-tion rate KL/day	MoU norm KL/day	Actual consump-tion rate KL/day	MoU norm KL/day	Actual consump-tion rate KL/day	
V	8.41	8.65	7.96	8.65	7.62	8.65	6.51	8.65	6.33	6.66
VI	8.41	8.65	7.32	8.65	6.65	8.65	7.47	8.65	7.75	6.61
VIII	9.99	14.30	13.41	14.30	10.79	14.30	10.41	14.30	11.10	11.10
IX	18.07	18.10	18.33	18.10	19.26	18.10	18.19	18.10	16.82	16.15
XI	18.07	18.10	19.34	18.10	15.07	18.10	12.09	18.10	16.85	18.36
XII	13.99	17.60	16.49	17.60	17.65	18.10	16.77	18.10	17.38	15.86
XIV	13.99	17.60	19.91	17.60	17.00	18.10	16.03	18.10	15.98	15.87
XV	19.39	24.50	23.68	24.50	23.61	26.00	21.25	26.00	23.97	22.01
XVI	19.39	24.50	24.39	24.50	24.90	26.00	23.67	26.00	25.00	18.21
XVII	19.39	24.50	24.32	24.50	23.50	26.00	25.21	26.00	24.50	21.89
Overall		**17.90**	**19.07**	**17.90**	**17.72**	**19.00**	**15.47**	**19.00**	**16.60**	

The Company had brought out some operational guidelines for achieving fuel efficiency. However, there was nothing on record to prove that the guidelines were conveyed to the dredgers and any suitable mechanism was laid down to monitor their adherence. Fuel consumption higher than builders' norms led to an excess expenditure of ₹ 85.71 crore during the period under audit.

The Ministry replied (January 2012) that the fuel consumption was arrived at on the basis of Specific Fuel Consumption data given by the Original Equipment Manufacturers for the equipments. Bringing out the multiple factors influencing fuel consumptions, the Ministry stated that dredger wise and port wise standardisation could not be carried out inspite of appointing The Energy and Resources Institute (TERI) to evolve a specific fuel consumption norm per dredger.

The reply of the Ministry is not tenable as the final fuel consumption targeted was higher than the builders' norms. Further, the Company has been in the business for 35 years and is aware of the all the factors that influence the fuel consumption and hence, the reply that the multiple factors make it impossible to fix levels of consumption is not satisfactory. The study conducted by TERI (November 2004) was only for the purpose of ascertaining whether the engines were performing well by studying the consumption pattern of one of the ten dredgers of the Company and hence this study was not relevant to the audit point.

The Company has agreed to consider the recommendations of audit for further study and called budgetary quotes from Indian Register of Shipping, Lloyds Register of Asia, Petroleum Conservation Research Institute, Bureau Veritas and Indian Oil Corporation of India Limited for conducting a study on the present fuel consumption by all DCI dredgers and to suggest suitable norms for fixation of fuel consumption for each dredger.

14.1.2.2 Procurement

As per the Company's Manual on Purchase Procedure, open tender enquiry is to be issued in cases where the estimated tender value is ₹ 50 lakh or more for products whose prices are not controlled by the Government. However, for the procurement of fuel and lubricants, the Company never invited tenders and sourced its entire requirement of Light Diesel Oil (LDO) and High Flash High Speed Diesel (HFHSD), both of which it used during the period under audit, only from Indian Oil Corporation Limited (IOCL) on the ground that IOCL alone is capable of supplying bunkers at all the dredging locations where it operates and that the prices of fuel is controlled by the Government. Further, it did not obtain any specific approval of the Board of Directors for deviating from its approved procedure. Moreover, the Company did not follow regular internal control procedures like (a) sending of indent by the competent authority to the Material Management Department; (b) placing a formal purchase order or entering into a long term fuel supply agreement with IOCL; (c) obtaining specific approval of competent authority before placing order etc.

Further, the Company lost an opportunity of availing a reduction in fuel costs by ₹ 3.38 crore on the 18,790 KL of LDO procured in 2007-08 as other parties which went in for competitive bidding availed themselves of an average discount of ₹ 1,800/KL. Further, it was seen that HPCL extended, on an average, discount of ₹ 310/KL on HSD also owing to competition among OMCs. Hence, the Company incurred an opportunity loss of nearly ₹ 4.89 crore due to procurement of 1, 57,673 KL of HFHSD during the four years ending 2010-11 without establishing competitive prices. Further, the Company did not call for an Expression of Interest for its annual estimated quantity of fuel and lubricants at various locations which would have enabled the OMCs to compute the economies of scale to create infrastructure. Moreover, IOCL withdrew the one month credit facility to the Company which led to additional financial burden in the form of interest of ₹ 1.71 Crore while IOCL was allowing 2 to 3 weeks credit facility to Visakhapatnam Port Trust. Due to this flawed practice of not inviting tenders and sourcing the entire requirement from IOCL only, the Company deprived itself of negotiating better price and better payment terms.

The Ministry stated (January 2012) that there is no need to call for quotations as prices of LDO/ HFHSD are controlled by the Government. Further, the Ministry stated that calling of quotations for obtaining bulk discounts has the constraint of immediate supply to the dredgers due to lack of sufficient logistic support facilities of other OMCs of the other oil companies. The Ministry stated that the earlier efforts of the Company for procuring fuel from other companies like BPCL and HPCL were not successful because of their comparatively inferior infrastructure facilities/poor response. Further, it was stated that the Company has a formal system of indenting/ordering/receiving/bill payment/ monitoring and detailed instructions were issued for revamping the existing system in October 2010.

The reply of the Ministry is not tenable as price of LDO/ HFHSD are decontrolled and quotations should have been called for these as per the policy. Further, the Company did not attempt to tender its requirement declaring the overall annual requirement for proving or disproving the capabilities of other oil companies to match the infrastructure advantage which IOCL purportedly enjoys. Further, as pointed out in audit, there are no regular internal control procedures like sending indent by the competent authority to its Material Management department/ placing a formal purchase order or entering into a long term fuel supply agreement with IOCL documenting its requirement and commercial terms and conditions/ obtaining specific approval of competent authority before placing order etc.

14.1.2.3 Issue and consumption of fuel and lubricants

It was noticed in audit that the bunkering requirement is assessed by the Chief Engineering Officer (CEO) of each dredger who sends an indent for fuel and lubricants to the Project Manager of the Company at the respective location of dredging which in turn is forwarded to IOCL to supply the requisitioned quantity. A Marine Delivery Receipt is signed by the CEO of the respective vessel and IOCL representative(s) immediately after the bunkering certifying the quantity, date and location at which the bunkers are supplied. IOCL raises invoices for the bunkers supplied on the basis of the MDR. Further there is no laid down procedure for recording consumption of fuel on board the dredgers. Moreover, there was no system of reconciliation of fuel consumption (a) as declared by the dredgers based on Daily Utilization Reports (DURs) and (b) as arrived at based on the details of fuel supplied to dredgers based on requisitions during the course of the year by the Head Office. On reconciliation between fuel consumed as per DURs and Finance Bill register in all 10 TSHDS during four years ending 31 March 2011, Audit noticed there were discrepancies which needed to be reconciled as indicated below:

Item	2007-08	2008-09	2009-10	2010-11
Fuel issued to the dredgers as per Finance Bill Register (in KL)	48870	45694	43360	47816
Less: Closing balance as per the above register (in KL)	2011	2323	2428	2974
Quantity consumed as per Finance Bill Register (in KL) (a)	46859	43371	40932	44841
Quantity declared to be consumed as per Daily Utilization Reports (DURs) of the dredgers (in KL) (b)	45844	41349	38209	45321
Difference (in KL) (a) – (b)	1015	2022	2723	-480
Average price of fuel (₹ per KL)	32802	36401	36640	41991
Value of non reconciled stock (₹ in crore)	**3.33**	**7.36**	**9.98**	**-2.01**

The cause for the above discrepancy was not analyzed by the Company. The non-existence of a system of reconciliation pre-empts the possibility of bringing in systemic changes or improved internal control measures after identifying the causes for proper stock and consumption accounting.

The Ministry stated (January 2012) that reconciliation of fuel consumption is based on the Utilisation Reports (DUR) and engine log book data. Informatively, the DUR data received from the dredgers comprise of reserve on board along with fuel consumption on day to day basis and is being monitored by the Company.

The reply of the Ministry is not tenable as it is silent about reasons for shortages pointed out in the para as well as non-reconciliation of fuel consumption declared by the dredgers based DURs vis-à-vis as arrived at based on the details of fuel supplied to dredgers. Further, even though DUR comprises of reserve on board along with fuel consumption, the audit considered consumption quantities only.

Supply of fuel at Sethusamundram Canal Project

Of the eight TSHDs chartered by the Company to carry out dredging operations at Sethusamudram Canal Project (SCP), the Company was to supply fuel to three dredgers as per contract which, *inter- alia*, provided for a minimum guaranteed production by each of the TSHDs. The details of fuel supply rate and guaranteed production rate agreed in the chartering contract along with dredging days in respect of two out of the three TSHDs chartered are indicated in the following table.

Name of TSHD	Date of contract	No. of days	Fuel supply rate KL/ day	Guaranteed Production Cu.m/ day
Sagar Hansa	04.04.07	119	36.00	19285.71
Pacifique	17.01.07	104	29.16	27652.14

Note: There is no issue in case of third chartered TSHD 'Professor Gorjunov'.

The agreements do not provide for reduction in supply of fuel corresponding to the shortfall in achieving the guaranteed production. Consequently, even though the actual production achieved by the above two TSHDs was only 82 *per cent* and 59 *per cent* respectively of their guaranteed production, the supply of the fuel rate was not restricted to the percentage of the achievement resulting in excess issue of 1691 KL of fuel valuing ₹ 5.55 crore. Further, in respect of two hired TSHDs (Gorjunov and Sagar Hansa), the fuel issue rate agreed in the contract was higher than the actual fuel consumption rate of similar TSHDs owned by the Company (even though their installed power as compared to Company's TSHDs was slightly higher) resulting in excess fuel being issued to them. Consequently, the Company allowed an excess fuel valuing ₹ 19.42 crore to the two chartered TSHDs. The Ministry replied (January 2012) that the recommendations of audit would be taken into consideration while entering into charter agreements in future for hiring of dredgers.

14.1.2.4 Claims for reimbursement of fuel escalation

The terms for raising of claims by the Company vary from customer to customer. It was observed that the delays in raising fuel escalation claims ranged from 10 days to 319 days as per the details given in the following table.

Delays in raising claims	Instances
0 to 30 days	4
31 to 120 days	48
121 to 210 days	11
211 to 300 days	6
300 to 400 days	1
Total	**70**

As at the end of 31 March 2011, claims valued ₹ 210.38 crore were made with delays resulting in an interest loss of ₹ 5.90* crore.

The Ministry stated (January 2012) that the delays in raising fuel escalation claims are partly due to delay in receiving bills form IOC for adjustment after making the weekly advance. The matter is being continuously pursued with IOC. The reply of the Ministry is not tenable as the issue is about delay on the part of the Company in raising claims. The Company should have raised the claims promptly. Further, the Company should have insisted on a suitable clause for submission of bills by IOC in time.

A similar observation on fuel and material escalation was reported in the Para No. 19.1.1 of CAGs Report No. 11 of 2008. It was pointed out that there were avoidable delays in raising escalation claims ranging from 15 to 118 days for fuel and upto 550 days for material which resulted in loss of interest of ₹ 2.93 crore. The Ministry of Shipping (Ministry) in its Action Taken Note (ATN) (July 2008) stated that in order to expedite raising of escalation claims in respect of fuel, internal arrangements have been

* ***Aggregate of average interest rates from year of claim to end March 2011 applied.***

made to forward the bills immediately on payment to project office and checking with log books is being carried out separately. But, audit noticed for the subsequent periods in the contracts entered into with Visakhapatnam Port Trust, Paradip Port Trust, Mormugao Port Trust, Naval Command (Kochi) that the Company continues to raise claims on account of fuel/ material escalation belatedly and the action taken as per the ATN of the Ministry is, therefore, not convincing.

A review of fuel escalation claims for the years 2007-08 to 2010-11 revealed that there were 70 outstanding claims as of 31 March 2011. Out of these, 15 cases amounting to ₹8.99 crore related to the period prior to 2007-08. It was noticed that there were delays in realizing amounts from customers ranging from 19 days to 1643 days as shown below:

Delays in realizing bills	Instances
0 to 30 days	4
31 to 120 days	23
121 to 300 days	18
301 to 400 days	9
401 to 900 days	1
901 to 1000 days	0
Greater than 1000 days	15
Total	**70**

Due to non existence of any contractual provision relating to levy of interest on delayed payment of fuel escalation claim, the Company suffered interest loss amounting to ₹ 19.41[♥] crore.

14.1.2.5 Oversight Role

Governance by the Board of Directors

The following deficiencies were noticed in the governance of the Company:

- In this increasing competitive world, the importance of cost reduction cannot be over emphasised. In the eleven quarterly reviews of performance of the Company by the Board of Directors, only on four occasions did the Board express concern about slippage of MoU ratings. On all the other occasions, the performance was only noted.
- Regarding the fuel consumption targets set in the MoU, the Board did not give due cognizance to the fixation of MoU norms based on scientific basis. Further, neither did the Board analyse or seek reasons for either good or bad performance nor did it give any guidance/ recommendations for improvement.
- Though the Board desired that strategy meetings should be held on a periodical basis to improve the performance of the Company, it did not ensure the adherence to its instructions till date which implies lack of follow-up by the Board of its instructions.

The Ministry stated (January 2012) that the fuel consumption norms as reflected in the MOU parameter are fixed not only basing on the OEM recommended SFOC but also the actual consumption trends observed with the experience gained over the years. The

[♥] ***Aggregate of average interest rates from year of claim to end March 2011 applied.***

actual performance against MOU targets is submitted to Board of Directors on quarterly basis and the performance is analyzed and discussed in the Board meetings.

It is to be stated here that though the average consumption was computed based on the SFOC of the OEM, the final figure of fuel consumption considered for each dredger in the MOU was above builder's norms as discussed in the Para 2.1.1 above and consequently, the targets for fuel consumption were not fixed scientifically.

Review of performance by the Administrative Ministry

Review of the performance of the Company by the Administrative Ministry is through the parameters agreed upon in the annual MoU. Since consumption of fuel and lubricants by the dredgers is a vital parameter affecting the profitability of the Company, it should have been given a higher weightage during the overall evaluation of the performance. On the contrary, the weightage for fuel consumption was reduced continuously year after year from 'seven' for the years 2005-06 to 2007-08 to 'five' for 2008-09, 'four' for 2009-10 and 'three' for 2010-11. Thus, this vital parameter which constitutes 39 *per cent* of operational expenditure has just 3 *per cent* weightage in the MoU.

Conclusion

The Company did not focus on optimisation of expenditure on fuel and lubricants. The Company did not fix the norms for fuel consumption rate on a scientific assessment, followed inappropriate purchase procedure for sourcing the requirement, did not determining competitive prices for procurement of fuel and lubricants and had inadequate internal control procedures for procurement of fuel and lubricants. There was no proper system and procedure to ensure regular reconciliation of fuel consumed with the issues made, prompt raising of claims for fuel escalation as well as realizing the amounts, linking the guaranteed performance and fuel supply rate agreed as per the agreements for chartering of dredgers. These deficiencies indicate a lack of professional handling of fuel consumption issues.

As a result of the above deficiencies, the Company lost an opportunity to save ₹ 164.63 crore on fuel consumption during 2007-11. This amount is equal to 49 *per cent* of the Profit Before Tax (₹ 335.19 crore) reported by the Company during these years. This shows that a professional approach in fuel management can bring in tremendous benefits to the Company and improve its bottom line substantially.

Recommendations

- ***The Company should fix norms for fuel consumption scientifically and should analyse the causes for low and high fuel consumption periodically.***
- ***The Company should consider invitation of tenders to meet its requirement of fuel and lubricants to obtain competitive rates and commercial terms.***
- ***Claims should be raised within 15 days of completion of dredging cycle and incorporate a provision for levying interest on delayed payment of fuel escalation claims.***
- ***The Ministry may ensure that (a) parameter of fuel consumption gets appropriate weightage in the MoU scheme and (b) the fuel consumption targets are fixed scientifically.***

The matter was referred to the Ministry in March 2012; their reply was awaited (May 2012).

The Shipping Corporation of India Limited

14.2 Investment in Joint Venture

The Shipping Corporation of India Limited did not conduct detailed study before entering into a Joint Venture for chemical tanker operations. The initially approved investment of ₹ 45 crore in the year 2006 increased to ₹ 141.80 crore in the year 2011 with no returns. The Company also suffered a loss of ₹ 32.56 crore towards operation of vessels.

The Shipping Corporation of India (SCI) entered into a Memorandum of Understanding (MOU) with Forbes and Sterling on 19 April 2006 with a view to form a Joint Venture (JV) for acquisition, managing and operating chemical tankers for the transportation of chemicals. Even before the MOU was signed Forbes and Sterling had decided to acquire, manage and operate chemical tankers either directly or through Joint Ventures, had held discussions with South Korean shipyards and had initiated to place a Letter of Intent (LOI) to freeze the price at about US$ 25 million per ship by the middle of April 2006. Accordingly, the MOU stated that Forbes Sterling will hold the prime responsibility for identifying the vessels to be acquired. Further, the MOU stated that in order to place orders for the ships before April 2006, SCI was to get the necessary approval from its board so that it could participate in the proposed JV before end of April 2006.

In the meeting of the Board of Directors (BOD) of SCI held on 25 April 2006, the BOD considered the proposal for a total investment of US$ 100 million for acquiring four tankers by the JV. The financing was to be done to the extent of 80 *per cent* by loans and 20 *per cent* through equal equity participation by both the JV Partners. The charter hire was estimated at US$ 13000 per day per ship. The BOD was apprised of the projected huge increase in refining capacity in India and the increase in demand for transporting vegetable oils and chemicals. The JV was expected to provide synergy for SCI and enable it to acquire chemical tankers through the Joint Venture route in an expeditious manner. The BOD approved formation of JV and equity investment of ₹ 45 crore.

A shareholders agreement was signed on 14 June 2006. As regards financing, it stated "All necessary funds for the operations and activities of the JVC which may not be covered by the subscribed and paid up capital shall be secured by injections of shareholders funds in proportion to their shareholdings in the JVC, or as shareholders loans. The Parties may however borrow/raise resources from Bankers, Financial Institutions." The agreement further stated that the BOD of JV was to have six non executive Directors, three each from both the partners. SCI nominated three members on the Board.

The ship building contract for four vessels was signed on 28 June 2006 between Forbes Sterling and the South Korean Shipyard. The JV was incorporated on 18 July 2006 as SCI Forbes Limited.

After the initial investment approval in April 2006, the SCI Board in its meeting held after more than two years in July 2008 deliberated on the estimation for other items of project cost given by the JV. Such cost related to interest during construction, preliminary and pre-operative expenses before delivery of the vessels. Such estimation increased the project cost to US$ 121.65 million. The financing arrangement was also discussed leading to the signing (August 2008) of sponsor support deed. The financing of the vessels was done by NATIXIS – HSBC bank through a loan agreement (August 2008). As per the loan agreement SCI had to provide cash deposits to sustain the requisite level of asset coverage. This led to further investments by SCI in the JV. The total investment of SCI in JV was ₹ 141.80 crore as on 31 March 2011.

A Committee was constituted by the Board (February 2011) to go into the working of SCI Forbes Limited and it submitted its report in June 2011. The Committee observed that there was no detailed project feasibility study either in-house or by an external agency. The valuation and inspection records prior to acquisition of vessels indicated that there was no evidence of visit to the yard. The revision of project cost in 2008 indicated omission of some costs in the initial estimates. Though SCI alone had some experience of operating chemical tankers it was incurring losses and the segment was not doing well even in 2007-08. The JV which started its chemical tankers business in July 2007 by in-chartering a vessel suffered losses in spite of surplus projected to the Board with the calculations made in March 2007 much at variance with the actuals, a few months later. Subsequently the JV acquired 4 ships between August 2009 and May 2010. The JV had outsourced the man power and technical management of the ships and the vessels were chartered to the JV partners who in turn sub-chartered those ships to the Womar Pool for commercial operations. Such an arrangement led to a large gap between the actual amount of US$ 13000 per day payable by each of the partners to the JV and the amount realized per day leading to huge loss in the balance sheet of the JV partners. The SCI had booked a loss of ₹ 32.56 crore towards standby charter agreement. While reviewing the option of ceasing the operations and winding up of the JV, the committee observed that after liquidating the liabilities of ₹ 333 crore by selling the vessels at ₹ 297 crore and utilizing the reserves, the JV would be left with a cash surplus of ₹ 125 crore (which means ₹ 62.50 crore for SCI as against the investment of ₹ 141.80 crore). The Committee concluded that the SCI might review the need to continue the JV as the JV had realized no strategic advantage or purpose for the SCI.

Audit observed that when the MOU and the JV were signed in 2006, SCI was a Mini-Ratna Company with delegated powers to enter into JVs involving investment of ₹ 500 crore as per the DPE guidelines (August 2005). The proposal submitted to the Board was not in conformity with the DPE guidelines (October 1997) for formation of JVs which provided that all such proposals should be prepared by or with the assistance of professionals and experts and appraised, in suitable cases, by financial institutions or reputed professional organization with expertise in the area.

When the aspect of not conducting a detailed feasibility study was brought (September 2011) to the notice of the Management, it replied (October 2011) that the acquisition proposal for the four chemical tankers (on account of JVC) was evaluated in terms of the same yardstick (as if it were SCI's own acquisition proposal) and the same passed muster.

In this connection, it was observed that the procedure (January 2001) for acquisition of ships provided that the acquisition would be related to the long term perspective plan of the Company. During the 10th plan period SCI had envisaged the acquisition of 31 vessels. It did not include acquisition of chemical tankers. This indicated that the Company had not visualized chemical tanker business in its long term plan.

Further, the established procedure for acquisition of own vessels also provided for preparation of a Project Report containing the projections like Internal Rate of Return

(IRR) and the Economic Rate of Return (ERR), each exceeding 12 *per cent*. IRR/ERR below the prescribed rate of 12 *per cent* was required to be justified by the Company and referred to the Government. The Project Report was to be based upon the then prevailing freight/charter hire rate and trends in international freight rates over a period of time were also required to be brought out in the said Report.

However, no Project Report was prepared in the instant case. The project IRR of the JV was 11.23 *per cent* (later revised to 10.69 *per cent* in July 2008) as against 12 *per cent* stipulated in the established procedure. Trends in international freight rates over a period of time were also not brought out in the proposal and only the then prevailing freight/charter hire rate was informed to the Board.

It was noticed that that Drewry Chemical Forecaster Quarter 4, 2005, which the Company depended upon for comparing the prevailing market price for chemical tankers, reported surplus capacity in the chemical tanker segment ranging from 13 to 30 *per cent* of the demand from 2000 to 2004. It also projected a surplus capacity ranging from 20 to 28 *per cent* of the demand during 2005 to 2009. However, this aspect was not brought to the knowledge of the BOD while seeking approval for the investment in the JV.

The loan financing was also not fully analysed by the BOD. The implications of (i) raising of loan by a new Company with no balance sheet (ii) risks relating to security value maintenance and (iii) any downward fall in the freight rates in future were not taken into account.

The MOU and the JV were subsequent to the decision already taken by Forbes Sterling to acquire chemical tankers. SCI was a premium national carrier of India while Forbes Sterling had practically no experience in chemical tanker trade. The board meeting was held on 25 April 2006 within six days of entering into of MOU which had clauses compelling the Company to complete the JV agreement by April 2006.

The JV agreement was, thus, entered into without going into the financial implication of the project as borne out by the subsequent developments as detailed above. The advantages of forming a JV for acquisition and operation of chemical tankers by SCI directly were never discussed. In the process the JV has become a drag on the Company's finances. The Company has also not got any strategic advantage as envisaged.

The Management stated (October 2011) that ship acquisition project did not involve any complexities and therefore, it did not consider it necessary for the investment proposal to be appraised by financial institutions or reputed professional organizations and that the need and justification for chemical carriers, economic viability etc. were reported to the BOD in April 2006. Regarding increase in the investment, it replied that at the time of formation promoters were seized of the working capital requirement and agreed that the same might be established with more accuracy at the time of delivery of the vessels. As regards inchartering of vessels at US$ 13000 per day, it stated that the two vessels were inchartered under a standby charter agreement to secure shipbuilding loans from the lending banks and therefore, the daily hire rate of inchartered vessels could not be compared with the prevailing chemical tanker hire rates.

The reply was not convincing due to the following:

- The total project cost of US$ 100 million was substantial and required a detailed study as per DPE guidelines. In fact, if a detailed study had been carried out, the increase in the project cost could have been visualized initially and submitted to the BOD.
- The project was to be financed with 80 *per cent* loan. However, while approving the project the following were not factored in:-
  - ➢ risks relating to security value maintenance in the background of JV not having any other free vessel to offer as collateral
  - ➢ any downward fall in the freight rates in future.
- Management had projected (April 2006) huge growth in the petrochemical industry in the country and high potential for the chemical tankers. However, the projection for chemical tankers did not materialize and the Company had to incharter the vessels in terms of the agreement with the lending banks at a steep rate of US$ 13000 per day resulting in a loss of ₹ 32.56 crore.

Thus, due to failure of the Company to conduct a detailed study to assess all the risk factors, the initially proposed investment of ₹ 45 crore increased to ₹ 141.80 crore as on 31 March 2011, which did not generate any return. Further, the Company had to suffer a loss of ₹ 32.56 crore during August 2009 to June 2011 for sustenance of the JV. Admittedly, the investment in the JV did not realize any strategic advantage or purpose to the Company.

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

14.3 Avoidable expenditure due to delay in finalization of contract

Inordinate delay in finalisation of contract for supply of stores items resulted in avoidable expenditure of ₹ 7.62 crore.

The Shipping Corporation of India Limited (Company) had been entering into rate contracts, normally for two years, for supply of stores items required for operation of vessels. The purchase manual of the Company provided for an option for extension of these contracts for a period of six months beyond the normal tenure of two years. Purchase Manual also stipulated that the tender procedure should be completed before the expiry of existing contract so as to take a decision whether to extend the contract by exercising the option or enter into a fresh contract, depending upon the competitiveness of rates.

The Company had entered into a contract for supply of stores items in May 2004 (effective from January 2004) with an option for extension. As the contract was due to expire in December 2005, the process for entering into a new contract was started by the Company in August 2005. However, the same got delayed on account of observations of the tender processing committee regarding categorisation of various price list items in the tender format. The Company could issue the notice inviting tenders only in August 2006 with 26 September 2006 as the due date. In the mean-time, the existing contractors continued to supply the stores items.

In response to the notice inviting tenders, the Company received (September 2006) offers from 12 parties out of which seven parties were technically qualified on 29 December 2006. The price bids of these seven parties were opened on 12 January 2007 and the quotes of M/s. Laxmi Enterprises (L1) were found to be the lowest being 63.47 *per cent* lower than the rates at which supplies were received under the earlier contract. However, the Company failed to finalise the contract within the validity period of the offer (March 2007) as per the general terms and conditions of the tender. Consequently, L1 withdrew the offer in April 2007.

Though there were clear directions of Central Vigilance Commission to re-tender in case of L-1 backing out, yet the Company offered (May 2007) the L1 rates to the remaining parties, However, the parties refused to accept the L1 rates but agreed to supply the stores items at L2 rates, which were 44.36 *per cent* lower than the rates under the earlier contract. The Management decided (July 2007) to award the contract to the existing four contractors at the L2 rates for six months from July 2007 onwards which was further extended upto September 2009 from time to time. The Company could finalise a new contract for one year from 1 October 2009 on competitive bidding basis only in October 2009.

Thus, due to non finalisation of contract with the L1 within the offer validity period, the Company had to procure stores at L2 rates for the period from January 2006 to September 2009 though the L1 rate was 34.35 *per cent*[1] lower than the L2 rates.

The Company failed to provide the complete data regarding the procurements made from January 2006 to September 2009 to Audit except for the period from July 2007 to June 2008. During the said one year, the Company purchased stores items of ₹ 22.17 crore at L2 rates resulting in an extra expenditure of ₹ 7.62 crore[2] as compared to L1 rates. The actual loss would be much more taking into account the full period of supplies during the 45 months i.e. from January 2006 to September 2009.

The Management attributed (September 2011) the delay in finalisation of tender to the efforts made by the Company to streamline the tendering process, enormity of work involved in processing of the technical and price bids, involvement of concerned officials in the integrated information technology system which delayed the handling of day-to-day work, processing of various other critical tenders and manpower constraints.

The reply of the Management is not acceptable as:

- system improvement in the tendering process cannot be a justification for inordinate delay in finalizing a contract.
- L1 withdrew due to non-finalization of the contract within the validity period of the offer as stipulated by the Company. The Management should have planned the process in advance taking into account the enormity of the same and man-power constraints, if any.

The inordinate delay in finalisation of contract resulted in avoidable expenditure of ₹ 7.62 crore in procurement of the stores items from July 2007 to June 2008. Additional expenditure incurred during the remaining period i.e. from January

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[1] ***Assuming initial rate at ₹100, L2 rate at ₹55.64 and L1 rate at ₹36.53 and using the formula [(L2-L1)/L2]* 100 = [(55.64-36.53)/55.64]*100 = 34.35 per cent***

[2] ***Purchases at L2 rate * 34.35 per cent = ₹22.17 crore * 34.35 percent = ₹7.62 crore***

2006 to June 2007 and from July 2008 to September 2009 could not be computed due to non-furnishing of the data by the Management.

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

CHAPTER XV: MINISTRY OF STEEL

KIOCL Limited

15.1 Loss in procurement of iron ore fines from NMDC

Acceptance of ore with lower Fe content, absence of norms for transit and handling losses and lack of internal control to regulate receipt of ore resulted in loss to the extent of ₹ 128.24 crore.

KIOCL Limited (the Company) entered into a long term agreement (LTA) (August 2005) with M/s. National Mineral Development Corporation (NMDC) for procurement of iron ore fines from its Donimalai Mines in Karnataka for the period from 2005-06 to 2009-10. The agreement provided guaranteed specification for Fe content of 64 *per cent* in iron ore fines and adjustment of price accordingly. A representative of the Company posted at the loading station was to supervise the loading of iron ore fines in the rakes. As per the agreement, the Company had to make an advance payment or establish a divisible irrevocable Letter of Credit (LC) in favour of the seller payable against documents. NMDC agreed to supply the iron ore based on the same terms beyond 2010 also till a new agreement was signed.

On a review of the agreement and the receipt of iron ore fines from NMDC, the following were observed:

1 Ferrous (Fe) Content in Iron Ore

Clause 4(II)(a) of the contract stated that 'for each one *per cent* increase/decrease in the Fe content stipulated in Clause-1, the base price shall be increased/decreased, as the case may be, by ₹ 25 per Wet Metric Tonnes (WMT), fraction pro rata'. Further, Clause 8 on Sampling and Analysis also stated that 'If the buyer so desires, three sample packets may be prepared from the quantities dispatched in the rakes in the presence of the buyer's representative out of which one will be for the Seller, one for the Buyer and one packet would be jointly sealed and kept as umpire sample. If the sample analysis variation in Fe content was within one *per cent*, the seller's analysis would be treated as final. In case the variation in Fe content between analysis of seller and buyer was more than one *per cent*, the umpire sample would be tested in any neutral laboratory and the result would be binding on both buyer as well as seller.

NMDC raised invoices based on the agreed rate after adjusting the variations in Fe content with reference to the results of the tests conducted at its own laboratory on the samples collected while loading. On arrival of the rakes at Mangalore, the samples collected at the time of unloading were tested at the Company's laboratory. In almost all cases, there were variations between the Fe content considered by NMDC while billing and the test results of the samples collected by the Company. However no action was taken by the Company to get the umpire sample tested in a neutral laboratory and settle the invoice accordingly in cases where variations in Fe content were more than 1 *per cent*. Since the terms of payment envisaged advance payment or establishment of irrevocable Letter of Credit in favour of NMDC on a monthly basis, the Company had made excess payment of ₹ 23 crore[♠] on 3504935.60 WMT of iron ore where Fe content was less by more than one *per cent* during the period from April 2008 to March 2011. The Company had not taken up the matter of obtaining refund of this amount from NMDC so far (October 2011).

Ministry stated (February 2012) that the issue regarding variation in quality had been taken up with NMDC at regular intervals and testing of umpire samples was also carried out by KIOCL (October 2010) in respect of three rakes and the variation observed was negligible. Further, according to the test results in respect of 19 rakes between July 2008 and June 2010, the variation of Fe content was not much and testing of umpire samples by an independent agency was resorted to only when there was a wide variance.

The reply is not satisfactory as, (i) though the Company had been incurring losses on account of variation in Fe content for a long time, the issue was taken up only in October 2010 in cases where the difference was negligible; and (ii) testing was carried out in the NMDC facilities instead of at a neutral laboratory. Moreover, the Ministry's contention that the variation of Fe content was not much in 19 rakes was not acceptable as data furnished by Ministry did not match the information furnished by the Company and is also not supported by the Umpire Sample Testing Reports. Further, the data furnished did not contain the details of Fe variations during January 2010 to March 2010 where the variation was up to 10.43 *per cent.*

2 Short receipt of Iron Ore

On a review of the receipt of iron ore fines during the period from 2005-06 to 2010-11, it was noticed that as against quantity of 6065516.40 WMT invoiced by NMDC, the actual quantity received by KIOCL was 5761502.67 WMT. No norms had been fixed by KIOCL for allowance of transit and handling losses. Assuming a reduction of 3 *per cent* for normal transit and handling losses, as was being followed by Rashtriya Ispat Nigam Limited, a CPSU under the same Ministry, there was a short receipt of 277240.27 MT. Since KIOCL paid NMDC for the invoiced quantity, KIOCL suffered a loss of ₹ 105.24 crore.

Ministry stated (February 2012) that the (i) shortage was due to transit and handling losses attributable to holes/openings in the railway wagons, improper locking system, handling losses while manually unloading, spillages and carpet formation, spillages from the tippers en-route to weigh bridge and handling losses in the plant premises etc.; (ii) a representative had been posted at loading site and the contractor had been instructed to clean rakes to avoid undercharge situations; (iii) fixation of norms for transit and handling losses was under the active consideration of Board of Directors; and (iv) the shortages during six years from 2005-06 to 2010-2011 were only around 5.59 per cent of the quantity of total iron ore fines transported.

The reply is not acceptable as (i) no norms for transit and handling losses had been fixed even as of February 2012 to serve as benchmark; (ii) the argument that the shortage in terms of quantity as well as value during 2005-2011 was not material could not be accepted, since it is based on the average loss for the 6 years and quantity lost during these years above 6 *per cent* was 0.17 million tonnes (valuing approximately ₹ 65 crore);

[♠] ***Calculated for supplies from April 2008 to March 2011 as Difference in Fe content*invoice quantity*bonus/penalty rate as applicable from time to time***

(iii) Rashtriya Ispat Nigam Limited (RINL), another CPSU under the same Ministry had fixed 3 *per cent* for normal transit and handling losses of iron ore fines and Audit had already considered the normal handling and transit loss at this rate while working out the short receipt of iron ore fines.

Thus, due to (i) acceptance of ore with lesser Fe content without exercising the option available for testing the umpire sample in a neutral laboratory; (ii) absence of scientific norms for transit and handling losses; (iii) failure to investigate the shortage of receipt from time to time indicating an absence of proper internal control system and (iv) inaction in taking preventive steps to curtail transit and handling losses, the Company incurred a total loss of ₹ 128.24* crore during the years from 2005-06 to 2010-11.

15.2 Irregularities in procurement and inventory management of LAM Coke

The decision of not procuring a third shipment of LAM coke at the lower rates offered during the EJC meeting held in February 2008 resulted in extra expenditure of ₹ 54.85 crore. Writing off of stock shortage of 9,144.153 MT coke valued at ₹ 32.41 crore was for reasons not justifiable.

Coke is a vital input in the operations of Blast Furnace Unit (BFU). The contracts for procurement of Low Ash Metallurgical (LAM) coke of the KIOCL Limited (the Company) were finalized through spot negotiations by an Empowered Joint Committee (EJC) of the Ministry of Steel. With coke prices rising in the global market, two meetings of EJC were held in February 2008 and June 2008. Against projected requirement of eight and five shipments for EJC meetings held in February 2008 and June 2008, the Company placed orders for two shipments at US$ 507 per MT (February 2008) and three shipments at US$712.50 per MT (June/July 2008) Price for third shipment procured against order placed in July 2008 was, however, revised to US$ 798 per MT due to increase of export duty in China.

The Coke was utilized up to August 2009 after which Blast Furnace was shut down due to uneconomical operations leaving a balance of 22,372 MT in stock which was physically verified (March 2010) by the Company and found to be only 13,228 MT. Proposal for write off of the 9,144 MT of LAM coke valuing ₹ 32.41 crore was approved (March 2011) by the Board.

Audit observed the following:

Deficiencies in the system of procurement

The decisions taken for procurement of LAM Coke in February 2008 and June/July 2008 were based on insufficient information as the Company did not make any attempt to ascertain the trends or collect data from diverse sources. The decision of the Company to procure only two shipments against the four shipments offered for delivery from March 2008 to June 2008, despite having storage capacity to stock three shipments (1.1 lakh MT), resulted in avoidable expenditure of ₹ 54.85 crore as the Company procured third shipment in August 2008 at the rate of US $ 798 per MT as against rate of US $ 509 for third shipment offered in February 2008.

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* *(₹ 23.00 crore + ₹ 105.24 crore)*

Authority of EJC

EJC was constituted (September 2002) by Ministry of Steel for negotiating long term contracts with global suppliers for supply of LAM Coke for Steel Authority of India Limited, Rashtriya Ispat Nigam Limited and the Company. Members of the Committee comprised three Joint Secretaries and nominees of all the three companies. The Administrative Ministry intimated in January 2005, that after detailed examination, it was decided that henceforth the EJC would function without Government nominees. Thereafter, SAIL stopped attending EJC meetings. RINL was the official coordinator of EJC.

Though Administrative Ministry authorized (January 2006) EJC to procure 80 *per cent* of the total procurement of LAM Coke by "Long Term Agreement" and 20 *per cent* by "Spot Purchase", Audit observed that EJC had not gone for long term contracts and all purchases were being made only through spot negotiations.

Limited Powers of Chairman and Managing Director

As per Company's delegation of powers (DOP) (December 1995), CMD with the concurrence of Director (Finance) could exercise powers for purchases up to ₹ 10 crore in each case. DOP was not revised even after merger of Kudremukh Iron & Steel Company Limited (KISCO[◊]) with the Company. Violation of delegated powers in case of procurement of three shipments in July 2008 at a consideration ₹ 292.07 crore with the approval of CMD was not only viewed seriously by the Board, but also attracted a stricture (July 2010) from the Administrative Ministry.

Write off of physical shortage of LAM coke

As on 31 March 2009, inventory of LAM Coke stood at 74791 MT as per books of Accounts and physical survey of inventory carried on by the Surveyor. However, a shortage of 9144.153 MT was noticed on physical verification of inventory by the same Surveyor as on 31 March 2010. The difference was written off with the approval of the Board (March 2011) on the basis of calculations for excess and shortage during handling and transit from 2000-01 to 2008-09.

Ministry stated (January 2012) that:

- *the Company placed order for two shipments at same price with different lay cans to avoid overlapping and logistic issues and the decision was based on a market report that there was a possibility of reduction in the price of coal beyond March 2008;*
- *the Company was advised in July 2010 to put in place well thought-out policies and procedures for handling such commercial matters, particularly related to procurement and Company intimated that the directions of Ministry had been implemented; and*
- *the shortage of 9144.15 MT of LAM Coke is the cumulative effect since inception of Blast Furnace Unit (formerly KISCO) while handling 10,08,308 MT of LAM*

◊ KISCO, a subsidiary of the Company, commenced commercial operations of the Pig Iron Plant in May 2001 and was procuring LAM Coke for producing pig iron. Later KISCO was merged with the KIOCL Limited w.e.f.1 April 2007. Board of KISCO had delegated powers (March 2004) to Chairman to approve the placement of order for one shipment of LAM Coke at a time irrespective of the value.

Coke (0.90 per cent) which is normal and well within the norms followed by other PSUs. Further, the loss was a normal transit loss which would have been dealt in normal course at the end of every year and the same was not done.

Reply of the Ministry is not acceptable as:

- the Company while submitting (February 2008) the proposal for procurement of two shipments to CMD, indicated that the upward trend in price was likely to continue for a further period of 4-5 months due to the then existing supply-demand situation.
- Based on the directives of the Government in July 2010, the Board of Directors constituted (October 2010) a Committee consisting of Chairman and three Members to bring out the policies and procedure for handling commercial matters and also to look into the delegation of powers. The Committee was yet to submit its Report to the Board as of January 2012. It was, therefore, incorrect for the Government to state that its directives had been implemented.
- No shortages were noticed and the physical quantity equal to the book balance was available on 31 March 2009. As the shortage was reported only during 2009-10, reporting the shortage as transit and handling losses accumulated since 2000-01 was not in order.

Thus, decision of not procuring a third shipment of LAM coke at lower rates offered during the EJC meeting held in February 2008 resulted in extra expenditure of ₹ 54.85[1] crore. Further, absence of proper inventory management resulted in shortage of stock of 9,144.153 MT LAM coke valued at ₹ 32.41 crore for which no responsibility was fixed and the write-off accorded was not based on proper justification.

Rashtriya Ispat Nigam Limited

15.3 Sale of Iron and Steel Products in Domestic Market

15.3.1 Introduction

Rashtriya Ispat Nigam Limited (Company), Visakhapatnam produces steel in its three million tonne steel plant at Visakhapatnam and has its own marketing set-up to sell the steel in domestic and international markets. The turnover is mainly from domestic market and export turnover is minimal. The table below shows the sales performance of RINL in four years ended 2010-11.

(Quantity in thousand tonnes/ value ₹ in crore)

Mode of sales	2007-08			2008-09			2009-10			2010-11		
	Quantity	Per cent	Value	Quantity	Per-cent	Value	Quantity	Per-cent	Value	Quantity	Per-cent	Value
Domestic	3059	91	9878	2863	99	10333	3455	94	10284	4658	96	11095
Exports	317	9	555	23	1	78	203	6	351	193	4	422
Total	3376	100	10433	2886[2]	100	10411	3658	100	10635	4851	100	11517

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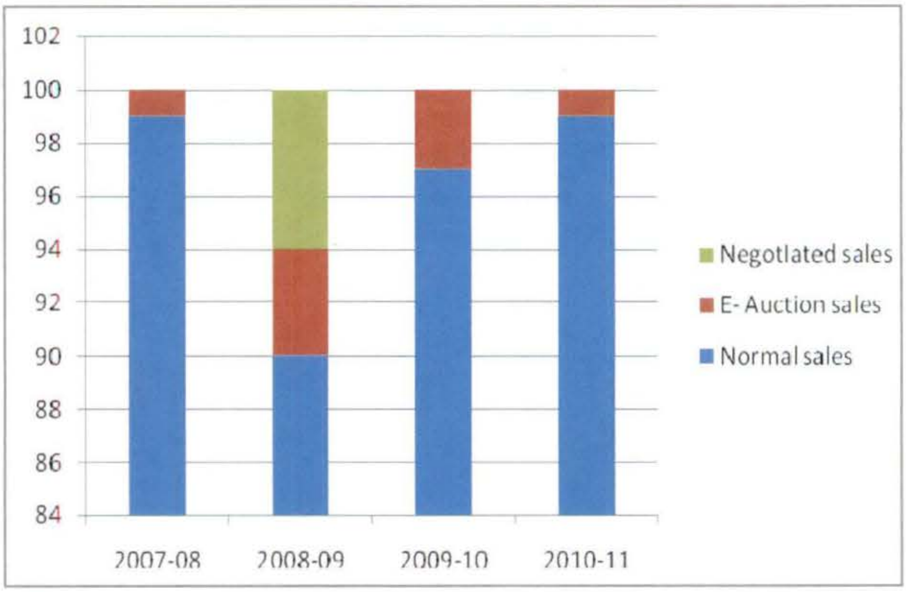
[1] ***₹122,24,19612 (Qty-32943.10 MT*US$798* ₹46.50 per US$) minus ₹67,39,07,443 (Qty-32943.10 MT *US$509* ₹40.19 per US$) = ₹54,85,12,169.***

[2] ***from August 2008 onwards sluggishness in the international and domestic markets affected the volume of sales and realizations and hence the sales/production during 2008-09 was low.***

Sales for domestic market consists of Normal sales on the basis of monthly operating prices fixed by the Company, E-auction sales and negotiated sales. The percentage of domestic sales made in each of the three types is depicted below:-



15.3.2 Audit scope and methodology

Sales for domestic market consists of Normal sales on the basis of monthly Review of sale of steel products in the domestic market covering the four years period ending 2010-11 was undertaken. The review covers monthly sales operations such as fixing and operation of monthly prices, granting of discounts and e-auction sales etc. Additionally, it covers analysis of overall sales data available at Corporate Office, detailed scrutiny was done of Headquarters (HQ) Sales at Visakhapatnam and five other Branch Sales Offices (BSOs) at Hyderabad, Chennai, Faridabad, Ludhiana and Ahmedabad, where the combined sales turnover of these BSOs was 56 *per cent* of the total domestic sales turnover of the Company during the three years period ended 2010-11.

15.3.3 Audit Objectives

The audit was conducted with the objective to assess the adequacy and effectiveness of the sales operation by examining that the Company has adequate sales manual/policies and procedures in place to regulate its sales operations relating to price fixation and payment & delivery terms. Further, it was also seen whether the policies and procedures were effectively followed by the Company and ensured revenue optimization.

15.3.4 Audit Findings

15.3.4.1Existence of Policies and frame work

Board of Directors of the Company approved the comprehensive marketing policy of the Company in May 2008 and revised it in August 2010. The Company issues policy guidelines for each year separately and has a sales manual covering the procedures relating to sales operations. Thus, the Company has the operational framework for sales operations in place.

However, we noticed that during January- March 2009, the Company resorted to 'negotiated sales' to dispose of slow/non-moving products. The products were sold below the applicable operating price resulting in a short realisation of ₹ 37.73 crore. The Company did not have a procedure for the same.

15.3.4.2 Structural deficiencies in Monthly Quantity Incentive (MQI) scheme

As per the term of price circular(November 2008), incentives under both the schemes, that is, Total Quantity Incentives (TQI) and Monthly Quantity Incentives (MQI) shall be passed for respective slab at the rate applicable for the particular slab. TQI is a discount offered to the customers based on the quantities lifted during the year ending 31 March, which is fixed on incremental basis. MQI is a discount offered to customers based on the quantities lifted during a month which is also on an incremental basis. Though TQI was continued to be passed on incremental basis till March 2010, MQI was changed in December 2008 to slab basis. In other words, TQI from April 2010 and MQI from December 2008 were not regulated on incremental basis for sales made in all the months from December 2008 to March 2011. The scheme excessively rewards the buyers who attain the next slab quantity.

Sl. No.	Quantities sold (Tonnes)	MQI under incremental slab method (₹)	MQI under total slab method (₹)	Difference in MQI under the two methods (₹)
1	500	2,50,000	2,50,000	Nil
2	501	2,50,750	3,75,750	1,25,000
3	1000	6,25,000	7,50,000	1,25,000
4	1001	6,26,000	10,00,000	3,74,000

As could be seen from the above table, for a mere increase in off take by one tonne in the second case over the first case in the above table and in the fourth case over the third case, the incremental/additional incentive allowed under the method adopted by the Company for MQI was ₹ 1,25,000 and ₹ 3,74,000 respectively. Thus, TQI from April 2010 and the MQI scheme from December 2008 are structurally flawed. As a result, the Company passed excess discount/incentive of ₹ 32.80 crore on account of MQI on pig iron (₹12.54 crore) and steel products (₹ 20.26 crore) sold during the period from December 2008 to March 2010. Besides, the Company (HQ Sales Wing) passed excess discount/incentives of ₹ 1.13 crore on account of TQI on steel products sold during the period from April 2010 to March 2011.

Management stated (December 2010) that MQI was offered to increase the volume of sales and the incentives/slabs are revised from time to time as per the requirement. It further stated that as per the feedback from branches and regions also it was informed that the other suppliers do not operate the incremental slabs and there was a need to change the slabs to absolute prices.

However, Audit noticed that TQI was also offered to increase the volume of sales and was fixed on incremental basis till March 2010. Further, Ministry's assurance to adopt incremental based incentives had not been compiled by the Company in respect of both MQI and TQI, which was pointed out in the draft para on 'sale of steel products' in April 2007.

15.3.4.3 Deficiencies in actual sales operations

A. Normal Sales

(i) Sale of products below the market price

Generally, the Company fixed monthly prices based on various inputs such as sales and inventory of the preceding month, market scenario (domestic and international), feedback from Regional Managers (RMs) and other internal factors.

Audit observed that in 4 out of 36 months period reviewed the Company sold the products below the prevailing market prices without considering the market feedback by its Regional/Branch Managers. As per the Management's own assessment, there was a scope to increase the prices of steel products considering the prevailing market conditions* during April to July 2008. But the Management, citing government directions, did not increase prices during the above period. On the contrary, prices were reduced (₹1800-₹2000 per tonne) on two occasions (9 April and 8 May 2008) during the said period. The loss of revenue, even considering the minimum increase of ₹ 1000 per tonne as per the market price feedback given by the RMs/BSOs, on a quantity of 9.44 lakh tonnes sold during April–July 2008, worked out to ₹ 94.43 crore.

The Management stated (December 2010) that it was agreed by the Company in one of the meetings with Secretary, Ministry of Steel in April 2008 to reduce prices by ₹ 2000 per tonne. It also stated that in the joint memorandum given by the major steel producers including RINL to Hon'ble Prime Minister of India, it was agreed to hold prices for three months.

Audit, however, observed that there was no formal instruction from the Government for reduction of prices. In a reply to the earlier audit para on 'sale of steel products' wherein sale of iron and steel material below market price during 1 March–11 May 2004 was accepted by the Company, the Ministry of Steel had replied (November 2007) that in future it would be ensured to keep record note of the decisions/discussions taken during such meetings. The assurance, however, was not complied with in the instant case.

(ii) Delay in effecting the revision in prices

As per the general terms and conditions of sale, prices ruling at the time of delivery are applicable. Apart from monthly revision, the Management increased the prices in mid-month in eleven occasions during the four years ending 2010-11. In three (19 December and 24 December 2009 and 15 March 2010) out of eleven occasions the Company implemented the price revision belatedly by more than two days. Due to delay in effecting the revision, there was a short realization of revenue of ₹ 30.58 crore on a quantity of 1.06 lakh tonnes of material sold during the intervening period, that is, the date of issue of price circular and the date of implementing the revised prices.

The Management replied (December 2010) that revision of prices involved updation of price master for all products and branches which requires minimum period of one day. It, however, stated that efforts would be made to quicken the process.

The Management contention is not tenable since, in four out of the eleven occasions the Management effected (29 March 2010) the revision of prices from the date of issue of

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* ***Increase in international prices of steel products, domestic prices of the secondary producers who held a major market share of 72 per cent in the long products segment and also increase in input costs.***

price circular itself. Thus, the delay in other three occasions lacked justification. Further, it is noticed that another PSU, SAIL, is making price revisions effective from the next day of issue of circular

(iii) Applying pre-revised prices on dispatches effected on subsequent day

As per clause 1.1 of the terms and conditions of Delivery Order (DO), the prices mentioned in the DO are provisional and prices ruling at the time of delivery are applicable unless otherwise specified. The Company increased the prices by ₹ 3500 per tonne with effect from 26 December 2009. Despite the increase, the Company charged the pre-revised prices on 24811 tonnes of iron and steel materials, which were physically delivered after 00:00 hours of 26 December 2009, which resulted in loss of revenue of ₹ 8.68 crore.

The Management stated (May 2010) that the extension granted for continuing delivery of DOs issued till end of 23 December 2009 at pre-revised prices was a strategic decision and as per approval of the Competent Authority.

The reply is not tenable as charging of pre-revised prices was in deviation of the terms and conditions governing the sale. The benefit accrued to the Company due to such strategic decision was neither visible nor recorded. Further, such decision benefited only few parties.

(iv) Extending price reduction retrospectively

The Company reduced the prices mid-month on seven occasions during the four years ended 2010-11. In four out of seven occasions (16 February, 8 May & 8 December 2008 and 13 May 2010), the price reduction♠ was correctly implemented from the date of decrease prospectively. Moreover, in the remaining three occasions (9 April, 18 November in 2008 and 19 January 2010) the price reduction was implemented retrospectively on already sold quantities and refund of differential amount to the parties was authorized on the grounds *of* price stability. As a result the, the Company refunded a total of ₹ 4.03 crore on past sold quantity of 15,219 tonnes in 2008-09 and 2009-10.

The Management stated (December 2010) that the reduction in prices retrospectively on 9th April 2008 was on the basis of understanding with the Ministry of Steel; on 18 November 2008 it was on the basis of need to assure the price stability to the customers and on 19 January 2010 it was a marketing tool to enhance the sales of Semis.

The reply is, however, not tenable since there was no formal instruction from the Ministry for reduction of prices retrospectively. Further, Company has not been applying the same principle in case of upward revision of prices. Thus, applying downward revision in respect of quantities already sold at the then prevailing prices was not only irregular and unwarranted but also against the fundamental tenets of financial propriety.

B. Negotiated Sales

Sale of prime products on negotiated basis below the applicable operating price

No procedure has been approved by the Company so far for negotiated sales. Audit observed that in 15 out of the 23 branches, the Company resorted to negotiated sales in three months from January to March 2009 and sold 1,82,153 tonnes of steel products

♠ The price reduction/discount was in the range of ₹1000 to 11500 per tonne.

below the applicable operating price in the name of negotiation sale. This resulted in short realization of ₹ 37.73 crore.

The Management stated (December 2010) that the process of negotiated sales was operated in a most transparent way by keeping available stocks on the notice board and giving information to all customers.

The reply is not tenable. Stock position was not displayed on the notice board and sale of material was done without meeting the *pre-requisite* of formally establishing slow/non-moving category of stocks as per the procedure.

C. E-Auction

E-auction for sale of secondary products without fixing reserve price

The Company had formulated e-auction procedure for sales of prime and defective products. The reserve price committee verifies the lots and fixes the reserve price for the lot. In violation of the approved e-auction procedure, e-auctions were initiated without fixing reserve price for 12 out of 41 lots relating to sale of secondary products at SSD[1] during 2008-09. Audit noticed that after receipt of offers against e-auction, the same were cancelled on the grounds that reserve price for the lots had not been fixed. Ultimately, the same material was sold on negotiation basis below[2] the best offer price obtained through e-auctions. Thus, by not fixing the required reserve price, the Company was put to loss of ₹ 1.17 crore.

The Management attributed (December 2010) reasons like inclusion of foreign materials in the lots, lots were not approachable, identification boards were not available etc.

The Management reply is not relevant and the case highlights failure of internal controls because it conducted e-auctions without fixing required reserve price.

Conclusion

The Company by and large, has operational framework in the form of marketing manual, policies and procedures to regulate its sales operations, except in case of sale on negotiated basis for which there was no formal approved procedure. Audit, however, observed certain deviations from procedures, standard terms and conditions in normal sales. Some of these gaps were pointed out by Audit earlier during April 2007 and despite Ministry's assurance, these gaps still persist. These deficiencies and irregularities resulted in a loss of ₹ 210.58 crore to the Company during four years (2007-11). The Company needs to address these deficiencies in order to optimize revenue.

Recommendations

- **Frame a procedure for negotiated sales and extend the e-auction procedure to the sale of iron and steel products.**
- **Consider implementing quantity based slab discounts on sale on incremental basis.**

[1] ***Scrap Salvage Department.***

[2] ***The difference between actual sale price and the best price through e-auction was in the range of ₹10650 and 13950 per tonne***

> - **Follow the system of provisional pricing for prompt recovery of increased prices, without waiting for updating price master.**

The matter was referred to the Ministry in February 2012; their reply was awaited (May 2012).

Steel Authority of India Limited

15.4 Material Management of SAIL Refractory Unit

15.4.1 Introduction

SAIL Refractory Unit (SRU) with its four plants located at Bhandaridah, Ranchi Road, Ramgarh and Bhilai came into existence from April 2007 on merger of Bharat Refractories Ltd. (BRL) in SAIL. SRU is engaged in production of different types of bricks, masses etc. for use in steel plants.

15.4.2 Objective & Methodology

The Material Management (MM) department of SRU was selected for thematic study as SRU was a newly established unit of SAIL and consumption of raw material & spares during 2008-11 formed the single largest component (ranging between 46 to 60 *per cent*) of the total expenditure. The actual expenses on consumption of raw material, stores & spares at ₹255.23 crore exceeded the planned budgeted expenditure of ₹ 225.49 crore. The SRU procures material through single, open and limited tender, but does not maintain a categorized list of the amount spent on the different modes of procurement. Hence a sample of two *per cent* of the Purchase Orders (POs) out of a total 8039 (POs) issued during 2007-10 was selected for examination.

The study was designed to assess the availability of a clearly laid down material management policy, effectiveness of the system of vendor selection, timely inspection of material, recovery against risk purchase, identification & disposal of obsolete assets/spares and adherence of the time schedule for different activities of MM. Audit included examination of various records maintained by the unit and collection of information by issue of audit requisition and discussions with Management

15.4.3 Audit Findings

15.4.3.1 Policy issues

(a) Violation of the Purchase Procedure

There was no documented purchase procedure/ contract guideline in erstwhile BRL. A purchase procedure (PCP-2006 of SAIL) was first circulated in March 2008 for gradual implementation in SRU, followed by PCP-2009 in September 2009. Both the purchase procedures (PCP-2006 & PCP-2009) were prepared in accordance with guidelines issued by Central Vigilance Commission (CVC) and were made applicable to all purchases / award of contracts.

In case of a Limited Tender Enquiry (LTE) if less than specified X+2 number of offers are received in the first attempt, Para no. 7.7 of PCP-2006 (Purchase Procedure) prescribes a second attempt to be made by inclusion of new vendors or extension of the due date.

It was observed that a LTE for procurement of 350 MT Flaky Graphite was issued (March 2009) to seven suppliers but only two parties quoted their rate. However, PO for 275 MT valuing ₹ 87.55 lakh was placed (April 2009) on L1 party without extension of due date or second attempt by way of re-tendering. This action was in violation of the purchase procedure and resulted in undue favour to the supplier. *Management stated (August 2011) that the procedure is now being strictly adhered to after the circulation of PCP- 2009.*

15.4.3.2 Planning issues

(a) Raising of incomplete indents and lack of uniformity in formats

Indents for procurement of stores and raw materials were not being raised in a standard format. Although Management stated (August 2011) that standard formats for indent of stores and raw material have been implemented after merger with SAIL, but the same were not found during our examination. Indents did not indicate details viz. indent no, specification of material, catalogue no., estimated cost, last PO and date, pending quantity of previous orders, material in pipeline, last three year's consumption pattern, required delivery date/period, mode of tendering, name of previous suppliers, minimum quantity required to be kept in the stock and stock position as on the date of indenting. In absence of above information, indents did not justify the procurement of material.

Ministry stated (March 2012) that standard formats have been introduced fully in December 2010. The fact remained that standard formats for goods acceptance/rejection note, stores issue note are yet to be followed.

(b) Non utilization of in house facilities

M-95 ramming mass* valuing ₹ 42.03 lakh was procured from outside parties for supply to Bokaro Steel Plant & Durgapur Steel Plant during 2007-10 in spite of having in-house facilities at SRU, Ranchi Road with comparably lower variable cost.

Management stated (August 2011) that after initial trial and satisfactory performance in 2010-11, the product has been taken up as regular manufacturing item for SRU Ranchi Road, and provision of any outsourcing during F.Y. 2011-12 has since been withdrawn from the Annual Production Plan.

The Ministry has re-iterated (March 2012) the views of the Management.

(c) Improper planning for procurement of Raw Material

Lack of co-ordination between various departments of MM and delay in finalization of tender attributed to shortfall of the required material. Audit came across cases where materials were requisitioned only at critical/ alarming stock position, resulting in delayed procurement and consequent loss of production.

In SRU Bhilai, against the yearly requirement of 7800 MT of Quartzite for producing 3900 MT of silica bricks, actual availability of Quartzite ranged between 4302 MT to 5463 MT during 2007-11. Thus, due to non-availability of basic material, production target for silica bricks could not be met and a contribution loss of ₹ 4.45 crore was incurred. Similarly, in SRU Ranchi Road non-availability of Sea water magnesia during the period 2007-11 interrupted the production of Magnesia Carbon Bricks and resulted in

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* ***It is used in convertors of SMS for ramming its bottom and setting of initial tap hole block.***

loss of contribution of ₹ 2.79 crore. IFICO plant also lost a contribution of ₹ 6.17 crore during 2007-11 due to non-availability of raw material which resulted in production loss of 9297.3 MT of bricks and mortars used in steel plants.

Management reply (August 2011) cannot be justified as all the reasons stated by the Management *such as naxal affected mining area, non-availability of quality material, limited stores, fund crisis and lack of storing capacity* were well known facts. Hence, procurement time schedule should have been planned accordingly to avoid these situations.

The Ministry re-iterated (March 2012) the views of the Management.

(d) Non adherence to the time schedule

- ***Delay in preparation of Store Receipt Voucher (SRV)***

SRV is the basic document for accounting (in store section) and valuation (in Finance and Accounts section) of the stores/inventory in SRU. A SRV is raised on the quantity received after checking of the consignment by the receiving section, and taking into account the short/damaged quantity of the goods.

As per ISO norm of Durgapur Steel Plant (one of integrated steel plants of SAIL), maximum 6 days are to be taken for preparation of SRV from the date of receipt of material in Day Book. However, audit noticed that there was abnormal delay of upto 396 days in preparation of SRV in the plants, in 747 cases out of 1111 case test checked during audit.

- ***Delay in recording of materials in Day Book***

The Day Book is the receiving register for all receiving sections which contains complete details of supplied inventory. On receipt of consignment, the concerned storekeeper enters all the details in the Day Book in serial order.

In 35 cases out of 70 cases verified in SRU, Ranchi Road, the entry in the daybook was delayed by upto 43 days, which as per normal practice should be noted down in the daybook on the same day. Such delay indicates failure of internal control as well as lack of seriousness in recording and accounting of received material.

- ***Delay in inspection***

As per norm of Bokaro Steel plant (one of integrated steel plants of SAIL), maximum 6 days are to be taken for inspection of the material after entry in the daybook. From a total 18147 SRVs issued by SRU, Bhandaridah and Bhilai, 809 cases were scrutinized and it was observed that in 317 cases the inspection of stores and raw material was delayed by upto 194 days, which in turn delayed the raising of Goods Receipt Note.

Management stated (August 2011) that efforts were being made to streamline the system procedure.

The Ministry re-iterated (March 2012) the views of the Management.

15.4.3.3 Vendor Development

The purchase procedure (clause 19.2 of PCP-2009) prescribes the constitution of a vendor development cell under the Head of MM with approval of the Chief executive of each plant/unit, for coordinating and monitoring all related activities. But no vendor development cell has since been constituted as the Management considered it (August 2011) as a small unit. Considering the fact that on an average 2340 purchase orders had been placed annually during 2007-11, the justification of the Management does not hold good.

Ministry stated (March 2012) that SRU is in the process of constitution of vendor development cell.

(a) Non development of vendor

Audit found that in the following cases the goods were procured from a single supplier without exploring any alternate source:

(i) SRU, Bhilai uses Chrome Ore fines as a major raw material in production of Basic Bricks. It was observed that unit was purchasing two grade of Chrome Ore (Cr_2O_3 46-48 *per cent* and 52-54 *per cent*) from M/s. Orissa Mining Corporation Limited, (M/s OMC), Bhubaneswar for the last 20-25 years on regular basis on the prices determined by the supplier.

Purchase of material without any tender for last 25 years from the same supplier was in contravention to the basic principles of procurement. *Management contended (August 2011) that the Refractory Grade Chrome Ore were purchased from OMC as per their standard terms and conditions.*

Ministry further stated (March 2012) that supply of Refractory Grade Chrome Ore was the monopoly of OMC. Ministry's contention is not acceptable as the material was purchased without any tender, hence presence of other suppliers in the market could not be known.

(ii) Micro Silica was used in SRU, Bhandaridah for production of castable. This item was procured from M/s. Elkem under brand name Micro Silica (Grade 971 U) on single tender basis for quite a long time on the plea of suitability of the material.

Management while accepting our contention has stated (August 2011) that material was procured on proprietary basis from M/S Elkem. However, alternate sources are being explored.

The Ministry re-iterated (March 2012) the views of the Management.

15.4.3.4 Procurement System and tendering processes

(a) Deficiencies in tendering – Splitting of indent

As a general principle indents should not be splitted, Clause no.5.3.2 of PCP-09 also disallows the splitting of purchase indents.

- Audit observed that against the requirement of 5917 MT Brown Fused Alumina for 2009-10, Global Tender Enquiry (GTE) was floated (August 2009) for 2500 MT only. Again 990 MT was procured (May 2010) through repeat orders approved by ED (SRU); and fresh LTE was issued for remaining 1530 MT in May/June 2010. Thus, three types of tendering methods were used by the Management against the same indent which resulted into avoidable extra procurement cost of ₹ 28.66 lakh.

The contention of the Management (August 2011) that price variation was mainly due to volatile market conditions and demand/ supply constraints and that there was no splitting *of annual requirement* is not acceptable as the required quantity could have been ordered with staggered delivery schedule to avoid any extra expenditure due to volatility of market.

The Ministry re-iterated (March 2012) the views of the Management.

- SRU, Bhandaridah and Bhilai raised the indents for a total quantity of 1896 MT of Silicon Carbide for 2009-10 but GTE was issued for 1050 MT for six-month requirement only. For another 688 MT, LTE was invited (April 2010) from all valid bidders of last global tender, and PO placed for 538 MT at a price higher by ₹7900 per ton. Thus, due to splitting of indent quantity and issuance of two POs, the unit incurred an extra expenditure of ₹ 42.50 lakh.

Management cited (August 2011) budgetary constraints for inviting GTE for six month requirement only and stated that extra expenditure was on account of price increase & demand and supply constraints prevalent at that time. Management reply is not tenable as the same item had to be procured subsequently at a higher rate, as order for the full-required quantity was not placed.

- In SRU, Bhandaridah 970 MT of FC Graphite was procured at higher rate in comparison to the rate finalized earlier (July 2009) through OTE and an extra expenditure of ₹56.07 lakh was incurred due to splitting of indent and non-placement of PO for full tendered quantity.

The reply of Management (August 2011) that prices of Graphite had subsequently gone up and there was apparent cartel formation by other tenderer, is not acceptable since market variation should have been factored earlier, and orders for the entire required quantity should have been placed with staggered delivery schedule to avoid procurement at high rates.

The Ministry re-iterated (March 2012) the views of the Management.

(b) Extending of undue favour to the suppliers

- SRU, Bhilai entered into MOU with Tamilnadu Magnesite Ltd. (TANMAG) for procurement of 6000 MT of Dead Burnt Magnesia (DBM) with a firm price subject to escalation for increase/decrease in price of furnace oil. It was noticed that after supplying DBM at MOU rate for two months (May-July 2008), TANMAG arbitrarily increased the rate of DBM claiming escalation for inputs besides furnace oil as well, which was against the provision of MOU. However, Management accepted the new rate and accepted 4839 MT of different grades of DBM at the higher rate, resulting in extra expenditure of ₹ 75.25 lakh.

Management accepted (August 2011) that no provision existed in the MOU for increase in price except on account of variation in the price of Furnace Oil, however recovery/corrective action taken by the Management, if any was still awaited.

The Ministry re-iterated (March 2012) the views of the Management.

- In another case, SRU Bhilai placed PO on M/s Almora Magnesite Ltd (AML) for 3700MT of DBM at a fixed rate of ₹ 7800/MT, but after supplying 2489 MT of DBM, M/s AML demanded (June 2008) price escalation against the provision of PO and on account of increased cost of furnace oil. Management however amended (September 2008) the PO and inserted escalation/de-escalation clause linked with the price of furnace oil and incurred an extra expenditure of ₹ 14.73 lakh on the rest of the supplies.

Management accepted (August 2011) that price was revised in spite of absence of price variation clause in the PO, but corrective action taken by the Management was since awaited.

Ministry further added (March 2012) that escalation was granted after approval of the competent authority. The fact remains that the price escalation was allowed in contravention of the PO.

(c) Materials purchased at higher rate

- For procurement of 1600 MT of De-hydrated Coal tar, SRU Bhandaridah issued LTE on eight parties who had responded in a previous OTE. M/s. Nangolia Hydrocarbon at an offered rate of ₹ 14886 /MT emerged as L_1. But in violation of the provisions of clause 9.2.2 of PCP-2009, the price bids were rejected without assessing technical viability, on the ground that the party had not submitted samples. After negotiation, POs to five other parties at the new L_1 rate of ₹ 15832/MT was issued (May 2007), incurring additional ₹ 15.14 lakh due to rejection of L_1 party without technical assessment.

  The rates for the balance quantity (528.99 MT) to be supplied since September 2007, was revised to ₹ 22032/MT on the plea that the price of crude tar had increased, although there was no price escalation clause in the PO and was also in violation of the provision of para 5.5.1(iii) of PCP 06 to be followed in firm price contract. This resulted in an undue favour of ₹32.80 lakh extended to the suppliers.

Management replied (August 2011) that M/S Nangolia Hydrocarbon did not submit the sample and it was known to them that acceptance of their offer would be a deviation from the standard terms and conditions of the enquiry leading to violation and consequential effects and price was revised in later case for un- interrupted production. The reply is not tenable as price bid was opened before the verification of the technical suitability of the material and Management had not made efforts to evaluate the technical suitability by getting sample from M/s Nangolia Hydrocarbon or confirmation from the sister concern, which was referred by the party to take the benefit of lower price. Further increasing of price to the benefit of supplier on the plea of production is not reasonable as there was no escalation clause in the previous PO.

The Ministry re-iterated (March 2012) the views of the Management.

- SRU, IFICO floated (June 2009) LTE to three parties for procurement of 1800 MT of Brown Fused Alumina (BFA) against which only one party i.e. M/s. Orient Abrasive Limited (OAL) quoted a landed rate of ₹ 40500/MT, and purchase orders for 450 MT was placed (February 2010). Although the Tender Committee (TC) recommended procurement through fresh OTE for the remaining quantity (1350 MT), but Management violated their recommendation and issued LTE. Again only one party i.e. OAL was found technically suitable with a rate of ₹ 45000/MT and PO placed (August 2010) on the party was at an avoidable extra expense of ₹ 60.75 lakh over previous rate.

Management stated (August 2011) that publishing the tender notice in any leading

Newspaper would have given no better response rather it would have been addition to cost without any fruitful result. The reply is not tenable as the recommendations of the TC were flouted and audit found that there was availability of material from foreign suppliers and orders of BFA were placed in June 2009 at a lower rate.

Ministry further added (March 2012) that the cost of equivalent imported BFA was higher. The reply is hypothetical and not based on evidence. The recommendation for procurement of BFA through OTE was, however, not adhered to by the Management.

15.4.3.5 Post contract management

Post contract Management is a vital activity for ensuring receipt of material as per delivery schedule and consistent with quality requirement. Audit observed cases of non-receipt of discount on defective material, non-invocation of risk purchase clause, foreclosure of earlier order and placement of subsequent order at a higher rate.

(a) Non receipt of discount on defective Material and release of Guarantee bond

Some physical defect was observed in the 336MT of Fused Magnesite supplied (July 2009) by M/s. Magmaple Minerals through its Indian agent M/s. Pan India Impex, after use of the raw material and during processing of bricks. The Joint sampling carried out with the representatives of M/s. Pan India Impex and tests conducted at a Govt. approved laboratory, revealed that the material was sub grade and below the specification. The Inspection clause of PO stated that in case of final rejection, the material was to be replaced free of cost. Management decided (September 2009) to avail some rebate as a penal action against the agency and to debar the party from participating in future bidding process. It was observed that neither any discount was received from the party nor his name was de-listed from the vendor list for future bidding. On the contrary, performance Guarantee bond of ₹ 5.25 lakh and earnest money ₹ 1.50 lakh was also released to the party.

Management stated (August 2011) that a committee was constituted by the then ED I/c for determining rebate amount, however the formation of committee was not formally circulated amongst its members and no rebate was therefore decided. The reply is shocking & displays the lackadaisical attitude of Management.

Ministry stated that (March 2012) the committee constituted for deciding the penalty towards supply of sub grade material has recommended a 6% penalty. Imposition of 6% penalty is a meagre compensation so far as physical defects observed in the manufactured bricks is concerned.

(b) Non initiation of Risk purchase action

- The PO placed (July 2008) on M/s. Adishri Limited, Hong Kong through its Indian agent M/s. Venketesh Udyog was cancelled on supplier's request, without any liability on either side although the general terms and conditions of the contract stipulated that 'If the seller failed to have the material delivered by the time or times agreed upon, the importer was free to buy such quantity at the risk and cost of the seller in every way'. The Company issued fresh LTE and L_1 price of US$ 1830 per MT was obtained as against US$ 1596 per MT obtained through GTE previously, incurring an additional cost of US$ 234 per MT. Justification for cancellation of PO without invoking of risk purchase clause was also not found on record, and the Company had to incur an additional cost of ₹ 29.35 lakh.

Management stated (August 2011) that M/s Adishri Limited, didn't supply any material due to change in export policy of China and contract was closed without any liability on either side. The justification of the Management is not convincing as the Indian agent of the defaulting party was called in the fresh LTE for procuring the same material, without insisting on the party to supply the ordered quantity at the old rate before participating in the LTE.

The Ministry re-iterated (March 2012) the views of the Management.

- Risk purchase clause was not invoked against M/s. China Mineral Processing Ltd and 1000MT of Brown Fused Alumina initially to be supplied (July 2007) at US$ 387655 was purchased (October 2007) from M/s. Taiynam Wyplex Industries Co. Ltd., Hong Kong at a rate higher by US$ 212345. Although recovery of ₹ 84.94 lakh (@ ₹ 40 per US$) was suggested by the finance department, SRU did not initiate risk purchase action against the party.

Management stated (August 2011) that the supply position was squeezed in view of the then upcoming Olympic games in china, which resulting in abrupt increase in prices and non-availability of material for shipment. But it was observed that the supplier had full knowledge of an upcoming Olympic event in china, at the time of bidding and non-availability of material with the supplier was not a valid reason for non-invocation of risk purchase claim.

Ministry stated (March 2012) that the Company has decided to forfeit earnest money of ₹ 1 lakh and debar the party for future tender for next three months. Forfeiture of earnest money is not enough as the Company failed to initiate risk purchase action to recover the differential cost of ₹ 84.95 lakh from the party.

15.4.3.6 Slow moving non-moving unserviceable and obsolete stores material.

A list of slow moving, non-moving, unserviceable and obsolete stores and spares was prepared by the Management on 31-3-2011 valuing ₹ 2.99 crore. These materials were lying in the stores for 5 to 30 years and no effective system for their periodical disposal was framed by SRU. Moreover the minimum level, maximum level and re-ordering level for the procurement, consumption and control of inventory, was also not fixed in any of its units.

Management stated (August 2011) that initiative has been taken to form a committee to look after the proper disposal of these assets.

The Ministry re-iterated (March 2012) the views of the Management.

15.4.3.7 Non-disposal of Scrap

It was noticed that approximate 262.80 MT of old and bended steel scraps valuing ₹ 39.42 lakh were lying scattered in different areas of SRU, Bhilai since long awaiting disposal. These Steel scrap were already in rusted and pitted condition and were kept in open space which was deteriorating their state further. Management accepted the audit observation and stated (November 2011) that 300 MT of scrap has since been collected for which reserve price is being fixed.

Similarly, in SRU, Bhandaridah various types of scraps valuing ₹ 0.55 crore were found awaiting disposal action. Management in their reply (August 2011) stated that proposal was under process to shift the material to SAIL steel plants for use in melting scrap.

However, it was found that the material was still lying in the stores of SRU, Bhandaridah awaiting disposal.

Ministry in its reply stated (March 2012) that the disposal action shall be completed within six months.

15.4.3.8 Poor implementation of information technology in MM.

The Company has two EDP centres – one at head office, Bokaro (catering to additional EDP work of Bhandaridah and Ranchi Road plant) and other at IFICO, Marar (Ramgarh). Audit observed that the computerized system of SRU were neither synchronized nor interlinked to get the information in the required format and in-time for management's decision making. Considering the fact that SRU, Bokaro placed POs valuing ₹ 146.72 crore during 2008-10, the computerization of MM Department was grossly inadequate, with only selective works being performed through computers.

Management stated (August 2011) that each SRU plant had computerized its activities on a piece meal basis and accepted the need for up-gradation of MM activities and further integration for which manpower was yet to be posted.

Ministry stated (March 2012) that the Company is in the process of computerization of MM activities in SRU.

Conclusion and Recommendations

Due to violation of Standard Purchase Procedure in different procurement activities and non-observance of prudent practices there was loss of ₹ 4.40 crore, loss of margin of ₹ 13.41 crore and cash outflow of ₹ 42.03 lakh. SRU should adhere to the provisions in the PCP of SAIL especially with regard to avoidance of splitting of indents, standard formats, invoking of risk purchase clause, adherence to escalation clause & post contract monitoring viz. timely receipt of material & quality assurance. Utilization of in-house facility should be optimized & IT system developed for better governance.

15.5 Avoidable loss in IISCO Steel Plant

The Company increased the requirement of oxygen from the contractor's plant even though the demand could be met from the existing guaranteed off-take. This resulted in payment of low demand charges for oxygen not lifted to the extent of ₹ 23.82 crore.

Oxygen is a vital input for steel production. IISCO Steel Plant (ISP-a unit of Steel Authority of India Limited (Company) had a 50 ton per day (TPD) capacity captive Oxygen Plant. The Company installed T. H. Furnace No. 1 and 2 in November 1999 and April 2004, respectively. To cater to this additional demand, the Company decided to set up oxygen plants of 70 TPD each on Build- Own - Operate (BOO) basis through agreements in September 1999 (BOO-I) and March 2004 (BOO-II) with M/s. GMGL (Contractor). The Contractor built the plant under BOO-I & BOO-II of 70 TPD and 200 TPD capacities that commenced operations from September 2001 and September 2006 respectively. One of the terms in the BOO-II agreement stipulated that in case of persistent low demand for oxygen[♠], the Company was required to pay low demand charges (LDC) as per agreed formula.

In May 2008, the agreement under BOO-II was amended and the requirement was increased from 140 TPD under the two agreements to 180 TPD in 2008-09 and 200 TPD from 2009-10 onwards foreclosing contract for BOO-I from June 2008. Guaranteed off-take as 180 TPD was to cater to oxygen requirement against Annual Business Plan (ABP) of 550000 ton of crude steel for 2008-09. The basic rate of oxygen in the amended contract was fixed at ₹ 2.50/Nm^3 for supplies upto 71.4 TPD and ₹ 4.70/ Nm^3 thereafter. The formula for low demand charges factored in the increased rate of ₹ 4.70/Nm^{3}of oxygen. The average consumption from BOO plants in 2008-09 fell short of the revised guaranteed off-take of 180TPD and the Company had to pay an LDC of ₹ 5.04 crore. From August 2006 to March 2011 the Company paid ₹ 23.82 crore to the Contractor as penalty for low demand.

Audit observed that:

- The user departments of ISP included four Blast Furnaces (BFs). The demand decreased after ISP closed down operation of its two BFs in February, 2008 and October, 2008 which were of 1922 & 1958 vintage respectively due to their uneconomical and unsafe operation. Even then the Company estimated an increase in production and increased (May 2008) the contractual supply. This increased the gap between demand and supply and the penalty payment amount (low demand charges).
- The total oxygen requirement of around 170 TPD during 2006-09 and around 140 TPD in 2009-11 could have been met with the existing supplies of 50+140 TPD and there was no need to enhance the guaranteed off-take to 180 TPD from the Contractor in May 2008 by amending the contract. Due to revision of rate to ₹ 4.70/ Nm^3 for supplies beyond 71.4 TPD, the factor for payment of low demand charges also increased.
- The captive Oxygen Plant was producing on an average 54-55 TPD i.e. more than its rated capacity with variable cost of production at ₹ 3.36/Nm^3 and ₹ 4.23/Nm^{3}during 2007-08 and 2008-09 respectively in comparison with the price paid for BOO oxygen which worked out to ₹ 7.45/Nm^3 and ₹ 7.65/Nm^3 during the same period. The captive plant was however temporarily shut down in December 2008 and eventually closed down in July 2009.
- Corporate Vigilance observed (May 2010) that the formula for calculating penalty appeared to be in favour of the contractor since the amount paid by the ISP for lower oxygen consumption became higher at times than the amount payable for consumption of minimum guaranteed tonnage. Audit verified the observations of vigilance above and found on test check that the amount of low demand paid to the contractor during 2008-11 did exceed the payment for actual consumption of gases on three occasions i.e. July 2009, October 2009 & September 2010.

The Management stated (September 2011) that the Annual Business Plan (ABP) of 550000 ton of crude steel for 2008-09 could not be achieved due to certain changes in

[♠] ***Demand falling below 68.6 TPD for more than three days in a calendar month.***

market scenario and closure of one Blast Furnace. Although, ISP took up with the supplier to reduce the guaranteed off-take quantities, the contractor did not agree to amend the contract. It was then decided to close down 50 TPD captive Oxygen plant to restrict the additional loss from operation of captive Oxygen plant and simultaneous payment of penalty to the supplier for low demand.

Management's reply is not acceptable in view of the following:

The projection of 550000 ton of crude steel in the ABP during 2008-09 was not realistic as the highest annual production of ISP was 469323 ton of crude steel during the previous five years ending 2008-09. It is pertinent to mention that this optimistic projection was made in spite of the closure of BF-1 in February 2008 and the deteriorating condition of BF-4*, which finally broke down in October 2008. Moreover, no documented basis for the 2008-09 ABP projections was made available to audit, indicating the absence of a proper system for its calculation.

Thus, increase in contractual supply based on an unrealistic production plan and increase in basic price of oxygen resulted in avoidable loss of ₹ 23.82 crore, besides closing down of captive oxygen production facility.

Corporate Vigilance had advised the concerned department of ISP to review the contract terms in respect of penalty clause and submit action taken report (May 2010). ISP constituted a committee (August 2010) to review the contract terms regarding penalty clause/payment for low demand of oxygen. The committee was reconstituted in June 2011 and the final report of the committee was still awaited (January 2012).

While re-iterating the view of the Management, the Ministry stated (April 2012) that procurement of oxygen from the open market would have been costlier than what was incurred through the BOO contract.

The reply of the Ministry is not relevant as the additional requirement of oxygen and in turn the increase in guaranted off-take, was itself based on unrealistic production targets.

15.6 Investment in pipe coating plant

Pipe coating plant commissioned at a cost of ₹ 56.36 crore to meet substantial increase in demand assessed in a market survey conducted way back in 2003 failed to generate adequate orders for coated pipes

Rourkela Steel Plant (RSP) of Steel Authority of India Limited (Company) has two Pipe Plants i.e. electric resistance welded pipe plant and spiral welded pipe plant. The SAIL Board accorded in-principle approval (October 2004) to install a pipe coating plant at a cost of ₹ 59 crore to improve the market for the pipes of RSP as users of pipes in hydrocarbon sector required the pipes in coated condition to prevent corrosion. The in-principle approval was given on the basis of market survey made by the Company in 2003 assessing substantial increase in demand for coated pipes. This was followed up after more than two years by the final approval in December 2006. The approval was for a pipe coating plant with 60000 tonne per annum capacity at an estimated cost of ₹ 68.27 crore and a completion schedule of 20 months with a post tax IRR of 24.62 *per cent.* The

*** *The Poor health of the BF-4 was well known to the management as the Furnace was last relined in 1995 and production of hot metal from this Furnace had reduced from 323885 tonnes in 2006-07 to 265279 tonnes during2007-08***

approval was accorded as the project was considered essential to remain competitive in the market. The plant was commissioned in January 2009 at a cost of ₹ 56.36 crore. The delay of 7 months was attributable to the contractor for which LD was imposed.

Audit observed that even after passage of almost three years since commissioning of the plant, the Company has not been able to obtain adequate orders for coated pipes. The plant carried out coating on 510 tonnes (2008-10) of pipe of which the Company could sell only 423.45 tonnes and the rest was lying in stock. During the year 2010-11 and 2011-12 (upto December 2011) there was nil production and the plant remained unutilised. The plant was funded out of internal resources and the interest on the same from February 2009 to January 2012 calculated at 8 *per cent* was ₹ 13.53 crore.

Management stated (September 2011) that the investment proposal was based on proper market survey and that the Company had obtained an order for 58 KMs. (15500 tonnes approx.) of coated pipes in June 2011, and that the plant's capacity utilisation would improve with the order and other future orders.

Ministry while re-iterating the views of the Management stated (April 2012) that after receipt of order for 15,500 tonnes, a fresh order for 402 tonnes has been received in November 2011 and RSP has become L1 in another tender for 3280 tonnes. The dispatch against the order of 15500 tonnes has started from February 2012 and after receipt of the two new orders the capacity utilization will go up by another 6.2 per cent.

Management's reply is not acceptable since even after receipt of the above order, only 26 *per cent* of the plant capacity would be utilized, and the receipt of new orders, would bring no significant improvement in the capacity utilization of the Pipe Coating Plant.

The justification for setting up the coating facility was that the sale of pipes was declining over the years and that coating plant would improve the market for pipes from RSP. However, the total sale of pipes including 423.45 tonnes of coated pipes declined from 75000 tonnes (2008-09) to 58000 tonnes (2009-10). In 2010-11 sale of uncoated pipes (as there was nil production of coated pipes) increased to 82000 tonnes. **Thus the project commissioned on the basis of market survey of 2003 had failed to generate adequate orders and had not tuned out to be essential to SAIL remaining competitive in the pipe market.**

15.7 Non-recovery of irregular subsidy extended to the employees

The Company was providing electricity to its employees residing in township of Bhilai Steel Plant at rates below the tariff fixed by the Chhattisgarh State Electricity Regulatory Commission in violation of the Department of Public Enterprise's as well as Company's instructions on payment of subsidy. An amount ₹ 3.05 crore extended as subsidy to the employees, was still to be recovered by the Company.

Wage revision of executives of Steel Authority of India Limited (Company) was implemented and the allowances and perks were revised w.e.f. 5 October 2009. As per Department of Public Enterprise's (DPE) instructions (November 2008) regarding wage revision, executives were eligible for maximum 50 *per cent* of basic pay as allowances and perks under 'Cafeteria Approach'. In compliance with the DPE orders, the Company issued (December 2009) orders that "With implementation of the 'Cafeteria Approach', all subsidies towards electricity, canteen/meal coupons etc. will stand withdrawn in case of executives". Hence, Bhilai Steel Plant (BSP) of the Company decided (February 2010) to withdraw electricity subsidy and revised the electricity charges to be recovered from executives residing in the Company township with retrospective effect from 1 October 2009.

In this regard Audit observed that:

- The revised electricity charges recovered from BSP executives were less than the tariff fixed by the Chhattisgarh State Electricity Regulatory Commission (CSERC) for BSP –TEED[♥] in its order dated 31 August 2009 for the year 2009-10 as detailed below.

Tariff fixed by the CSERC (₹/Unit)				Revised electricity charges being recovered from executives (₹/Unit)			
Unit slab	Fixed Charges	Energy charges	Total	Unit slab	Fixed Charges	Energy charges	Total
0 -100 units	1.15	1.15	2.30	0–500 units	1.00	0.90	1.90
101-200 units	2.00	2.00	4.00	0–700 units	1.20	1.25	2.45
Above 200 units	2.75	2.75	5.50	0–above 700 units	1.50	1.50	3.00

- From the above, it was evident that the electricity subsidy had not been withdrawn fully and non-recovery of electricity charges from the executives at the rates fixed by the CSERC amounted to extending subsidy.
- Wage revision provision prohibited any perks to executives beyond the maximum limit of 50 *per cent* of basic pay under 'Cafeteria Approach'. Payment of subsidy as above was in violation of DPE instructions of November 2008 as well as Company's guidelines of December 2009.
- The subsidy on electricity to executives residing in township continued upto July 2011. The amount of subsidy so paid worked out to ₹ 3.05 crore from October 2009 to July 2011.

Ministry stated (December 2010) that charges recovered from the executives were in line with the CSERC approved rates for Chhattisgarh State Power Distribution Company Limited (CSPDCL) applicable in entire Chhattisgarh State which was market price and as such no subsidy was paid to the executives.

The contention of the Ministry was not acceptable as:

- CSERC approved rates for CSPDCL were not applicable to the executives of BSP residing in the township as BSP - TEED, was a separate licensee under Section 14 of the Electricity Act 2003 for which separate tariff was fixed by the CSERC. Thus recovery from executives below the tariff fixed by the CSERC was subsidy to executives.
- The tariff order passed by the CSERC was not followed by the Company which was a violation of the Electricity Act, 2003 as Section 45(1) of the Act states that "the prices to be charged by a distribution licensee for the supply of electricity by him shall be in accordance with such tariffs fixed from time to time and condition of this license".

[♥] ***Town Electrical Engineering Department (TEED) of BSP supplies electricity to the BSP Township***

- The Company was charging higher rate i.e. rate fixed by the CSERC from other domestic consumers (consumers other then the SAIL employees) and providing electricity to its employees at lower rate.

Charging lower rate from the executives below the tariff fixed by the CSERC amounted to subsidy, which was irregular. Although BSP is recovering electricity charges as per new tariff w.e.f. 1 August 2011, the subsidy extended to the employees during October 2009 to July 2011 amounting to ₹ 3.05 crore has not been recovered by the Company.

CHAPTER XVI: MINISTRY OF TEXTILES

British India Corporation Limited

16.1 Sale of land

16.1.1 Introduction:

British India Corporation Limited (Company), registered in February 1920, owns and manages two woollen mills, one at Kanpur in Uttar Pradesh and another at Dhariwal in Punjab. The Company was declared sick in 1992 and the Board for Industrial and Financial Reconstruction (BIFR) sanctioned a rehabilitation scheme in December 2002 for implementation in two years. As this scheme was not fully implemented, a modified rehabilitation scheme was approved by the Government of India (GOI) in June 2011.

As per the rehabilitation scheme of December 2002, the cost of scheme was ₹ 210.51 crore. The envisaged source and utilization of fund was as follows:

(₹in crore)

Source of Fund	Amount	Utilization of fund	Amount
Sale of Surplus Assets	124.51	Payment of dues to Banks/Financial Institution	92.25
Grant from GOI	49.00	Modernization and renovation of plant/machinery	46.58
		Working capital	7.25
Interest free loan from GOI	37.00	Voluntary retirement schemes	7.00
		Cash loss and other dues	57.43
Total	**210.51**	**Total**	**210.51**

Even after nine years, the rehabilitation scheme was not fully implemented as the plant could not be modernized due to non-generation of enough funds from the sale of assets. The financial position and operating results of the Company during the years 2006 to 2010 is given below:

(₹in crore)

Particulars	2006-07	2007-08	2008-09	2009-10
Share Capital	31.71	31.71	31.71	31.71
Accumulated loss	(193.26)	(161.98)	(206.01)	(248.64)
Sales (projected in rehabilitation scheme)	98.00	98.00	98.00	98.00
Sales (actual)	11.87	6.03	3.54	3.54
Net profit (projected)	10.37	7.62	6.46	5.21
Net profit (actual)	(13.40)*	31.27**	(44.03)	(42.63)

****includes profit from sale of assets of ₹12.59 crore and GOI grant of ₹18 crore for salary***

***** includes profit from sale of assets of ₹40.51 crore, write back of provisions of ₹14.42 crore and GOI grant of ₹18 crore for salary***

It can be seen that the actual sale was negligible during last four years ended 2009-10 compared to the projections of rehabilitation scheme, due to delay in full implementation of the rehabilitation scheme (i.e. non-modernization of the plant) and consequent negligible production. There was substantial operating loss in last several years, against the profit projected in the rehabilitation scheme, mainly due to high fixed cost towards salary of employees and negligible production. The financial statements for the year 2010-11 were yet to be finalized (March 2012).

16.1.2 Audit Objective, Scope and Methodology

Non-generation of enough funds from sale of surplus properties (land including structures thereon) was the main reason for non-completion of the rehabilitation scheme. Audit was, therefore, conducted to examine adequacy of due diligence on surplus assets and the efficiency with which the sales process was carried out.

Audit covered 'sale of Kanpur properties' as the same was expected to generate a major part (₹ 104.78 crore) of the total funds required to finance the rehabilitation scheme.

Audit reviewed the records relating to sale of the Company's Kanpur properties and other related documents i.e. minutes of Board of Directors and Asset Sale Committee, Company's correspondence with Ministry of Textiles, State of Uttar Pradesh and BIFR.

16.1.3 Audit Findings:

16.1.3.1Non-maintenance of details of the properties

(a) Non-maintenance of Fixed Assets Register

The Company did not maintain proper details to identify all properties it owned and classify each property as leasehold/ expired lease/freehold. Statutory auditors repeatedly pointed out the non-maintenance of statutorily required 'Register of Fixed Assets' in the Company.

Management stated (December 2011) that a register of fixed assets of the Company had been prepared in the year 2010. Audit observed that the absence of proper records of the properties led to bottlenecks in generation of funds from sale of properties, which ultimately impacted full implementation of the rehabilitation scheme of 2002, as pointed out in the succeeding paragraphs.

(b) Company unaware of existence of its three encroached lands

As per the survey conducted (May 2003) by District Magistrate, Kanpur, three properties belonging to the Company were found encroached upon. The Company was unaware of the existence of these lands in its name prior to the survey as per details given below.

Sl. No.	Name of property in Kanpur	Area	Circle rate for year 2011	Value of land	Current status of land
		(sq.mtr.)	(₹/sq.m.)	(₹ in crore)	
1	Bhairoghat, Plot no. 3	922.92	14000	1.29	Encroached property near crematorium place
2	Parmat, Plot no. 394,400-402	6845.76	11000	7.53	Land is under possession of Tannery and Footwear Corp. of India, A Central Government Company.

3	Plot no. 68, Civil Lines	2084.05	30,000	6.25	Land encroached by various people
	Total	**9,852.73**		**15.07**	

Thus due to negligence in maintenance of Fixed Assets Register, the Company could not declare these lands as surplus land as also the fact that these properties got encroached in absence of any oversight.

16.1.3.2 Absence of due diligence and internal controls

In accordance with the terms of the rehabilitation scheme, the Company was responsible for obtaining all statutory approvals and no objection certificates from concerned authorities/agencies for implementation of the scheme. The Ministry of Textiles (the Ministry), GOI, constituted (January 2003) an Asset Sale Committee (ASC), consisting of representatives from the Ministry, State Government, operating agency, BIFR and the Company, for undertaking sale of properties of the Company. ASC was responsible for effecting sale of assets in a transparent manner, generate maximum resources for the revival plan and monitor the sales progress.

The Company appointed (February 2002) M/s Price Waterhouse Cooper Private Limited (PWC) as property consultant for the sale of surplus land, which was confirmed (January 2003) by ASC. As PWC miserably failed to carry out its duty in respect of the assets' portfolio analysis and identify the possible bottlenecks in the sale process, its contract was terminated in January/April 2004.

Audit observed that the Company and ASC relied solely on consultant's reports regarding classification and valuation of properties as there was no system of vetting of the consultant's report in the Company. The following discrepancies in the classification and valuation of Kanpur properties were noticed in audit.

(a) Wrong classification of land as to lease status

In the advertisement for sale of properties under phases II & III (March/May 2003), six properties were incorrectly shown as current lease properties even though the lease of these properties had already expired.

Management stated (December 2011) that the classification of properties was based on the information available in the records of the Company. In fact, records of District Administration should have been verified instead of relying on its own information as there was no authentic or reliable record of properties in the Company in absence of the 'Fixed Asset Register' for decades.

(b) Wrong classification as to usage of land

Two properties (BIC Club and Wisteria) were industrial land as per records of Kanpur Development Authority (KDA) but advertised (May 2003) as residential properties by the Company.

The Management stated (December 2011) that these properties were possibly advertised as residential properties based on assumption as these were being used for residential purpose and club for a long period. The Ministry stated (January 2012) that there was no financial loss as there was no industrial circle rate for the location and, as per circle rate book, the residential rate was applicable for the area. However, the fact remains that, in absence of reliable records of the properties in the Company, the records of KDA should have been verified in case of all properties to find out the current status of land.

(c) Short fixation of reserve price by ₹6.30 crore

Reserve prices of land were fixed on the basis of old circle rates (1999) in respect of sales advertised in phases I, II & III (January 2003 to May 2003) which led to fixation of reserve price below the then circle rates (year 2002) by ₹ 4.23 crore in respect of 8 properties (**Annexure-XXI**). As a consequence, in case of seven properties, the highest bid price was below the price as per circle rates of 2002 and the difference between the highest bid price and the advertised reserve price amounted to ₹ 1.39 crore in these cases (**Annexure-XXI**). Further, the value of building/structure was not considered while working out the reserve price resulting in short fixation of reserve price of 26 properties by ₹ 2.07 crore (**Annexure-XXII**), even though the amount of ₹ 104.78 crore expected to be generated from sale of Kanpur assets included this amount of ₹ 2.07 crore based on evaluation report (2001) of an approved/registered Government valuer.

As any sale could not be confirmed if the highest bid falls below the advertised reserve price, the Company lost ₹ 3.46 crore (₹ 1.39 crore+₹ 2.07 crore) due to fixation of lower reserve price. Audit observed that, other than termination of the contract, no punitive action was taken against PWC for their negligence in the assigned due diligence work.

The Management/Ministry's argument (February 2012) that, as no charge against PWC were established, the Company had not proceeded against PWC for recovery of damages, is not convincing because the contract with PWC was terminated (January 2004) for their failure in carrying out the due diligence as per the terms of contract.

16.1.3.3 Flawed process of land sale led to non-modernization of plant and consequent unwarranted pressure on exchequer for salary payment of idle manpower

The Company identified 29 surplus properties in Kanpur under the rehabilitation scheme and the same were put up for sale in three phases (between January 2003 and May 2003). One additional property was advertised for sale in December 2003 and two more properties in February 2007. Out of these 32 properties, only two properties were freehold, 13 properties were under perpetual lease for 999 years and 17 properties were under current lease for 99 years (including 9 properties where the current lease had expired).

The Company invited bids for sale of land in three phases (January to May 2003) by undertaking the responsibility of the conversion of land to freehold at its own expense, on the assumption that the land would be converted at nominal rates by the State Government as envisaged in the rehabilitation scheme. Audit observed that the State Government had agreed before BIFR to provide concessions in the conversion of land to freehold. However, the State Government further informed (February 2003) the Company that 'the Economic Affairs Committee of the Cabinet in its meeting held on 2.1.2003 directed it to 'permit the Company to sell the additional surplus land to the extent that no reliefs and concessions are required'. However, the Company went ahead with the sale process, simultaneously pursuing the State Government for approving the conversion at nominal charges but failed.

Meanwhile, as per the terms of notice inviting bids for sale of properties, 25 *per cent* of the sale price was to be paid by the highest bidder as advance and the balance 75*per cent* amount was to be received by the Company on conversion of leasehold land to freehold. However, the sale of properties was not complete so far (March 2012) in case of 22 properties for want of conversion to freehold. The present status of the sale of various properties (March 2012) is stated in **Annexure-XXIII.**

An amount of ₹ 77.54 has been received so far, including ₹ 51.84 crore from sale of freehold properties and those properties sold under phase-IV & V **(Annexure-XXIII)**. Out of this, only an amount of ₹ 25.82 crore was received from leasehold properties advertised under phases-I to III. Audit observed that this entire fund was utilized for repayment of dues to banks/financial institution as stipulated in the rehabilitation scheme. An amount of ₹ 54.78 crore, towards 75*per cent* of sale price of 18 leasehold properties, could not be received so far due to failure of the Company to get the leasehold land converted to freehold.

As the Company failed to get approval of the State Government for conversion of the land at nominal rates, in July 2008, application for the conversion in case of six properties was submitted to the State Government's District Administration along with payment of conversion charges at the then circle rates (paid by the buyers), which was rejected (June/July 2011) by the latter on grounds of non-payment of lease rent by the Company since 1992, non-renewal of the lease period or difference between the area of land for which the conversion was applied for and the actual area as per Administration records. In remaining cases neither the buyers deposited the conversion charges with the Company nor was application submitted to concerned authority for the conversion so far.

Thus, due to absence of due diligence on the properties before advertising the sale and consequent non-conversion of leasehold land into freehold, the modernization/renovation of the plant could not be completed till date. Consequently, the production was negligible and losses were mounting in the Company for last several years.

As a consequence of the losses, the GOI had to pay ₹ 147 crore, beyond the terms of rehabilitation scheme, as grant (₹ 72 crore) and loan (₹ 75 crore) for salary payment for the years 2004-05 to 2010-11. GOI had already released the grant of ₹ 49 crore and interest free loan of ₹ 37 crore during initial period as per the terms of rehabilitation scheme of 2002. These entire funds of ₹233 crore proved to be fruitless as this fund did not increase production in the Company and the manpower/plant remained idle.

In June 2011, the Cabinet, GOI further accorded 'in principle' approval to a revised rehabilitation scheme, at revised cost of ₹ 341.60 crore, subject to the condition that permission is first obtained for sale of the surplus land from the State of Uttar Pradesh. The revised scheme did not appear to have effectively addressed the issue of revival of the Company, as the scheme again depended on the long pending unresolved issue of conversion of lands to freehold.

The Ministry contended (January 2012) that because of non-fulfilment of commitment made by the Government of Uttar Pradesh before the BIFR, in regard to the conversion of land at nominal charges, there was delay in implementation of the rehabilitation scheme and the cost overrun.

The Ministry's contention is not acceptable, because, the Company advertised the sale of properties without proper due diligence for identification and removal of the bottlenecks in the sales process.

Audit did not find any justification/rationale for keeping the manpower idle for non-modernization of the plant, just on the excuse of non-fulfilment of commitment by the State Government. The GOI should have reviewed the developments and provided separate fund for modernization of the plant and working capital to increase production in the Company. This fund for the modernization could be recouped in near future from receipts of sale of surplus land and the excise duty on increased production. Moreover, the aforesaid fruitless expenditure in the Company has been much more than the amount required for completing the modernization of plant.

16.1.3.4 Loss due to unwarranted registration of 'agreement to sale'

The issue of unconcluded sale of surplus land was considered by the Ministry based on the legal opinion obtained (March 2005 from the Senior Government Counsel and a second opinion obtained in consultation with the Ministry of Law. Accordingly, the Ministry decided (June 2005) to cancel all the sales of land in Kanpur since 2002, as it (the sale) was void in the eyes of law, and call for fresh bids after revaluation of the properties. The Ministry issued cancellation orders in June 2005 for the sale of land at Kanpur.

Some of the successful bidders represented to the Ministry for delay in executing registered 'agreements to sale' by the Company. Despite a favorable legal opinion for a fresh sale, the Ministry, at the level of Minister, decided to revoke the cancellation order and directed (August 2006) the Company to execute registered 'agreements to sale' with successful bidders with the precondition that conversion charges beyond the circle rates of 1998 would be borne by the respective buyers.

Audit noticed that the State Government had agreed in February 2005 to give permission for the conversion of land to freehold on payment of charges at circle rates of 1998. Therefore, the agreement with the buyers in August 2006, that they would bear the charges beyond circle rates of 1998, had no value in taking the decision to have the 'agreement to sale' registered.

The Company executed (September 2006) the registered 'agreement to sale', binding itself to sell leasehold lands at 2003 bid rates. Audit observed that above decision of the Ministry deprived the Company of the benefit of ₹ 109.03 crore i.e. increase in prices of the lands based on circle rates of 2011 less liability of conversion charges at the circle rates of 1998 (**Annexure-XXIV**).

The Ministry stated (January 2012) that, in order to avoid legal complication and in view of the decision of Hon'ble Allahabad High Court in the case of Value Shopee Limited vs. British India Company (BIC), the agreement for sales was registered in the larger interest of the revival as otherwise the successful bidders might have gone to the Court and whole process of the revival of the Company could have jeopardized.

However, Audit is of the opinion that:

(i) The legal opinion categorically stated that "agreement in question is not a contract for sale in the eyes of law and is a void document. It does not create any obligation to BICL for its enforcement as it is not registered deed --." The fact that the buyers had agreed (August 2006) to pay the conversion charges beyond circle rates of 1998 validated the legal opinion that they had a very weak case in absence of a registered 'agreement to sales'.

(ii) The Court decision referred to in the Ministry reply was issued in May 2010/February 2011 directing GOI that "the case be decided by the Collector in accordance with the latest Government order governing Nazul land". Hence, the Company had no powers to sell the land without the permission of the State Administration. The State Government had already informed the Company from time to time not to sell the property without its prior approval. In September 2003, the District Magistrate, Kanpur had asked the Ministry to stop the sales process till its further directions.

(iii) The net sales value of 19 leasehold properties at the bid rates of 2003, after taking into the conversion charges (₹ 47.35 crore) payable by the Company at 1998 circle rates, comes to only ₹ 27.86 crore **(Annexure-XXIV)** which was not a big amount and its non-receipt should not have stalled the rehabilitation scheme as GOI was already paying substantial grant/loan to the Company since 2004-05 beyond the terms of the rehabilitation scheme.

(iv) The Minister's order to have the 'agreement to sale' registered in fact led to a situation where the Company neither succeeded in revival strategy nor did it receive maximum value from the sale of land. In fact, under present situation, the buyers may reap the benefit of entire appreciation in prices of properties since 2003 by paying only 25 *per cent* of the bid rates of 2003.

(v) The 'agreement to sale' was registered in September 2006 on the condition that the buyers would bear the conversion charges beyond circle rate of 1998. However, instead of applying for the conversion based on the then current circle rates, the Ministry continued to pursue the State Government to give permission for the conversion at circle rates of 1998. This indicated that the urgency in revival scheme was compromised for seeking the benefit on conversion charges for the buyers.

Conclusion

- **The Company/ASC failed to have proper due diligence on the valuation of the properties as well as identify the bottlenecks in sale of land. The reserve price was fixed on lower side on account of circle rate and value of structures and the advertisement for sale was initiated in January 2003 without obtaining necessary approvals from the State of Uttar Pradesh.**
- **There was unnecessary hurry in concluding the sales of land by getting the 'agreement to sale' registered with the buyers ignoring the legal advice and the warnings of the State Government, which led to loss of ₹ 109.03 crore to the Company on account of increase in value of the properties at the circle rates of 2011.**
- **The Company suffered huge losses and GOI had to provide grant/loan of ₹ 147 crore to the Company beyond the terms of the rehabilitation scheme, mainly for want of funds for modernization of plant and the working capital. Considering the problems in generation of funds from sale of properties, the GOI could have provided separate fund for modernization of plant to avoid/reduce the grant/loan.**

In brief, due to flawed sale process, lack of internal controls and weak governance, the revival scheme has not succeeded (March 2012) and, as a consequence, there was unwarranted pressure on exchequer.

Recommendation

The Company should review and remove the bottlenecks which are coming in the way to conversion of leasehold land to freehold and streamline the sale process so as to derive maximum fund from the sale of surplus land.

CHAPTER XVII

Follow-up on Audit Reports (Commercial)

Audit Reports of the Comptroller and Auditor General of India (CAG) represent the culmination of the process of scrutiny starting with initial inspection of accounts and records maintained in various offices and departments of PSUs. It is, therefore, necessary that appropriate and timely response is elicited from the Executive on the Audit findings included in the Audit Reports.

The Lok Sabha Secretariat requested (July 1985) all the Ministries to furnish notes (duly vetted by Audit) indicating remedial/corrective action taken by them on various paragraphs/appraisals contained in the Audit Reports (Commercial) of the CAG as laid on the table of both the Houses of Parliament. Such notes were required to be submitted even in respect of paragraphs/appraisals which were not selected by the Committee on Public Sector Undertakings (COPU) for detailed examination. The COPU in its Second Report (1998-99-Twelfth Lok Sabha), while reiterating the above instructions, recommended:

- setting up of a monitoring cell in each Ministry for monitoring the submission of Action Taken Notes (ATNs) in respect of Audit Reports (Commercial) on individual Public Sector Undertakings (PSUs);
- setting up of a monitoring cell in Department of Public Enterprises (DPE) for monitoring the submission of ATNs in respect of Reports containing paras relating to a number of PSUs under different Ministries; and
- submission to the Committee, within six months from the date of presentation of the relevant Audit Reports, the follow up ATNs duly vetted by Audit in respect of all Reports of the CAG presented to Parliament.

While reviewing the follow up action taken by the Government on the above recommendations, the COPU in its First Report (1999-2000-Thirteenth Lok Sabha) reiterated its earlier recommendations that the DPE should set up a separate monitoring cell in the DPE itself to monitor the follow-up action taken by various Ministries/Departments on the observations contained in the Audit Reports (Commercial) on individual undertakings. Accordingly, a monitoring cell is functioning in the DPE since August 2000 to monitor the follow up on submission of ATNs by the concerned administrative Ministries/Departments. Monitoring cells have also been set up within the concerned Ministries for submission of ATNs on various Reports (Commercial) of the CAG.

Further in a recent meeting of the Committee of Secretaries (June 2010) it was decided to make special efforts to clear the pending ATNs/ATRs on CAG Audit Paras and PAC recommendations within the next three months. While conveying this decision (July, 2010), the Ministry of Finance recommended institutional mechanism to expedite action in the future.

A review in Audit revealed that despite reminders, the remedial/corrective ATNs on the transaction audit/compliance audit paragraphs/reviews contained in the last five years' Audit Reports (Commercial) relating to the PSUs under the administrative control of various Ministries, as detailed in **Appendix-III**, were not received by Audit for vetting. No ATN has been received in respect of 9, 6, 10, 15 and 17 transaction audit/compliance audit paragraphs/reviews contained in Audit Reports (Commercial) of 2006, 2007, 2008 2009 and 2010 respectively. Further 51 transaction audit/compliance audit paragraphs/reviews contained in Audit Reports presented in Parliament during March to September 2011 was also awaited.

Out of 108 paras/reviews on which ATNs were awaited, 21 paragraphs related to PSUs under the Ministry of Finance (Banking and Insurance Division), 16 paragraphs related to Ministry of Communication and Information Technology, 7 paragraphs related to PSUs under the Ministry of Petroleum and Natural Gas, and 7 paragraphs related to Ministry of Heavy Industries & Public Enterprises.

(A. K.PATNAIK)
Deputy Comptroller and Auditor General
and Chairman, Audit Board

New Delhi
Dated: 1 August, 2012

Countersigned

(VINOD RAI)
Comptroller and Auditor General of India

New Delhi
Dated: 1 August, 2012

APPENDICES

&

ANNEXURES

Appendix I

(Referred to in para 9.5)

Recoveries at the instance of Audit during 2010-11

Amount (₹ in lakh)

Name of the Ministry/ Department	**Name of the PSU**	**Audit observation in brief**	**Amount of recovery pointed out by audit**	**Amount recovered by the Management**
Road Transport	National Highways Authority of India	Recovery of interest in r/o KU-III Package on the amount recoverable from the contractor pending for more than a year – Corridor Management Unit, Bhilwara	Amount not quantified	4.26
Finance-Insurance Division	United India Insurance Company Limited	Short charging of fire premium due to incorrect application of basic fire rate under AIFT and consequential loss (fire) tariff	9.17	9.17
	The New India Assurance Company Limited	Non adjustment of receivable dues pending since 2003-04 from the outgoing share of coinsurers.	204.66	269.64
	National Insurance	Staff Mediclaim Policy with NIA-Non receipt of refund of	323.28	328.06

	Company Limited	excess premium paid		
		Short charging of premium due to application of incorrect rates	10.00	10.00
	The Oriental Insurance Company Limited	Lack of follow up action to recover ₹ 43.64 lakh	55.99	55.92
		Non-collection of co-insurance dues from ICICI Lombard General Insurance Company	29.72	29.72
Telecommunications	Mahanagar Telephone Nigam Limited	Excess Payment of pension contribution - Maharashtra circle	14.40	14.40
Defence Production & Supplies	Bharat Earth Movers Limited	Recovery of excess amount paid to the vendor - KGF, H&P Division	9.55	9.55
		Payment for the procured materials at the pre-revised rates instead of revised rates resulted in excess payment to the vendor - KGF, E&M Division	33.68	35.46
Power	NTPC Limited	Settlement of payments for supply of Coal by M/s Mahanadi Coalfields Ltd. on the basis of old agreement instead of at new agreement rate which prescribed different basis leading to excess payment - Simhadri	210.81	210.81
	Neyveli Lignite Corporation Limited	Loss due to non claiming of extra rupee liability arising in payment of Government Guarantee fees.	206.69	7.81

Steel	Steel Authority of India Limited	Excess payment of ₹ 14.27 lakh towards escalation charges to the contractors engaged for taxi service - Bhilai Steel Plant	14.27	10.64
		Violation of DPE orders in implementation of 2nd Pay Revision for executives in BSP/Bhilai resulting in irregular payment - Bhilai Steel Plant	Amount not quantified.	14.13
Consumer Affairs Food and Public Distribution	Food Corporation of India	Excess payment on account of VAT to State Government - DO Varanasi	4.21	4.08
		Non recovery of VAT from State agencies on sale of food grains under PDS leading to inflation of food subsidy - DO Shahjanpur	41.12	50.45
		Excess payment to state agencies on purchase of wheat due to payment without deducting moisture gain - DO Shahjanpur	7.76	8.52
		Excess payment to State agencies on purchase of wheat due to payment without deducting storage gain - DO Sitapur	11.62	11.62
		Excess payment to millers due to adoption of wrong rate for quality cut -DO Sitapur and Hoshiarpur	5.08 & 11.63	5.59& 11.31
		Non-recovery of dumping charges from state government - RO Dehradun	53.27	53.27
		Avoidable Payment of VAT on with held elements under	62.52	34.87

		CMR procurement during the seasons KMS 2008-09 and 2009-10 - DO Karimnagar		
		Unwarranted payment of interest on Rural Development Cess under Custom Milled Rice procured from APSC Ltd resulted in additional subsidy burden - DO Karimnagar	161.34	100.01
		Excess payment on account of gunny depreciation to State Govt. and its agencies on procurement of CMR rice - DO Patiala	233.00	233.00
		Excess reimbursement of gunny cost to State Agencies - DO Patiala	61.71	61.71
		Excess payment of incidentals on state pool wheat delivered to central pool - DO Patiala	161.00	170.57
		Non recovery of excess payment made to state government agencies on account of incidentals & carryover charges and interest there on- DO Patiala	2,553.16	2,553.16
		Non recovery of employer's provident fund contribution on leave encashment -DO Patiala and Hoshiarpur	21.12 & 10.59	17.72 & 10.99
		Excess payment to state agencies on a/c of storage gain on wheat procured under central pool - DO Hissar	541.00	541.00
		Non return of 1684 gunny bales from state agencies given during April 2007 - DO Faridkot	203.26	185.21

		Excess payment to state agencies for wheat crop year 2007-08 on account of wrong calculation of interest charges - DO Faridkot	81.47	85.86
		Excess payment of carry over charges to state agencies as per final rates for the rabi 2003-04 - DO Faridkot	92.47	60.69
		Over payment on account of gunny cost to state government and its agencies on procurement of CMR rice (crop year 2008-09) - DO Hoshiarpur	207.64	211.68
		Excess payment of incidentals on state pool wheat (Crop year 2007-08) delivered to central pool - DO Hoshiarpur	174.00	173.79
		Excess payment of gunny cost on wheat (RMS 2009-10) - DO Hoshiarpur	76.77	90.74
		Excess payment to state agencies on account of storage gain on wheat procured under central pool - DO Hissar	229.40	256.62
		Irregular payment of custody & maintenance charges on CMR to state agencies - DO Hissar	64.56	54.55
			8,438.92	**8,382.58**

Appendix II

(Referred to in para 9.6)

Corrections/Rectifications at the instance of Audit

Name of the Ministry	Name of PSU	Audit observation/suggestion in brief	Action taken by the Management
Consumer Affairs Food and Public Distribution	Central Warehousing Corporation	The Company had not made the accounting treatment for claims lodged with insurance company in accordance with its Accounting policy No 12	The Accounting policy 12 regarding insurance claims was amended.
		The Company had not disclosed its accounting policy regarding creating provision for doubtful debts in accordance with the requirements of AS-1.	New accounting policy for creating a provision for bad and doubtful debts was adopted.
Agriculture	National Seeds Corporation Limited	The Company entered into an agreement with the transport contractor for transport of seeds on city to city basis and thus paid payments for	The payment term was changed to 'from loading point to delivery point' in the tender floated for new contract.

Name of the Ministry	Name of PSU	Audit observation/suggestion in brief	Action taken by the Management
		higher distance following the contractual terms.	
Heavy Industries	Bharat Heavy Electricals Limited	The company failed to deduct the taxes and duties/freight, which are reimbursable by the customer as per the terms of the contract, from the landed cost, while preparing the comparative statement to find out L1, which resulted in loss of ₹ 3.29 lakh.	The management issued a detailed circular clarifying the treatment to be given for taxes and duties while preparing the CS landed cost for various types of contracts in future.
Defence	Hindustan Aeronautics Limited	Short term investments for less than 15 days were being processed without approval of committee as prescribed under the approved procedure for investment of surplus funds.	After incorporating the modifications suggested by audit, the procedure for short term investments was approved by the board.
		Inclusion of expenditure met towards schools run by the HAL under Corporate Social Responsibility in the past.	While compiling the CSR expenditure for the year 2010-11, expenditure towards Grant/aid etc to HAL schools was excluded

Appendix III

(Referred to in Chapter XVII)

Statement showing the details of Audit Reports prior to 2011 (Commercial) for which Action Taken Notes are pending

No. & year of Report	Name of the Report	Para No.
Department of Bio-Technology		
12 of 2006	Compliance Audit	Para 19.1.1
11 of 2007	Compliance Audit	Para 3.1.1
9 of 2010	Compliance Audit	Para 1.1.1
Ministry of Chemicals and Fertilizers		
PA 9 of 2008	**Performance Audit on Working of Udyogmandal Division of FACT Limited**	
11 of 2008	Compliance Audit	Para 9.2.1
24 of 2009	Compliance Audit	Paras 13.2.1(a) and 13.2.1(d)
10 of 2010-11	**Performance audit of IT Systems in selected PSUs**	**Chapter-IV**
Ministry of Civil Aviation		
12 of 2006	Compliance Audit	Paras 4.1.1 and16.2.1
23 of 2009	**Performance Audit on Frequent flyer Programme of NACIL**	**Chapter-I**
3 of 2011	Compliance Audit	Paras 2.1, 2.2, 2.3 and 2.5
Ministry of Coal		
9 of 2010	Compliance Audit	Para nos. 3.3.1, 3.4.1 and 3.5.1
3 of 2011	Compliance Audit	Paras 3.1, 3.2 and 3.3
Ministry of Commerce and Industries		
9 of 2010	Compliance Audit	Para 4.1.1 and 4.2.1
3 of 2011	Compliance Audit	Para 4.1

No. & year of Report	Name of the Report	Para No.
Ministry of Communication & Information Technology		
Report No 13 of 2006	Compliance Audit	Paras 4.19 and 6.2
Report No 12 of 2007	Compliance Audit	Para 4.7
Report No 12 of 2008	Compliance Audit	Paras 2.3, 3.14, 5.2 and 5.6
Report No 25 of 2009	Compliance Audit	Paras 5.1, 5.2, 5.3 and 5.5
Report No 9 of 2009-10	Compliance Audit	Paras 5.2.1 and 5.2.2
Report No 3 of 2011	Compliance Audit	Paras 5.3, 5.6 and 5.7
Ministry of Consumer Affairs, Food and Public Distribution		
3 of 2011	Compliance Audit	Paras 6.1, 6.2, 6.3, 6.4 and 6.5
Ministry of Defence		
9 of 2010	Compliance Audit	Para 7.1.1
3 of 2011	Compliance Audit	Paras 6.1.3, 7.1, 7.2, 7.3, 7.4 and 7.5
Ministry of Finance (Banking Division)		
12 of 2006	Compliance Audit	Paras 2.1.1 and 2.2.1
22 of 2007	Performance Audit Housing Finance Activities in Central Public Sector Housing Finance Companies	Chapter-III
PA 10 of 2008	Performance Audit on Distribution and Manufacturing modules under ERP - Bharatiya Reserve Bank Note Mudran (Private) Limited	Chapter-IV
Ministry of Finance (Insurance Division)		
12 of 2006	Performance Audit on the General Insurance System Software	Chapter 7
11 of 2007	Transaction Audit Observations	Para 10.2.1, 10.3.4 and 10.4.3

No. & year of Report	Name of the Report	Para No.
24 of 2009	Compliance Audit	Paras 8.2.1 and 8.3.2
9 of 2010	Compliance Audit	Paras 9.2.1, 9.4.1, 9.4.2 and 9.4.3
3 of 2011	Compliance Audit	Paras 9.1, 9.2, 9.3, 9.4, 9.5 and 9.6
No 10 of 2010-11	**Health Service Insurance of New India Assurance Co. Ltd, Oriental Insurance Co. Ltd and National Insurance Co. Limited**	**Chapter-V**
Ministry of Heavy Industries and Public Enterprises		
24 of 2009	Compliance Audit	Para 9.3.1
3 of 2011	Compliance Audit	Paras 10.1, 10.2, 10.3, 14.1, 14.2 and 14.3
Ministry of Housing and Urban Poverty Alleviation		
3 of 2011	Compliance Audit	Para 11.1
Ministry of Petroleum & Natural Gas		
12 of 2006	Transaction Audit	Para 14.8.1
9 of 2010	Compliance Audit	Para 13.6.1
3 of 2011	Compliance Audit	Paras 12.1, 12.2, 12.6, 12.7 and 12.9
Ministry of Power		
11 of 2008	Compliance Audit	Para 20.1.1
3 of 2011	Compliance Audit	Paras 13.1, 13.4 and 13.5
22 of 2010-11	**Performance Audit on Capacity Addition programme project management of NTPC Limited**	**Chapter-I**
Ministry of Road Transport and Highways		
11 of 2008	Compliance Audit	Paras 18.1.1 and 18.1.2
9 of 2010	Compliance Audit	Para 17.1.1 and 17.1.2
3 of 2011	Compliance Audit	Para 15.1

No. & year of Report	Name of the Report	Para No.
Ministry of Shipping		
3 of 2011	Compliance Audit	Para 16.2
10 of 2010-11	Performance audit on Ship repair activity in Indian dockyards	Chapter-IX
Ministry of Steel		
24 of 2009	Compliance Audit	Paras 13.1.1(e), 17.2, 17.4, 17.5, and 17.9
27 of 2010-11	Performance audit of CSR in SAIL & RINL	
Ministry of Textiles		
9 of 2010	Compliance Audit	Para 20.1.1
10 of 2010-11	Performance audit on Fulfillment of socio economic objectives	Chapter-X

Annexure-I

(Referred to in para 5.1)

Statement showing avoidable expenditure on the expansion of MSC based WLL system

Sl. No.	Name of the Circle	Location where MSC was installed	Working lines before expansion	Capacity before expansion	Total capacity after expansion	Working lines after expansion	Spare capacity	Cost incurred for expansion (₹)
1	Andhra Pradesh	Tirupati	Mar-08	16314	100K	150K	Mar-10	15961
		Madapur	Mar-08	7164	100K	150K	Mar-10	25330
2	Gujarat	Ahmedabad	Mar-09	17819	50K	100K	Mar-10	25366
3	Maharashtra	Nashik	Dec-08	50664	100K	200K	Mar-10	74802
4	Orissa	Bhubaneshwar	Dec-08	87164	100K	200K	Aug-10	85095
5	Chennai Telecom District	Chennai	Nov-09	39469	50K	100K	Sep-10	40044
6	Jammu & Kashmir	Srinagar	Nov-10	47092	100K	150K	Feb-11	46452
							Total	**293869650**

Annexure-II

(Referred to in para 5.1)

Statement showing avoidable procurement of IFWTs/FWTs in Tamilnadu circle

Year	BTS Capacity	Working Connections	Procurement of FWTs/IFWTs	Closing Stock of FWTs/IFWTs	No. of closures
2005-06	250750	133247	89760	4646	19870
2006-07	318250	323811	265100	6973	61476
2007-08	432500	397035	92750	82312	99991
2008-09	432750	407079	102150	159839	102388
2009-10	577000	421296	39390	187963	79433
2010-11	622500	411925	2850	215708	124927

Annexure - III

(Referred to in Para 8.4.3)

Statement showing depreciation of Equity Investments as on 31st March 2011

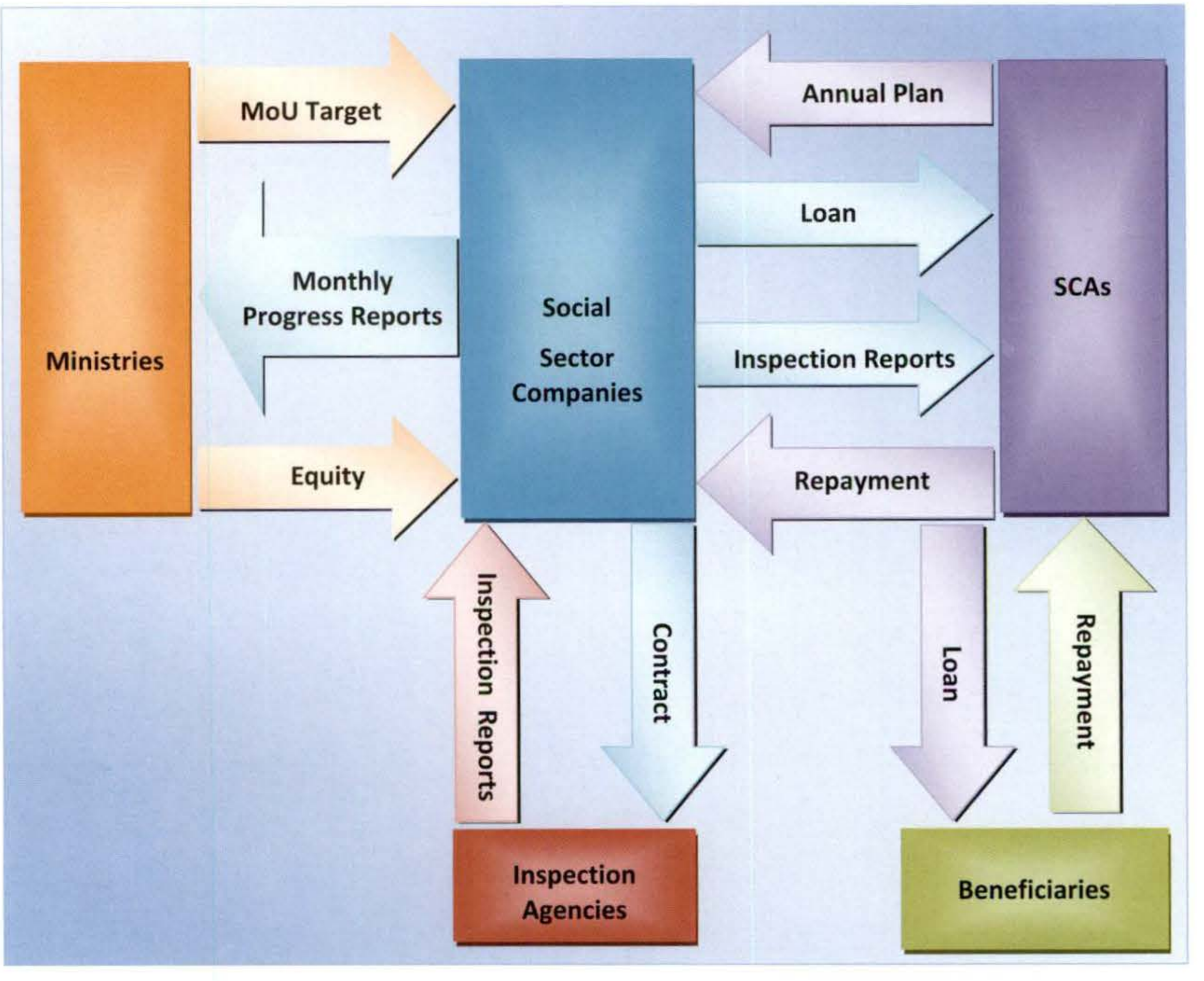
Sl. No.	COMPANY NAME	PAID-UP	No. of scrips	Face Value	Book Price	Book Value	Market Rate	Depreciation	% (Book Price-Market Rate)/Book Price * 100
1	Cambridge Solutions Limited	10	15400	154000	633.81	9760645.85	33.3	-9247825.85	94.75
2	JCT Limited	2.5	117938	294845	44.77	5279900.78	2.92	-4935521.82	93.48
3	Standard Batteries Limited	1	84100	84100	40.3	3389230	5.4	-2935090	86.60
4	JK Sugar Limited	10	5385	53850	129.28	696172.26	18.1	-598703.76	86.00
5	Kopran Limited	10	139100	1391000	165.07	22960585.9	23.4	-19705645.9	85.82
6	Sanghi Polyesters Limited	10	45000	450000	10	450000	1.9	-364500	81.00
7	Welspun Syntex Limited	10	75000	750000	66.67	5000000	13.85	-3961250	79.23
8	Saurashtra Cement Limited	10	54237	542370	72.93	3955615	16.5	-3060704.5	77.38
9	S&S Power Switchgear Equipment Limited	10	30875	308750	176.31	5443559.63	42.69	-4125505.88	75.79
10	Gujrat Heavy Chemicals Limited	10	720735	7207350	155.57	112121744.5	39.8	-83436491.45	74.42
11	Nahar Industrial Enterprises	10	30690	306900	210.31	6454373.9	57.65	-4685095.4	72.59
12	Summit Securities Limited	10	25604	256040	296.81	7599606.7	101.65	-4996960.1	65.75
13	Sree Rayalseema Alkalies Limited	10	10800	108000	27.69	299000	9.66	-194672	65.11
14	Alok Inds Limited	10	17100	171000	55.03	941003.11	22.15	-562238.11	59.75
15	Man Aluminium Limited	10	25000	250000	123.04	3075883.62	53.35	-1742133.62	56.64
16	OMAXE Limited	10	7078	70780	310	2194180	137.1	-1223786.2	55.77
17	Mahanagar Telephone Nigam Limited	10	1994544	19945440	91.87	183236945.3	45.35	-92784374.93	50.64

18	**Tainwala Chemical Limited**	10	57300	573000	34.35	1968421.58	17	-994321.58	50.51
19	**Consolidated Construction Consortium Limited**	2	88815	177630	102	9059130	50.5	-4573972.5	50.49
20	**DLF Limited**	2	39352	78704	525	20659800	267.2	-10144945.6	49.10
21	**Bengal Tea and Fabrics Limited**	10	22666	226660	88.11	1997090.93	47	-931788.93	46.66
22	**Jaypee Infratech Limited**	10	3827500	38275000	102	390405000	58.05	-168218625	43.09
23	**Oudh Sugar Mills**	10	185670	1856700	49	9098524.02	30.3	-3472723.02	38.16
24	**Oswal Agro Mills Limited**	10	188280	1882800	67.63	12732690	43.84	-4478494.8	35.18
25	**Man Industries (India) Limited**	5	348727	1743635	95.39	33264894.4	63.75	-11033548.15	33.17
26	**NHPC Limited**	10	462617	4626170	36	16654212	25.3	-4950001.9	29.72
27	**Williamson Finan. Services**	10	41989	419890	50.67	2127731.52	36	-616127.52	28.95
28	**Morepen Laboratories Limited**	2	3104675	6209350	7.51	23315331.25	5.35	-6705320	28.76
29	**Jindal Steel Works Energy Limited**	10	550212	5502120	100	55021200	71.65	-15598510.2	28.35
	Total			**93916084**		**949162472.2**		**-470278878.7**	

Annexure-IV

(Referred to in Para 9.4.3 A)

Process Flow Chart



Annexure-V

(Referred to in Para 9.4.3 A)

Details of Financials of the Companies for the last three years

(₹ in crore)

Financials	2008-09	2009-10	2010-11
NMDFC			
Paid up share capital	643.25	790.73	933.16
Accumulated Reserves	114.72	121.16	136.30
Excess of Income over Expenditure	6.44	15.13	31.60
Loans and Advances	711.52	824.38	943.65

NBCFDC			
Paid up share capital	526.35	562.35	600.42
Accumulated Reserves	219.45	238.26	254.13
Excess of Income over Expenditure	18.81	15.87	19.20
Loans and Advances	711.46	751.19	775.26

NSTFDC			
Paid up share capital*	230.50	230.50	277.33
Accumulated Reserves	123.57	129.41	135.36
Excess of Income over Expenditure	7.14	5.84	5.96
Loans and Advances	280.09	306.62	346.98

NSFDC			
Paid up share capital*	476.80	521.80	596.80
Accumulated reserves	180.63	200.54	214.70
Excess of income over expenditure	10.60	19.75	13.95
Loans and advances	626.52	656.38	719.11

** includes share application money*

Annexure-VI

(Referred to in Para 9.4.3 A1 (i))

Statement of Disbursement and Investment for last three years

(₹ in crore)

Year	2008-09	2009-10	2010-11	Total
NSTFDC				
Fixed/term Deposits at the end of year	64.50	41.75	16.50	122.75
Disbursement during the year	92.74	83.76	95.18	271.68
Percentage	69.55%	49.84%	17.34%	**45.18%**
NBCFDC				
Fixed/term Deposits at the end of year	33.65	39.93	68.83	142.41
Disbursement during the year	151.02	158.48	175.33	484.83
Percentage	22.28%	25.20%	39.26%	**29.37%**
NMDFC				
Fixed/term Deposits at the end of year	42.75	84.77	135.99	263.51
Disbursement during the year	128.99	195.06	233.17	557.22
Percentage	33.14%	43.46%	58.32%	**47.29%**
NSFDC				
Fixed/Term Deposits at year end	0	12.50	75.90	88.40
Disbursement during the year	145.33	151.19	180.09	476.61
Percentage (%)	0	8.27%	42.15%	**18.55%**

Annexure –VII

(Referred to in Para 9.4.3 A1(iii))

List of chronic defaulters with total over dues as at 31.03.2011

(₹ in crore)

Sl. No.	State	Full Name of SCAs	Over dues
NSFDC			
1	Andhra Pradesh	Andhra Pradesh Scheduled Castes Co-operative Finance Corporation Ltd.	79.15
2	Assam	Assam State Development Corporation for Scheduled Castes Ltd.	9.72
3	Madhya Pradesh	Madhya Pradesh State Co-operative SCs Finance & Development Corp.	51.22
4	Manipur	Manipur Tribal Development Corporation Ltd.	1.37
5	Uttar Pradesh	Uttar Pradesh Schedules Castes Finance & Development Corporation Ltd.	43.94
		Total	**185.40**
NBCFDC			
1	Assam	Assam State Development Corporation for Other Backward Classes Ltd.	4.74
2	Bihar	Bihar State Backward Classes Finance & Development Corporation.	21.91
3	Chhattisgarh	Chhattisgarh State Antyavasayee Sahkari Vitta Avam Vikas Nigam	2.73
4	Gujarat	Gujarat Backward Classes Development Corpn.	23.90
5	Madhya Pradesh	Madhya Pradesh Pichhara Varg Tatha Alpasankhayak Vitta Avam Vikas Nigam,	30.43
6	Madhya Pradesh	Madhya Pradesh State Co-operative SCs Finance and Dev. Corp.	1.22
7	Manipur	Manipur Tribal development corporation Ltd.	7.03
8	Orissa	Orissa Backward Classes Development Finance Cooperative Corp.	9.34
9	Uttar Pradesh	Uttar Pradesh Pichhara Varg Vitta Avam Vikas Nigam Ltd	34.73
		Total	**136.03**
NMDFC			
1	Assam	Assam Minority Development Corporation	4.9
2	Jammu & Kashmir	J&K SC/ST & Backward Classes Development Corporation	4.31
3	Madhya Pradesh	M.P. Hastashilp Vikas Nigam	7.76
4	Mizoram	Zoram Industrial Development Corporation	11.72
5	Manipur	Directorate for Minorities and Other Backward Classes	3.06
6	Orissa	Orissa Backward Classes Finance & Dev. Cooperative Corporation	7.98
7	Uttar Pradesh	U.P. Minorities Finance and Development Corporation	61.1
8	Gujarat	Gujarat Backward Classes Finance and Development Corporation	3.98
9	Gujarat	Gujarat Minorities Finance and Development Corporation	16.74
		Total	**121.55**

NSTFDC			
1	Assam	Assam Plain Tribes Development Corporation	22.8
2	Manipur	Manipur Tribal Development Corporation	7.68
3	Jharkhand	Jharkhand State Tribal Development Corporation	6.64
4	Mizoram	Mizoram Urban Co-operative Development Bank Ltd.	5.05
5	Nagaland	Nagaland State Co-operative Bank	1.86
6	Orissa	Orissa SC and ST Development & Finance Co-op.	2.82
7	Mizoram	Mizoram Khadi & Village Industries Board	3.17
8	Mizoram	Multi-purpose Co-operative Society Ltd.	0.28
9	Madhya Pradesh	M.P. Adivasi Vittam Aivam Vikas Nigam	15.53
10	Lakshadweep	Lakshadweep Development Corporation Ltd.	0.7
11	Tripura	Tripura Scheduled Tribes Co-opeative	4.74
12	Karnataka	Dr. B.R. Ambedkar Development Corporation Ltd.	5.48
		Total	**76.75**
		Grand Total	**519.73**

Annexure-VIII

(Referred to in Para 9.4.3 A2 (ii))

Details of beneficiary verification during last three years ending 31 March 2011

Year	No. of Beneficiaries* availed loan	No. of Beneficiaries inspected**	*Per cent* of Beneficiary inspection
NSFDC			
2008-09	37041	472	1.27
2009-10	58983	800	1.36
2010-11	47728	135	0.28
Total	**143752**	**1407**	**0.98**

NBCFDC			
2008-09	122273	1600	1.31
2009-10	123041	1500	1.22
2010-11	128537	2929	2.28
Total	**373851**	**6029**	**1.61**

NMDFC			
2008-09	***	***	***
2009-10	149391	4031	2.70
2010-11	51198	4512	8.81
Total	**200589**	**8543**	**4.26**

NSTFDC			
2008-09	42216	1537	3.64
2009-10	37439	2225	5.94
2010-11	95632	2088	2.18
Total	**175287#**	**5850**	**3.34**

** Years from which samples were selected were not made available to Audit. Hence, the figures of respective years are taken for comparison.*

*** includes beneficiaries verification covered in evaluation studies.*

**** Specific number of Beneficiaries to be inspected was not assigned during 2008-09.*

 # includes beneficiaries assisted under income generating activities only.

Annexure-IX

(Referred to in para 11.1.3.5)

Outstandings of Ministries as on 31.03.2011 (More than ₹ 50 Lakh)

Party code	Ministry	2 Years - 3 Years		>3 Years		Total		Net Debit	Net Debit more than 30 days
		Debit	Unadjusted credit	Debit	Unadjusted credit	Total Debit	Total Credit		
		(₹)	(₹)	(₹)	(₹)	(₹)	(₹)	(₹)	
MC027	Ministry of External Affairs	6395	162792	439554	1180138	136,865,844	100,035,168	36,830,676	46,601,736
MC024	Ministry of Defence	5424221	2225629	8654366	398517	48,648,112	10,928,994	37,719,118	32,399,484
MC048	Ministry of Home Affairs	3798148	2035386	6828252	1459365	46,825,560	14,908,987	31,916,573	29,805,661
DC041	Department of SC & Technology	1440332	1288801	1376288	1695047	55,810,267	41,937,159	13,873,108	24,569,110
MC066	Ministry of Environment & Forests	2107986	1172057	5316321	1375646	34,826,451	16,130,600	18,695,851	19,763,444
MC036	Ministry of Pet. N. Gas	1567331	463272	3205491	554719	22,878,755	5,284,002	17,594,753	18,242,207
MC022	Ministry of Chemical	3868863	156842	2733287	95380	15,314,356	1,627,583	13,686,773	13,929,867
MC021	Ministry of Agriculture	2829759	1420029	2208229	484236	18,941,806	3,765,646	15,176,160	11,852,124
PC010	Planning Commission	777977	263350	269279	338916	15,859,580	3,409,420	12,450,160	11,801,940
MC046	Ministry of Personnel & Training	1165280	132256	2917883	1091892	15,393,123	4,653,040	10,740,083	11,765,806
MC030	Ministry of Health	1731710	1165909	1554250	1422661	20,510,813	7,243,840	13,266,973	10,976,181
MC028	Ministry of Finance	660361	1104957	1176724	3384465	31,841,700	18,211,010	13,630,690	10,797,451
MC041	Ministry of Urban Affairs	1628097	352883	1904289	395030	12,037,313	1,780,517	10,256,796	9,965,592
MC062	Ministry of Chemical & Fertilizer	1286191	37007	463151	145375	11,524,955	1,483,092	10,041,863	9,420,907
MC102	Ministry of S&P Implement	0	28412	68691	130319	12,642,787	1,506,104	11,136,683	8,803,826
MC037	Ministry of Power	1175822	523229	2469823	871023	11,271,819	4,381,660	6,890,159	7,871,640
MC081	Ministry of Textiles	0	205372	0	459269	11,835,875	4,206,235	7,629,640	7,735,019
MC023	Ministry of Commerce	1260570	450033	1747981	918547	13,548,749	4,644,001	8,904,748	7,499,997

Party code	Ministry	2 Years - 3 Years		>3 Years		Total		Net Debit	Net Debit more than 30 days
		Debit	Unadjusted credit	Debit	Unadjusted credit	Total Debit	Total Credit		
MC044	Mnistry of Labour	247529	79913	131291	20762	7,395,407	286,614	7,108,793	6,265,574
DC006	Department of Public Enterprises	1160794	114461	1354380	152286	7,661,601	1,677,731	5,983,870	6,091,667
DC018	Ministry of Information Technology	383533	376390	672061	137405	10,844,648	2,602,956	8,241,692	6,015,743
MC045	Ministry of Coal	1024723	655083	2000440	186582	15,935,815	8,283,308	7,652,507	5,880,803
MC039	Ministry of steel	288353	131693	1062318	186623	6,798,775	1,662,859	5,135,916	5,550,584
MC031	Ministry of Heavy Industries	381917	485559	1195672	366325	7,092,183	1,179,899	5,912,284	5,075,101
Total		34,215,892	15,031,315	49,750,021	17,450,528	592,306,294	261,830,425	330,475,869	328,681,464
Net Amount		19,184,577		32,299,493		330,475,869			

Source: Age-wise Debtors summary of Delhi Branch as on 31.03.2011.

Annexure-X

(Referred to in para 12.2.3.3. (a))

Transmission line	Scheduled date of completion	Actual Date of completion	Time overrun (Months)	Reasons for delay
220KV BTPS-Ramgarh Line	January 2005	Sept.- 2006	20	Abnormal delay in finalization of the re-tendered offer and delay in fabrication and delivery of steel towers.
220KV Durgapur MTPS Line	March 2007	July 2007	4	Improper estimation of work and inclusion of new items and pile foundation
MTPS-Barjora line	April 2005	December 2005	8	Inordinate delay due to improper selection of incapable contractors, improper estimation and additional work during execution of work above LOA
220 KV D/C LILO from CTPS-MTPS lines to Kalyaneswari S/S & extn. up to Pithakari	November 2008	March 2011	27	Inordinate delay due to change in route alignment and ROW problem

Annexure-XI

(Referred to in para 12.2.3.3 (a) & (b))

Contracts in progress

Sl. No	Name of the Project	Month of sanction	Month of issue of NIT	Time taken for issue of NIT (months)	Month of opening of tech/ comm. bid	Month of issue of LOA	Time taken for issue of LOA	Schedule completion month	Physical Progress	Ordered value (₹ in crore)	Total cost booked upto March 2011 (₹ in Crore)	Reasons for delay.
						Sub-stations						
1	220KV Dhanbad Sub-station with interconnecting lines	Dec 2006	NA	-	April 2007	Sept. 2007	6	Sept 2009	80%	44.27	75.29	Non acquisition of land, delay in issue of drawings, activity schedule, bar chart and NIT.
						Transmission Lines						
2	220KV D/C Transmission line from MTPS to proposed 220 KV Gola S/Sand associated bays.	March 2006	June 2006	4	Aug 2006	Dec. 2006	-6	Dec. 2008	75%	100.2	132.74	Delay in supply of drawings and suspension of activities due to not handing over of clear site to contractor
3	Dhanbad – Govindpur line	Sept 2007	Oct 2007	1	Dec 2007	Sept 2008	11	Sept 2009	10%	3.93	NIL	Delay in check and survey work. Excavation works not yet completed

** As per Works & Procurement Manual, four months time is allowed for processing of tender. * NA= Not Available*

Annexure–XII

(Referred to in Para 12.2.3.3 (b))

Delays in construction of Sub Stations

Sub-Station	Scheduled date of completion	Actual Date of completion	Time overrun (Months)	Reasons for delay
220KV Burnpur Sub-station	February 2004	May 2006	26	Inadequate survey, non preparation of Feasibility Report, delay in issuance of NIT, LOA, additional scope of work and new items
220KV Barjora Sub-station with terminal bays at MTPS	September 2003	January 2006	28	Inordinate delay due to improper selection of incapable contractors, improper estimation and additional work during execution of work above LOA
220KV Ramgarh Sub-station	June 2003	April 2005	22	Delay in negotiation of land, finalization of drawings, changes in drawings and reducing scope during execution
132KV/33KV Jamuria sub-station	September 2007	December 2009	28	Improper estimation of work, changes in civil works, addition of new tennis and non-synchronization transmission line

Annexure–XIII

(Referred to in Para 12.2.3.3. (c))

Delay in Installation of transformers

Sl. No.	**Sub-station**	**(MVA)**	**Sanction date**	**Issue of NIT**	**P.O. date**	**Despatch Clarence**	**Commissioning**
1.	Durgapur	80	10.8.04	23.11.04	17.10.05	10.7.06	25.01.07
2.	Durgapur	80	10.8.04	23.11.04	17.10.05	31.07.06	01.10.08
3.	MTPS	80	10.8.04	23.11.04	17.10.05	31.07.06	24.05.10
4.	Kumardhubi	50	10.8.04	23.11.04	22.2.06	08.10.06	31.8.10
5	Kalipahari	50	10.8.04	23.11.04	22.2.06	22.12.06	04.09.08
6	Nimiaghat	31.5	4. 4.06	17. 7.06	9.7.06	11.06.08	18.08.09
7	Bahri	31.5	4.4.06	17.7.06	9.7.06	30.6.08	10.8.10
8	Kumardhubi	25	4..4.06	6.2.07	25.9.07	16.7.08	24.11.08
9	Belmuri	25	4.4.06	6.2.07	25.9.07	16.7.08	21.12.10
10	Koderma	25	29.5.06	6.2.07	25.9.07	29.9.08	22.6.10
11	Patherdih	25	29.5.06	6.2.07	25.9.07	29.9.08	12.12.10
12	Ramkanali	25	29.5.06	6.2.07	25.9.07	-	31.03.11

Annexure-XIV

(Referred to in Para 12.2.3.5 (i))

Tripping/ Shut down/Break down

Sub Station	2005-06		2006-07		2007-08		2008-09		2009-10		2010-11		Total	
	No.	Hrs.	No.	Hrs.	No.	Hrs.	No.	Hrs.	No.	Hrs.	No.	Hrs.	No.	Hrs.
Belmuri	99	8.974	171	37.75	119	266.60	67	49.73	10	18.38	36	13.20	502	394.63
Burdwan	20	1973.9	110	120.95	41	383.80	65	750.9	37	781.78	59	28.59	332	4038.82
Burnpur		Nil		Nil	8	1.4	10	0.4	5	0.4	41	141.5	64	143.7
Kumardubi					1713	1052.8	808	285.19	921	656.03	631	397.84	4073	2391.86
Kalipahari	249	141	268	108	321	168	253	164	260	145	727	420.15	1351	1146.15
Kalyaneswari	45	41.5	89	203.18	104	289.14	81	158.92	115	283.66	172	199.06	1028	1175.46
Ramkanali	193	29.15	189	26.05	262	358.15	243	36	222	28.59	157	227.25	1266	705.19
Giridih	1935	2506.54	477	145.32	755	105.12	1077	309.94	2181	512.74	2769	2256.43	6425	5836.09
Hazaribag		1956.29		2186.27		2092.95		2322.01	N.A	2578.61	NA	4528.2	N.A	15664.33
Barjora	2	18.34	2	1.00	5	82.58	7	295.9	6	29.98	NA	2280.16	22	2707.96
Parulia	99	471.30	154	369.84	183	148.33	237	472.91	280	888.95	NA	1161.97	953	3513.3
Durgapur	70	1203.25	34	830	48	305.27	59	939.85	86	604.28	NA	434.98	297	4317.63
Total	**2712**	**8349.94**	**1494**	**4028.36**	**3559**	**5253.34**	**2907**	**5785.75**	**4123**	**6528.4**		**12089.33**		**42035.12**

Total 42035.12 hours/6 years = 7005.85 hours/12 SS = 583.82 hours per SS per year.

Annexure-XV

(Referred to in Para-12.2.3.5 (i) (c))

Summary of Overdrawal (MVA)

Sl. No.	Name of SS	2005-06	2009-10	2010-11
		Total	Total	Total
1	Burdwan	5.717	13.978	314.749
2	Giridih	7.830	19.450	1028.585
3	Kalnyashwari	Nil	110.290	Nil
4	Kalipahari	13.44	132.28	150782
5	Ramgarh	4.20	19.02	46.6
6	Koderma	5.00	11.00	15.8
Total		36.187	306.018	152187.73

Note: Calculation is based on maximum overdrawal for a month

Annexure-XVI

(Referred to in Para-12.2.3.5 (ii))

Load restriction/Load shedding

Name of S/S	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11	Total
	Hrs.	Hrs.	Hrs.	Hrs.	Hrs.	Hrs	Hrs.
Belmuri	100.76	100.05	440.19	353.188	1852.20	NIL	2846.39
Burdwan	1129.56	848.67	3621.49	11595.29	34793.67	20930.84	72919.52
Burnpur	Nil	Nil	135	1021.5	4696.5	4643.16	10496.16
Kumardubi	1802.74	1894.6	2716.76	5805.72	10854.8	5604.42	28679.04
Kalipahari	918	841	3018	6474	14968	13689.51	39908.51
Kalyaneswari	251.96	1795.77	3394.95	8329.37	28558.07	5397.21	47727.33
Ramkanali			943	3743	5356	2828.0	12870.00
Barjora	Nil	Nil	1996.2	21025.95	86307.72	8431.3	117761.17
Parulia	487.14	780.78	6644.17	16938.34	53024.56	109850.59	187725.58
Durgapur	120.25	169.75	985.75	2090.5	5584.48	346.6	9297.33
Total	**4810.41**				**245996**	**171721.63**	**491341.08**

Annexure-XVII

(Referred to in Para 12.2.3.5 (iii) (a))

Distribution loss

Sub Station	No.of SS	Consumers with check meter	Consumers without check meter	Total	Max. & Min. range in percentage
Belmuri	2	2	-	2	1.04-0.676
Burdwan		8	-	8	
Burnpur	4	1	-	1	5.69-1.217
Kumardubi			10	10	
Kalipahari		-	5	5	
Ramkanali		-	2	2	
Giridih	1	23	-	23	16.72-0.04
Ramgarh	4	22	-	22	18.554-0.04
Hazaribag		1	-	1	
Konar		2	-	2	
Koderma		7	-	7	
Barjora	3	-	9	9	16.19-0.41
Parulia		12	-	12	
Durgapur		15	-	15	
	14	**93**	**26**	**119**	

Out of 93 consumers, the distribution loss was more than 2 per cent in case of 28 consumers resulting in loss of energy of 11,27,68,351 kwh.= 11,27,68,351 kwh * ₹2.94 (tariff rate)= ₹33.15 crore

Annexure-XVIII

(Referred to in para 12.3.3.2)

Mejia Thermal Power Station- Grade Slippage

Month and Year	Coal Company	Average UHV as per Joint sampling	Grade as per Joint sampling (Average)	Base Price as per Joint sampling	GCV as per Joint sampling (Lowest value is taken)	GCV of Station Coal (Lab. Report)	Grade as per Station coal (Lab report)	Base Price as per Station coal (lab Report)	Difference of GCV	Difference of Price	Qty of Coal received (Rail)	Excess payment
		Kcal/kg)		(₹)	(Kcal/kg)	(Kcal/kg)		(₹)	(Kcal/kg)	(₹)	(MT)	(₹)
1	*2*	*3*	*4*	*5*	*6*	*7*	*8*	*9*	*6-7=10*	*5-9=11*	*12*	*11X12=13*
Nov'2008	BCCL	4349.30	D	900.00				570.00				
	ECL	4309.67	D	1360.00	4800.00	**3736.00**	**F**	630.00	**1064.00**	**530.00**	351574.23	18,63,34,341.90
Total/Average		**4329.49**	**D**	**1130.00**				**600.00**				
Mar'2009	BCCL	4234.10	D	900.00				570.00				
	ECL	NA			4800.00	**3751.00**	**F**		**1049.00**	**330.00**	341519.61	11,27,01,471.30
Total/Average		**4234.10**	**D**	**900.00**				**570.00**				
2008-09					**4800.00**							**17,94,214,879.20**
Jul'2009	BCCL	4152.34	E	720.00				570.00				
	ECL	5698.55	B	1800.00	4800.00	**3777.00**	**F**	630.00	**1023.00**	**660.00**	292558.29	19,30,88,471.40
Total/Average		**4925.45**	**D**	**1260.00**				**600.00**				
Nov'2009	BCCL	4056.70	E	830.00				660.00				
	ECL	5705.55	B	2070.00	4800.00	**4034.00**	**F**	730.00	**766.00**	**755.00**	331230.26	25,00,78,846.30
Total/Average		**4881.13**	**D**	**1450.00**				**695.00**				
Mar'2010	BCCL	4124.77	E	830.00				660.00				
	ECL	5519.47	C	1820.00	4800.00	**3980.00**	**F**	730.00	**820.00**	**630.00**	346691.95	21,84,15,928.50
Total/Average		**4822.12**	**D**	**1325.00**				**695.00**				
2009-10					**4800.00**							**264,63,32,984.80**
Jul'2010	BCCL	4081.86	E	830.00	4800.00	**3467.00**	**G**	470.00	**1333.00**	**975.00**	338012.21	32,95,61,904.75
	ECL	5652.31	B	2070.00				480.00				

Total/Average		**4867.09**	**D**	**1450.00**				**475.00**				
Nov'2010	BCCL	4327.75	D	1040.00	4800.00	**3477.00**	G	470.00	**1323.00**	**570.00**	427157.29	24,34,79,655.30
	ECL	NA										
Total/Average		**4327.75**	**D**	**1040.00**				**470.00**				
Mar'2011	BCCL	4311.00	D	1040.00	5400.00	**3635.00**	F	660.00	**1765.00**	**1820.00**	397971.84	72,43,08,748.80
	ECL	5630.00	B	3990.00				730.00				
Total/Average		**4970.50**	**C**	**2515.00**				**695.00**				
2010-11					**5000.00**							**518,94,01,235.40**
Grand Total												**962,99,49,099.40**

Chandrapura Thermal Power Station (CTPS)

Month and Year	Coal Company	Grade as per Joint sampling (Average)	Base Price as per Joint sampling	GCV as per Joint sampling (Lowest value is taken)	GCV of Station Coal (Lab. Report)	Grade as per Station coal (Lab report)	Base Price as per Station coal (lab Report)	Difference of GCV	Excess payment (for the year)
			(₹)	**(Kcal/kg)**	**(Kcal/kg)**		**(₹)**	**(Kcal/kg)**	**(₹)**
1	2	4	5	6	7	8	9	6-7=10	13
July'2008	BCCL	E	720	4410					
	CCL	E	720	4200	4257.5	E	720	47.5	
Total/Average		E	720	4305					
Nov'2008	BCCL	E	720	4292.3					
	CCL	E	720	4200	4215	E	720	31.15	**44,30,73,484**
Total/Average		E	720	4246.15					
Mar'2009	BCCL	E	720	4509.67					
	CCL	E	720	4200	4345	E	720	9.84	
Total/Average		E	720	4354.84					
2008-09			**720**	**4302**			**720**		
Jul'2009	BCCL	E	720	4309.09	4315	E	720	-60.45	**81,16,31,564**

	CCL	E	720	4200					
Total/Average		E	720	4254.55					
Nov'2009	BCCL	E	830	4500	4087.5				
	CCL	E	790	4200		F	645	262.5	
Total/Average		E	810	4350					
Mar'2010	BCCL	NA		NIL	3955				
	CCL	E	790	4200		F	645	245	
Total/Average		E	790	4200					
2009-10				**4268.18**			**670**		
Jul'2010	BCCL	E	830	4300	4020				
	CCL	E	790	4200		F	645	230	
Total/Average		E	810	4250					
Nov'2010	BCCL	E	830	4430.76	3912.5				
	CCL	E	790	4200		F	645	402.88	
Total/Average		E	810	4315.38					**100,01,11,792**
Mar'2011	BCCL	E	830	4331.7	3800				
	CCL	E	790	4200		F	645	465.85	
Total/Average		E	810	4265.85					
2010-11				**4277.08**			**645**		
Grand Total									**225,48,16,840**

Annexure-XIX

(Referred to in para 12.3.3.4)

Transit loss in excess of CERC norms

Year	MTPS			DTPS			BTPS			Total	
	Transit Loss		Value (₹ in crore)	Transit Loss		Value (₹ in crore)	Transit Loss		Value (₹ in crore)	Quantity (Lakh MT)	Value (₹ in crore)
	Percent	Quantity (Lakh MT)		Percent	Quantity (Lakh MT)		Percent	Quantity (Lakh MT)			
2006-07	3.53	1.22	17.04	0	0	0	2.93	0.43	5.78	1.65	22.82
2007-08	2.10	0.83	13.11	2.89*	0.29*	5.72	0.28	0.05	0.67	1.17	19.50
2008-09	1.71	0.73	11.02	9.56	1.46	36.38	4.02	0.68	10.42	2.87	57.82
2009-10	9.78	4.13	102.43	0	0	0	3.35	0.55	9.01	4.68	111.45
2010-11	1.51	0.75	19.44	2.23	0.35	10.88	5.48	0.85	14.77	1.95	45.09
Total	3.67	7.66	163.04	5.11	2.1	52.97	3.14	2.57	40.65	12.33	256.66

** Measured by the management on adhoc basis.*

Annexure-XX

(Referred to in para 12.3.3.6)

Loss due to excess generation of un-burnt carbon over norms

Year	BTPS		CTPS		DTPS		MTPS	
	Qty in lakh MT	**₹ in Crore***	**Qty in lakh MT**	**₹ in Crore***	**Qty in lakh MT**	**₹ in Crore***	**Qty in lakh MT**	**₹ in Crore***
2006-07	1.16	38.77	0.23	6.68	0.19	9.54	0.61	23.21
2007-08	1.23	40.73	0.34	10.33	0.15	7.77	0.56	24.53
2008-09	0.92	36.06	0.70	24.39	0.15	10.46	0.45	18.66
2009-10	1.45	65.79	0.47	19.28	0.42	37.69	0.25	17.52
2010-11	1.64	80.99	0.74	33.23	0.11	10.64	0.42	31.22
Total	6.40	262.34	2.48	93.91	1.02	76.10	2.29	115.14

Grand Total Quantity = 6.40 +2.48 + 1.02 + 2.29 = **12.19 Lakh MT**

Grand Total amount = 262.34 +93.91 +76.10 + 115.14 = ₹ 547.49 crore

Annexure-XXI

(Referred to in Para 16.1.3.2 (c))

Detail of properties where reserve price was below current circle rates of year 2002

Sl. No.	Name of property	Reserve price fixed (₹ in crore)	Valuation as circle rate 2002 (₹ in crore)	Short fixation of reserve price (₹ in crore)	Actual sale price as per highest bid	Sales price being below the correct circle rate
i	ii	iii	iv	v= iv - iii	vi	vii= iv- vi
1	Wattle Grove	3.40	3.52	0.12	3.45	0.17
2	Normanhurst	7.50	*7.95*	0.45	7.73	0.22
3	Abbotsford	3.58	*4.12*	0.54	4.01	0.11
4	Air Dale	2.41	*3.51*	1.10	2.55	0.96
5	Palm	2.23	*3.24*	1.01	2.88	0.36
6	Wisteria	3.58	*4.11*	0.53	4.1	0.01
7	BIC Club	2.87	*3.30*	0.43	3.02	0.28
8	Woodland	3.30	*3.35*	0.05	3.97	-
	Total	**28.87**	***33.10***	***4.23***	**31.71**	**1.39**

Annexure-XXII

(Referred to in Para 16.1.3.2 (c))

Statement of value of structures as per approved Government valuer

Sl. Nos.	Name of property	Market value (₹ in lakh)
Phase-1(January 2003)		
1	Chitrakoot	9.92
2	Wattle Grove	10.2
3	Dilaram	4.91
4	Normanhurst	10.77
5	Clock Tower	14.83
Phase-2 (March 2003)		
6	Morton Lodge	3.83
7	Nirban	10.8
8	Glean View	6.21
9	Glen Lodge	7.02
11	Jungle Annex	10.41
12	Aldeen	6.88
13	Taviet Grove	7.82
14	Abbotsford	7.24
Phase-3 (May 2003)		
15	Air Dale	8.16
16	Palm	5.35
17	Westeria	7.53
18	BIC Club	13.07
19	Woodland	5.70
20	New Palace	7.16
21	Sisaman	8.34
22	Mayfield	4.07
23	Macrobertganj, Part 1	8.23
Phase-4 (December 2003)		
24	Sutherland House	21.58
Phase-VB (March 2007)		
25	Midhurst	6.81
26	W.S. Office	0
	Total	**206.86**

Annexure-XXIII

(Referred to in Para 16.1.3.3)

Present status of surplus properties

Nos. of land	Phase	Lease type	25 *per cent* advance (₹ in crore)	Full amount received (₹ in crore)	Present status of sale
Land sale complete by executing sales deed					
1	1	Freehold	-	5.01	Sales complete on 'as is and where is' basis by effecting registration of sales deed and full amount of ₹51.84 crore.
1	IV	Freehold	-	12.52	
2	V	Perpetual	-	34.31	
Lands under 'agreement to sell' but sales deed not executed pending conversion					
3	I	Perpetual	-	5.83	Possession handed over
1	II	Current Lease	-	1.85	Possession handed over
18	I, II, III	5 Expired Lease, 10 Perpetual lease 3 Current Lease	18.02	-	• Possession not handed over. • ₹ 54.78 crore towards 75 *per cent* of sale value to be received after the conversion.
Unsold land					
6	I, III	-	-	-	Unsold for want of bids or the property being encroached upon
Total Properties					
32	I-V	Total	18.02	59.52	Total amount of ₹ 77.54 received so far and ₹ 59.52 is pending in 18 cases pending conversion.

Annexure-XXIV

(Referred to in Para 16.1.3.4)

Statement of Difference in value of properties at Circle Rate of 2011and Sale Consideration of Properties with the buyer

Name of the property	Area	Circle Rates for 2011	Total Value of Property	Actual Sale Value	Difference
	(sq.m.)	(₹ per q.m.)	(₹crore)	(₹ crore)	(₹ crore)
Normanhurst	13247	27500	36.43	7.73	28.70
Clock Tower	4047	27500	11.13	3.71	7.42
Morton Lodge	5214	27500	14.34	4.41	9.93
Nirban	7906	27500	21.74	6.81	14.93
Abbot fort	4115	27500	11.32	4.01	7.31
Glean Lodge	4777	27500	13.14	3.87	9.27
Jungle Annexe	4376	27500	12.03	3.11	8.92
Aldeen	4029	27500	11.08	2.96	8.12
Taviot Grove	3644	27500	10.02	2.4	7.62
Glean View	4943	27500	13.59	4.01	9.58
Air Dale	3506	27500	9.64	2.55	7.09
Palm	3238	27500	8.90	2.88	6.02
Westaria	4114	27500	11.31	4.1	7.21
BIC Club	3298	27500	9.07	3.02	6.05
Woodland	5584	14000	7.82	3.97	3.85
New Palace	3780	14000	5.29	2.93	2.36
Sisaman	3469	14000	4.86	2.75	2.11
Mayfield	2358	14000	3.30	2.02	1.28
Macrobert Ganj I &IV	11047	15000	16.57	7.97	8.60
Total			231.59	75.21	156.38
Less: Conversion charge at circle rate-1998				47.35	47.35
Net realisable				**27.86**	**109.03**