Report of the Comptroller and Auditor General of India

for the year ended March 2005

Union Government (Defence Services) Air Force and Navy No. 5 of 2006

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PREFACE

This Report for the year ended March 2005 has been prepared for submission to the President under Article 151 of the Constitution. The Report relates mainly to matters arising from test audit of the financial transactions of Ministry of Defence, Air Force, Navy, Coast Guard. Results of audit of Ministry of Defence, in so far as they relate to Army and Ordnance Factories, Army HQ, Ordnance Factory Board, field units of Army, Ordnance Factories, associated Research and Development units and Military Engineer Services have been included in Report No.4 of 2006.

The Report includes18 paragraphs.

The cases mentioned in the Report are among those which came to notice in the course of audit during 2004-05 and early part of 2005-06 as well as those which came to notice during earlier years, but could not be included in the previous Reports.

OVERVIEW

The expenditure, during 2004-05, on Air Force and Navy was Rs 23,229 crore and Rs 13,576 crore respectively which, together, represent 46.81 *per cent* of the expenditure of Rs 78,633 crore on Defence Services.

Some of the major findings arising from test audit of transactions of the Air Force, the Navy, and the Coast Guard included in the Report, are discussed below:

I Acquisition of Executive Jets for Communication Squadron

The Ministry acquired five Executive Jets at a cost of Rs 712.51 crore. The poor usage of the aircraft sought to be replaced did not justify the acquisition which was made through a non-competitive process, entailing acceptance of an exorbitant amount of Rs 126.90 crore for five aircraft towards modification of interiors and in-flight entertainment.

(Para 2.1)

II Procurement of Unmanned Aerial Vehicles

Twelve Unmanned Aerial Vehicles (UAVs) imported at a cost of Rs 567 crore in the wake of the Kargil Review Committee recommendation could not be utilized due to injudicious selection of operational sites and inability of Navy to complete infrastructure facilities in time for their operations.

(Para 2.2)

III Acquisition of Missiles by IAF

The tender process adopted in conclusion of a contract for import of missile at a cost of Rs 407.30 crore for Air Force lacked competitiveness and transparency. Ineffective negotiations resulted in contracted missiles already Rs 50.60 crore more expensive than the more advanced version of the same missile available with the Air Force.

(Para 2.3

IV Parking of funds with Public Sector Undertaking

Ministry advanced Rs 995.70 crore to Mazagaon Dock Ltd. Between 1996 and 2002 without placing any orders to avoid surrender of funds. Failure to recover adequate financial compensation resulted in a financial loss to the extent of Rs 156.12 crore till March 2005.

(Para 2.6)

V Acquisition of Marine Pollution Surveillance Capacity

Three Dornier aircraft costing Rs 102 crore received in March 2001 by the Coast Guard for marine pollution surveillance were not provided with vital Operational Role Equipment due to improper handling by Government. There was no assurance that the equipment contracted after much delay was appropriate.

(Para 5.1)

VI Extra expenditure in purchase of Navigation System

Ministry's failure to take advantage of the prices available under an option clause of a contract within its validity period and belated exercise of the option clause at higher prices without inviting bids from other vendors led to extra expenditure of Rs 29.90 crore in import of 95 sets of Navigational System for the Air Force.

(Para 2.4)

VII Procurement of one extra fast attack craft

A vintage Extra Fast Attack Craft was acquired at a cost of Rs 33.56 crore citing urgent operational requirement of the Navy through a process, which precluded competition and lacked transparency. Failure to negotiate an appropriate depreciation resulted in loss of Rs 4.16 crore.

(Para 4.1)

VIII Irregular grant of allowances of DSC personnel

DSC personnel engaged with the Air Force formations in the North East were not entitled to the counter insurgency allowance and related concessions. Failure of internal controls led to irregular payment of counter insurgency allowance aggregating Rs 3.51 crore.

(Para 2.5)

IX Import of spares at exorbitant prices

Avoiding internal controls at different stages and taking decision on incorrect premises by Naval HQ led to acceptance of higher rate in import of spares. A more judicious decision to place orders for specific items on competitive basis would have yielded a saving to the extent of Rs 9 crore.

(Para 4.3)

X Non-commissioning of imported equipment

Poor planning resulted in delay in completion of works services for phase-I of Service Support Centre for SU-30 aircraft leading to non-commissioning of equipment worth Rs 53.95 crore since June/October 2004.

(Para 3.3)

XI Acquisition of ready built flats for Coast Guard

Although acquisition of ready built flats for Coast Guard was simultaneously processed alongwith Navy, Ministry did not explore the possibility of waiver of interest charges, exemption of stamp duty and registration charges in respect of coast Guard as in the case of Navy resulting in avoidable extra expenditure of Rs. 2.63 crore.

(Para 5.2)

XII Unauthorised construction of Officers' Institute

Prime land valuing Rs 74.24 lakh was utilized to construct a transit accommodation by Western Air Command in IAF unauthorisdely under the nomenclature of Officers' Institute involving irregular expenditure of Rs 33.18 lakh.

(Para 3.2)

XIII Procurement of spares for test rig

Delay in taking action in procurement of spares for test rig by the Air Force at the appropriate time led to excess expenditure of about Rs two crore.

(Para 3.1)

XIV Unnecessary import of stores under special financial powers

Special financial powers delegated to Naval HQ in the wake of Operation Parakram were invoked for unnecessary purchase of spares worth Rs one crore for turbo alternators for INS Virat even though the ship was neither identified as front line ship, nor there was adequate justification for their procurement.

(Para 4.2)

XV Recoveries at the instance of Audit

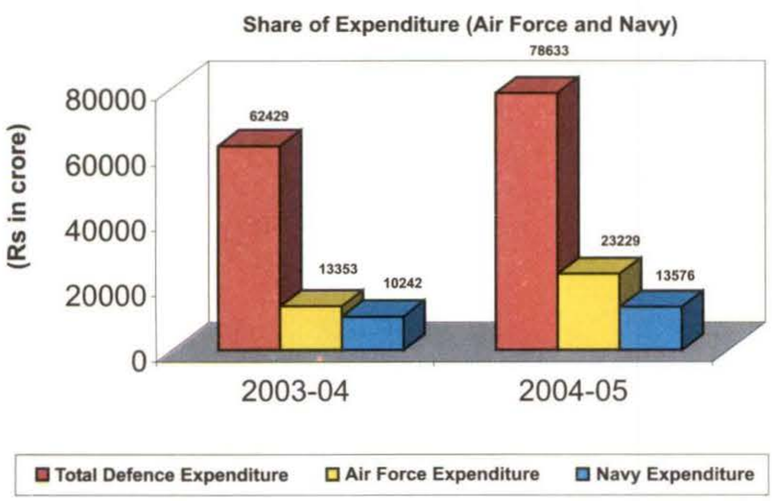
An aggregated amount of Rs 4.98 crore was recovered at the instance of Audit.

(Paras 3.4, 4.4 and 5.3)

CHAPTER I : FINANCIAL ASPECTS

1 Financial Aspects

1.1 The total revenue and capital expenditure on Defence Services during 2004-2005 was Rs 78,633 crore as against Rs 62,429 crore during 2003-2004. This was 25.95 *per cent* higher than the expenditure of 2003-2004. The share of the Air Force and the Navy in the total expenditure on Defence Services in 2004-2005 was Rs 23,229 crore and Rs 13,576 crore respectively, including that on capital acquisitions. The expenditure on the Air Force was 73.96 *per cent* higher than the expenditure during the preceding year, and in case of the Navy it was 32.55 *per cent* higher than the preceding year.



1.2 Expenditure on the Air Force and the Navy during 2004-2005 under broad categories is analysed in the following table:

Category	AIR FORCE		NAVY	
	Rs in crore	*Per cent* of total	Rs in crore	*Per cent* of total
Pay and allowances	2311	9.95	1401	10.32
Transportation	190	0.82	125	0.92
Stores	5018	21.60	2487	18.32
Works	805	3.47	394	2.90
Repair & Refits[1]	-	-	432	3.18
Other expenditure	122	0.52	422	3.11
Capital acquisitions	14783	63.64	8315	61.25
Total	**23229**	**100**	**13576**	**100**

[1] There is no independent Accounting Head for repair and refits in respect of Air Force in the budget

1.3 The summarized position of appropriation and expenditure during 2004-2005 in respect of the Air Force and the Navy is reflected in the table below:

(Rs in crore)

	Final Grant/ Appropriation	**Actual Expenditure**	**Total Excess/Savings (+) / (-)**
	AIR FORCE		
REVENUE			
Voted	8675.57	8445.15	(-) 230.42
Charged	1.23	0.69	(-) 0.54
CAPITAL			
Voted	14813.67	14781.55	(-) 32.12
Charged	7.17	2.12	(-) 5.05
Total	**23497.64**	**23229.51**	**(-)268.13**
	NAVY		
REVENUE			
Voted	5375.20	5260.42	(-) 114.77
Charged	2.43	0.50	(-) 1.93
CAPITAL			
Voted	8377.36	8314.18	(-) 63.17
Charged	2.61	1.20	(-) 1.41
Total	**13757.60**	**13576.30**	**(-) 181.28**

Unspent provisions constituted 1.14 *per cent* of the final grant/appropriation of the Air Force, and 1.32 *per cent* of the Navy.

The total capital expenditure on Defence Services for the year 2004-2005 was Rs 31,994 crore, as against Rs 16,863 crore during 2003-2004. The Air Force and the Navy together accounted for Rs 23,099 crore, representing 72 *per cent* of this expenditure.

1.4 An analysis of the Appropriation Accounts, Defence Services, has been included in the Report of the Comptroller and Auditor General of India for the year ended March 2005: Union Government – Accounts of the Union Government (Report No. 1 of 2006).

1.5 An amount of Rs 4.98 crore was recovered at the instance of Audit during the year.

CHAPTER II : MINISTRY OF DEFENCE

2.1 Acquisition of Executive Jets for Communication Squadron

The Ministry contracted for procurement of five Executive Jets at a cost of Rs 712.51 crore, four of them for use as VIP aircraft. While the propriety of the acquisition in replacement of the existing fleet was open to question, commitment of an additional expenditure of Rs 126.90 crore for providing upgraded facilities in the aircraft did not reflect adequate concern for deriving value for money.

The Ministry concluded a contract with M/s Embraer of Brazil in September 2003 for acquisition of five Executive Jets at an aggregated price of USD 145.41 million (Rs 712. 51 crore[1]). Four of these aircraft valuing Rs 571.54 crore were meant for the Communication Squadron of the IAF, while the remaining one valued at Rs 140.97 crore was for the Border Security Force.

The Communication Squadron (Squadron) of the IAF maintains a fleet of two Boeing, seven Avro aircraft and six MI-8 helicopters. The Ministry decided (September 2003) to replace the seven Avro aircraft by four Executive Jets. The Avro aircraft were stated to be used for the visit of foreign delegations, Indian VIPs and Other Entitled Persons (OEP) while the requirement of the three entitled personages – the President, the Vice President and the Prime Minister were met by the two Boeing aircraft.

A review in audit of the actual use of the Avro fleet of the Communication Squadron showed only about 3.9 *per cent* use by the three entitled personages. The use by OEPs was 46.9 *per cent*, the use for training assignments was 37 *per cent* and the balance was used for Route Transport Role (RTR). Considering the prevalent usage of the Avro fleet, it would appear that the new aircraft would be used largely to meet the requirements of OEPs who, as per Government policy, were expected to make use of commercial air services on official duties. In fact, the Ministry stated (January 2006) that the Executive Jets were also to be used by OEPs. The grounds on which the procurement was justified were the higher cruise speed and more comfortable flight. The

[1] 1USD = Rs 49

reasonableness of these two grounds need to be viewed in the background of the low utilization of the existing Avro fleet (to be replaced by the Executive Jets) for the entitled personages. In fact, as much as 87 *per cent* of the flying needs of the three entitled personages were met only by the existing Boeing aircraft and not by the Avro fleet.

Apart from the question relating to the basic necessity of the purchase, several other infirmities were noticed in the processing of the procurement. Though the aircraft were non-defence in nature, the tendering process adopted was Request for Proposals (RFP) to select the vendors rather than Open Global Tenders (OGT). Bids were received from six vendors of which three were found technically acceptable. Non issue of global tenders contravened the provisions of para 18.1 of the Defence Procurement Procedure 1992 which stipulated that for any standard equipment, wide publicity was to be given through open advertisement in newspapers and trade journals. The Ministry's contention (January 2006) that global tendering was not adopted as the Self-Protection Suite (SPS) had security and technological implications was not convincing because the SPS was actually sourced from another vendor and the aircraft vendor only had to integrate the SPS with the aircraft. Another infirmity in the procurement process was not associating the representatives of HAL[2], CEMILAC[3] and DGAQA[4] with the procurement process contrary to the recommendations of the High Powered Committee (COFAA[5]) of 1997.

Of the total contracted price of USD 29.16 million (Rs 142.88 crore[1]) per aircraft for the IAF squadron, the cost of the basic aircraft was USD 20.08 million (Rs 98.39 crore). The rest of the price of the aircraft comprised USD 5.18 million (Rs 25.38 crore) for interiors and in-flight entertainment, USD 1.15 million (Rs 5.63 crore) for additional avionics, USD 1.25 million (Rs 6.13 crore) for integrating the SPS and USD 1.9 million (Rs 9.31 crore) for spares, testers, ground equipment and training, reduced by discount of USD 0.4 million (Rs 1.96 crore). The accepted price for interiors and in-flight entertainment was more than five times that quoted in the second lowest offer (USD 936,500) for similar facilities.

The expenditure of Rs 101.52 crore on interiors and in-flight entertainment in respect of the four aircraft for the Communication Squadron underscored inadequate concern for economy. An amount of Rs 25.38 crore was also spent for the same purpose for the aircraft procured for the BSF, taking the total expenditure on interiors and in-flight entertainment on the five aircraft to

[2] Hindustan Aeronautics Limited
[3] Centre for Military Airworthiness and Certification
[4] Director General of Aeronautical Quality Assurance
[5] Committee on Fighter Aircraft Accidents

Rs 126.90 crore. Such large expenditure on these facilities would appear to be even less justified because of the fact that the current price of the aircraft (excluding spares) available on the internet was USD 22.45 million (May 2005) which was below the contracted price of USD 27.26 million[6] of the aircraft (excluding spares etc.).

2.2 Procurement of Unmanned Aerial Vehicles

Unmanned Aerial Vehicles (UAVs) procured at a total cost of Rs 567 crore could not be put to operational use due to failure to create infrastructure for their operation and injudicious selection of operational sites.

A contract was concluded in July 2001 with a foreign firm for procurement of 12 Unmanned Aerial Vehicles (UAVs), associated equipment and spares at a cost of USD 120.55 million (Rs 566.57 crore). The UAVs were to be deployed in three strategic locations, S1, S2 and S3.

The Request For Proposals (RFP) was issued in May 2000 only to one firm from whom UAVs had been procured by the IAF in 2000. This resulted in a single vendor situation. UAVs were contracted to be delivered between July 2002 and October 2003. However, due to the delay of four months in opening the Letter of Credit (LOC) the delivery got delayed and these were eventually delivered between December 2002 and March 2004. All the UAVs received were stationed at the Intensive Flying Training Unit instead of being deployed widely over different locations.

Audit scrutiny revealed that the infrastructure for deployment of UAV had not yet been created at the strategic site S1. It took over four years for acquisition of land, soil testing, preparation of estimates etc. at this deployment site. Sanction for works at the station was issued only in March 2005, to be completed by 2007. The Navy decided not to deploy UAVs from another selected site S2 as the location was prone to incessant rains and the civil administration had not made land available. The Ministry informed audit in December 2005 that an alternative to site S2 has been earmarked for setting up infrastructure facilities for deployment of UAVs.

Thus the Navy did not take into account the climatic conditions of the deployment station S2 before firming up their requirement of UAVs and could not ensure timely creation of infrastructure facilities for deployment at site S1.

[6] USD 29.16 million minus USD 1.9 million for spares

The entire fleet procured at a cost of Rs 567 crore has consequently been used minimally for training purposes and for limited fleet support operations between September and December 2004.

In sum, no operational advantage was realized despite resorting to a non-competitive process of procurement. The UAVs procured at a cost of Rs 567 crore between December 2002 and March 2004 based on an operational requirement could not be utilised due to deployment difficulties and the inability of the Navy to complete infrastructure facilities in time for their operation.

2.3 Acquisition of Missiles by IAF

Absence of effective negotiation and a competitive and transparent process resulted in the Government paying at least USD 10.52 million (Rs 50.60 crore) over the reference price.

The Ministry concluded a contract with M/s ARTEM of Ukraine in May 2003 for acquisition of 216 missiles (Air-to-Air type 'A') at an aggregated cost of USD 84.24 million (Rs 407.30[7] crore). The contract was awarded on a single tender basis. IAF had initially projected requirement of 144 new missiles. The procurement quantity was increased to 216 missiles as M/s ARTEM could not guarantee any success of the old missiles that they had been asked to refurbish.

Audit examination revealed that the price of USD 390,000 contracted by the Ministry for each missile was 25 *per cent* higher than the last purchase price of a more advanced version of missile type 'A' acquired from another vendor in 2000 at USD 312,352 per missile. In their evaluation of the reasonableness of price with vendors of Soviet origin, the Ministry was generally using annual escalation of 3 *per cent*. The escalation allowed in this case was almost 8 *per cent* per annum. A scrutiny of the procurement process followed in this case pointed to several factors that rendered the procurement uncompetitive resulting in high prices.

a) The Request for Proposal (RFP) issued to seven vendors allowed only 33 days' time from the date of issue and the only vendor who responded within the stipulated time was M/s ARTEM who had the

[7] USD 1 = Rs 48.35

advantage of prior knowledge of the proposal, being involved in negotiations for refurbishing of the existing stock of missiles of type 'A'. In fact, it was only on their refusal to refurbish the missiles that the decision was taken to procure new missiles.

b) In their evaluation and subsequent negotiations, the PNC did not factor in the price of USD 312,352 valid in 2000 in terms of the contract of November 1996 for a more advanced version of the missile as a bench mark for bringing down the price of the sole vendor. Instead, they were content with a 1.76 *per cent* discount on the quoted price offered by the vendor.

c) The bid was accepted though it did not meet the requirements of the RFP regarding inclusion of cost of refurbishment of missiles and product support. The vendor also did not make any provision for ToT[8]. Such significant deviations from the RFP would, in a competitive context, merit rejection of the bid.

The Ministry stated in December 2005 that the base price of USD 408,197 per missile was arrived at on the basis of the price of RR 118,500 per missile obtained from a contract of 1st September 1986 which was escalated @ 3 *per cent* annually till 1989 and then converted to USD. Thereafter, the USD value was escalated @ 3 *per cent per annum* till 2002 to arrive at the base price adopted in the contract. This, however, did not explain the Ministry's action in using 1986 price of missiles when 2000 price of a more advanced version was available for comparison.

The Ministry's contention that 33 days' time allowed to all vendors was reasonable in view of the procurement being a revenue procurement was not tenable since procurement of Missile is a capital investment even if it is to replace old stock. Allowing only 33 days' time from the date of issue of RFP on the ground of revenue procurement despite the expenditure being Rs 400 crore was not proper.

Lack of competition coupled with failure to negotiate with the single vendor on the basis of the available reference price of 2000 resulted in the Government paying Rs 50.60 crore (USD 10.52 million) in excess of the reference price (duly escalated by 3 *per cent per annum*).

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[8] Transfer of Technology

2.4 Extra expenditure in purchase of Navigation System

Failure to take advantage of the prices available under an option clause within the validity period and adoption of a non-competitive process resulted in procurement of 95 sets of INGPS at exorbitant price entailing extra expenditure of Rs 29.90 crore.

The Ministry concluded a contract in October 2003 with M/s Sagem, France for procurement of 95 sets of Inertial Navigation Global Positioning System (INGPS) and associated equipment at an aggregated cost of Euro 8.052[9] million (Rs 42.03 crore).

Audit scrutiny revealed that the total requirement of INGPS to meet the requirements of SU-30, Jaguar and MiG-27 aircraft had been assessed by Air HQ in 1998 at 250 sets. In keeping with the policy of progressive licenced manufacture, the Ministry had concluded a contract with M/s Sagem in March 1999 for import of 40 sets with each set costing USD 29,000 with a possibility for Transfer of Technology (ToT) subject to approval of the French Government. An option (clauses 40.1 and 40.3) for further purchase of 175 sets at the same price up to 18 months (September 2000) had been negotiated into the contract.

The failure of the vendor to obtain the approval of the French Government became apparent in the months following the conclusion of the contract (March 1999). The refusal of the French Government to give approval was due to the varied applications of these items which attracted the Missile Technology Control Regime. A formal communication from the vendor regarding the French Government's refusal came in December 2000. By that time the option clause for 175 sets had lapsed in September 2000.

Pressed by the needs of IAF[10]/HAL[11], the Ministry decided in February 2002 to make further procurement from M/s Sagem under the option clause 40.4 of the March 1999 contract which provided for mutually agreed prices. The vendor now quoted Euro 104,170 (USD 119,653[12]) per set, which was more than four times the price contracted earlier (March 1999). Even though the Ministry concluded that this amounted to commercial blackmail, they neither

[9] 1 Euro = Rs 52.20
[10] Indian Air Force
[11] Hindustan Aeronautics Limited
[12] 1 USD = Euro 0.8706 (October 2003)

issued a fresh Request for Proposal (RFP) nor invited the other known vendor (M/s Sextant, now M/s Thales) of the equipment. M/s Sextant had quoted USD 45,000 in the earlier bid against M/s Sagem's quote of USD 29,000. Instead the Ministry negotiated only with M/s Sagem. The price agreed in the contract (October 2003) was USD 87,296 which was still three times higher than the last purchase price. Further, the Ministry took 20 months in concluding the contract after the decision to purchase.

The Ministry stated in December 2005 that it would not have been proper to exercise the option clause earlier in the light of HAL's continuing dialogue on ToT with M/s SAGEM and the possibility of in house production through ToT. The Ministry added there was no alternative but to pursue the Sagem option for immediate requirement for the upgrade programme even at enhanced cost, since adaptation of a different INGPS from a different vendor would have further delayed the MiG-27 programme by 12 to 18 months. The Ministry's contention is not tenable owing to the following:

- Clause 41 of the March 1999 contract envisaged a joint techno-economic study on ToT to be conducted at the earliest, but not later than six months from the effective date of contract i.e September 1999. This had not been done and by December 1999 there was indication that ToT might not be possible.
- IAF had already procured 125 sets of another manufacturer for upgradation programme of MiG-21 BIS aircraft. Faced with 'commercial blackmail' they could have re-tendered the requirement.
- In a meeting held on 22 October 1999 chaired by Joint Secretary (Air) it was decided to exercise the option clause for purchase of INGPS at the price of the March 1999 contract to suit the milestone of serial up-gradation of 38 MiG-27 aircraft. But this was not followed up.
- MiG-27 up-gradation programme even otherwise has been rescheduled to be completed by May 2008 with overall delay of 42 months.

Thus, failure of Ministry to invoke the option clause within the validity period led to an excess expenditure of Rs 29.90 crore on procurement of 95 sets of INGPS including spares and associated equipment.

2.5 Irregular grant of allowance to DSC personnel

Failure of internal control at various stages led to irregular payment of counterinsurgency allowance aggregating Rs 3.51 crore and related concessions to DSC personnel engaged with Air Force formations.

Counterinsurgency allowance along with various other field service concessions was authorized by the Government in January 1994 to the Army troops deployed in counterinsurgency operation in Kashmir (Ops Rakshak) and the North East (Ops Rhino) with effect from 1 April 1993. In March 1995 similar facilities were extended, with retrospective effect from 1 April 1993, to IAF personnel deployed for counterinsurgency operations under Ops. Rakshak in Kashmir. Four Air Force Wings located in the North East paid counterinsurgency allowance aggregating Rs 3.51 crore between May 1999 and August 2004 to the personnel of Defence Security Corps (DSC) platoons engaged with them for safeguarding installations and assets of the Wings.

Scrutiny of the relevant records revealed the following:

a) The DSC personnel were not entitled to the counterinsurgency allowance and related concessions because the Government had not declared the Air Force units located in the North East areas as engaged in counterinsurgency operations (Ops Rhino), and the service personnel of IAF Units to which the DSC personnel were attached were not drawing the allowance.

b) In terms of the operating and administrative instructions of the Defence Security Corps (DSC), platoons attached with Air Force Wings could not be engaged in any operation outside the Air Force premises.

c) The authorization of the allowance to the DSC personnel by the General Officer Commanding (GOC) of the Army Corps contravened the Ministry's order of 14 June 1999 since the authorization was not supported by any certificate from local formation commanders (Air Force Wings) that the DSC platoons had participated in counter insurgency operations.

d) Internal controls had failed at various stages as detailed below:

i) The administrative authorities of the Air Force Wings at the time of publishing the Office Order failed to detect the erroneous authorization in the notification issued by the GOC.

ii) The Pay and Accounts Officer, who maintained Individual Running Ledger Account (IRLAs) of the DSC personnel platoon wise and compiled the expenditure on Pay and Allowances separately for Air Force was also required to check the orders and the entitlement portion of the IRLAs with reference to rules and orders.

iii) The Accountant Officers of the Air Force Wings at the time of disbursement could not detect the inadmissible payment.

iv) During the audit of cash accounts, the Local Audit Officers (Defence Accounts Department) did not point out the payment of the inadmissible allowance.

On this being pointed out in Audit (November 2003), the payment of the allowance was discontinued between December 2003 and August 2004. There was an urgent need for strengthening internal controls so that similar instances did not recur.

The matter was referred to the Ministry in June 2005. Reply was awaited (January 2006).

2.6 Parking of funds with Public Sector Undertaking

Ministry advanced Rs 995.70 crore to MDL to avoid surrender of funds without placing any order on the PSU. While MDL benefited by way of cash flow, Government suffered a financial loss to the extent of Rs 156.12 crore.

Ministry sanctioned and paid to Mazagon Dock Limited (MDL) an aggregate amount of Rs 995.70 crore between 1996 and 2002 as advance payments against a project sanctioned by the Government in February 1997 for construction of a submarine.

Audit scrutiny of the records revealed that:

(i) advance payments were sanctioned even though no letter of intent was placed and no contract for construction of the submarine had been concluded with MDL. These advances were paid to the MDL at the end of each financial year. While releasing advance of

Rs 377 crore in March 2001 to MDL, the Ministry stated that this was aimed at utilizing provisions in the current year's budget so as to avoid surrender of funds and to limit/reduce impact on the next year's capital budget of the Navy. Ministry sanctioned and paid another advance of Rs 553.70 crore on 26 March 2002. Such advance payments were clearly against all canons of financial propriety and artificially inflated the capital expenditure of the Navy each year.

(ii) Details of the Advance Account for the project maintained by MDL indicate that of the Rs 995.70 crore advanced, Rs 930.70 crore were interest bearing. The interest has been credited at the average rate of 5.36 *per cent* per annum. During this period the borrowing rates of Government of India however were higher between 9.24 and 10.58 *per cent*. In other words, while Government of India bore interest liability of Rs 323.02 crore in respect of the amount advanced to MDL up to March 2005, the interest credited and accrued on the basis of the average rate of interest applied by MDL was only Rs 219.32 crore. Besides this, MDL was not paying any interest since 1996-97 on the balance of Rs 65 crore. Interest liability of the Government on the basis of similar borrowing rate on this amount worked out to Rs 52.42 crore during the last nine years up to March 2005.

Payment of advances to M/s MDL without conclusion of contract resulted in loss of Rs 156.12 crore up to March 2005.

The matter was referred to the Ministry in September 2005. No reply was received till January 2006.

2.7 Response of the Ministries/Departments to Draft Audit Paragraphs

On the recommendations of the Public Accounts Committee, the Ministry of Finance (Department of Expenditure) issued directions to all Ministries in June 1960 to send their response to the Draft Audit Paragraphs proposed for inclusion in the Report of the Comptroller and Auditor General of India within six weeks.

Draft Paragraphs/Reviews proposed for inclusion in the Report of the Comptroller and Auditor General of India, Union Government, Defence Services (Air Force and Navy) for the year ended March 2005, No.5 of 2006, were forwarded to the Secretary, Ministry of Defence between June 2005 and September 2005 through demi-official letters drawing his attention to the Audit findings and requesting Ministry to send their response within the stipulated six weeks. It was brought to the personal notice of the Defence Secretary that since the issues are likely to be included in the Audit Report of the Comptroller and Auditor General of India, which are placed before Parliament, it would be desirable to include Ministry's comments in the matter.

Despite above instructions of the Ministry of Finance issued at the instance of the Public Accounts Committee, the Ministry of Defence did not send replies to 5 Draft Paragraphs out of 18 Paragraphs included in this Report. Thus, the response of the Ministry could not be included in respect of these 5 paragraphs.

Ministry/Department	Total number of Paragraphs on the Ministry/ Department included in the Report	Number of Paragraphs in which reply not received from the Ministry of Defence	Paragraph Numbers
Ministry of Defence	18	5	2.5, 2.6, 2.8, 3.1 and 3.2.

2.8 Follow up on Audit Reports

Despite repeated instructions and recommendations of the Public Accounts Committee, the Ministry of Defence did not submit initial Action Taken Notes on 12 Audit Paragraphs.

With a view to ensuring the accountability of the Executive in respect of all issues dealt with in various Audit Reports, the Public Accounts Committee desired that Action Taken Notes (ATNs) on all paragraphs pertaining to the Audit Reports for the year ended 31 March 1996 onwards be submitted to them, duly vetted by Audit, within four months from the laying of the Reports in Parliament.

Review of the outstanding Action Taken Notes on Audit Paragraphs relating to the Air Force and Navy as of 31 January 2006 revealed that the Ministry had not submitted the initial ATNs in respect of 12 out of 60 paragraphs included in the Audit Reports up to and for the year ended March 2004 as enumerated in Appendix.

The matter was referred to the Ministry in December 2005. Reply was awaited (January 2006).

CHAPTER III : AIR FORCE

Procurement

3.1 Procurement of spares for test rig

Delay in taking timely action in procurement of spares at the appropriate time led to excess expenditure of nearly Rs 2 crore.

Air HQ concluded a contract with M/s Snecma Moteurs, France in September 2003 for supply of 175 lines of spares at an aggregated cost of Euro 610,715 (Rs 3.25 crore) to be delivered between June and November 2004. These spares were required for day to day maintenance of test rigs installed for testing accessories of aero-engine of Mirage 2000 in No. 4 Base Repair Depot (BRD).

Audit scrutiny of the documents concerning the contract revealed the following:

(a) The contract was concluded on a single tender basis on proprietary article certificate granted by the users to M/s Snecma Moteurs who were the OEM of the test rigs. In fact, the spares were not manufactured by the firm but sourced from other manufacturers. As such issue of proprietary article certificate was not correct.

(b) The price quoted in April 2003 were much higher than those quoted earlier in September 1999 along with the recommended list after the installation of the rigs. At the 1999 price the 175 lines contracted would have cost Rs 1.08 crore which was only one third of the contracted amount. The 200 *per cent* increase over 3 years was unjustified.

(c) That the prices contracted were inordinately high is also supported by the fact that procurement of some spares made through Air Attache Washington in February 2003 were at prices 431 to 483 *per cent* lower.

(d) As per IAF instructions, spares were to be provisioned along with the equipment. The delay in purchase of the spares is attributable to delay on the part of the Equipment Depot in finalizing the requirement, delay of the DOE-M[1], in raising the indent and delay in invitation of quotation by the Directorate of Purchase in Air HQ.

Thus, failure to take timely action in procurement of spares at the appropriate time led to excess expenditure of about Rs 2 crore.

The case was referred to Ministry in August 2005; the reply was awaited as of January 2006.

Works Services

3.2 Unauthorised construction of Officers' Institute

Prime Land valued at Rs 74.24 lakh was utilized to construct a transit accommodation unauthorisedly under the nomenclature of Officers' Institute by HQ WAC involving irregular expenditure of Rs 33.18 lakh.

Construction of an Officers' Institute was completed at Subroto Park, New Delhi in August 2003 at a cost of Rs 33.18 lakh at the HQ Western Air Command (WAC). The Officers Institute was constructed on prime land measuring 402.41 sq mtr valued by the Defence Estate Office at Rs 74.24 lakh. The work was sanctioned by the AOC-in-C[2] under delegated powers on the ground that adequate clubbing facilities were not available in the Officers' Mess.

Audit scrutiny revealed that Officers' Institutes are scaled for officers strength in excess of 100 only on a station basis. As Subroto Park had not been classified as a station, the use of delegated powers was not appropriate. Moreover, the Officers' Institute that was constructed consisted of 5 suites that were unlikely to augment recreational facilities for officers.

Scrutiny of other records revealed that HQ WAC had earlier informed Air HQ in March 2002 regarding shortage of accommodation for visiting/trainee officers. It had then been indicated that there was no scope for further construction, as single officers' accommodation had been constructed as per scale. Thus, the construction of five suites (referred to as the Officers' Institute) was intended to augment accommodation at Subroto Park in excess of the scale. Prime land was utilized to build an infrastructure which was not authorized and expenditure of Rs 33.18 lakh was irregularly incurred for the purpose.

[1] DOE-M – Directorate of Engineering - Marine
[2] AOC-in-C = Air Officer Commanding in Chief

The case was referred to the Ministry in July 2005; reply was awaited as of January 2006.

3.3 Non-commissioning of imported equipment

Failure to complete works services for the Service Support Centre resulted in non-commissioning of imported equipment worth Rs 53.95 crore since their receipt in June/October 2004. The works would be ready only by September 2006.

A full fledged Service Support Centre (SSC) was to be established at No.2 Wing (Air Force) for SU-30 aircraft. Optical Laser System (OLS) and Radio Communication Complex (KADLIE) costing USD 11,869,103 (Rs 53.95 crore)[3] was contracted in May 2003 for Phase I of the SSC and received at 2 Wing (AF) in June/ October 2004. The equipment had not yet been commissioned. The major factor leading to delay in commissioning was non-completion of works services.

The works services required for installation/commissioning of the equipment though finalized by October 2002 have not been completed yet and is scheduled for completion in March 2006. The works were sanctioned by HQ South Western Air Command in March 2004 after a delay of 17 months at a cost of Rs 1.70 crore with the date of completion within 104 weeks from release of work. The Ministry intimated in September 2005 that the works sanctioned in March 2004 could not be executed due to non-availability of funds. Funds could be released only in August 2004. Further delay up to February 2005 was due to the requirement of non-destructive testing of the existing structure of overhead crane, which had to be referred to the consultant. The Ministry added that the delay in setting up of repair facilities for imported equipment was due to non-conclusion of contract for deputation of Russian specialists to install the equipment. Ministry's contention is not tenable as HQ WAC took 16 months in sanctioning civil works after its assessment was finalized in October 2002, and there was delay in availability of funds. Even if the contract for deputation of Russian specialists had been concluded in time, the specialists would not have been able to install the equipment without the civil works having been completed.

Thus, poor planning resulted in delay in completion of Phase I SSC and led to equipment worth Rs 53.95 crore awaiting commissioning since June/October 2004.

[3] USD = Rs 45.45

Miscellaneous

3.4 Recovery at the instance of Audit

At the instance of audit Defence Accounts Department initiated action for recovery of Rs 58.28 lakh on account of stage payment.

In June 2001, HAL Bangalore claimed an advance of Rs 76.68 lakh representing 65 *per cent* stage payment against a repair task of Kiran variants assigned to them by Air HQ. In August 2001, Dy. Controller of Defence Accounts (DCDA) passed the invoice in full but allowed payment of Rs 13.86 lakh after recovering an amount of Rs 62.82 lakh against past outstandings. However, due to incorrect accounting, the demand was noted only for Rs 13.86 lakh instead of Rs 76.68 lakh.

On this being pointed out in audit, DCDA in June 2005, accepted the discrepancy and informed that against the total demand of Rs 76.68 lakh, an amount of Rs 18.40 lakh had been adjusted. DCDA agreed to the recovery of the balance of Rs 58.28 lakh and also agreed with audit that Government had lost interest of Rs 21.47 lakh on account of HAL holding the amount for a long period.

CHAPTER IV : NAVY

Procurement

4.1 Procurement of one extra fast attack craft

Acquisition of one XFAC under FTP was unjustified and did not meet the urgent operational requirement of the Navy. The procurement precluded competition and led to purchase of a technically inferior craft.

A contract was concluded in March 2003 with M/s Israel Aircraft Industries Limited (IAI) for import of one extra fast attack craft (XFAC) and associated base and depot spares at a total cost of USD 6.985 million[1] (Rs 33.56 crore). The basic price of the craft was USD 3.76 million. The case was processed under Fast Track Procedure (FTP) and contract was awarded on single tender basis. The craft was delivered in October 2003.

Audit scrutiny of the relevant documents revealed the following: -

a) As per projections made by the Navy in May 2002, immediate acquisition was needed to meet urgent operational commitments. The Navy at that time had two XFAC in its inventory. The first craft was constructed by IAI in May 1998 and the second at Goa Shipyard Limited (GSL) under licence, in May 1999.

b) The proposal for immediate acquisition of one XFAC was in response to a request received from IAI dated 4 January 2002 by Naval HQ to consider purchase of one XFAC, off the shelf. After receipt of the proposal, the Navy processed the case for immediate acquisition under FTP. Meanwhile, in March 2000, the Navy had initiated a case for production of two XFACs at GSL but this proposal was not handled on priority. It was only in September 2002 that the Ministry placed the

[1] 1USD = Rs 48.05

letter of intent with GSL and in March 2003 finalised the contract with them.

c) The Defence Procurement Board (DPB) deliberated the proposal for off the shelf purchase in June 2002 and decided that initially a technical delegation should be deputed to IAI to report on the suitability of the craft and the time frame for delivery and other relevant details before giving its consent for adoption of FTP. The Naval HQ, instead of sending a technical delegation team as required under rules, chose to send a single senior officer to Israel for technical evaluation. The officer carried out a technical inspection of the craft in September 2002 and recommended its acceptance. Audit scrutiny revealed that it was an older version of the existing XFAC with the Navy, having lower displacement (45 tonnes as against 54 tonnes for the existing XFAC), inferior main engines (8 cylinders as against existing 12 cylinders) and reduced speed, of 40 knots against 44 knots. The Ministry stated in December 2005 that a single senior officer was deputed as he had the overall perspective of Indian Navy's plans and policies with regard to the force levels and foreign cooperation. The contention of the Ministry is not tenable as technical evaluation is generally done by a technical team as per Defence Procurement Procedure laid down by Ministry in 2002.

d) The technical inspection report was accepted by the DPB which gave its approval for procurement in December 2002 through the FTP.

e) The XFAC sanctioned for outright purchase had been constructed by IAI in 1997 and had been under preservation on the cradle. Though the case was projected as a "distress sale and opportunity buy" by the Navy, the PNC could obtain only a seven *per cent* discount on the basic cost of XFAC acquired in 2003. Considering the fact that the XFAC was more than six years old and of lower specifications than the ones acquired earlier, it would have been reasonable for the price to be depreciated by 30 *per cent* in view of the anticipated life of the craft being 20 years. Applying a straight line depreciation of 5 *per cent* per annum on the 2003 basic price of the craft (as quoted by the supplier) of USD 3.76 million, the basic price that could be reasonably offered to IAI would be USD 2.64 million. As against this, the Navy paid USD 3.50 million. There was, thus, extra expenditure of USD 864,800 (Rs 4.16 crore) in procuring the XFAC off the shelf.

The Ministry in December 2005 endorsed Naval HQ reply that the cost of XFAC acquired from Israel was 30 *per cent* less than the cost of two XFACs ordered on GSL in September 2002. The contention of Ministry is not tenable as the XFAC procured from Israel was of 1997 vintage and was technically inferior to the XFAC built indigenously. Clearly, therefore, the costs were not comparable.

Thus, the procurement of a vintage XFAC through a process which precluded competition by adopting the Fast Track Procedure resulted in extra expenditure of Rs 4.16 crore.

4.2 Unnecessary import of stores under special financial powers

Special financial powers delegated to meet the requirements of Operation Parakram were invoked for purchase of spares for turbo alternators installed in INS Viraat without adequate justification leading to unnecessary purchase of rotor assembly of Rs one crore.

During 2003-04 Naval HQ imported 148 spares at a cost of Rs 5.38 crore as overhaul kit for turbo alternators installed in INS Viraat under a contract concluded by the Director of Procurement (DPRO), of Naval HQ in October 2002 with M/s. Allen Steam Turbines, UK, the Original Equipment Manufacturer. The import was sanctioned by the Controller of Logistics (COL) in the Naval HQ under the special financial powers delegated by the Government in February 2002 to meet operational requirements of Operation Parakram, The requirement of obtaining concurrence of the Integrated Financial Adviser (IFA) was dispensed with under the special financial powers.

Audit scrutiny of the documents relating to the purchase revealed that the circumstances of this procurement did not justify use of the special financial powers delegated by the Government. The contract was hastily concluded on 31 October 2002, the last day of the validity of special financial powers. The proposal was moved on 28 October 2002 and processed expeditiously citing criticality of requirement, approval of Competent Financial Authority (CFA) being accorded on 30 October 2002. Use of these special financial powers, however, obviated the need of concurrence of IFA, which is a critical internal control for scrutiny of purchases with reference to necessity, regularity, justification of price etc. The next action viz. opening of letter of Credit for the purchase was, however, taken after four months in February 2003 and delivery of spares was completed in April 2004.

Detailed scrutiny in audit of the items imported also revealed that the inclusion of the rotor assembly fitted in turbo alternator costing Rs one crore was unnecessary. The Navy was already holding two turbo alternators under Depot Spares and Machinery (DSM) package of the ship and the condition of both the rotor assemblies of the turbo alternators was stated to be satisfactory. The prescribed norms of war reserve which follow the normal stocking policy of 1:4 for holding such main equipment would not warrant any additional purchase. This inference is also substantiated by the fact that the Technical Evaluation Committee constituted by the COL (September 2002) for review of the spares for war reserve, which included members from the Technical Directorate as well as from DPRO/ DLS had recommended deletion of this item.

Denying hasty conclusion of the contract, Ministry stated in August 2005 that the provisioning activities for procurement of spares had commenced in July 2002 before raising of the indent in 17 October 2002. The Ministry added that the purchase proposal had also concurrence of representatives from Finance at the time of approval by the Naval Logistic Committee and the ratio 1:4 for war reserve is not applicable to spares. The Ministry's contention was not tenable as INS Viraat was not identified as the frontline ship for this operation as per the Naval HQ directives of 21 August 2002 and as such exercising special power in this respect was irregular. Further the policy of maintaining ratio 1:4 for war reserve is applicable to spares as clarified in NHQ directive of 10 February 2003.

The rotor assembly remained in stock (August 2005) since its receipt in November 2003. As the ship is due for phasing out in 2007, prospect of its utilization in the coming years would seen to be remote.

Use of delegated financial powers without adequate justification by COL who is the CFA in this case lead to unnecessary expenditure of Rs one crore on purchase of spares.

4.3 Import of spares at exorbitant prices

Decisions taken in Naval HQ on incorrect premises coupled with internal control lapses led to acceptance of higher rates in the contract for purchase of spares.

The Material Organisation, Visakhapatnam placed an indent for supply of spares for main diesel engines used in ships and submarines in April 2000. Tender enquires were issued in January 2002 by the Naval HQ to six firms. Only one firm, M/s Vnesheconomservices responded (April 2002) and offered 296 items against 377 tendered for, at a cost of Rs 12.87 crore. The offer was not accepted and in July 2002, Naval HQ decided to re-tender. Tenders were issued to eight firms. Two firms, M/s Ukrspetsexport and M/s Vnesheconomservices quoted. The Naval HQ concluded a contract in November 2002 with M/s Ukrspetsexport for supply of 372 items of spares at a total cost of USD 4,901,616[2] (Rs 23.83 crore).

M/s Vnesheconomservices had bid for 263 items of spares in the second round. Their bid was not considered by Naval HQ on the ground that they did not have an export licence. Audit scrutiny revealed that the prices quoted by M/s Vnesheconomservices were lower than the contracted prices for 205 items by Rs 9.18 crore. Detailed scrutiny of the papers revealed that at different stages internal controls were bypassed as under:

(a) The initial indent prepared by the Material Organisation, Visakhapatnam in April 2000 estimated the cost at Rs 2.55 crore. This needed approval of the Ministry of Defence (MOD). However, while processing the case for approving the indent, Director of Logistic Support, Naval HQ brought it down to Rs 54 lakh, seemingly arbitrarily. This was within the powers delegated to Assistant Controller of Logistic (ACOL) in Naval HQ who approved the indent in July 2001.

(b) The bid received from M/s Vnesheconomservices in the first round of tendering in March 2002 was rejected on the ground that the prices were exorbitant in respect of 54 items and that it was a single tender situation. In fact, the prices were exorbitant only in

[2] 1USD = Rs 48.60

respect of three items as stated by Director of Mechanical Engineering (DME), which is the Professional Directorate in Naval HQ in May 2002. DME had confirmed that the order could be placed on M/s Vnesheconomservices for 293 items. However, the offer was not accepted and Naval HQ chose to re-tender.

(c) In the second round (September 2002), Naval HQ again excluded M/s Vnesheconomservices from the competition. The reason cited was that the Embassy of Ukraine had informed Naval HQ that the firm did not have an export license. Audit scrutiny of the relevant documents revealed that the Embassy of Ukraine had only confirmed that M/s Vnesheconomservices was a subsidiary enterprise who had no license of the Government of Ukraine to carry out export of military and defence products and in accordance with Ukrainian Legislation had to export their product through M/s Ukrspetsexport. In fact, the Naval Wing of the Embassy of India, Ukraine had placed three purchase orders on the same vendor for supply of equipment and spares for Medium Refit of naval ships in September 2002 on behalf of Naval HQ.

(d) Against the original estimate of Rs 54 lakh, the proposed contract price finally reached Rs 23.83 crore after the second round of tendering in September 2002. The delegation to the Controller of Logistic in this respect was only Rs 8 crore. However, the special financial powers delegated in February 2002 for Op Parakram were invoked for approving this procurement without obtaining either the concurrence of Integrated Financial Adviser or the approval of the Ministry of Defence. The decision for placing the orders on the firm was taken on 28 October 2002, three days before expiry of the special delegation of financial powers on 31 October 2002. The contract was concluded on 6 November 2002.

Thus bypassing of internal controls in the defence procurement system and reliance on incorrect premises for taking procurement decisions rendered the procurement process non-competitive and resulting in import of spares at higher prices. A more judicious decision to place orders for specific items on the lower of the two bidders would have yielded a saving of the order of Rs 9 crore.

Miscellaneous

4.4 Recoveries at the instance of audit

At the instance of Audit, Navy recovered Rs 3.14 crore on account of interest against advance from MDL. In another case, erroneous calculation of the amount of liquidated damages and interest by PCDA led to short recovery of Rs. 70.10 Lakh from ECIL, which was finally recovered at the instance of audit.

At the instance of audit, Navy recovered Rs3.84 crore in two cases, which are discussed below:

<u>Case I</u>

The Principal Controller of Defence Accounts (PCDA) of Navy adjusted an advance payment of Rs 274 crore in phases during the period between May 2001 and September 2002. The amount was paid in March 2001 to the Mazagaon Dock Ltd. (MDL) Mumbai for a ship building project under a sanction accorded by the Government in March 2001.

Audit scrutiny (July 2004) revealed that out of Rs.274 crore adjusted, Rs 57.77 crore was adjusted between April and September 2002, on which PCDA failed to recover interest in disregard of the government sanction of March 2001which stipulated that the MDL was to pay interest at the prevailing government borrowing rate on the outstanding amount with effect from 1 April 2002. Interest on this account worked out to Rs 2.47 crore and interest on interest for the period between October 2002 and June 2004 worked out to Rs 0.67 crore which was to be recovered from MDL.

On this being pointed out in Audit in July 2004, PCDA (Navy) recovered Rs 3.14 crore from MDL in December 2004.

Ministry accepted the facts of the case in December 2005.

<u>Case II</u>

The Ministry placed a supply order on Electronic Corporation of India Limited (ECIL) in March 2003 for procurement of 100 sets of Transreceivers at an aggregated cost of Rs 38.83 crore to be delivered between December 2003 and March 2004. The Principal Controller of Defence Accounts, Navy (PCDA (N)) recovered Rs 73.88 lakh comprising Rs 59.53 lakh on account of liquidated damages and Rs 14.35 lakh on account of interest on advance of Rs 7.77 crore paid in terms of supply order as ECIL had failed to complete the delivery within the time stipulated in the supply order.

Audit scrutiny (January 2005) revealed that the liquidated damages and interest on advance required to be recovered from ECIL, worked out to Rs 111.44 lakh and Rs 32.54 lakh respectively aggregating Rs 143.98 lakh. On this being pointed out in audit (January 2005), PCDA (N) recovered the balance of Rs 70.10 lakh from ECIL in February 2005 and March 2005.

Accepting the facts, the Ministry stated (December 2005) that PCDA (N) had been advised to ensure payment as per terms and conditions of the contract.

CHAPTER V : COAST GUARD

Acquisition

5.1 Acquisition of Marine Pollution Surveillance Capacity

Three Dorniers costing Rs 102 crore received in March 2001 for marine pollution surveillance were not provided with vital Operational Role Equipment (ORE) owing to the inability of the Ministry to finalise the contract.

In view of the handicap experienced by Coast Guard in carrying out oil slick pollution surveillance due to lack of equipment, a proposal for inducting three Dornier aircraft equipped with Pollution Surveillance Systems (PSS) at a total financial outlay of Rs 128.04 crore was approved by Government in 2000. The aircraft were scheduled for induction between March 2001 and April 2003.

Audit examination of the relevant records revealed that while the aircraft were delivered by HAL[1] by March 2001, they had not yet been equipped to carry out oil slick pollution surveillance. Detailed examination brought out several lacunae in handling the critical capacity building programme.

I. Delay in finalisation of the contract: Though identification of the two vendors for the PSS and their technical evaluation was completed in February 2000, the contract with M/s Swedish Space Corporation (SSC) was signed only in March 2002. Considerable time was lost after receipt of techno commercial bids in March 2000 as follows:

- It took four months to complete technical negotiations after opening the bids.
- Commercial bids were opened six months after completion of technical negotiations and 11 months after their receipt.
- Price negotiations were conducted six months after opening of commercial bids.

[1] HAL - Hindustan Aeronautic Limited

- Approval of Raksha Mantri (RM) was obtained three months after conclusion of price negotiation.
- Contract was signed in March 2002, three months after approval of RM

II. Non-competitive and opaque process: Identification of only two vendors was stated to be based entirely on information received from three Naval Attaches (NA) based at Washington, Bonn and London. The Ministry endorsed the evaluation of the high value equipment by the Naval Attaches. Considering the value of the equipment, a more broad based tendering process would have enhanced competition. The Ministry agreed with the audit conclusion in December 2005.

III. Favouring one vendor: M/s SSC was selected for the supply despite the following:

a) Similar equipment procured from the same vendor did not perform satisfactorily. Besides, the firm had earlier failed to honour its repair commitments. These facts were not brought to the notice of the PNC[2] by the Coast Guard HQ. The Coast Guard HQ stated in November 2005 that at the time of PNC, they did not notice the previous performance of the company. This is not tenable since the equipment procured in 1986 did not function satisfactorily from the beginning and Coast Guard HQ was carrying on protracted correspondence with M/s SSC over the years.

b) The cost of the main equipment quoted by M/s SSC was higher by Rs 2.65 crore. The SSC bid for spares was lower at Rs 1.18 crore as against Rs 3.51 crore quoted by the other vendor. Adding the cost of spares to the main equipment quote during price comparison resulted in the bid of M/s SSC becoming lower. Audit noticed that the two bids for spares were not comparable. While M/S SSC quoted for a mixed package of Line Replaceable Units (LRUs) and smaller units, the other quote included one set of complete LRUs. The qualitative difference in bids was due to lack of clarity in RFP[3]. Loading of the bid of M/S SSC was, therefore, essential if price of spares was to be included for comparison of the bids. The Ministry attributed (November 2005) this lapse to the lack of experience of Coast Guard HQ in operating such equipment. The reply is not tenable since the general principles of bid evaluation and comparison are applicable to all kinds of procurement.

[2] PNC - Price Negotiation Committee

[3] RFP - Request For Proposals

IV. **Frozen Contract:** The Coast Guard HQ in July 2003 proposed renegotiation of the contract in the following areas:

a) Delivery of the second and third system be made only after successful trials of first system and go ahead given by Coast Guard without any time limitation;

b) contract may be made on turn key basis as it would make the seller responsible for any delay during commissioning, and

c) modification of payment terms.

Approval of the Ministry to renegotiate was accorded after seven months in February 2004. The above modifications to the contract was accepted by M/s SSC and approved by RM in January 2005.

In sum, the Coast Guard acquired three aircraft costing Rs 102 crore for marine pollution surveillance, but had no equipment to go with them. There was no assurance that the equipment contracted after much delay would be appropriate. Meanwhile, the Coast Guard, the designated National Agency, continued without the ability to carry out oil slick pollution surveillance. The Ministry stated in November 2005 that three aircraft were being used for pollution surveillance visually and the PSS only will help in extension of visual ranges. The Ministry's reply is not tenable as the PSS was required to detect the presence of oil slick and measuring the thickness of oil spill which could not be done visually.

5.2 Acquisition of ready built flats for Coast Guard

The Ministry, while handling the acquisition of ready built flats from TNHB[4] for Navy and Coast Guard simultaneously, did not explore the possibility of waiver of interest charges, exemption of stamp duty and registration charges in respect of Coast Guard as in the case of Navy resulting in avoidable extra expenditure of Rs 2.63 crore.

The Ministry accorded sanctions in December 2002 and March 2003 respectively for outright purchase of 243 ready built flats (152 for Coast Guard and 91 for Navy) at a total cost of Rs 24.87 crore. This was to meet the accommodation requirements of troops posted at Chennai.

[4] TNHB - Tamil Nadu Housing Board

The acquisition proposal was initiated by Coast Guard in March 2001. In May 2002, a PNC chaired by Joint Secretary (Navy) was constituted to finalize the deal. After deliberations, TNHB, in June 2002, agreed to sell Coast Guard 152 flats along with 40,235 Sq. ft. of open land at a cost of Rs 20.56 crore. This included Rs 2.43 crore as interest charges calculated from the date of validity of their offer (31 March 2002) till the actual payment. As a result of further negotiations held in October 2002, TNHB reduced the cost to Rs 19.86 crore. Ministry accorded sanction for purchase of 152 flats in December 2002. Payment of Rs 19.86 crore was also made to TNHB in December 2002 itself. The payment included interest charges of Rs 2.43 crore and stamp duty of Rs 19.86 lakh. The flats were taken over by Coast Guard in March 2003.

Similarly, a case of outright purchase of 91 flats was initiated by the Navy as early as June/July 2001. It could not be finalised before April 2002 due to observations raised by MES[5] when TNHB increased the cost of the flats. However, the PNC again chaired by JS(Navy) could prevail upon TNHB to extend the validity of the original offer up to 31 March 2003. Consequently the interest payment got waived off.

Thus, though both the acquisitions were handled by Ministry simultaneously, they did not explore the possibility of waiver of interest charges and exemption of stamp duty and registration charges in respect of Coast Guard as was done in the case of Navy. This resulted in avoidable extra expenditure of Rs 2.63 crore.

Ministry stated in November 2005 that efforts were made by the members of the Price Negotiation Committee to negotiate the waiver of interest and registration charges with TNHB. Ministry's contention is not tenable since PNC held on 30 May 2002 negotiated only for reduced rate of interest and registration charges and at no stage did Coast Guard seek complete waiver of these two charges.

[5] MES – Military Engineer Services

Miscellaneous

5.3 Recoveries at the instance of audit

At the instance of Audit, the Principal Controller of Defence Accounts (Navy) recovered an amount of Rs 56 lakh from M/s Goa Shipyard Limited on account of liquidated damages.

Scrutiny of the records relating to the acquisition of one Advanced Offshore Patrol Vessel by Coast Guard from Goa Shipyard Limited (Yard 1180) revealed that only an amount of Rs 6.10 crore was adjusted on account of liquidated damages for delayed delivery (18 months) as against Rs 6.66 crore recoverable in terms of the contract. On this being pointed out by Audit (July 2004), the balance of Rs 56 lakh was adjusted by the Principal Controller of Defence Accounts (Navy) in December 2004.

The Ministry accepted the facts in September 2005.

(B.K. CHATTOPADHYAY)
Director General of Audit
Defence Services

New Delhi
Dated: 6th March 2006

Countersigned

(VIJAYENDRA N. KAUL)
Comptroller and Auditor General of India

New Delhi
Dated: 6th March 2006

APPENDIX

(Refers to in Paragraph 2.8)

List of Action Taken Notes not received as of 31 January 2006

Sl. No.	Report No. and Year	Chapter of the Report	Para No.	Pertains to	Brief Subject
1.	7 of 2003	III	11	Air Force	Procurement of defective equipment
2.	7 of 2004	II	2.1	MOD	Irregular payment of transport allowance
3.	7 of 2004	III	3.6	Air Force	Non-crediting of revenue into Public Fund
4.	7 of 2004	IV	4.4	Navy	Non-utilisation of a newly constructed technical building for the intended purpose
5.	7 of 2004	V	5.1	Coast Guard	Non-utilisation of a prime land
6.	7 of 2005	II	2.3	MOD	Unauthorised operation of training institutions in Naval Bases
7.	7 of 2005	II	2.4	MOD	Procurement of Brake Parachutes
8.	7 of 2005	II	2.7	MOD	Irregular payment of Modified Field Area Allowance
9.	7 of 2005	III	3.1	Air Force	Irregularity in purchase of mosquito nets
10.	7 of 2005	III	3.3	Air Force	Infructuous expenditure on untested flooring
11.	7 of 2005	III	3.4	Air Force	Avoidable expenditure due to unauthorized life extension of helicopter
12.	7 of 2005	IV	4.2	Navy	Procurement of Compressor Condensing Units